



**ALLINA HEALTH SYSTEM**

Consolidated Financial Statements

December 31, 2017 and 2016

(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, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

#### *Management's Responsibility for the 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, 2017 and 2016, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Minneapolis, Minnesota  
March 12, 2018

**ALLINA HEALTH SYSTEM**  
Consolidated Balance Sheets  
December 31, 2017 and 2016  
(Dollars in thousands)

| <b>Assets</b>  | <b>2017</b>         | <b>2016</b>      |
|--|---------------------|------------------|
| Current assets:  |                     |                  |
| Cash and cash equivalents  | \$ 147,520          | 172,710          |
| Short-term investments   | 404,934             | 451,327          |
| Patient accounts receivable, less allowances for uncollectible<br>accounts of \$104,965 in 2017 and \$90,656 in 2016 | 506,044             | 470,216          |
| Inventories  | 65,751              | 64,225           |
| Other current assets   | 99,459              | 94,546           |
|  | 1,223,708           | 1,253,024        |
| Investments  | 1,701,240           | 1,330,283        |
| Investments with limited uses  | 158,934             | 151,537          |
| Land, buildings, and equipment, net  | 1,221,692           | 1,166,397        |
| Other assets   | 337,188             | 290,036          |
|  | 4,642,762           | 4,191,277        |
| <b>Total assets</b>  | <b>\$ 4,642,762</b> | <b>4,191,277</b> |
| <b>Liabilities and Net Assets</b>  |                     |                  |
| Current liabilities:   |                     |                  |
| Accounts payable and accrued expenses  | \$ 439,373          | 463,851          |
| Other current liabilities  | 130,565             | 111,377          |
|  | 569,938             | 575,228          |
| Long-term debt   | 949,048             | 818,192          |
| Other liabilities  | 421,857             | 409,721          |
|  | 1,940,843           | 1,803,141        |
| <b>Total liabilities</b>   | <b>1,940,843</b>    | <b>1,803,141</b> |
| Net assets:  |                     |                  |
| Unrestricted   | 2,530,561           | 2,222,241        |
| Temporarily restricted   | 115,478             | 109,078          |
| Permanently restricted   | 55,880              | 56,817           |
|  | 2,701,919           | 2,388,136        |
| <b>Total net assets</b>  | <b>2,701,919</b>    | <b>2,388,136</b> |
| <b>Total liabilities and net assets</b>  | <b>\$ 4,642,762</b> | <b>4,191,277</b> |

See accompanying notes to consolidated financial statements.

**ALLINA HEALTH SYSTEM**

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2017 and 2016

(Dollars in thousands)

|  | <u>2017</u>       | <u>2016</u>      |
|--|-------------------|------------------|
| Revenues:  |                   |                  |
| Patient service revenue net of contractual adjustments | \$ 3,969,975      | 3,777,363        |
| Provision for bad debts                                | <u>(118,272)</u>  | <u>(85,604)</u>  |
| Net patient service revenue                            | 3,851,703         | 3,691,759        |
| Other operating revenue                                | <u>283,397</u>    | <u>255,930</u>   |
| Total revenues   | <u>4,135,100</u>  | <u>3,947,689</u> |
| Expenses:  |                   |                  |
| Salaries and benefits                                  | 2,577,728         | 2,495,717        |
| Supplies and services                                  | 916,677           | 855,816          |
| Depreciation and amortization                          | 175,378           | 165,433          |
| Financing costs  | 39,204            | 37,726           |
| State assessments and taxes                            | 86,157            | 82,147           |
| Utilities and maintenance                              | 76,650            | 72,244           |
| Other operating expenses                               | <u>117,439</u>    | <u>119,359</u>   |
| Total expenses   | <u>3,989,233</u>  | <u>3,828,442</u> |
| Operating income before strike expenses                | 145,867           | 119,247          |
| Strike expenses  | <u>—</u>          | <u>(135,587)</u> |
| Operating income (loss)                                | 145,867           | (16,340)         |
| Nonoperating gains (losses):                           |                   |                  |
| Investment return                                      | 166,794           | 83,374           |
| Losses on interest rate swap agreements                | (6,656)           | (3,178)          |
| Loss on debt refinancing                               | (6,767)           | —                |
| Other  | <u>(3,836)</u>    | <u>(3,255)</u>   |
| Excess of revenues over expenses                       | <u>\$ 295,402</u> | <u>60,601</u>    |

**ALLINA HEALTH SYSTEM**

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2017 and 2016

(Dollars in thousands)

|   | <u>2017</u>         | <u>2016</u>      |
|---|---------------------|------------------|
| Unrestricted net assets:  |                     |                  |
| Excess of revenues over expenses                                | \$ 295,402          | 60,601           |
| Net assets released from restrictions for capital purposes      | 14,649              | 12,588           |
| Amortization of unrealized loss on interest rate swap agreement | 874                 | 874              |
| Other   | <u>(2,605)</u>      | <u>(3,924)</u>   |
| Increase in unrestricted net assets                             | <u>308,320</u>      | <u>70,139</u>    |
| Temporarily restricted net assets:                              |                     |                  |
| Contributions   | 19,335              | 22,508           |
| Investment return   | 13,681              | 7,828            |
| Net assets released from restrictions                           | (26,818)            | (24,461)         |
| Other   | <u>202</u>          | <u>(2,700)</u>   |
| Increase in temporarily restricted net assets                   | <u>6,400</u>        | <u>3,175</u>     |
| Permanently restricted net assets:                              |                     |                  |
| Contributions for endowment funds                               | 157                 | 272              |
| Investment return   | (859)               | 1,267            |
| Other   | <u>(235)</u>        | <u>—</u>         |
| (Decrease) increase in permanently restricted net assets        | <u>(937)</u>        | <u>1,539</u>     |
| Increase in net assets  | 313,783             | 74,853           |
| Net assets at beginning of year                                 | <u>2,388,136</u>    | <u>2,313,283</u> |
| Net assets at end of year                                       | <u>\$ 2,701,919</u> | <u>2,388,136</u> |

See accompanying notes to consolidated financial statements.

**ALLINA HEALTH SYSTEM**

Consolidated Statements of Cash Flows

Years ended December 31, 2017 and 2016

(Dollars in thousands)

|  | <u>2017</u>       | <u>2016</u>       |
|--|-------------------|-------------------|
| Operating activities:  |                   |                   |
| Increase in net assets   | \$ 313,783        | 74,853            |
| Adjustments to reconcile increase in net assets to net cash and cash equivalents provided by operating activities: |                   |                   |
| Depreciation and amortization  | 175,378           | 165,433           |
| Provision for bad debts  | 118,272           | 85,604            |
| Gain on sales of properties  | (19,413)          | (2,739)           |
| Unrealized gain on interest rate swaps   | (4,788)           | (9,458)           |
| Loss on debt refinancing   | 6,767             | —                 |
| Realized and unrealized gains on investments, net  | (146,768)         | (63,087)          |
| Restricted contributions   | (17,122)          | (22,780)          |
| Contributions of cash for long-lived assets  | (2,370)           | (2,449)           |
| Earnings on joint ventures   | (28,431)          | (16,389)          |
| Changes in assets and liabilities:   |                   |                   |
| Change in accounts receivable and other current assets   | (159,801)         | (88,885)          |
| Change in accounts payable and other current liabilities   | (401)             | 8,241             |
| Change in other assets and liabilities   | 130               | (8,346)           |
| Net cash and cash equivalents provided by operating activities   | <u>235,236</u>    | <u>119,998</u>    |
| Investing activities:  |                   |                   |
| Proceeds from sales of land, buildings, and equipment  | 9,518             | 36,930            |
| Purchases of land, buildings, and equipment  | (241,479)         | (222,881)         |
| Contributions of cash for long-lived assets  | 2,370             | 2,449             |
| Purchases of investments classified as trading, net  | (186,306)         | (125,609)         |
| Sales of investments with limited uses, net  | 1,113             | 3,153             |
| Distributions received from joint ventures   | 24,169            | 13,816            |
| Contributions to joint ventures  | (6,855)           | (17,590)          |
| Net cash and cash equivalents used in investing activities   | <u>(397,470)</u>  | <u>(309,732)</u>  |
| Financing activities:  |                   |                   |
| Restricted contributions, net  | 17,183            | 23,707            |
| Change in outstanding checks payable   | (4,593)           | 12,701            |
| Refinancing of long-term debt  | (159,990)         | —                 |
| Proceeds from issuance of long-term debt   | 310,977           | —                 |
| Deferred debt acquisition costs  | (2,602)           | —                 |
| Principal payments of long-term debt   | (23,931)          | (23,079)          |
| Net cash and cash equivalents provided by financing activities   | <u>137,044</u>    | <u>13,329</u>     |
| Decrease in cash and cash equivalents  | (25,190)          | (176,405)         |
| Cash and cash equivalents at beginning of year   | <u>172,710</u>    | <u>349,115</u>    |
| Cash and cash equivalents at end of year   | \$ <u>147,520</u> | \$ <u>172,710</u> |
| Schedule of noncash financing activity:  |                   |                   |
| Capitalized lease  | \$ 92             | 679               |

See accompanying notes to consolidated financial statements.

