ALLINA HEALTH SYSTEM

Consolidated Financial Statements

December 31, 2016, 2015, and 2014

(With Independent Auditors' Reports Thereon)

ALLINA HEALTH SYSTEM

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

Independent Auditors' Report

The Board of Directors
Allina Health System:

Report on Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Allina Health System and its subsidiaries (the System), which comprise the consolidated balance sheets as of December 31, 2016, 2015, and 2014, and the related consolidated statements of operations and changes in net assets, and cash flows for each of the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Allina Health System and its subsidiaries as of December 31, 2016, 2015, and 2014, and the results of their operations and their cash flows for each of the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Minneapolis, Minnesota
March 14, 2017

ALLINA HEALTH SYSTEM

Consolidated Balance Sheets

December 31, 2016, 2015, and 2014

(Dollars in thousands)

Assets		**2016**	**2015**	**2014**
Current assets:				
Cash and cash equivalents	$	172,710	349,115	180,985
Short-term investments		451,327	351,062	357,511
Patient accounts receivable, less allowances for uncollectible accounts of $90,656 in 2016, $74,216 in 2015, and $70,285 in 2014		470,216	465,058	419,522
Inventories		64,225	61,297	55,311
Other current assets		94,546	100,341	109,389
		1,253,024	1,326,873	1,122,718
Investments		1,330,283	1,247,229	1,180,534
Investments with limited uses		151,537	149,313	150,162
Land, buildings, and equipment, net		1,166,397	1,142,461	1,041,950
Other assets		290,036	261,313	242,630
Total assets	$	4,191,277	4,127,189	3,737,994
Liabilities and Net Assets				
Current liabilities:				
Accounts payable and accrued expenses	$	463,851	434,851	428,185
Other current liabilities		111,377	119,041	101,760
		575,228	553,892	529,945
Long-term debt		818,192	844,436	609,371
Other liabilities		409,721	415,578	420,545
Total liabilities		1,803,141	1,813,906	1,559,861
Net assets:				
Unrestricted		2,222,241	2,152,102	2,008,030
Temporarily restricted		109,078	105,903	115,155
Permanently restricted		56,817	55,278	54,948
Total net assets		2,388,136	2,313,283	2,178,133
Total liabilities and net assets	$	4,191,277	4,127,189	3,737,994

See accompanying notes to consolidated financial statements.

ALLINA HEALTH SYSTEM

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2016, 2015, and 2014

(Dollars in thousands)

		2016	2015	2014
Revenues:				
Patient service revenue net of contractual adjustments	$	3,777,363	3,620,983	3,465,733
Provision for bad debts		(85,604)	(98,536)	(93,547)
Net patient service revenue		3,691,759	3,522,447	3,372,186
Other operating revenue		255,930	274,445	231,495
Total revenues		3,947,689	3,796,892	3,603,681
Expenses:				
Salaries and benefits		2,495,717	2,322,105	2,240,474
Supplies and services		855,816	858,331	787,580
Depreciation and amortization		165,433	155,253	147,844
Financing costs		37,726	28,245	24,392
State assessments and taxes		82,147	79,823	79,481
Utilities and maintenance		72,244	74,612	74,317
Other operating expenses		119,359	129,502	103,649
Total expenses		3,828,442	3,647,871	3,457,737
Operating income before strike expenses		119,247	149,021	145,944
Strike expenses		(135,587)	—	—
Operating (loss) income		(16,340)	149,021	145,944
Nonoperating gains (losses):				
Investment return		83,374	(33,234)	46,990
Losses on interest rate swap agreements		(3,178)	(17,608)	(42,800)
Contributions received in acquisitions		—	34,849	—
Other		(3,255)	(2,507)	(3,243)
Excess of revenues over expenses	$	60,601	130,521	146,891

(Continued)

ALLINA HEALTH SYSTEM

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2016, 2015, and 2014

(Dollars in thousands)

		2016	2015	2014
Unrestricted net assets:				
Excess of revenues over expenses	$	60,601	130,521	146,891
Net assets released from restrictions for capital purposes		12,588	9,698	7,080
Amortization of unrealized loss on interest rate swap agreement		874	874	874
Other		(3,924)	2,979	(4,251)
Increase in unrestricted net assets		70,139	144,072	150,594
Temporarily restricted net assets:				
Contributions		22,508	21,399	31,884
Investment return (loss)		7,828	(2,231)	4,360
Net assets released from restrictions		(24,461)	(27,400)	(21,151)
Other		(2,700)	(1,020)	1,137
Increase (decrease) in temporarily restricted net assets		3,175	(9,252)	16,230
Permanently restricted net assets:				
Contributions for endowment funds		272	371	396
Investment return		1,267	(41)	34
Other		—	—	(515)
Increase (decrease) in permanently restricted net assets		1,539	330	(85)
Increase in net assets		74,853	135,150	166,739
Net assets at beginning of year		2,313,283	2,178,133	2,011,394
Net assets at end of year	$	2,388,136	2,313,283	2,178,133

See accompanying notes to consolidated financial statements.

ALLINA HEALTH SYSTEM

Consolidated Statements of Cash Flows

Years ended December 31, 2016, 2015, and 2014

(Dollars in thousands)

		2016	2015	2014
Operating activities:				
Increase in net assets	$	74,853	135,150	166,739
Adjustments to reconcile increase in net assets to net cash and cash equivalents provided by operating activities:				
Depreciation and amortization		165,433	155,253	147,844
Provision for bad debts		85,604	98,536	93,547
Goodwill impairment		—	4,110	1,454
Gain on sales of land, buildings, and equipment		(2,739)	(524)	(2,236)
Unrealized loss on interest rate swaps		(9,458)	4,249	29,273
Realized and unrealized (gains) losses on investments, net		(63,087)	61,035	(27,775)
Restricted contributions		(22,780)	(21,770)	(32,280)
Contributions of cash for long-lived assets		(2,449)	(1,504)	(3,288)
Contributions received in acquisitions		—	(34,849)	—
Earnings on joint ventures		(16,389)	(12,310)	(12,988)
Pension plan expenses		2,254	538	8,666
Pension plan contributions		(1,822)	(2,358)	(1,347)
Changes in assets and liabilities net of acquisition:				
Change in accounts receivable and other current assets		(88,885)	(143,647)	(142,734)
Change in accounts payable and other current liabilities		8,241	38,483	8,103
Change in other assets and liabilities		(8,778)	(5,474)	(6,281)
Net cash and cash equivalents provided by operating activities		119,998	274,918	226,697
Investing activities:				
Proceeds from sales of land, buildings, and equipment		36,930	8,613	39,458
Purchases of land, buildings, and equipment		(222,881)	(218,328)	(169,747)
Contributions of cash for long-lived assets		2,449	1,504	3,288
Cash received in acquisitions		—	987	—
(Purchases) sales of investments classified as trading		(125,609)	(117,130)	(64,910)
Sales (purchases) of investments with limited uses		3,153	(472)	(4,597)
Draws on construction funds		—	13	—
Distributions received from joint ventures		13,816	10,072	11,767
Contributions to joint ventures		(17,590)	(21,066)	(1,187)
Net cash and cash equivalents used in investing activities		(309,732)	(335,807)	(185,928)
Financing activities:				
Restricted contributions, net		23,707	24,856	23,907
Change in outstanding checks payable		12,701	(22,329)	3,609
Principal payment on line of credit		—	—	(19,965)
Proceeds from issuance of note payable		—	250,000	20,165
Deferred debt acquisition costs		—	(2,632)	—
Principal payments of long-term debt		(23,079)	(20,876)	(20,204)
Net cash and cash equivalents provided by financing activities		13,329	229,019	7,512
(Decrease) increase in cash and cash equivalents		(176,405)	168,130	48,281
Cash and cash equivalents at beginning of year		349,115	180,985	132,704
Cash and cash equivalents at end of year	$	172,710	349,115	180,985
Schedule of noncash financing activity:				
Capitalized lease	$	679	10,756	—

See accompanying notes to consolidated financial statements.

(1) Organization and Basis of Presentation

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

The System consists of five hospitals located in the Minneapolis and Saint Paul metropolitan area, seven hospitals located outside the metropolitan area, physician clinics employing approximately 1,370 providers, various other health care-related entities, and seven foundations supporting health-related services.

In January 2015, the System acquired District One Hospital, and became the sole owner (note 19).

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

(2) Summary of Significant Accounting Policies

(a) Use of Estimates

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

(b) Cash and Cash Equivalents

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

(c) Outstanding Checks

Outstanding checks that are book or bank overdrafts are classified as cash flows from financing activities in the consolidated statements of cash flows.

(d) Pledges Receivable

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

(e) Derivative Financial Instruments

The System uses interest rate swaps as part of its risk-management strategy to manage exposure to fluctuations in interest rates and to manage the overall cost of its debt. Interest rate swaps are used to hedge identified and approved exposures. Interest rate swaps are recognized as either assets or liabilities in accordance with the netting provisions in the counterparty agreement and are measured at fair value.

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

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

For interest rate swaps that are designated and qualify as cash flow hedges, the effective portion of the gains or losses resulting from changes in the fair value is reported as a component of unrestricted net assets. The ineffective portion, if any, is reported in excess of revenues over expenses in the current period. If hedging relationships cease to be highly effective, gains or losses on the interest rate swaps would be reported in excess of revenues over expenses, and accumulated losses would be amortized into excess of revenues over expenses over the remaining life of the debt. Any differences between interest received and paid under the interest rate swap designated as a cash flow hedge is recorded as a component of interest expense. As of December 31, 2016, 2015, and 2014, the System does not have any swaps designated as cash flow hedges.

(f) Inventories

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

(g) Bond Issue Costs

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

(h) Investments in Unconsolidated Entities

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

(Dollars in thousands)

(i) Investments with Limited Uses

Investments with limited uses are reported at fair value and include assets held by trustees for repayment of long-term debt, assets in escrow for capital projects, vendor deposits, and donor-restricted funds.

(j) Land, Buildings, and Equipment

Land, buildings, and equipment are carried at cost and depreciated using the straight-line method over their estimated useful lives. Interest cost, net of related interest income, incurred during the period for construction of capital assets is capitalized as a component of the cost of acquiring those assets and totaled $376, $444, and $243 for 2016, 2015, and 2014, respectively.

The following useful lives are used in computing depreciation:

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

(k) Deferred Income Taxes

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

The System follows ASC Topic 740, *Income Taxes* (ASC 740), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. ASC 740 prescribes a more-likely than-not recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken. Under ASC 740, tax positions will be evaluated for recognition, derecognition, and measurement using consistent criteria and will provide more information about the uncertainty in income tax assets and liabilities. As of December 31, 2016, 2015, and 2014, the System does not have any significant assets or liabilities recorded for uncertain tax benefits. The System has not recorded any reserves or related accruals for interest and penalties for uncertain income tax positions.

(l) Professional and General Liability Claims

The System is insured for professional and general liability claims in excess of self-insured retention limits with an external insurance carrier. The provision for estimated claims includes estimates of ultimate costs for both reported claims and claims incurred but not reported.

(m) Temporarily and Permanently Restricted Net Assets

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

(n) Donor-Restricted Gifts

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

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

(o) Net Patient Service Revenue

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

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

(p) Other Operating Revenue

Other operating revenue includes income from investments in unconsolidated entities, rental income, pharmacy and ancillary sales, and grant revenue. Grant revenue includes Meaningful Use-Health Information Technology for Economic and Clinical Health Act Stimulus Grants of $2,815, $3,695 and $14,848 for 2016, 2015, and 2014, respectively.

(Continued)

(q) Operating Income Before Strike Expenses

Revenue, gains, expenses, and losses (except for those items identified as strike expenses) are included in operating income before strike expenses.

In 2016, administrative, staffing, and travel costs associated with Minnesota Nurses Association (MNA) strikes resulted in expenses of $135,587.

(r) Excess of Revenues over Expenses

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

(s) Adoption of New Accounting Standards

On January 1, 2016, the System adopted guidance under Accounting Standards Update 2015-03, *Interest – Imputation of Interest*, which amended ASC Subtopic 835-30, *Interest – Imputation of Interest*. The amendment required that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, rather than a long-term asset. The adoption of the authoritative guidance resulted in a reclassification of $6,072 of unamortized deferred financing costs from other assets to long-term debt on the balance sheet as of January 1, 2016. The December 31, 2015 and 2014 balances were also reclassed to conform to the 2016 presentation. Other than this reclassification, the adoption of the authoritative guidance did not have an impact on the consolidated financial statements.

On December 31, 2015, the System adopted guidance under Accounting Standards Update 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, which amended ASC Topic 820, *Fair Value Measurement*. The amendments remove the requirement to categorize within the fair value hierarchy investments whose fair values are measured at net asset value (or its equivalent). The adoption of the authoritative guidance did not have a material effect on the System's consolidated financial statements.

(t) Investment Securities

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

(Dollars in thousands)

(u) Fair Value Measurements

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

(v) Reclassifications

Certain reclassifications have been made to the 2015 and 2014 consolidated financial statements to conform to the 2016 presentation.

(3) Net Patient Service Revenue

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

The System utilizes a process to identify and appeal certain settlements by Medicare and other third-party payers. Additional reimbursement is recorded in the year the appeal is successful. During 2016, 2015, and 2014, successful appeals, cost report settlements, and other adjustments to prior year estimates resulted in an increase in net patient service revenue of $11,886, $1,820, and $39,679, respectively. The System recognizes significant amounts of patient service revenue at the time services are rendered even though it does not assess the patient’s ability to pay. For uninsured patients who do not qualify for charity care, the System recognizes revenue on the basis of discounted rates. On the basis of historical experience, a significant portion of the System’s patients will be unable or unwilling to pay for the services provided. Thus, the System records a significant provision for bad debts related to uninsured patients and self-pay balances of insured patients who are unable or unwilling to pay for the services provided. The System also records a provision for bad debts related to self-pay balances of insured patients. Patient service revenue net of contractual allowances and discounts (but before the provision for bad debts) recognized in the period by major payer is as follows:

	2016	2015	2014
Medicare and Medicaid	40 %	40 %	39 %
Managed care	56	54	55
Commercial and other	2	4	3
Self-pay	2	2	3
	100 %	100 %	100 %

(Continued)

(Dollars in thousands)

The System grants credit without collateral to its patients, most of whom are residents in the communities that it serves and are insured under third-party payer agreements. The System reduces its patient accounts receivable by an allowance for doubtful accounts. Deductibles and coinsurance are classified as either third-party or self-pay receivables on the basis of which party has the primary remaining financial responsibility, while the total gross revenue remains classified based on the primary payer at the time of service. In evaluating the collectibility of accounts receivable, the System analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. The System used a consistent methodology to estimate the allowance and provision for bad debts in the years 2016, 2015, and 2014. For receivables associated with self-pay patients after satisfaction of amounts due from insurance, the System follows established guidelines for charging off certain past-due patient balances against the allowance for doubtful accounts, which was $69,638, $78,849, and $81,114 in the years 2016, 2015, and 2014, respectively. The System has not changed its charity care or uninsured discount policies during the years 2016, 2015, and 2014. The System does not maintain an allowance for doubtful accounts from third-party payers, nor did it have significant write-offs from third-party payers. The mix of net patient accounts receivable by major payer as of December 31 consists of the following:

	2016	2015	2014
Medicare and Medicaid	35 %	37 %	34 %
Managed care	44	44	42
Self-pay	14	12	16
Commercial and other	7	7	8
	100 %	100 %	100 %

Two managed care payers accounted for approximately 38%, 37%, and 36% of net patient service revenue in 2016, 2015, and 2014, respectively. Amounts due from these two managed care payers accounted for approximately 27%, 29%, and 25% of net patient accounts receivable at December 31, 2016, 2015, and 2014, respectively.

(4) Community Benefits

The System follows Internal Revenue Service reporting guidelines for categories of community benefit provided in the service areas of the System. The major components are defined below.

(a) Cost of Providing Charity Care (Also Referred to as Financial Assistance)

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

(b) Costs in Excess of Medicaid Payments

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

(c) Medicaid Surcharge

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

(d) Costs of Other Means-Tested Government Programs (MinnesotaCare Tax)

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

(e) Community Health Improvement Services

In the furtherance of its charitable purpose, the System provides a wide variety of community health improvement programs and activities to the various communities that it serves in response to specific needs within those communities. Examples are programs and activities designed to improve the quality of life and build healthier communities. Community services activities include but are not limited to, health screenings, support counseling for patients and families, crisis intervention, health enhancement and wellness programs, classes on specific conditions, and telephone information services. Examples of community benefit and engagement programs operated by the System include Backyard Initiative; Free Bikes 4 Kidz; Neighborhood Health Connection; Health Powered Kids; and Change to Chill.

(f) Subsidized Health Services

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

(g) Health Profession Education

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

(h) Research

The System participates in clinical and community health research that is shared with the health care community, including clinical research related to integrative medicine and cancer interventions as well as community health research related to care model innovations and population health. Since January 1, 2014, research costs have been reported net of restricted grants designated and released for research purposes.

(i) Cash and In-Kind Contributions

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

(Continued)

(Dollars in thousands)

(j) Other Community Benefit Cost

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

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

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

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

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

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

Community Building – The System engages in community activities that address root causes of health problems such as poverty, homelessness, and environmental issues by participating in activities including economic development work, workforce development, public safety efforts, and community health improvement work.

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

	2016	2015	2014
Cost of providing charity care (charges forgone of $49,307, $36,220, and $50,623, respectively)	$ 21,200	14,800	21,400
Costs in excess of Medicaid payments	56,800	49,800	57,300
Medicaid surcharge	24,800	24,000	25,500
MinnesotaCare tax	47,500	47,000	45,500
Community health improvement services	7,900	9,500	9,100
Subsidized health services	2,700	3,500	3,800
Health professions education	15,500	17,200	25,300
Research	4,300	3,800	4,800

(Continued)

(Dollars in thousands)

		2016	2015	2014
Cash and in-kind contributions	$	3,100	3,200	2,600
Other community benefit cost		4,800	5,500	4,900
Total cost of community benefit		188,600	178,300	200,200
Costs in excess of Medicare payments		256,200	213,800	168,500
Other care provided without compensation (bad debt)		85,600	98,500	93,500
Discounts offered to uninsured patients		32,100	26,700	32,600
Taxes and fees		4,800	5,100	4,600
Community building		400	500	800
Total value of community contributions	$	567,700	522,900	500,200

(5) Cash and Cash Equivalents and Investments

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

		2016	2015	2014
Cash and cash equivalents	$	172,710	349,115	180,985
Money market collective fund and short-term fixed income		74,146	74,444	114,118
Fixed income		932,010	865,847	864,850
Equity securities		256,486	350,892	290,046
Investments accounted for at net asset value		670,505	456,421	419,193
	$	2,105,857	2,096,719	1,869,192

(Continued)

(Dollars in thousands)

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

		2016	2015	2014
By trustee for repayment of long-term debt	$	51	54	52
By trustee for swap collateralization		4,070	7,220	6,750
In escrow for capital projects		—	—	13
Donor-restricted funds		144,973	138,484	139,792
Vendor deposits		2,443	3,555	3,555
	$	151,537	149,313	150,162