## **ALLINA HEALTH SYSTEM**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

### **(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 1,420 providers, various other health care-related entities, and seven foundations supporting health-related services.

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.

## ALLINA HEALTH SYSTEM

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

### **(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, 2017 and 2016, 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 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).

## ALLINA HEALTH SYSTEM

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(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 \$2,883 and \$376 for 2017 and 2016, 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 Topic 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 Topic 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, 2017 and 2016, 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.

## **ALLINA HEALTH SYSTEM**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

### ***(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.

## ALLINA HEALTH SYSTEM

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

### **(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 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) Investment Securities**

The System classifies its investments as trading or available-for-sale. The available-for-sale investments include debt service funds 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.

### **(t) 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.

### **(u) Reclassifications**

Certain reclassifications have been made to the 2016 consolidated financial statements to conform to the 2017 presentation.

### **(v) Recently Issued Accounting Standards**

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The standard requires an entity to recognize revenue when the entity transfers control of promised goods and services to the customer. Revenue is recognized in an amount that reflects the consideration an

## ALLINA HEALTH SYSTEM

### Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

entity expects to receive in exchange for those goods and services. An entity is also required to disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The System has evaluated the requirements of the new standard to ensure that processes, systems, and internal controls are in place to collect the necessary information to implement the standard, which became effective for the System on January 1, 2018, and the new disclosures required post implementation are in the process of being drafted. The System used a portfolio approach to apply the new model to classes of payers with similar characteristics and analyzed cash collection trends over an appropriate collection look-back period depending on the payer. Adoption of ASU No. 2014-09 will result in changes to the presentation and disclosure of revenue related to uninsured or underinsured patients. Prior to the adoption of ASU No. 2014-09, the provision for bad debts related to self-pay patients, as well as co-pays and deductibles owed by patients with insurance. Under ASU No. 2014-09, the estimated uncollectible amounts due from these patients are generally considered a direct reduction to net operating revenues and, correspondingly, result in a material reduction in the amounts presented separately as provision for bad debts. The System also assessed the impact of the new standard on various reimbursement programs that represent variable consideration and concluded that accounting for these programs under the new standard is substantially consistent with the historical accounting practices. While the adoption of ASU No. 2014-09 will have a material effect on the presentation of net operating revenues in the consolidated statements of operations and changes in net assets and will impact certain disclosures, it will not materially impact the financial position, results of operations, or cash flows of the System. There was no cumulative effect of a change in accounting principle recorded related to the adoption of ASU No. 2014-09 on January 1, 2018.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which requires lessees to recognize leases on balance sheet and disclose key information about leasing arrangements. The new standard establishes a right-of-use (ROU) model that requires a lessee to recognize an ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as finance or operating, with classification affecting the pattern and classification of the expense recognition in the income statement. The new standard is effective for the System beginning January 1, 2019. The System continues to evaluate the standard, but expects it will have a material effect on the consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958)*, to change the way a not-for-profit entity (NFP) classifies and presents net assets on the face of the financial statements and presents information in the financial statements and notes about the NFP's liquidity, financial performance, and cash flows. The amendment changes the way an NFP reports classes of net assets, from the currently required three classes to two, by eliminating the distinction between resources with permanent restrictions and those with temporary restrictions. The amendment also requires the NFP to provide enhanced disclosure about the nature, amounts and effects of the various types of donor-imposed restrictions, the NFP's management of its liquidity to meet short-term demands for cash, and the types of resources used and how they are allocated to carrying out the NFP's activities. The standard is effective for the System beginning January 1, 2018. The System does not expect the standard to have a material effect on the consolidated financial statements, other than the additional disclosure required by the standard.

**ALLINA HEALTH SYSTEM**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

**(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 2017 and 2016, successful appeals, cost report settlements, and other adjustments to prior year estimates resulted in an increase in net patient service revenue of \$14,586 and \$11,886, 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:

|                       | <u>2017</u>  | <u>2016</u>  |
|-----------------------|--------------|--------------|
| Medicare and Medicaid | 41 %         | 40 %         |
| Managed care          | 54           | 56           |
| Commercial and other  | 2            | 2            |
| Self-pay              | 3            | 2            |
|                       | <u>100 %</u> | <u>100 %</u> |

**ALLINA HEALTH SYSTEM**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(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 2017 and 2016. 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 \$96,512 and \$69,638 in the years 2017 and 2016, respectively. The System has not changed its charity care or uninsured discount policies during the years 2017 and 2016. 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:

|                       | <u>2017</u>  | <u>2016</u>  |
|-----------------------|--------------|--------------|
| Medicare and Medicaid | 36 %         | 35 %         |
| Managed care          | 40           | 44           |
| Self-pay              | 14           | 14           |
| Commercial and other  | 10           | 7            |
|                       | <u>100 %</u> | <u>100 %</u> |

Two managed care payers accounted for approximately 37% and 38% of net patient service revenue in 2017 and 2016, respectively. Amounts due from these two managed care payers accounted for approximately 26% and 27% of net patient accounts receivable at December 31, 2017 and 2016, 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.

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### **(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. Research costs are reported net of restricted grants designated and released for research purposes.

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**(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.

**(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:

|  | <u>2017</u> | <u>2016</u> |
|--|-------------|-------------|
| Cost of providing charity care (charges foregone of \$48,965 and \$49,307, respectively) | \$ 20,700   | 21,200      |
| Costs in excess of Medicaid payments   | 38,500      | 56,800      |
| Medicaid surcharge   | 25,400      | 24,800      |
| MinnesotaCare tax  | 51,100      | 47,500      |
| Community health improvement services  | 8,800       | 7,900       |

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|   | <u>2017</u>       | <u>2016</u>    |
|---|-------------------|----------------|
| Subsidized health services                          | \$ 7,700          | 2,700          |
| Health professions education                        | 19,600            | 15,500         |
| Research  | 3,800             | 4,300          |
| Cash and in-kind contributions                      | 3,000             | 3,100          |
| Other community benefit cost                        | <u>4,200</u>      | <u>4,800</u>   |
| Total cost of community benefit                     | 182,800           | 188,600        |
| Costs in excess of Medicare payments                | 255,900           | 256,200        |
| Other care provided without compensation (bad debt) | 118,300           | 85,600         |
| Discounts offered to uninsured patients             | 35,600            | 32,100         |
| Taxes and fees                                      | 4,600             | 4,800          |
| Community building                                  | <u>300</u>        | <u>400</u>     |
| Total value of community contributions              | <u>\$ 597,500</u> | <u>567,700</u> |

**(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:

|  | <u>2017</u>         | <u>2016</u>      |
|--|---------------------|------------------|
| Cash and cash equivalents                                | \$ 147,520          | 172,710          |
| Money market collective fund and short-term fixed income | 58,184              | 74,146           |
| Fixed income   | 1,022,956           | 932,010          |
| Equity securities  | 201,548             | 153,991          |
| Real return mutual fund                                  | 133,397             | 102,495          |
| Investments accounted for at net asset value             | <u>849,023</u>      | <u>670,505</u>   |
|  | <u>\$ 2,412,628</u> | <u>2,105,857</u> |