Total investment return consists of the following:

		2016	2015	2014
Investment earnings in unrestricted net assets:				
Interest and dividend income (net of expense of $1,524, $1,458, and $1,397 for 2016, 2015, and 2014, respectively)	$	26,350	23,859	21,925
Realized gains (losses) on investments		16,186	(2,182)	14,278
Unrealized gains (losses) on investments		40,838	(54,911)	10,787
		83,374	(33,234)	46,990

		2016	2015	2014
Investment earnings in restricted net assets:				
Interest and dividend income	$	3,032	1,670	1,684
Realized gains on investments		2,654	372	2,470
Unrealized gains (losses) on investments		3,409	(4,314)	240
		9,095	(2,272)	4,394
	$	92,469	(35,506)	51,384

(Continued)

(Dollars in thousands)

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

		2016	2015	2014
Nonoperating gains (losses)	$	83,374	(33,234)	46,990
Changes in restricted net assets		9,095	(2,272)	4,394
	$	92,469	(35,506)	51,384

(6) Other Current Assets

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

		2016	2015	2014
Pledges and notes receivable	$	2,439	3,429	7,266
Prepaid expenses		15,919	15,875	20,184
Third-party payer settlement receivables		12,115	21,506	9,989
Other miscellaneous receivables		64,073	59,531	71,950
	$	94,546	100,341	109,389

(7) Land, Buildings, and Equipment

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

		2016	2015	2014
Land and land improvements	$	97,480	96,932	95,488
Buildings		1,482,804	1,433,768	1,316,725
Equipment		1,564,663	1,490,601	1,410,022
		3,144,947	3,021,301	2,822,235
Less accumulated depreciation and amortization		2,063,706	1,942,090	1,820,356
		1,081,241	1,079,211	1,001,879
Construction in progress		85,156	63,250	40,071
	$	1,166,397	1,142,461	1,041,950

(Continued)

(Dollars in thousands)

(8) Other Assets

Other assets as of December 31 consist of the following:

		2016	2015	2014
Cash surrender value of insurance policies	$	4,161	4,129	4,422
Pledges and notes receivable, less current portion		21,173	22,236	23,753
Investment in unconsolidated entities		97,855	77,692	54,788
Deferred compensation		148,366	136,688	136,308
Other		18,481	20,568	23,359
	$	290,036	261,313	242,630

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

	Percentage ownership		Equity investment 2016	Equity investment 2015	Equity investment 2014	Share of net earnings 2016	Share of net earnings 2015	Share of net earnings 2014
St. Francis Regional Medical Center	46.55 %	$	47,534	40,163	34,156	8,371	6,007	3,873
Other entities	10%–50%		50,321	37,529	20,632	8,018	6,303	9,115
		$	97,855	77,692	54,788	16,389	12,310	12,988

The following table reflects summarized financial information for all other entities as of and for the years ended December 31:

		2016	2015	2014
Total assets	$	203,433	158,091	123,073
Total liabilities		120,000	79,403	48,330
Total net assets	$	83,433	78,688	74,743
Total revenue	$	150,050	136,225	129,866
Total operating expenses		130,744	122,633	100,933
Total investment return and other nonoperating		(917)	—	—
Excess of revenues over expenses	$	18,389	13,592	28,933

(Dollars in thousands)

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

		2016	2015	2014
Total assets	$	173,005	162,357	156,742
Total liabilities		66,733	68,933	70,354
Total net assets	$	106,272	93,424	86,388
Total revenue	$	146,837	137,215	125,894
Total operating expenses		131,543	122,678	116,086
Total investment return and other nonoperating		2,624	(1,088)	268
Excess of revenues over expenses	$	17,918	13,449	10,076

(9) Accounts Payable and Accrued Expenses

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

		2016	2015	2014
Outstanding checks	$	48,118	35,417	57,746
Trade accounts payable		92,687	65,102	44,361
Accrued payroll, taxes, and vacation		188,178	191,982	186,183
MinnesotaCare tax payable		15,382	14,047	13,150
Other		119,486	128,303	126,745
	$	463,851	434,851	428,185

(Continued)

(Dollars in thousands)

(10) Other Current Liabilities

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

		2016	2015	2014
Current portion of estimated reserves for professional and general liability claims	$	10,128	12,012	12,354
Current portion of estimated reserves for workers' compensation claims		12,797	14,008	13,911
Employee health plan claims incurred but not reported		19,854	16,927	16,498
Defined-contribution retirement plan		43,488	41,250	38,650
Due to third-party payers		769	10,896	—
Current portion of long-term debt		24,341	23,948	20,347
	$	111,377	119,041	101,760

(11) Long-Term Debt

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

		2016	2015	2014
Fixed Rate Revenue Bonds, Series 2009A-1 (Allina Health System), annual interest rate from 4.50% to 5.25%	$	102,815	104,715	106,415
Fixed Rate Revenue Bonds, Series 2009A-2 (Allina Health System), annual interest from 3.25% to 5.50%		68,530	68,700	68,860
Variable Rate Revenue Bonds, Series 2009B&C (Allina Health System), Variable Rate Demand Notes, average annual interest rate of 0.36% during 2016; 0.71% at December 31, 2016		164,525	164,525	164,525
Fixed Rate Revenue Bonds, Series 2007A (Allina Health System), annual interest rate from 4.50% to 5.50%		87,540	97,030	105,415
Variable Rate Revenue Bonds, Series 2007C (Allina Health System), Variable Rate Demand Notes, average annual interest rate of 0.41% during 2016; 0.71% at December 31, 2016		119,700	120,500	121,250

(Dollars in thousands)

		2016	2015	2014
Variable Rate Revenue Bonds, Series 1998A (Allina Health System) Periodic Auction Reset, average annual interest rate of 0.58% during 2016; 1.0% at December 31, 2016	$	14,575	14,575	14,575
Variable Rate Health Care System Revenue Bonds, Series 1993B (HealthSpan) Periodic Auction Reset, average annual interest rate of 0.56% during 2016; 0.84% at December 31, 2016		8,700	17,000	24,900
Fixed Rate Taxable Bonds, Series 2015 (Allina Health System), annual interest rate of 4.805%		250,000	250,000	—
Fixed Rate Health Care Facilities Revenue Note, Series 2014 (Allina Health System), annual interest rate of 2.55%		18,520	19,210	20,165
Capitalized leases		9,185	13,745	4,053
Other		1,669	1,626	163
		845,759	871,626	630,321
Unamortized portion of original issue premium		2,339	2,830	3,320
Unamortized deferred financing		(5,565)	(6,072)	(3,923)
Current portion		(24,341)	(23,948)	(20,347)
	$	818,192	844,436	609,371

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

In September 2015, the System issued a fixed-rate Taxable Bond, Series 2015, in the aggregate principal amount of $250,000. The 2015 Bonds are secured by the Obligated Group's pledged revenue and were issued for the purpose of funding new projects and strategic initiatives.

In December 2014, the City of Minneapolis, on behalf of the System, issued a fixed-rate Revenue Note, Series 2014, in the aggregate principal amount of $20,165. The 2014 Revenue Note is secured by the Obligated Group's pledged revenue and was used to pay off the portion of the System's line of credit relating to the refinancing of the Regina Medical Center 2010 Series Bond.

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

The Series 2009B&C Bonds are secured by letters of credit issued by two banks. Repayment of draws against the letters is secured by term credit agreements with the banks in the amount of $114,525, which expires on January 5, 2018, and $50,000, which expires on January 3, 2018. If the bonds were put and not remarketed, the banks would be required to purchase the bonds. Draws under the term credit agreements to repay the banks for the purchase of the bonds are payable in an amount equal to the principal payments necessary to repay the draws over five years in equal quarterly installments, beginning 367 days after the draw, based on the bank's base rate plus 2.00%.

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

On June 18, 2008, the System completed a conversion of the Series 2007C Bonds from auction rate securities to variable rate demand bonds. This conversion included the insurer's consent to remove the insurance and for a bank to support the bonds with a direct pay letter of credit. Repayment of draws against the letter is secured by a term credit agreement with the bank in the aggregate amount of $119,700, which expires on January 3, 2018. If the bonds were put and not remarketed, the bank would be required to purchase the bonds. Draws under the term credit agreement to repay the bank for the purchase of the bonds are payable in an amount equal to the principal payments necessary to repay the draws over five years, beginning 367 days after the draw, based on the bank's base rate plus 2.00%.