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

|  | <u>2017</u>       | <u>2016</u>    |
|--|-------------------|----------------|
| By trustee for repayment of long-term debt | \$ 87             | 51             |
| By trustee for swap collateralization      | 2,920             | 4,070          |
| Donor-restricted funds                     | 153,484           | 144,973        |
| Vendor deposits                            | 2,443             | 2,443          |
|  | <u>\$ 158,934</u> | <u>151,537</u> |

Total investment return consists of the following:

|  | <u>2017</u>       | <u>2016</u>   |
|--|-------------------|---------------|
| Investment earnings in unrestricted net assets:  |                   |               |
| Interest and dividend income (net of expense of \$1,881 and \$1,524 for 2017 and 2016, respectively) | \$ 31,810         | 26,350        |
| Realized gains on investments  | 2,086             | 16,186        |
| Unrealized gains on investments  | 132,898           | 40,838        |
|  | <u>166,794</u>    | <u>83,374</u> |
| Investment earnings in restricted net assets:  |                   |               |
| Interest and dividend income   | 1,038             | 3,032         |
| Realized gains on investments  | 4,644             | 2,654         |
| Unrealized gains on investments  | 7,140             | 3,409         |
|  | <u>12,822</u>     | <u>9,095</u>  |
|  | <u>\$ 179,616</u> | <u>92,469</u> |

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

|                                  | <u>2017</u>       | <u>2016</u>   |
|----------------------------------|-------------------|---------------|
| Nonoperating gains               | \$ 166,794        | 83,374        |
| Changes in restricted net assets | 12,822            | 9,095         |
|                                  | <u>\$ 179,616</u> | <u>92,469</u> |

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**(6) Other Current Assets**

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

|  | <u>2017</u>      | <u>2016</u>   |
|--|------------------|---------------|
| Pledges and notes receivable             | \$ 3,177         | 2,439         |
| Prepaid expenses                         | 15,387           | 15,919        |
| Third-party payer settlement receivables | 12,851           | 12,115        |
| Other miscellaneous receivables          | 68,044           | 64,073        |
|  | <u>\$ 99,459</u> | <u>94,546</u> |

**(7) Land, Buildings, and Equipment**

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

|  | <u>2017</u>         | <u>2016</u>      |
|--|---------------------|------------------|
| Land and land improvements                     | \$ 98,462           | 97,480           |
| Buildings                                      | 1,626,638           | 1,482,804        |
| Equipment                                      | 1,634,570           | 1,564,663        |
|  | 3,359,670           | 3,144,947        |
| Less accumulated depreciation and amortization | <u>2,190,506</u>    | <u>2,063,706</u> |
|  | 1,169,164           | 1,081,241        |
| Construction in progress                       | <u>52,528</u>       | <u>85,156</u>    |
|  | <u>\$ 1,221,692</u> | <u>1,166,397</u> |

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**(8) Other Assets**

Other assets as of December 31 consist of the following:

|  | <u>2017</u>       | <u>2016</u>    |
|--|-------------------|----------------|
| Cash surrender value of insurance policies         | \$ 4,477          | 4,161          |
| Pledges and notes receivable, less current portion | 19,201            | 21,173         |
| Investment in unconsolidated entities              | 121,165           | 97,855         |
| Deferred compensation                              | 174,704           | 148,366        |
| Other  | 17,641            | 18,481         |
|  | <u>\$ 337,188</u> | <u>290,036</u> |

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 |               | Distributions received |                 | Share of net earnings |               |
|-------------------------------------|----------------------|-------------------|---------------|------------------------|-----------------|-----------------------|---------------|
|                                     |                      | 2017              | 2016          | 2017                   | 2016            | 2017                  | 2016          |
| St. Francis Regional Medical Center | 47.50 %              | \$ 49,704         | 47,534        | (9,001)                | (1,000)         | 11,171                | 8,371         |
| Other entities                      | 10%–50%              | 71,461            | 50,321        | (15,168)               | (12,816)        | 17,260                | 8,018         |
|                                     |                      | <u>\$ 121,165</u> | <u>97,855</u> | <u>(24,169)</u>        | <u>(13,816)</u> | <u>28,431</u>         | <u>16,389</u> |

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

|  | <u>2017</u>      | <u>2016</u>   |
|--|------------------|---------------|
| Total assets                                   | \$ 218,103       | 203,433       |
| Total liabilities                              | 121,434          | 120,000       |
| Total net assets                               | <u>\$ 96,669</u> | <u>83,433</u> |
| Total revenue                                  | \$ 159,503       | 150,050       |
| Total operating expenses                       | 135,477          | 130,744       |
| Total investment return and other nonoperating | (640)            | (917)         |
| Excess of revenues over expenses               | <u>\$ 23,386</u> | <u>18,389</u> |

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

|  | <u>2017</u>       | <u>2016</u>    |
|--|-------------------|----------------|
| Total assets                                   | \$ 175,734        | 173,005        |
| Total liabilities                              | <u>64,991</u>     | <u>66,733</u>  |
| Total net assets                               | <u>\$ 110,743</u> | <u>106,272</u> |
| Total revenue                                  | \$ 157,932        | 146,837        |
| Total operating expenses                       | 140,428           | 131,543        |
| Total investment return and other nonoperating | <u>5,865</u>      | <u>2,624</u>   |
| Excess of revenues over expenses               | <u>\$ 23,369</u>  | <u>17,918</u>  |

**(9) Accounts Payable and Accrued Expenses**

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

|                                      | <u>2017</u>       | <u>2016</u>    |
|--------------------------------------|-------------------|----------------|
| Outstanding checks                   | \$ 43,525         | 48,118         |
| Trade accounts payable               | 76,431            | 92,687         |
| Accrued payroll, taxes, and vacation | 196,117           | 188,178        |
| MinnesotaCare tax payable            | 16,596            | 15,382         |
| Other                                | <u>106,704</u>    | <u>119,486</u> |
|                                      | <u>\$ 439,373</u> | <u>463,851</u> |

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**(10) Other Current Liabilities**

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

|   | <u>2017</u>       | <u>2016</u>    |
|---|-------------------|----------------|
| Current portion of estimated reserves for professional and general liability claims | \$ 10,586         | 10,128         |
| Current portion of estimated reserves for workers' compensation claims              | 12,484            | 12,797         |
| Employee health plan claims incurred but not reported                               | 19,540            | 19,854         |
| Defined-contribution retirement plan  | 45,452            | 43,488         |
| Due to third-party payers   | 16,268            | 769            |
| Current portion of long-term debt   | 26,235            | 24,341         |
|   | <u>\$ 130,565</u> | <u>111,377</u> |

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**(11) Long-Term Debt**

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

|   | <u>2017</u> | <u>2016</u> |
|---|-------------|-------------|
| Fixed Rate Revenue Bonds, Series 2009A-1<br>(Allina Health System), annual interest<br>rate from 4.50% to 5.25%   | \$ 51,915   | 102,815     |
| Fixed Rate Revenue Bonds, Series 2009A-2<br>(Allina Health System), annual interest rate<br>from 3.25% to 5.50%   | 34,940      | 68,530      |
| Variable Rate Revenue Bonds,<br>Series 2009B and C (Allina Health System),<br>Variable Rate Demand Notes, average<br>annual interest rate of 0.80% during 2017;<br>1.76% at December 31, 2017 | 164,525     | 164,525     |
| Fixed Rate Revenue Bonds, Series 2007A<br>(Allina Health System), annual interest<br>rate from 4.50% to 5.50%   | —           | 87,540      |
| Variable Rate Revenue Bonds, Series 2007C<br>(Allina Health System), Variable Rate<br>Demand Notes, average annual interest<br>rate of 0.83% during 2017; 1.73% at<br>December 31, 2017       | 119,125     | 119,700     |
| Variable Rate Revenue Bonds, Series 1998A<br>(Allina Health System) Periodic Auction<br>Reset, average annual interest rate of<br>1.50% during 2017; 2.15%<br>at December 31, 2017            | 14,575      | 14,575      |
| Variable Rate Health Care System<br>Revenue Bonds, Series 1993B<br>(HealthSpan) Periodic Auction Reset,<br>average annual interest rate of 1.17%<br>during 2017                               | —           | 8,700       |
| Fixed Rate Taxable Bonds, Series 2015<br>(Allina Health System), annual interest<br>rate of 4.805%  | 250,000     | 250,000     |
| Fixed Rate Health Care Facilities Revenue<br>Note, Series 2014 (Allina Health System),<br>annual interest rate of 2.55%   | 17,710      | 18,520      |

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|   | <u>2017</u>       | <u>2016</u>     |
|---|-------------------|-----------------|
| Fixed Rate Revenue Bonds, Series 2017A<br>(Allina Health System), annual interest<br>rate of 5.00%                      | \$ 78,515         | —               |
| Fixed Rate Health Care Facilities Revenue<br>Note, Series 2017B (Allina Health System)<br>annual interest rate of 2.13% | 77,845            | —               |
| Fixed Rate Taxable Bonds, Series 2017<br>(Allina Health System), annual interest<br>rate of 4.43%                       | 150,000           | —               |
| Capitalized leases  | 7,329             | 9,185           |
| Other   | 1,810             | 1,669           |
|   | <u>968,289</u>    | <u>845,759</u>  |
| Unamortized portion of original issue premium   | 12,995            | 2,339           |
| Unamortized deferred financing  | (6,001)           | (5,565)         |
| Current portion   | <u>(26,235)</u>   | <u>(24,341)</u> |
|   | <u>\$ 949,048</u> | <u>818,192</u>  |

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 November 2017, the City of Minneapolis, on behalf of the System, issued fixed-rate Revenue Refunding Bonds, Series 2017B, in the aggregate principal amount of \$77,845. The 2017B Bonds are secured by the Obligated Group's pledged revenue and was used to refinance the Series 2007A Fixed Rate Revenue Bonds. The gain on the refinancing of the debt was \$1,769.

In April 2017, the System issued a fixed-rate Taxable Bond, Series 2017, in the aggregate principal amount of \$150,000. The 2017 Bonds are secured by the Obligated Group's pledged revenue and were issued for the purpose of funding new projects and strategic initiatives.

In April 2017, 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 2017A, in the aggregate principal amount of \$78,515. The 2017A Bonds are secured by the Obligated Group's pledged revenue and were used to refinance and legally defease, in part, the Series 2009A-1 and 2009A-2 Bonds. The loss on the refinancing of the debt was \$8,536.

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The Series 2009B and 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 4, 2021, and \$50,000, which expires on January 4, 2021. 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 1998A Bonds is insured. Interest rates on the variable rate Series 1998A is 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 \$119,125, which expires on January 4, 2021. 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%.

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, 2017 are as follows:

|            |    |         |
|------------|----|---------|
| 2018       | \$ | 26,235  |
| 2019       |    | 27,174  |
| 2020       |    | 27,089  |
| 2021       |    | 27,087  |
| 2022       |    | 27,425  |
| Thereafter |    | 833,279 |

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, 2017 are as follows:

|            |    |         |
|------------|----|---------|
| 2018       | \$ | 26,235  |
| 2019       |    | 83,054  |
| 2020       |    | 82,869  |
| 2021       |    | 82,842  |
| 2022       |    | 83,105  |
| Thereafter |    | 610,184 |

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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.

As of December 31, 2017 and 2016, the System posted collateral of \$2,920 and \$4,070, 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, 2017, 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 2017 | Counterparty  |
| 2009BC                          | Other liabilities      | \$ 10,431        | 41,131                      | 3.74 %    | % of LIBOR    | 1.00 %                        | Wells Fargo   |
| 2009BC                          | Other liabilities      | 31,217           | 123,394                     | 3.73      | % of LIBOR    | 1.00                          | JP Morgan     |
| 2007C                           | Other liabilities      | 22,671           | 119,125                     | 3.58      | % of LIBOR    | 0.16                          | US Bank       |
| 2001                            | Other liabilities      | 15,318           | 50,000                      | 5.17      | SIFMA         | 0.66                          | Goldman Sachs |
| 1998A                           | Other liabilities      | 1,215            | 15,075                      | 4.44      | SIFMA         | 0.66                          | Goldman Sachs |
| Total                           |                        | \$ <u>80,852</u> | <u>348,725</u>              |           |               |                               |               |

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                           |                        | \$ <u>85,640</u> | <u>349,300</u>              |           |               |                               |               |

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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 on change in fair value recognized as nonoperating: gains on interest rate swap agreements |              | Amount of loss reclassified from unrestricted net assets into revenues over expenses as nonoperating: losses on interest rate swap agreements |              | Amount of interest paid to counterparty recognized as nonoperating: losses on interest rate swap agreements |                 | Total          |                |
|-------|---|--------------|---|--------------|---|-----------------|----------------|----------------|
|       | 2017  | 2016         | 2017  | 2016         | 2017  | 2016            | 2017           | 2016           |
|       | 2009BC  | \$ 1,672     | 3,725   | —            | —   | (4,557)         | (5,107)        | (2,885)        |
| 2007C | 1,855   | 2,687        | —   | —            | (3,281)   | (3,645)         | (1,426)        | (958)          |
| 2001  | 771   | 2,371        | —   | —            | (2,190)   | (2,406)         | (1,419)        | (35)           |
| 1998A | 490   | 675          | (874)   | (874)        | (542)   | (604)           | (926)          | (803)          |
|       | <u>\$ 4,788</u>   | <u>9,458</u> | <u>(874)</u>  | <u>(874)</u> | <u>(10,570)</u>   | <u>(11,762)</u> | <u>(6,656)</u> | <u>(3,178)</u> |

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 \$1,809 and \$2,489 less as of December 31, 2017 and 2016, respectively, than the mark-to-market valuations (note 14).

Interest paid, net of amounts capitalized, was \$30,193 and \$28,802 during 2017 and 2016, 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 0.50% 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 \$4,489 and \$9,836 at December 31, 2017 and 2016, respectively. There were no draws on the line of credit at December 31, 2017 and 2016.

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**(12) Other Liabilities**

Other liabilities as of December 31 consist of the following:

|   | <u>2017</u>       | <u>2016</u>    |
|---|-------------------|----------------|
| Estimated reserves for professional and<br>general liability claims, less current portion | \$ 40,678         | 37,218         |
| Estimated reserves for workers'<br>compensation claims, less current portion              | 31,021            | 32,478         |
| Net pension and postretirement liability  | 21,575            | 19,294         |
| Interest rate swaps payable   | 80,852            | 85,640         |
| Deferred compensation   | 197,860           | 171,426        |
| Leasehold incentive allowance   | 15,797            | 18,623         |
| Financing obligation  | 17,024            | 25,624         |
| Other   | 17,050            | 19,418         |
|   | <u>\$ 421,857</u> | <u>409,721</u> |

**(13) Restricted Net Assets**

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

|                           | <u>2017</u>       | <u>2016</u>    |
|---------------------------|-------------------|----------------|
| Capital                   | \$ 13,236         | 14,730         |
| Charity and indigent care | 5,191             | 4,776          |
| Education and research    | 26,255            | 26,857         |
| Patient care              | 21,433            | 20,346         |
| Other                     | 49,363            | 42,369         |
|                           | <u>\$ 115,478</u> | <u>109,078</u> |

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

|                           | <u>2017</u>      | <u>2016</u>   |
|---------------------------|------------------|---------------|
| Capital                   | \$ 128           | 128           |
| Charity and indigent care | 1,806            | 1,806         |
| Education and research    | 19,014           | 18,906        |
| Patient care              | 12,339           | 12,713        |
| Other                     | <u>22,593</u>    | <u>23,264</u> |
|                           | <u>\$ 55,880</u> | <u>56,817</u> |

#### (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 limited partnerships and better than 30-day liquidity in commingled trusts. 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

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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 a 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, subject to notification period and other requirements specific to each investee.