(Dollars in thousands)

Aggregate annual maturities of long-term debt and mandatory sinking fund requirements, as stated under the actual debt terms, for each of the five years and thereafter following December 31, 2016, are as follows:

2017	$	24,341
2018		25,358
2019		26,639
2020		27,048
2021		27,165
Thereafter		715,208

Aggregate principal payments of long-term debt based on the variable rate demand notes being put back to the System and a corresponding draw being made on underlying liquidity facilities, for each of the five years and thereafter following December 31, 2016, are as follows:

2017	$	24,341
2018		81,378
2019		82,634
2020		82,943
2021		83,035
Thereafter		491,428

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

(Dollars in thousands)

As of December 31, 2016, 2015, and 2014, the System posted collateral of $4,070, $7,220, and $6,750, respectively, related to one of the System's swaps due to changes in interest rates. The following table provides details regarding the System's fair value of the derivative instruments at December 31, 2016, none of which are designated as cash flow hedging instruments:

Fixed payer interest rate swaps

Swap	Balance sheet location	Fair value	Notional amount outstanding	Rate paid	Rate received	Average rate received in 2016	Counterparty
2009BC	Other liabilities	$ 10,850	41,131	3.74 %	% of LIBOR	0.65 %	Wells Fargo
2009BC	Other liabilities	32,470	123,394	3.73	% of LIBOR	0.65	JP Morgan
2007C	Other liabilities	24,526	119,700	3.58	% of LIBOR	0.49	US Bank
2001	Other liabilities	16,089	50,000	5.17	SIFMA	0.33	Goldman Sachs
1998A	Other liabilities	1,705	15,075	4.44	SIFMA	0.34	Goldman Sachs
Total		$ 85,640	349,300				

The following table provides details regarding the System's fair value of the derivative instruments at December 31, 2015, none of which are designated as cash flow hedging instruments:

Fixed payer interest rate swaps

Swap	Balance sheet location	Fair value	Notional amount outstanding	Rate paid	Rate received	Average rate received in 2015	Counterparty
2009BC	Other liabilities	$ 11,783	41,131	3.74 %	% of LIBOR	0.48 %	Wells Fargo
2009BC	Other liabilities	35,263	123,394	3.73	% of LIBOR	0.47	JP Morgan
2007C	Other liabilities	27,213	120,500	3.58	% of LIBOR	0.36	US Bank
2001	Other liabilities	18,459	50,000	5.17	SIFMA	0.03	Goldman Sachs
1998A	Other liabilities	2,380	15,075	4.44	SIFMA	0.03	Goldman Sachs
Total		$ 95,098	350,100				

The following table provides details regarding the System's fair value of the derivative instruments at December 31, 2014, none of which are designated as cash flow hedging instruments:

Fixed payer interest rate swaps

Swap	Balance sheet location	Fair value	Notional amount outstanding	Rate paid	Rate received	Average rate received in 2014	Counterparty
2009BC	Other liabilities	$ 11,139	41,131	3.74 %	% of LIBOR	3.00 %	Wells Fargo
2009BC	Other liabilities	33,331	123,394	3.73	% of LIBOR	0.45	JP Morgan
2007C	Other liabilities	26,400	121,250	3.58	% of LIBOR	0.35	US Bank
2001	Other liabilities	17,445	50,000	5.17	SIFMA	0.05	Goldman Sachs
1998A	Other liabilities	2,534	15,075	4.44	SIFMA	0.05	Goldman Sachs
Total		$ 90,849	350,850				

(Dollars in thousands)

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

	Amount of gain (loss) on change in fair value recognized as nonoperating: gains (losses) on interest rate swap agreements			Amount of loss reclassified from unrestricted net assets into revenues over expenses as nonoperating: gains (losses) on interest rate swap agreements			Amount of interest paid to counterparty recognized as nonoperating: gains (losses) on interest rate swap agreements			Total		
	2016	2015	2014	2016	2015	2014	2016	2015	2014	2016	2015	2014
2009BC	$ 3,725	(2,576)	(15,868)	—	—	—	(5,107)	(5,371)	(5,409)	(1,382)	(7,947)	(21,277)
2007C	2,687	(813)	(8,476)	—	—	—	(3,645)	(3,878)	(3,921)	(958)	(4,691)	(12,397)
2001	2,371	(1,014)	(4,984)	—	—	—	(2,406)	(2,567)	(2,551)	(35)	(3,581)	(7,535)
1998A	675	154	55	(874)	(874)	(874)	(604)	(669)	(772)	(803)	(1,389)	(1,591)
	$ 9,458	(4,249)	(29,273)	(874)	(874)	(874)	(11,762)	(12,485)	(12,653)	(3,178)	(17,608)	(42,800)

The System records the swaps’ liability at fair value, which requires nonperformance risk (i.e., credit risk), to be included in the valuation. Nonperformance risk is defined as the risk that the obligation will not be fulfilled and affects the value at which the liability is transferred. This nonperformance risk is determined by adjusting the discounting rate by a credit spread as of the reporting date. The addition of the credit spread to the discounting rate reduces the reported liability. Because of market volatility, the fair value reported liability of the swaps is $2,489, $3,401, and $6,724 less as of December 31, 2016, 2015, and 2014, respectively, than the mark-to-market valuations (note 14).

Interest paid, net of amounts capitalized, was $28,802, $18,170, and $16,330 during 2016, 2015, and 2014, respectively.

The System has a Revolving Credit Agreement with Wells Fargo Bank through June 17, 2019, which consists of a line of credit of $26,000. The interest rate on the line of credit is the Reserve Adjusted London Interbank Offered Rate (LIBOR) plus 0.5%, and is secured by a note under the 1998 Master Trust Indenture. The unused line fee for the revolving line of credit is 0.15% per annum. The System had insurance-related letters of credit applied against the line of credit in the amount of $9,836, $5,468, and $2,536 at December 31, 2016, 2015, and 2014, respectively. There were no draws on the line of credit at December 31, 2016, 2015, and 2014.

(Dollars in thousands)

(12) Other Liabilities

Other liabilities as of December 31 consist of the following:

		2016	2015	2014
Estimated reserves for professional and general liability claims, less current portion	$	37,218	42,862	42,498
Estimated reserves for workers' compensation claims, less current portion		32,478	31,902	30,005
Net pension and postretirement liability		19,294	17,882	20,591
Interest rate swaps payable		85,640	95,098	90,849
Deferred compensation		171,426	160,093	165,052
Leasehold incentive allowance		18,623	19,840	22,455
Financing obligation		25,624	25,624	25,624
Other		19,418	22,277	23,471
	$	409,721	415,578	420,545

(13) Restricted Net Assets

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

		2016	2015	2014
Capital	$	14,730	15,585	17,147
Charity and indigent care		4,776	4,472	4,712
Education and research		26,857	24,151	22,061
Patient care		20,346	19,086	20,232
Other		42,369	42,609	51,003
	$	109,078	105,903	115,155

(Dollars in thousands)

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

		2016	2015	2014
Capital	$	128	128	128
Charity and indigent care		1,806	1,806	1,806
Education and research		18,906	18,827	18,644
Patient care		12,713	12,712	12,710
Other		23,264	21,805	21,660
	$	56,817	55,278	54,948

(14) Fair Value Measurements

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

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

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

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

Level 1 Inputs: Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date

Level 2 Inputs: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly through corroboration with observable market data

(Dollars in thousands)

Level 3 Inputs: Unobservable inputs for the asset or liability, that is, inputs that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing an asset or liability (including risk assumptions) developed based on the best information available in the circumstances

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

For Level 2 and Level 3 cash equivalents and fixed income assets that rely on significant other observable inputs and significant unobservable inputs, the System employs multiple third-party information providers to help determine the fair value of the assets. Level 2 and Level 3 securities in separately managed accounts are held at Bank of New York Mellon (BNYMellon), who acts as Trustee and Custodian for the assets. As Custodian, BNYMellon uses multiple pricing services to value the assets. The investment managers utilize their own pricing services and valuation processes. Any significant discrepancies between Custodian and investment manager values are reconciled on a monthly basis by the managers and BNYMellon. The System also employs an investment consultant who researches significant pricing differences between the manager and custodian on a security-by-security basis. The consultant will notify the Custodian of any significant pricing issues.

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

The System's financial assets and liabilities that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2016 as follows:

		Fair value measurements using		
	Total	**Level 1**	**Level 2**	**Level 3**
Cash and cash equivalents:				
Cash	$ 38,028	38,028	—	—
Money market funds	134,682	134,682	—	—
Total cash and cash equivalents	172,710	172,710	—	—
Short-term and long-term investments – trading securities:				
Short-term fixed income	21,994	19,106	2,888	—
Money market fund	31,586	31,586	—	—
Total short-term fixed income and money market	53,580	50,692	2,888	—

(Dollars in thousands)

	Total	Fair value measurements using Level 1	Level 2	Level 3
Equity:				
Financials	$ 25,023	25,023	—	—
Consumer	11,618	11,618	—	—
Industrials	10,674	10,674	—	—
Technology	3,274	3,274	—	—
Healthcare	2,173	2,173	—	—
Global equity mutual funds	121,730	121,730	—	—
All asset mutual fund	14,635	11,890	2,745	—
Other equity	48,374	48,374	—	—
Total equity	237,501	234,756	2,745	—
Fixed income:				
U.S. Treasury securities	148,775	148,775	—	—
U.S. Agency securities	149,174	—	149,174	—
Corporate bonds	201,647	—	201,647	—
Mortgage, commercial, and asset-backed securities	94,937	—	94,937	—
Sovereigns	5,515	—	5,515	—
Term loan/private placement	68,057	—	67,567	490
Unconstrained fixed income mutual funds	175,396	175,396	—	—
Other	26,153	—	26,153	—
Total fixed income	869,654	324,171	544,993	490
Total investments accounted for at net asset value	620,875			
Total investments – trading securities	1,781,610	609,619	550,626	490
Investments with limited uses – trading securities:				
Short-term fixed income	8,054	7,913	141	—
Money market collective fund	12,461	12,461	—	—
Equity	18,985	18,766	219	
Fixed income	54,549	21,544	32,966	39
Investments accounted for at net asset value	49,630			
Restricted foundation trusts (fixed income)	7,807	—	7,807	—
Total investments with limited uses – trading securities	151,486	60,684	41,133	39

(Continued)

(Dollars in thousands)

		Fair value measurements using		
	Total	Level 1	Level 2	Level 3
Investments with limited uses – available-for-sale securities:				
Money market fund	$ 51	51	—	—
Total investments with limited uses – available-for-sale securities	51	51	—	—
Total investments with limited uses	151,537	60,735	41,133	39
Total	$ 2,105,857	843,064	591,759	529
Liabilities:				
Interest rate swaps	$ 85,640	—	85,640	—