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, 2017 as follows:

|  | Total     | Fair value measurements using |         |         |
|--|-----------|-------------------------------|---------|---------|
|  |           | Level 1                       | Level 2 | Level 3 |
| Cash and cash equivalents:                                 |           |                               |         |         |
| Cash   | \$ 41,153 | 41,153                        | —       | —       |
| Money market funds   | 106,367   | 106,367                       | —       | —       |
| Total cash and cash equivalents                            | 147,520   | 147,520                       | —       | —       |
| Short-term and long-term investments – trading securities: |           |                               |         |         |
| Short-term fixed income                                    | 2,528     | 1,550                         | 978     | —       |
| Money market fund  | 39,090    | 39,090                        | —       | —       |
| Total short-term fixed income and money market             | 41,618    | 40,640                        | 978     | —       |

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|   | <u>Total</u> | <u>Fair value measurements using</u> |                |                |
|---|--------------|--------------------------------------|----------------|----------------|
|   |              | <u>Level 1</u>                       | <u>Level 2</u> | <u>Level 3</u> |
| Equity:   |              |                                      |                |                |
| Financials  | \$ 27,463    | 27,463                               | —              | —              |
| Consumer  | 15,366       | 15,366                               | —              | —              |
| Industrials   | 14,646       | 14,646                               | —              | —              |
| Technology  | 1,769        | 1,769                                | —              | —              |
| Healthcare  | 3,035        | 3,035                                | —              | —              |
| Global equity mutual funds                              | 105,098      | 105,098                              | —              | —              |
| Other equity  | 21,110       | 18,094                               | 3,016          | —              |
| Total equity  | 188,487      | 185,471                              | 3,016          | —              |
| Fixed income:   |              |                                      |                |                |
| U.S. Treasury securities                                | 177,057      | 177,057                              | —              | —              |
| U.S. agency securities                                  | 170,864      | —                                    | 170,864        | —              |
| Corporate bonds   | 183,196      | —                                    | 183,196        | —              |
| Mortgage, commercial,<br>and asset-backed securities    | 85,289       | —                                    | 85,289         | —              |
| Sovereigns  | 4,615        | —                                    | 4,615          | —              |
| Term loan/private placement                             | 75,550       | —                                    | 75,183         | 367            |
| Unconstrained fixed-income<br>mutual funds              | 225,136      | 225,136                              | —              | —              |
| Other   | 26,964       | —                                    | 26,964         | —              |
| Total fixed income                                      | 948,671      | 402,193                              | 546,111        | 367            |
| Other investments-real return<br>mutual fund            | 133,397      | 133,397                              | —              | —              |
| Total investments accounted for<br>at net asset value * | 794,001      | —                                    | —              | —              |
| Total investments –<br>trading securities               | 2,106,174    | 761,701                              | 550,105        | 367            |
| Investments with limited uses – trading<br>securities:  |              |                                      |                |                |
| Short-term fixed income                                 | 107          | 62                                   | 45             | —              |
| Money market collective fund                            | 16,371       | 16,371                               | —              | —              |
| Equity  | 13,061       | 12,852                               | 209            | —              |
| Fixed income  | 57,096       | 25,114                               | 31,957         | 25             |
| Real return mutual funds                                | 9,244        | 9,244                                | —              | —              |

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|   | <u>Total</u>        | <u>Fair value measurements using</u> |                |                |
|---|---------------------|--------------------------------------|----------------|----------------|
|   |                     | <u>Level 1</u>                       | <u>Level 2</u> | <u>Level 3</u> |
| Restricted foundation trusts<br>(fixed income)                            | \$ 7,945            | —                                    | 7,945          | —              |
| Investments accounted for<br>at net asset value *                         | <u>55,022</u>       | <u>—</u>                             | <u>—</u>       | <u>—</u>       |
| Total investments with limited<br>uses – trading securities               | <u>158,846</u>      | <u>63,643</u>                        | <u>40,156</u>  | <u>25</u>      |
| Investments with limited uses –<br>available-for-sale securities:         |                     |                                      |                |                |
| Money market fund   | <u>88</u>           | <u>88</u>                            | <u>—</u>       | <u>—</u>       |
| Total investments with limited<br>uses – available-for-sale<br>securities | <u>88</u>           | <u>88</u>                            | <u>—</u>       | <u>—</u>       |
| Total investments with<br>limited uses                                    | <u>158,934</u>      | <u>63,731</u>                        | <u>40,156</u>  | <u>25</u>      |
| Total   | <u>\$ 2,412,628</u> | <u>972,952</u>                       | <u>590,261</u> | <u>392</u>     |
| Liabilities:  |                     |                                      |                |                |
| Interest rate swaps   | \$ 80,852           | —                                    | 80,852         | —              |

\* Certain investments that are measured at fair value using the net asset value per share (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to amounts presented in the statements of consolidated balance sheets.

|   | <u>Fair value<br/>measurements,<br/>Level 3</u> |
|---|---|
| Balance, December 31, 2016  | \$ 529  |
| Total realized and unrealized losses<br>included in excess of revenues over<br>expenses | (20)  |
| Purchases   | 555   |
| Sales   | <u>(672)</u>                                    |
| Balance, December 31, 2017  | <u>\$ 392</u>                                   |

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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:

|  | Total     | Fair value measurements using |         |         |
|--|-----------|-------------------------------|---------|---------|
|  |           | 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   | —       |
| 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                                 | 75,196    | 75,196                        | —       | —       |
| All asset mutual fund                                      | 14,635    | 11,890                        | 2,745   | —       |
| Total equity   | 142,593   | 139,848                       | 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     |
| Other investments-real return mutual fund                  | 94,908    | 94,908                        | —       | —       |
| Total investments accounted for at net asset value *       | 620,875   | —                             | —       | —       |
| Total investments – trading securities                     | 1,781,610 | 609,619                       | 550,626 | 490     |

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|   | <u>Total</u>        | <u>Fair value measurements using</u> |                |                |
|---|---------------------|--------------------------------------|----------------|----------------|
|   |                     | <u>Level 1</u>                       | <u>Level 2</u> | <u>Level 3</u> |
| 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             |
| Restricted foundation trusts (fixed income)                         | 7,807               | —                                    | 7,807          | —              |
| Investments accounted for at net asset value *                      | 49,630              | —                                    | —              | —              |
| Total investments with limited uses – trading securities            | <u>151,486</u>      | <u>60,684</u>                        | <u>41,133</u>  | <u>39</u>      |
| Investments with limited uses – available-for-sale securities:      |                     |                                      |                |                |
| Money market fund   | 51                  | 51                                   | —              | —              |
| Total investments with limited uses – available-for-sale securities | <u>51</u>           | <u>51</u>                            | <u>—</u>       | <u>—</u>       |
| Total investments with limited uses                                 | <u>151,537</u>      | <u>60,735</u>                        | <u>41,133</u>  | <u>39</u>      |
| Total   | <u>\$ 2,105,857</u> | <u>843,064</u>                       | <u>591,759</u> | <u>529</u>     |
| Liabilities:  |                     |                                      |                |                |
| Interest rate swaps   | \$ 85,640           | —                                    | 85,640         | —              |

\* Certain investments that are measured at fair value using the net asset value per share (or its equivalent) as a practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to amounts presented in the statements of consolidated balance sheets.

|  | <u>Fair value measurements, Level 3</u> |
|--|---|
| Balance, December 31, 2015   | \$ 1,178                                |
| Total realized and unrealized gains included in excess of revenues over expenses | 32                                      |
| Purchases  | 298                                     |
| Sales  | (979)                                   |
| Balance, December 31, 2016   | <u>\$ 529</u>                           |

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There were no significant transfers into or out of Level 1, Level 2, or Level 3 securities during the years ended December 31, 2017 and 2016.

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, 2017 and 2016 are as follows:

| <b>December 31, 2017</b>                  |                            |                                 |   |                                     |   |
|---|----------------------------|---------------------------------|---|-------------------------------------|---|
|   | <b>Net<br/>asset value</b> | <b>Unfunded<br/>commitments</b> | <b>Redemption<br/>frequency<br/>(if currently<br/>eligible)</b> | <b>Redemption<br/>notice period</b> | <b>Redemption<br/>settlement<br/>period</b> |
| Global bonds fund                         | \$ 93,937                  | —                               | Monthly   | 15 days                             | Up to 30 days                               |
| Global equity fund                        | 327,555                    | —                               | Daily/bi-monthly  | 1–10 days                           | Up to 5–10 days                             |
| Emerging markets equity fund              | 100,818                    | —                               | Daily/weekly  | 5/10 days                           | Up to 7–10 days                             |
| Equity long/short hedge funds             | 80,900                     | —                               | Monthly/quarterly   | 30–90 days                          | Up to 10–90 days                            |
| Opportunistic fixed-income<br>hedge funds | 138,466                    | —                               | Quarterly   | 45–90 days                          | 1–90 days                                   |
| Private equity funds                      | 70,838                     | 60,713                          | Not redeemable  | NA                                  | NA  |
| Emerging market debt fund                 | 36,509                     | —                               | Daily   | Same day                            | Up to 15 days                               |
| Total                                     | <u>\$ 849,023</u>          | <u>60,713</u>                   |   |                                     |   |
| <b>December 31, 2016</b>                  |                            |                                 |   |                                     |   |
|   | <b>Net<br/>asset value</b> | <b>Unfunded<br/>commitments</b> | <b>Redemption<br/>frequency<br/>(if currently<br/>eligible)</b> | <b>Redemption<br/>notice period</b> | <b>Redemption<br/>settlement<br/>period</b> |
| Global bonds fund                         | \$ 85,530                  | —                               | Monthly   | 15 days                             | Up to 30 days                               |
| Global equity fund                        | 241,785                    | —                               | Daily/bi-monthly  | 1–10 days                           | Up to 5–10 days                             |
| Emerging markets equity fund              | 64,905                     | —                               | Daily/weekly  | 5/10 days                           | Up to 7–10 days                             |
| Equity long/short hedge funds             | 73,827                     | —                               | Monthly/quarterly   | 30–90 days                          | Up to 10–90 days                            |
| Opportunistic fixed-income<br>hedge funds | 111,323                    | —                               | Quarterly   | 45–90 days                          | 1–90 days                                   |
| Fund of hedge funds                       | 647                        | —                               | In liquidation  | NA                                  | NA  |
| Private equity funds                      | 64,023                     | 42,726                          | Not redeemable  | NA                                  | NA  |
| Emerging market debt fund                 | 28,465                     | —                               | Daily   | Same day                            | Up to 15 days                               |
| Total                                     | <u>\$ 670,505</u>          | <u>42,726</u>                   |   |                                     |   |

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.

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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.

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.

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.

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.

Private equity funds include two limited partnership investments that focus on health care services and information technology companies, a limited partnership that makes venture capital investments in healthcare 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 co-invests in intermediate-term opportunities sourced by absolute return, private capital, and real asset managers, as well as two limited partnerships that invest 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.

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.

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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, 2017 as follows:

|                                 | <u>Total</u> | <u>Fair value measurements using</u> |                |                |
|---------------------------------|--------------|--------------------------------------|----------------|----------------|
|                                 |              | <u>Level 1</u>                       | <u>Level 2</u> | <u>Level 3</u> |
| Assets:                         |              |                                      |                |                |
| Mutual funds:                   |              |                                      |                |                |
| Large cap domestic equity       | \$ 61,240    | 61,240                               | —              | —              |
| International equity            | 28,468       | 28,468                               | —              | —              |
| Fixed income                    | 29,363       | 29,363                               | —              | —              |
| Other                           | 34,188       | 34,188                               | —              | —              |
| Total mutual funds              | 153,259      | 153,259                              | —              | —              |
| Guaranteed investment contracts | 21,445       | —                                    | —              | 21,445         |
| Total assets                    | \$ 174,704   | 153,259                              | —              | 21,445         |

|                            | <u>Fair value measurements, Level 3</u> |
|----------------------------|---|
| Balance, December 31, 2016 | \$ 18,063                               |
| Total interest income      | 280                                     |
| Purchases                  | 11,617                                  |
| Sales                      | (8,515)                                 |
| Balance, December 31, 2017 | \$ 21,445                               |

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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:

|                                 | <u>Total</u> | <u>Fair value measurements using</u> |                |                |
|---------------------------------|--------------|--------------------------------------|----------------|----------------|
|                                 |              | <u>Level 1</u>                       | <u>Level 2</u> | <u>Level 3</u> |
| 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         |

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

**(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 \$12,383 and \$11,322, which are fair value measured using Level 1 criteria except for \$64 and \$259 that are measured at net asset value, as a practical expedient, as of December 31, 2017 and 2016, respectively. This plan has a projected benefit obligation of \$12,844 and \$11,756 using a discount rate of 3.77% as of December 31, 2017 and 2016. The System made contributions of \$692 and \$822 and

**ALLINA HEALTH SYSTEM**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

recorded a total pension expense of \$719 and \$1,065 in 2017 and 2016, respectively. The unfunded balance of \$461 and \$434, respectively, as of December 31, 2017 and 2016 is reported in the consolidated balance sheets as a noncurrent other liability.

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 \$27,750 and \$26,275, which are fair value measured using Level 2 criteria, and has a projected benefit obligation of \$37,280 and \$34,244 using a discount rate of 4.00% and 4.25% as of December 31, 2017 and 2016. The System made contributions of \$1,000 and \$1,000 in 2017 and 2016, respectively, and recorded a total pension expense of \$2,562 and \$1,171 in 2017 and 2016, respectively. The unfunded balance of \$9,530 and \$7,968 as of December 31, 2017 and 2016, respectively, is reported in the consolidated balance sheets as a noncurrent other liability.

During 2018, the System expects to make required pension contributions totaling approximately \$1,130 for the plans, but may elect to make additional contributions.

Expected future benefit payments for the plans for the ten years following December 31, 2017 are as follows:

|           |    |                      |
|-----------|----|----------------------|
| 2018      | \$ | 2,522                |
| 2019      |    | 2,472                |
| 2020      |    | 2,460                |
| 2021      |    | 2,811                |
| 2022      |    | 2,763                |
| 2023–2027 |    | <u>15,030</u>        |
|           | \$ | <u><u>28,058</u></u> |

**ALLINA HEALTH SYSTEM**

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

**(b) Multi-Employer Plans**

Contributions to the union-sponsored multiemployer plans are made in accordance with collective bargaining agreements. The risks of participation in these multiemployer plans are different from single-employer plans in the following aspects: a) assets contributed to the multiemployer 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 multiemployer 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, 2017 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 2017 and 2016 is for the plan's year-end at December 31, 2016 and 2015, 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 | PPA status |       | FIP/RP Status pending/implemented | Contributions of the System in plan year |        | Surcharge imposed | Expiration date of collective bargaining agreement |
|---|-------------------------|------------|-------|-----------------------------------|--|--------|-------------------|--|
|   |                         | 2016       | 2015  |                                   | 2016                                     | 2015   |                   |  |
| Tw in City Hospitals<br>Minnesota Nurses<br>Association<br>Pension Plan | 41-6184922-001          | Green      | Green | N/A                               | \$ 39,229                                | 34,864 | No                | May 31, 2019                                       |
| Other funds   |                         |            |       |                                   | 3,122                                    | 4,074  |                   |  |
| Total contributions   |                         |            |       |                                   | \$ 42,351                                | 38,938 |                   |  |

Total amounts expensed under the union-sponsored multiemployer plans were \$48,411 and \$44,770 for 2017 and 2016, respectively.

The System contributes more than 5% of the total contributions to all of the plans in which it participated for the plan years 2016 and 2015. The System is required to make minimum contributions each year and will make contributions of \$38,756 in 2018.