	Fair value measurements, Level 3
	Term loan
Balance, December 31, 2015	$ 1,178
Total realized and unrealized losses included in excess of revenues over expenses	32
Purchases	298
Sales	(979)
Balance, December 31, 2016	$ 529

(Dollars in thousands)

The System's financial assets and liabilities that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2015 as follows:

		Fair value measurements using		
	Total	**Level 1**	**Level 2**	**Level 3**
Cash and cash equivalents:				
Cash	$ 82,819	82,819	—	—
Money market funds	266,296	266,296	—	—
Total cash and cash equivalents	349,115	349,115	—	—
Short-term and long-term investments – trading securities:				
Short-term fixed income	34,606	32,405	2,201	—
Money market fund	13,850	13,850	—	—
Total short-term fixed income and money market	48,456	46,255	2,201	—
Equity:				
Financials	17,563	17,563	—	—
Consumer	7,971	7,971	—	—
Industrials	10,035	10,035	—	—
Technology	3,060	3,060	—	—
Healthcare	2,325	2,325	—	—
Global equity mutual funds	272,983	272,983	—	—
Other equity	11,264	7,765	3,499	—
Total equity	325,201	321,702	3,499	—
Fixed income:				
U.S. Treasury securities	206,102	206,102	—	—
U.S. Agency securities	89,034	—	89,034	—
Corporate bonds	157,857	—	157,857	—
Mortgage, commercial, and asset-backed securities	97,952	—	97,952	—
Sovereigns	3,779	—	3,779	—
Term loan/private placement	57,717	—	56,625	1,092
All asset mutual fund	46,834	46,834	—	—
Unconstrained fixed income mutual funds	124,145	124,145	—	—
Other	18,210	—	18,210	—
Total fixed income	801,630	377,081	423,457	1,092
Total investments accounted for at net asset at net asset value	423,004			
Total investments – trading securities	1,598,291	745,038	429,157	1,092

(Dollars in thousands)

	Total	Fair value measurements using Level 1	Level 2	Level 3
Investments with limited uses – trading securities:				
Short-term fixed income	$ 13,762	13,642	120	—
Money market collective fund	12,171	12,171	—	—
Equity	25,691	25,415	276	—
Fixed income	54,259	26,560	27,613	86
Investments accounted for at net asset value	33,417			
Restricted foundation trusts (fixed income)	9,958	—	9,958	—
Total investments with limited uses – trading securities	149,258	77,788	37,967	86
Investments with limited uses – available-for-sale securities:				
Money market fund	55	55	—	—
Total investments with limited uses – available-for-sale securities	55	55	—	—
Total investments with limited uses	149,313	77,843	37,967	86
Total	$ 2,096,719	1,171,996	467,124	1,178
Liabilities:				
Interest rate swaps	$ 95,098	—	95,098	—

	Fair value measurements, Level 3 Term loan
Balance, December 31, 2014	$ 1,146
Total realized and unrealized losses included in excess of revenues over expenses	(5)
Purchases	200
Sales	(163)
Balance, December 31, 2015	$ 1,178

(Dollars in thousands)

The System's financial assets and liabilities that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2014 as follows:

		Fair value measurements using		
	Total	**Level 1**	**Level 2**	**Level 3**
Cash and cash equivalents:				
Cash	$ 17,971	17,971	—	—
Money market funds	163,014	163,014	—	—
Total cash and cash equivalents	180,985	180,985	—	—
Short-term and long-term investments – trading securities:				
Short-term fixed income	56,498	54,040	2,458	—
Money market fund	28,866	28,866	—	—
Total short-term fixed income and money market	85,364	82,906	2,458	—
Equity:				
Financials	16,354	16,354	—	—
Consumer	8,269	8,269	—	—
Industrials	9,466	9,466	—	—
Technology	2,556	2,556	—	—
Healthcare	2,481	2,481	—	—
Global equity mutual funds	217,622	217,622	—	—
Other equity	11,013	7,841	3,172	—
Total equity	267,761	264,589	3,172	—
Fixed income:				
U.S. Treasury securities	173,208	173,208	—	—
U.S. Agency securities	99,722	—	99,722	—
Corporate bonds	136,122	—	136,122	—
Mortgage, commercial, and asset-backed securities	100,963	—	100,963	—
Sovereigns	5,456	—	5,456	—
Term loan/private placement	44,841	—	43,783	1,058
All asset mutual fund	94,719	94,719	—	—
Unconstrained fixed income mutual funds	123,915	123,915	—	—
Other	18,989	—	18,989	—
Total fixed income	797,935	391,842	405,035	1,058
Total investments accounted for at net asset at net asset value	386,985			
Total investments – trading securities	1,538,045	739,337	410,665	1,058

(Dollars in thousands)

		Fair value measurements using		
	Total	Level 1	Level 2	Level 3
Investments with limited uses – trading securities:				
Short-term fixed income	$ 13,967	13,847	120	—
Money market collective fund	14,776	14,776	—	—
Equity	22,285	22,021	264	—
Fixed income	56,509	29,194	27,227	88
Investments accounted for at net asset value	32,208			
Restricted foundation trusts (fixed income)	10,406	—	10,406	—
Total investments with limited uses – trading securities	150,151	79,838	38,017	88
Investments with limited uses – available-for-sale securities:				
Money market fund	$ 11	11	—	—
Total investments with limited uses – available-for-sale securities	11	11	—	—
Total investments with limited uses	150,162	79,849	38,017	88
Total	$ 1,869,192	1,000,171	448,682	1,146
Liabilities:				
Interest rate swaps	$ 90,849	—	90,849	—

	Fair value measurements, Level 3
	Term loan
Balance, December 31, 2013	$ 218
Total realized and unrealized losses included in excess of revenues over expenses	(34)
Purchases	1,299
Sales	(337)
Balance, December 31, 2014	$ 1,146

There were no significant transfers into or out of Level 1, Level 2, or Level 3 securities during the years ended December 31, 2016, 2015, and 2014.

(Dollars in thousands)

Fair value measurements of investments in certain entities that calculate net asset value per share (or its equivalent), including restricted and unrestricted assets, as of December 31, 2016, 2015, and 2014 are as follows:

	December 31, 2016			
	Net asset value	Unfunded commitments	Redemption frequency (if currently eligible)	Redemption notice period
Global bonds fund	$ 85,530	—	Monthly	15 days
Global equity fund	241,785	—	daily/bi-monthly	1–10 days
Emerging markets equity fund	64,905	—	Daily/weekly	5/10 days
Equity long/short hedge funds	73,827	—	Monthly/quarterly	30–90 days
Opportunistic fixed income hedge funds	111,323	—	Quarterly	45–90 days
Fund of hedge funds	647	—	Quarterly	90 days
Private equity funds	64,023	42,726	10 years	NA
Emerging market debt fund	28,465	—	Daily	Same day
Total	$ 670,505	42,726		

	December 31, 2015			
	Net asset value	Unfunded commitments	Redemption frequency (if currently eligible)	Redemption notice period
Global bonds fund	$ 65,335	—	Monthly	15 days
Global equity fund	77,691	—	45 days	15 days
Emerging markets equity fund	35,334	—	Daily	5 days
Equity long/short hedge funds	74,175	—	Monthly/quarterly	30–90 days
Opportunistic fixed income hedge funds	104,346	—	Quarterly	45–90 days
Fund of hedge funds	1,047	—	Quarterly	90 days
Private equity funds	45,053	39,924	10 years	NA
Emerging market debt fund	53,440	—	Daily	Same day
Total	$ 456,421	39,924		

(Dollars in thousands)

	December 31, 2014			
	Net asset value	Unfunded commitments	Redemption frequency (if currently eligible)	Redemption notice period
Global bonds fund	$ 63,248	—	Monthly	15 days
Global equity fund	77,575	—	45 days	15 days
Emerging markets equity fund	33,393	—	Daily	5 days
Equity long/short hedge funds	68,729	—	Monthly/ quarterly	30–90 days
Opportunistic fixed income hedge funds	89,314	—	Quarterly	45–90 days
Fund of hedge funds	1,743	—	Quarterly	90 days
Private equity funds	27,004	31,935	10 years	NA
Emerging market debt fund	58,187	—	Daily	Same day
Total	$ 419,193	31,935		

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

Global equity fund includes two funds that invest in global equities. The net asset value of the fund has been estimated using the net asset value per share of the investment. The fund provides full disclosure of the underlying holdings.

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

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

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

Fund of hedge funds include investments in fund of hedge funds that pursue multiple strategies to diversify risks and reduce volatility. The value of the investments in this category has been estimated using the net asset value per share of the investments. The fund is currently in liquidation and is making quarterly redemptions to shareholders.

(Continued)

(Dollars in thousands)

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

Private equity funds include a limited partnership investment that focuses on health care services and information technology companies, a limited partnership that makes direct real estate investments through senior secured and floating rate direct lending to middle market United States companies, a limited partnership that coinvests in intermediate-term opportunities sourced by absolute return, private capital, and real asset managers, as well as two limited partnerships that invests in distressed and opportunistic real estate investments. The fair value of the portfolio companies is determined using valuation techniques and procedures in accordance with recommendations by the American Institute of Certified Public Accountants for valuing private companies.