At the date the System's consolidated financial statements were issued, Forms 5500 were not available for the plan year ended December 31, 2017.

**(c) Defined-Contribution Plans**

Certain employees of the System are eligible to participate in defined-contribution plans, whereby 50% of the employees' initial 4.0% of salary contributions is matched. The System provides an additional

## ALLINA HEALTH SYSTEM

### Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

annual nonelective employer contribution for eligible employees to the defined-contribution plans. 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 \$69,032 and \$66,966 for 2017 and 2016, respectively.

#### **(d) Postretirement Welfare Benefits**

The System provides postretirement welfare benefits to certain employees. Postretirement welfare cost was \$786 and \$594 for 2017 and 2016, respectively. As of December 31, 2017 and 2016, accumulated postretirement benefit obligation was \$11,761 and \$11,084, respectively, and accrued postretirement benefit cost was \$11,584 and \$10,891, respectively. A discount rate of 3.45%, a rate of return on plan assets of 5.00%, and a medical plan trend rate of 7.00% in 2017, decreasing to 5.00% in 2022 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. In 2017, the System established a wholly owned captive insurance subsidiary for a portion of the self-insured deductible. Premiums paid to the captive insurance subsidiary are based on claims in the reimbursement layer and are eliminated upon consolidation. 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 \$94,769 and \$92,621 as of December 31, 2017 and 2016, 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 \$19,540 and \$19,854 as of December 31, 2017 and 2016, 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, 2017 and 2016. 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 \$4,489 through December 31, 2021. 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.

## ALLINA HEALTH SYSTEM

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

### (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 \$2,868 and \$1,861 in 2017 and 2016, respectively.

As of December 31, 2017 and 2016, the taxable subsidiaries of the System's continuing operations had a gross deferred tax asset of \$48,863 and \$69,881, 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 \$47,968 and \$69,438, respectively, and a gross deferred tax liability of \$896 and \$443, respectively, primarily attributable to depreciation and a change in accounting method of a taxable subsidiary. The valuation allowance decreased by \$21,470 and \$925 during 2017 and 2016, respectively.

As of December 31, 2017 and 2016, the continuing operations of the System and its subsidiaries had net operating loss carryforwards of \$112,217 and \$119,264, respectively, for income tax purposes, which expire in various years through 2037.

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, 2017 and 2016, 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.

H.R. 1, originally known as the Tax Cuts and Jobs Act (the Act), was signed into law on December 22, 2017. The Act is effective for the system as of January 1, 2018. The Act contains various provisions affecting both taxable and tax-exempt entities. Tax-exempt entities are impacted in part by the inclusion of a new excise tax on excess compensation for covered employees, changes to unrelated business income, changes to tax rates, as well as their ability to advance refund bonds. In addition, tax-exempt entities may be impacted through certain for-profit subsidiaries and/or joint ventures based on the Act's provisions for tax rates, elimination of the corporate alternative minimum tax, changes to net operating loss utilization and carryover/carryback period, and measurement of deferred taxes as well as other limitations on deductions. The Act's provisions may also impact donor tax incentives for charitable giving. The System is currently assessing the overall impact of the Act and its impact on the consolidated financial statements.

### (18) Commitments and Contingencies

The System has various noncancelable operating occupancy lease agreements and other operating lease agreements for computer, medical, communication, and other equipment. The terms of certain of the lease agreements contain lease escalation clauses, allow for renewal of the leases, and require the System to pay operating costs in addition to minimum base rent. Base rent expense for operating leases totaled \$33,357 and \$30,234 for the years ended December 31, 2017 and 2016, respectively.

## ALLINA HEALTH SYSTEM

### Notes to Consolidated Financial Statements

December 31, 2017 and 2016

(Dollars in thousands)

Aggregate future minimum lease payments required under operating lease agreements in effect on December 31, 2017 are as follows:

|            |    |                |
|------------|----|----------------|
| 2018       | \$ | 30,304         |
| 2019       |    | 29,637         |
| 2020       |    | 27,679         |
| 2021       |    | 25,618         |
| 2022       |    | 23,160         |
| Thereafter |    | <u>121,240</u> |
|            | \$ | <u>257,638</u> |

Approximately 42% of employees are represented by various collective bargaining arrangements, of whom approximately 12% are represented by arrangements that are pending or expire within one year.

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

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

#### (19) 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:

|                            | <u>2017</u>         | <u>2016</u>      |
|----------------------------|---------------------|------------------|
| Healthcare services        | \$ 3,441,511        | 3,259,153        |
| General and administrative | <u>547,722</u>      | <u>569,289</u>   |
|                            | \$ <u>3,989,233</u> | <u>3,828,442</u> |

#### (20) Subsequent Events

The System has evaluated subsequent events from the consolidated balance sheet date through March 12, 2018, the date at which the consolidated financial statements were issued, and determined there are no other items to disclose.



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

## Independent Auditors' Report

The Board of Directors  
Allina Health System:

We have audited the consolidated financial statements of Allina Health System and its subsidiaries as of and for the years ended December 31, 2017 and 2016, and have issued our report thereon dated March 12, 2018, 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 12, 2018

**ALLINA HEALTH SYSTEM**

Consolidating Balance Sheet

December 31, 2017

(Dollars in thousands)

| <b>Assets</b>   | <b>Obligated<br/>Group</b> | <b>Other<br/>nonobligated</b> | <b>Eliminations</b> | <b>Allina<br/>Health<br/>System</b> |
|---|----------------------------|-------------------------------|---------------------|-------------------------------------|
| Current assets:   |                            |                               |                     |                                     |
| Cash and cash equivalents   | \$ 138,154                 | 9,366                         | —                   | 147,520                             |
| Short-term investments  | 404,934                    | —                             | —                   | 404,934                             |
| Patient accounts receivable, less allowance for<br>uncollectible accounts and charity care of \$104,965 | 485,475                    | 20,569                        | —                   | 506,044                             |
| Inventories   | 65,606                     | 145                           | —                   | 65,751                              |
| Other current assets  | 96,268                     | 3,191                         | —                   | 99,459                              |
|   | <u>1,190,437</u>           | <u>33,271</u>                 | <u>—</u>            | <u>1,223,708</u>                    |
| Investments   | 1,658,637                  | 42,603                        | —                   | 1,701,240                           |
| Investments with limited uses   | 16,181                     | 142,753                       | —                   | 158,934                             |
| Beneficial interests in net assets of Allina Foundations  | 204,265                    | —                             | (204,265)           | —                                   |
| Land, buildings, and equipment, net   | 1,213,609                  | 8,083                         | —                   | 1,221,692                           |
| Other assets  | 256,215                    | 80,973                        | —                   | 337,188                             |
| Total assets  | <u>\$ 4,539,344</u>        | <u>307,683</u>                | <u>(204,265)</u>    | <u>4,642,762</u>                    |
| <b>Liabilities and Net Assets</b>   |                            |                               |                     |                                     |
| Current liabilities:  |                            |                               |                     |                                     |
| Accounts payable and accrued expenses   | \$ 423,873                 | 15,500                        | —                   | 439,373                             |
| Other current liabilities   | 129,772                    | 793                           | —                   | 130,565                             |
|   | <u>553,645</u>             | <u>16,293</u>                 | <u>—</u>            | <u>569,938</u>                      |
| Long-term debt  | 945,953                    | 3,095                         | —                   | 949,048                             |
| Other liabilities   | 353,630                    | 68,227                        | —                   | 421,857                             |
| Total liabilities   | <u>1,853,228</u>           | <u>87,615</u>                 | <u>—</u>            | <u>1,940,843</u>                    |
| Net assets:   |                            |                               |                     |                                     |
| Unrestricted  | 2,471,579                  | 58,982                        | —                   | 2,530,561                           |
| Temporarily restricted  | 158,657                    | 107,650                       | (150,829)           | 115,478                             |
| Permanently restricted  | 55,880                     | 53,436                        | (53,436)            | 55,880                              |
| Total net assets  | <u>2,686,116</u>           | <u>220,068</u>                | <u>(204,265)</u>    | <u>2,701,919</u>                    |
| Total liabilities and net assets  | <u>\$ 4,539,344</u>        | <u>307,683</u>                | <u>(204,265)</u>    | <u>4,642,762</u>                    |

See accompanying independent auditors' report.