The System's deferred compensation investments recorded as other assets that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2016 as follows:

		Fair value measurements using		
	Total	**Level 1**	**Level 2**	**Level 3**
Assets:				
Mutual funds:				
Large cap domestic equity	$ 62,807	62,807	—	—
International equity	21,792	21,792	—	—
Fixed income	26,803	26,803	—	—
Life cycle	2,661	2,661	—	—
Money market	3,372	3,372	—	—
Other	12,868	12,868	—	—
Total mutual funds	130,303	130,303	—	—
Guaranteed investment contracts	18,063	—	—	18,063
Total assets	$ 148,366	130,303	—	18,063

(Dollars in thousands)

	Fair value measurements, Level 3
Balance, December 31, 2015	$ 16,890
Total interest income	243
Purchases	(4,505)
Sales	5,435
Balance, December 31, 2016	$ 18,063

The System's deferred compensation investments recorded as other assets that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2015 as follows:

		Fair value measurements using		
	Total	Level 1	Level 2	Level 3
Assets:				
Mutual funds:				
Large cap domestic equity	$ 46,085	46,085	—	—
Midcap domestic equity	7,115	7,115	—	—
Small cap domestic equity	2,696	2,696	—	—
International equity	20,850	20,850	—	—
Fixed income	24,924	24,924	—	—
Balanced	8,390	8,390	—	—
Life cycle	2,196	2,196	—	—
Money market	4,491	4,491	—	—
Other	3,051	3,051	—	—
Total mutual funds	119,798	119,798	—	—
Guaranteed investment contracts	16,890	—	—	16,890
Total assets	$ 136,688	119,798	—	16,890

(Dollars in thousands)

		Fair value measurements, Level 3
Balance, December 31, 2014	$	13,082
Total interest income		211
Purchases		7,773
Sales		(4,176)
Balance, December 31, 2015	$	16,890

The System’s deferred compensation investments recorded as other assets that are measured at fair value on a recurring basis were recorded using the fair value hierarchy at December 31, 2014 as follows:

			Fair value measurements using		
		Total	Level 1	Level 2	Level 3
Assets:					
Mutual funds:					
Large cap domestic equity	$	43,443	43,443	—	—
Midcap domestic equity		8,020	8,020	—	—
Small cap domestic equity		7,374	7,374	—	—
International equity		19,020	19,020	—	—
Fixed income		26,985	26,985	—	—
Balanced		8,978	8,978	—	—
Life cycle		2,692	2,692	—	—
Money market		3,213	3,213	—	—
Other		3,501	3,501	—	—
Total mutual funds		123,226	123,226	—	—
Guaranteed investment contracts		13,082	—	—	13,082
Total assets	$	136,308	123,226	—	13,082

(Dollars in thousands)

	Fair value measurements, Level 3
Balance, December 31, 2013	$ 11,411
Total interest income	236
Purchases	(4,742)
Sales	6,177
Balance, December 31, 2014	$ 13,082

(15) Benefit Plans

(a) Defined-Benefit Cash Balance Plans

The System is making contributions pursuant to provisions of a collective bargaining agreement. The assets for these active participants are in a stand-alone defined-benefit pension plan, known as the Allina Health Pension Plan for Collectively Bargained Employees. This plan holds assets of $11,322, $10,435, and $9,272, which are fair value measured using Level 1 criteria except for $259, $404, and $640 that are measured at net asset value as of December 31, 2016, 2015, and 2014, respectively. This plan has a projected benefit obligation of $11,756, $10,608, and $9,754 using a discount rate of 3.77%, 3.89%, and 3.54% as of December 31, 2016, 2015, and 2014, respectively. The System made contributions of $822, $1,358, and $615 and recorded a total pension expense of $1,065, $1,049, and $1,218 in 2016, 2015, and 2014, respectively. The unfunded balance of $434, $173, and $482, respectively, as of December 31, 2016, 2015, and 2014 is reported in the consolidated balance sheets as a noncurrent other asset.

The defined-benefit pension plan of Courage Center was assumed in June 2013 with the acquisition of Courage Center. This plan, which was frozen in 2009, holds assets of $26,275, $25,138, and $24,973, which are fair value measured using Level 2 criteria, and has a projected benefit obligation of $34,244, $32,936, and $34,282 using a discount rate of 4.25%, 4.0%, and 4.0% as of December 31, 2016, 2015, and 2014. The System made contributions of $1,000, $1,000, and $732 in 2016, 2015, and 2014, respectively, and recorded a total pension (expense) gain of $(1,171), $511, and $(7,077) in 2016, 2015, and 2014, respectively. The unfunded balance of $7,968, $7,798, and $9,309 as of December 31, 2016, 2015, and 2014, respectively, is reported in the consolidated balance sheets as a noncurrent other liability.

During 2017, the System expects to make required pension contributions totaling approximately $708 for the plans, but may elect to make additional contributions.

(Continued)

(Dollars in thousands)

Expected future benefit payments for the plans for the ten years following December 31, 2016 are as follows:

2017	$	1,908
2018		2,262
2019		2,281
2020		2,341
2021		2,613
2022–2026		13,876
	$	25,281

(b) Multi-Employer Plans

Contributions to the union-sponsored multi-employer plans are made in accordance with collective bargaining agreements. The risks of participation in these multi-employer plans are different from single-employer plans in the following aspects: a) assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers; b) if a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers; and c) if the System chooses to stop participating in some of its multi-employer plans and if the plan is underfunded, the System may be required to pay those plans an amount based on the underfunded status of the plan, referred to as the withdrawal liability. The System's participation in these plans for the year ended December 31, 2016 is outlined in the table below. The "EIN/Pension Plan Number" column provides the Employee Identification Number (EIN) and the three-digit plan number, if applicable. Unless otherwise noted, the most recent Pension Protection Act (PPA) zone status available in 2016, 2015, and 2014 is for the plan's year-end at December 31, 2015, 2014, and 2013, respectively. The zone status is based on information that the System received from the plan and is certified by the plan's actuary. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow zone are less than 80% funded, and plans in the green zone are at least 80% funded. The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. The last column lists the expiration date(s) of the collective-bargaining agreement(s) to which the plans are subject:

Pension fund	EIN/Pension plan number	Pension protection act zone status 2015	Pension protection act zone status 2014	FIP/RP Status pending/ implemented		Contributions of the System in plan year 2015	Contributions of the System in plan year 2014	Surcharge imposed	Expiration date of collective bargaining agreement
Twin City Hospitals Minnesota Nurses Association Pension Plan	41-6184922-001	Green	Green	N/A	$	34,864	35,961	No	May 31, 2019
Other funds						4,074	4,491		
Total contributions					$	38,938	40,452		

(Dollars in thousands)

Pension fund	EIN/Pension plan number	Pension protection act zone status 2014	Pension protection act zone status 2013	FIP/RP Status pending/ implemented	Contributions of the System in plan year 2014	Contributions of the System in plan year 2013	Surcharge imposed	Expiration date of collective bargaining agreement
Twin City Hospitals Minnesota Nurses Association Pension Plan	41-6184922-001	Green	Yellow	N/A	$ 35,961	35,433	No	May 31, 2016
Other funds					4,491	4,247		
Total contributions					$ 40,452	39,680		

Total amounts expensed under the union-sponsored multi-employer plans were $44,770, $40,893, and $41,827 for 2016, 2015, and 2014, respectively.

The System contributes more than 5% of the total contributions to all of the plans in which it participated for the plan years 2015, 2014, and 2013. The System is required to make minimum contributions each year and will make contributions of $43,009 in 2017.

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

At the date the System's consolidated financial statements were issued, Forms 5500 were not available for the plan years ended in 2016.

(c) Defined-Contribution Plans

Certain employees of the System are eligible to participate in defined-contribution plans, whereby 50% of the employees' initial 4% of salary contributions is matched. The defined-contribution plans were enhanced effective January 1, 2009 to provide an additional annual nonelective employer contribution for eligible employees as a replacement to the contribution made to the frozen pension plan. The additional contribution is given as a percent of pay, ranging from 3.0% to 4.5%, based on years of vesting service. Contributions are made during the year following the calendar year-end. The contribution payable to employees is recorded in other current liabilities. Total amounts expensed under defined-contribution plans were $66,966, $63,289, and $59,467 for 2016, 2015, and 2014, respectively.

(d) Postretirement Welfare Benefits

The System provides postretirement welfare benefits to certain employees. Postretirement welfare cost was $594, $658, and $481 for 2016, 2015, and 2014, respectively. As of December 31, 2016, 2015, and 2014, accumulated postretirement benefit obligation was $11,084, $10,132, and $11,094, respectively, and accrued postretirement benefit cost was $10,891, $9,911, and $10,800, respectively. A discount rate of 3.85%, a rate of return on plan assets of 5.0%, and a medical plan trend rate of 7.0% in 2016, decreasing to 5.0% in 2020 and thereafter, have been assumed.

(16) Self-Insurance Reserves

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

The System has made provisions for estimated professional and general liability and workers' compensation claims that have been retained by the System because of deductible provisions of various policies or because of unasserted claims and other uninsured exposures. Reserves of $92,621, $100,784, and $98,768 as of December 31, 2016, 2015, and 2014, respectively, have been recorded based on undiscounted historical data for professional and general liability and on a present-value basis using an annual discount rate of 2% for workers' compensation claims.

Under the comprehensive welfare benefit plan, the System has made provisions for claims reported but not paid and claims incurred but not reported of $19,854, $16,927, and $16,498 as of December 31, 2016, 2015, and 2014, respectively. Management of the plan believes the provisions are adequate to cover claims incurred

The System has a fixed-rate surety bond in the amount of $52,547 at December 31, 2016, and $49,943 at 2015 and 2014. The surety bond was obtained in connection with the System's self-insured workers' compensation program at a rate of 0.31% per annum.

The System also has unused letters of credit totaling $9,836 through June 30, 2017. The letters of credit were obtained in connection with the System's self-insured automobile and construction programs and Centers for Medicare and Medicaid Services Accountable Care Organization program at a fee of 0.45% per annum.

(17) Taxes

The System has been determined to qualify as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code. The System has also been determined to be exempt from federal and state income tax on related income under Section 501(a) of the Internal Revenue Code and Minnesota Statute Section 290.05, Subdivision 2. Certain of the System's subsidiaries and affiliates qualify as tax-exempt organizations, while others are taxable. The System and its subsidiaries paid taxes of $1,861, $1,229, and $1,717 in 2016, 2015, and 2014, respectively.

As of December 31, 2016, 2015, and 2014, the taxable subsidiaries of the System's continuing operations had a gross deferred tax asset of $69,881, $68,837, and $68,851, respectively, resulting from net operating loss carryforwards, employee compensation and benefits accruals, provision for bad debts, and limitation of charitable contributions, offset by valuation allowances of $69,438, $65,513, and $68,569, respectively, and a gross deferred tax liability of $443, $325, and $282, respectively, primarily attributable to depreciation and a change in accounting method of a taxable subsidiary. The valuation allowance decreased by $925, $56, and $10,377 during 2016, 2015, and 2014, respectively.

(Continued)

(Dollars in thousands)

As of December 31, 2016, 2015, and 2014, the continuing operations of the System and its subsidiaries had net operating loss carryforwards of $119,264, $114,765, and $119,453, respectively, for income tax purposes, which expire in various years through 2036.

The System has analyzed income tax positions taken for filing with the Internal Revenue Service and all state jurisdictions where it operates. The System believes that income tax filing positions will be sustained upon examination and does not anticipate any adjustments that would result in a material adverse effect on the System's consolidated financial statements. As of December 31, 2016, 2015, and 2014, the System does not have any significant liabilities for uncertain tax benefits. The filings for the years ended 2013 to 2016 are open to examination by federal and state authorities.

(18) Commitments and Contingencies

The System has various noncancelable operating occupancy lease agreements and other operating lease agreements for computer, medical, communication, and other equipment. The terms of certain of the lease agreements contain lease escalation clauses, allow for renewal of the leases, and require the System to pay operating costs in addition to minimum base rent. Base rent expense for operating leases totaled $30,234, $29,630, and $27,581, for the years ended December 31, 2016, 2015, and 2014, respectively.

Aggregate future minimum lease payments required under operating lease agreements in effect on December 31, 2016 are as follows:

2017	$	26,893
2018		26,279
2019		23,880
2020		21,872
2021		20,369
Thereafter		146,885
	$	266,178

The System has incurred financing obligations relating to space lease agreements in a medical office building and a clinic. Under the guidance in ASC Topic 840, *Leases*, the System is considered the owner of the buildings. As of December 31, 2016, 2015, and 2014, the cost of the buildings and the related financing obligation are included in the accompanying consolidated balance sheets in property and equipment, net, and in other liabilities, respectively.

Approximately 41% of employees are represented by various collective bargaining arrangements, of whom approximately 11% are represented by arrangements that are pending or expire within one year.

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

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

(19) Acquisitions

On January 1, 2015, the System acquired substantially all assets and liabilities of the Rice County District One Hospital (District One Hospital). The System is now the sole owner of the hospital. The results of District One Hospital's operations, including total revenues of $48,040, have been included in the consolidated financial statements since the acquisition date.

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

		District One Hospital
Current and other long-term assets	$	4,629
Property and equipment		34,769
Liabilities		(4,549)
Long-term debt		—
Total identifiable net assets acquired	$	34,849
Unrestricted nonoperating contribution received in acquisition	$	34,849

(Dollars in thousands)

(20) Functional Expenses

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

	2016	2015	2014
Healthcare services	$ 3,259,153	3,097,772	2,906,919
General and administrative	569,289	550,099	550,818
	$ 3,828,442	3,647,871	3,457,737

(21) Subsequent Events

The System has evaluated subsequent events from the consolidated balance sheet date through March 14, 2017, the date at which the consolidated financial statements were issued, and determined there are no other items to disclose.

KPMG LLP
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Independent Auditors' Report

The Board of Directors
Allina Health System:

We have audited the consolidated financial statements of Allina Health System as of and for each of the years ended December 31, 2016, 2015, and 2014, and have issued our report thereon dated March 14, 2017, which contained an unmodified opinion on those consolidated financial statements. Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information is presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Minneapolis, Minnesota
March 14, 2017

ALLINA HEALTH SYSTEM

Consolidating Balance Sheet

December 31, 2016

(Dollars in thousands)

Assets		Obligated Group	Other nonobligated	Eliminations	Allina Health System
Current assets:					
Cash and cash equivalents	$	166,469	6,241	—	172,710
Short-term investments		451,327	—	—	451,327
Patient accounts receivable, less allowance for uncollectible accounts and charity care of $90,656		449,845	20,371	—	470,216
Inventories		64,059	166	—	64,225
Other current assets		93,734	812	—	94,546
		1,225,434	27,590	—	1,253,024
Investments		1,279,528	50,755	—	1,330,283
Investments with limited uses		14,688	136,849	—	151,537
Beneficial interests in net assets of Allina Foundations		200,945	—	(200,945)	—
Land, buildings, and equipment, net		1,156,000	10,397	—	1,166,397
Other assets		219,320	70,716	—	290,036
Total assets	$	4,095,915	296,307	(200,945)	4,191,277
Liabilities and Net Assets					
Current liabilities:					
Accounts payable and accrued expenses	$	445,235	18,616	—	463,851
Other current liabilities		110,723	654	—	111,377
		555,958	19,270	—	575,228
Long-term debt		814,220	3,972	—	818,192
Other liabilities		353,336	56,385	—	409,721
Total liabilities		1,723,514	79,627	—	1,803,141
Net assets:					
Unrestricted		2,162,291	59,950	—	2,222,241
Temporarily restricted		153,293	103,236	(147,451)	109,078
Permanently restricted		56,817	53,494	(53,494)	56,817
Total net assets		2,372,401	216,680	(200,945)	2,388,136
Total liabilities and net assets	$	4,095,915	296,307	(200,945)	4,191,277

See accompanying independent auditors’ report.

ALLINA HEALTH SYSTEM

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2016

(Dollars in thousands)

	Obligated Group	Other nonobligated	Eliminations	Allina Health System
Revenues:				
Patient service revenue net of contractual adjustments	$ 3,759,177	18,186	—	3,777,363
Provision for bad debts	(86,099)	495	—	(85,604)
Net patient service revenue	3,673,078	18,681	—	3,691,759
Other operating revenue	236,474	34,645	(15,189)	255,930
Total revenues	3,909,552	53,326	(15,189)	3,947,689
Expenses:				
Salaries and benefits	2,482,518	13,199	—	2,495,717
Supplies and services	814,687	41,129	—	855,816
Depreciation and amortization	163,583	1,850	—	165,433
Financing costs	37,354	372	—	37,726
Services provided by (to) related divisions	17,917	(2,728)	(15,189)	—
State assessments and taxes	81,519	628	—	82,147
Utilities and maintenance	71,608	636	—	72,244
Other operating expenses	118,452	907	—	119,359
Total expenses	3,787,638	55,993	(15,189)	3,828,442
Operating income before strike expenses	121,914	(2,667)	—	119,247
Strike expenses	(135,587)	—	—	(135,587)
Operating (loss) income	(13,673)	(2,667)	—	(16,340)
Nonoperating gains (losses):				
Investment return	82,162	1,212	—	83,374
Losses on interest rate swap agreements	(3,178)	—	—	(3,178)
Contributions received in acquisitions	—	—	—	—
Other	(1,993)	(1,262)	—	(3,255)
Excess of revenues over expenses	$ 63,318	(2,717)	—	60,601

ALLINA HEALTH SYSTEM

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2016

(Dollars in thousands)

	Obligated Group	Other nonobligated	Eliminations	Allina Health System
Unrestricted net assets:				
Excess of revenues over expenses	$ 63,318	(2,717)	—	60,601
Net assets released from restrictions for capital purposes	2,449	10,139	—	12,588
Transfer net assets released to Obligated Group	10,419	(10,419)	—	—
Amortization of unrealized loss on interest rate swap agreement	874	—	—	874
Capital contributions to nonobligated group affiliates, net	(4,201)	4,201	—	—
Other	(1,620)	(2,304)	—	(3,924)
Increase (decrease) in unrestricted net assets	71,239	(1,100)	—	70,139
Temporarily restricted net assets:				
Contributions	2,449	20,059	—	22,508
Investment return	215	7,613	—	7,828
Net assets released from restrictions	(2,449)	(22,012)	—	(24,461)
Change in beneficial interests in net assets of Allina Foundations	2,538	—	(2,538)	—
Other	(351)	(2,349)	—	(2,700)
Increase (decrease) in temporarily restricted net assets	2,402	3,311	(2,538)	3,175
Permanently restricted net assets:				
Contributions for endowment funds	25	247	—	272
Investment return	1,200	67	—	1,267
Change in beneficial interests in net assets of Allina Foundations	314	—	(314)	—
Increase (decrease) in permanently restricted net assets	1,539	314	(314)	1,539
Increase (decrease) in net assets	75,180	2,525	(2,852)	74,853
Net assets at beginning of year	2,297,221	214,155	(198,093)	2,313,283
Net assets at end of year	$ 2,372,401	216,680	(200,945)	2,388,136

See accompanying independent auditors' report.

ALLINA HEALTH SYSTEM

Consolidating Balance Sheet

December 31, 2015

(Dollars in thousands)

Assets		Obligated Group	Other nonobligated	Eliminations	Allina Health System
Current assets:					
Cash and cash equivalents	$	342,556	6,559	—	349,115
Short-term investments		351,062	—	—	351,062
Patient accounts receivable, less allowance for uncollectible accounts and charity care of $74,216		443,268	21,790	—	465,058
Inventories		61,163	134	—	61,297
Other current assets		105,961	(5,620)	—	100,341
		1,304,010	22,863	—	1,326,873
Investments		1,189,474	57,755	—	1,247,229
Investments with limited uses		17,866	131,447	—	149,313
Beneficial interests in net assets of Allina Foundations		198,093	—	(198,093)	—
Land, buildings, and equipment, net		1,126,447	16,014	—	1,142,461
Other assets		195,114	66,199	—	261,313
Total assets	$	4,031,004	294,278	(198,093)	4,127,189
Liabilities and Net Assets					
Current liabilities:					
Accounts payable and accrued expenses	$	418,847	16,004	—	434,851
Other current liabilities		118,386	655	—	119,041
		537,233	16,659	—	553,892
Long-term debt		839,776	4,660	—	844,436
Other liabilities		356,774	58,804	—	415,578
Total liabilities		1,733,783	80,123	—	1,813,906
Net assets:					
Unrestricted		2,091,052	61,050	—	2,152,102
Temporarily restricted		150,891	99,925	(144,913)	105,903
Permanently restricted		55,278	53,180	(53,180)	55,278
Total net assets		2,297,221	214,155	(198,093)	2,313,283
Total liabilities and net assets	$	4,031,004	294,278	(198,093)	4,127,189

See accompanying independent auditors' report.

ALLINA HEALTH SYSTEM

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2015

(Dollars in thousands)

	Obligated Group	Other nonobligated	Eliminations	Allina Health System
Revenues:				
Patient service revenue net of contractual adjustments	$ 3,603,439	17,544	—	3,620,983
Provision for bad debts	(98,774)	238	—	(98,536)
Net patient service revenue	3,504,665	17,782	—	3,522,447
Other operating revenue	249,039	39,191	(13,785)	274,445
Total revenues	3,753,704	56,973	(13,785)	3,796,892
Expenses:				
Salaries and benefits	2,307,920	14,185	—	2,322,105
Supplies and services	818,208	40,123	—	858,331
Depreciation and amortization	153,981	1,272	—	155,253
Financing costs	27,861	384	—	28,245
Services provided by (to) related divisions	16,088	(2,303)	(13,785)	—
State assessments and taxes	78,864	959	—	79,823
Utilities and maintenance	74,145	467	—	74,612
Other operating expenses	121,371	8,131	—	129,502
Total expenses	3,598,438	63,218	(13,785)	3,647,871
Operating income (loss)	155,266	(6,245)	—	149,021
Nonoperating (losses) gains:				
Investment return	(31,118)	(2,116)	—	(33,234)
Losses on interest rate swap agreements	(17,608)	—	—	(17,608)
Contributions received in acquisitions	34,849	—	—	34,849
Other	(1,911)	(596)	—	(2,507)
Excess of revenues over expenses	$ 139,478	(8,957)	—	130,521

(Continued)

ALLINA HEALTH SYSTEM

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2015

(Dollars in thousands)

	Obligated Group	Other nonobligated	Eliminations	Allina Health System
Unrestricted net assets:				
Excess of revenues over expenses	$ 139,478	(8,957)	—	130,521
Net assets released from restrictions for capital purposes	1,504	8,194	—	9,698
Transfer net assets released to Obligated Group	9,267	(9,267)	—	—
Amortization of unrealized loss on interest rate swap agreement	874	—	—	874
Capital contributions to nonobligated group affiliates, net	(4,018)	4,018	—	—
Other	5,828	(2,849)	—	2,979
Increase (decrease) in unrestricted net assets	152,933	(8,861)	—	144,072
Temporarily restricted net assets:				
Contributions	2,004	19,395	—	21,399
Investment losses	(51)	(2,180)	—	(2,231)
Net assets released from restrictions	(1,504)	(25,896)	—	(27,400)
Change in beneficial interests in net assets of Allina Foundations	(16,362)	—	16,362	—
Other	(465)	(555)	—	(1,020)
(Decrease) increase in temporarily restricted net assets	(16,378)	(9,236)	16,362	(9,252)
Permanently restricted net assets:				
Contributions for endowment funds	27	344	—	371
Investment losses	(24)	(17)	—	(41)
Change in beneficial interests in net assets of Allina Foundations	327	—	(327)	—
Increase (decrease) in permanently restricted net assets	330	327	(327)	330
Increase (decrease) in net assets	136,885	(17,770)	16,035	135,150
Net assets at beginning of year	2,160,336	231,925	(214,128)	2,178,133
Net assets at end of year	$ 2,297,221	214,155	(198,093)	2,313,283

See accompanying independent auditors' report.

ALLINA HEALTH SYSTEM

Consolidating Balance Sheet

December 31, 2014

(Dollars in thousands)

Assets	Obligated Group	Other nonobligated	Eliminations	Allina Health System
Current assets:				
Cash and cash equivalents	$ 175,655	5,330	—	180,985
Short-term investments	357,511	—	—	357,511
Patient accounts receivable, less allowance for uncollectible accounts and charity care of $70,285	396,991	22,531	—	419,522
Inventories	55,168	143	—	55,311
Other current assets	111,073	(1,684)	—	109,389
	1,096,398	26,320	—	1,122,718
Investments	1,117,520	63,014	—	1,180,534
Investments with limited uses	17,559	132,603	—	150,162
Beneficial interests in net assets of Allina Foundations	214,128	—	(214,128)	—
Land, buildings, and equipment, net	1,025,697	16,253	—	1,041,950
Other assets	178,805	63,825	—	242,630
Total assets	$ 3,650,107	302,015	(214,128)	3,737,994
Liabilities and Net Assets				
Current liabilities:				
Accounts payable and accrued expenses	$ 416,423	11,762	—	428,185
Other current liabilities	101,760	—	—	101,760
	518,183	11,762	—	529,945
Long-term debt	609,371	—	—	609,371
Other liabilities	362,217	58,328	—	420,545
Total liabilities	1,489,771	70,090	—	1,559,861
Net assets:				
Unrestricted	1,938,119	69,911	—	2,008,030
Temporarily restricted	167,269	109,161	(161,275)	115,155
Permanently restricted	54,948	52,853	(52,853)	54,948
Total net assets	2,160,336	231,925	(214,128)	2,178,133
Total liabilities and net assets	$ 3,650,107	302,015	(214,128)	3,737,994

See accompanying independent auditors’ report.

ALLINA HEALTH SYSTEM

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2014

(Dollars in thousands)

	Obligated Group	Other nonobligated	Eliminations	Allina Health System
Revenues:				
Patient service revenue net of contractual adjustments	$ 3,438,104	27,629	—	3,465,733
Provision for bad debts	(92,777)	(770)	—	(93,547)
Net patient service revenue	3,345,327	26,859	—	3,372,186
Other operating revenue	210,078	34,468	(13,051)	231,495
Total revenues	3,555,405	61,327	(13,051)	3,603,681
Expenses:				
Salaries and benefits	2,221,767	18,707	—	2,240,474
Supplies and services	747,885	39,695	—	787,580
Depreciation and amortization	146,711	1,133	—	147,844
Financing costs	23,748	644	—	24,392
Services provided by (to) related divisions	14,182	(1,131)	(13,051)	—
State assessments and taxes	78,728	753	—	79,481
Utilities and maintenance	73,691	626	—	74,317
Other operating expenses	98,478	5,171	—	103,649
Total expenses	3,405,190	65,598	(13,051)	3,457,737
Operating income (loss)	150,215	(4,271)	—	145,944
Nonoperating gains (losses):				
Investment return	44,943	2,047	—	46,990
Losses on interest rate swap agreements	(42,800)	—	—	(42,800)
Other	(2,490)	(753)	—	(3,243)
Excess of revenues over expenses	$ 149,868	(2,977)	—	146,891

ALLINA HEALTH SYSTEM

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2014

(Dollars in thousands)

		Obligated Group	Other nonobligated	Eliminations	Allina Health System
Unrestricted net assets:					
Excess of revenues over expenses	$	149,868	(2,977)	—	146,891
Net assets released from restrictions for capital purposes		3,288	3,792	—	7,080
Transfer net assets released to Obligated Group		5,745	(5,745)	—	—
Amortization of unrealized loss on interest rate swap agreement		874	—	—	874
Capital contributions to nonobligated group affiliates, net		819	(819)	—	—
Other		(651)	(3,600)	—	(4,251)
Increase (decrease) in unrestricted net assets		159,943	(9,349)	—	150,594
Temporarily restricted net assets:					
Contributions		3,288	28,596	—	31,884
Investment return		140	4,220	—	4,360
Net assets released from restrictions		(3,304)	(17,847)	—	(21,151)
Change in beneficial interests in net assets of Allina Foundations		13,479	—	(13,479)	—
Other		785	352	—	1,137
Increase (decrease) in temporarily restricted net assets		14,388	15,321	(13,479)	16,230
Permanently restricted net assets:					
Contributions for endowment funds		30	366	—	396
Investment return		32	2	—	34
Change in beneficial interests in net assets of Allina Foundations		376	—	(376)	—
Other		(523)	8	—	(515)
(Decrease) increase in permanently restricted net assets		(85)	376	(376)	(85)
Increase (decrease) in net assets		174,246	6,348	(13,855)	166,739
Net assets at beginning of year		1,986,090	225,577	(200,273)	2,011,394
Net assets at end of year	$	2,160,336	231,925	(214,128)	2,178,133

See accompanying independent auditors' report.