**ALLINA HEALTH SYSTEM**

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2017

(Dollars in thousands)

|  | <b>Obligated<br/>Group</b> | <b>Other<br/>nonobligated</b> | <b>Eliminations</b> | <b>Allina<br/>Health<br/>System</b> |
|--|----------------------------|-------------------------------|---------------------|-------------------------------------|
| <b>Revenues:</b>                                       |                            |                               |                     |                                     |
| Patient service revenue net of contractual adjustments | \$ 3,950,967               | 19,008                        | —                   | 3,969,975                           |
| Provision for bad debts                                | (118,846)                  | 574                           | —                   | (118,272)                           |
| Net patient service revenue                            | 3,832,121                  | 19,582                        | —                   | 3,851,703                           |
| Other operating revenue                                | 268,584                    | 33,361                        | (18,548)            | 283,397                             |
| Total revenues   | 4,100,705                  | 52,943                        | (18,548)            | 4,135,100                           |
| <b>Expenses:</b>                                       |                            |                               |                     |                                     |
| Salaries and benefits                                  | 2,564,844                  | 12,884                        | —                   | 2,577,728                           |
| Supplies and services                                  | 871,302                    | 45,375                        | —                   | 916,677                             |
| Depreciation and amortization                          | 173,582                    | 1,796                         | —                   | 175,378                             |
| Financing costs  | 38,759                     | 445                           | —                   | 39,204                              |
| Services provided by (to) related divisions            | 21,475                     | (2,927)                       | (18,548)            | —                                   |
| State assessments and taxes                            | 86,571                     | (414)                         | —                   | 86,157                              |
| Utilities and maintenance                              | 75,889                     | 761                           | —                   | 76,650                              |
| Other operating expenses                               | 115,430                    | 2,009                         | —                   | 117,439                             |
| Total expenses   | 3,947,852                  | 59,929                        | (18,548)            | 3,989,233                           |
| Operating income (loss)                                | 152,853                    | (6,986)                       | —                   | 145,867                             |
| <b>Nonoperating gains (losses):</b>                    |                            |                               |                     |                                     |
| Investment return                                      | 163,533                    | 3,261                         | —                   | 166,794                             |
| Losses on interest rate swap agreements                | (6,656)                    | —                             | —                   | (6,656)                             |
| Contributions received in acquisitions                 | (6,767)                    | —                             | —                   | (6,767)                             |
| Other  | (2,398)                    | (1,438)                       | —                   | (3,836)                             |
| Excess (deficit) of revenues over expenses             | \$ 300,565                 | (5,163)                       | —                   | 295,402                             |

**ALLINA HEALTH SYSTEM**

Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2017

(Dollars in thousands)

|  | <u>Obligated<br/>Group</u> | <u>Other<br/>nonobligated</u> | <u>Eliminations</u> | <u>Allina<br/>Health<br/>System</u> |
|--|----------------------------|-------------------------------|---------------------|-------------------------------------|
| Unrestricted net assets:   |                            |                               |                     |                                     |
| Excess (deficit) of revenues over expenses                         | \$ 300,565                 | (5,163)                       | —                   | 295,402                             |
| Net assets released from restrictions for capital purposes         | 2,370                      | 12,279                        | —                   | 14,649                              |
| Transfer net assets released to Obligated Group                    | 13,704                     | (13,704)                      | —                   | —                                   |
| Amortization of unrealized loss on interest rate swap agreement    | 874                        | —                             | —                   | 874                                 |
| Capital contributions to nonobligated group affiliates, net        | (6,112)                    | 6,112                         | —                   | —                                   |
| Other  | (2,113)                    | (492)                         | —                   | (2,605)                             |
| Increase (decrease) in unrestricted net assets                     | <u>309,288</u>             | <u>(968)</u>                  | <u>—</u>            | <u>308,320</u>                      |
| Temporarily restricted net assets:                                 |                            |                               |                     |                                     |
| Contributions  | 2,370                      | 16,965                        | —                   | 19,335                              |
| Investment return  | 373                        | 13,308                        | —                   | 13,681                              |
| Net assets released from restrictions                              | (2,370)                    | (24,448)                      | —                   | (26,818)                            |
| Change in beneficial interests in net assets of Allina Foundations | 3,378                      | —                             | (3,378)             | —                                   |
| Other  | 1,613                      | (1,411)                       | —                   | 202                                 |
| Increase (decrease) in temporarily restricted net assets           | <u>5,364</u>               | <u>4,414</u>                  | <u>(3,378)</u>      | <u>6,400</u>                        |
| Permanently restricted net assets:                                 |                            |                               |                     |                                     |
| Contributions for endowment funds                                  | —                          | 157                           | —                   | 157                                 |
| Investment return  | (879)                      | 20                            | —                   | (859)                               |
| Change in beneficial interests in net assets of Allina Foundations | (58)                       | —                             | 58                  | —                                   |
| Other  | —                          | (235)                         | —                   | (235)                               |
| (Decrease) increase in permanently restricted net assets           | <u>(937)</u>               | <u>(58)</u>                   | <u>58</u>           | <u>(937)</u>                        |
| Increase (decrease) in net assets                                  | 313,715                    | 3,388                         | (3,320)             | 313,783                             |
| Net assets at beginning of year                                    | <u>2,372,401</u>           | <u>216,680</u>                | <u>(200,945)</u>    | <u>2,388,136</u>                    |
| Net assets at end of year  | \$ <u>2,686,116</u>        | <u>220,068</u>                | <u>(204,265)</u>    | <u>2,701,919</u>                    |

See accompanying independent auditors' report.

**ALLINA HEALTH SYSTEM**

Consolidating Balance Sheet

December 31, 2016

(Dollars in thousands)

| <b>Assets</b>  | <b>Obligated<br/>Group</b> | <b>Other<br/>nonobligated</b> | <b>Eliminations</b> | <b>Allina<br/>Health<br/>System</b> |
|--|----------------------------|-------------------------------|---------------------|-------------------------------------|
|  | <u>          </u>          | <u>          </u>             | <u>          </u>   | <u>          </u>                   |
| 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<br>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                              |
|  | <u>1,225,434</u>           | <u>27,590</u>                 | <u>—</u>            | <u>1,253,024</u>                    |
| 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                             |
|  | <u>4,095,915</u>           | <u>296,307</u>                | <u>(200,945)</u>    | <u>4,191,277</u>                    |
| <b>Total assets</b>  | <b>\$ 4,095,915</b>        | <b>296,307</b>                | <b>(200,945)</b>    | <b>4,191,277</b>                    |
|  |                            |                               |                     |                                     |
| <b>Liabilities and Net Assets</b>  |                            |                               |                     |                                     |
| Current liabilities:   |                            |                               |                     |                                     |
| Accounts payable and accrued expenses  | \$ 445,235                 | 18,616                        | —                   | 463,851                             |
| Other current liabilities  | 110,723                    | 654                           | —                   | 111,377                             |
|  | <u>555,958</u>             | <u>19,270</u>                 | <u>—</u>            | <u>575,228</u>                      |
| Long-term debt   | 814,220                    | 3,972                         | —                   | 818,192                             |
| Other liabilities  | 353,336                    | 56,385                        | —                   | 409,721                             |
|  | <u>1,723,514</u>           | <u>79,627</u>                 | <u>—</u>            | <u>1,803,141</u>                    |
| 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                              |
|  | <u>2,372,401</u>           | <u>216,680</u>                | <u>(200,945)</u>    | <u>2,388,136</u>                    |
| <b>Total net assets</b>  | <b>2,372,401</b>           | <b>216,680</b>                | <b>(200,945)</b>    | <b>2,388,136</b>                    |
| <b>Total liabilities and net assets</b>  | <b>\$ 4,095,915</b>        | <b>296,307</b>                | <b>(200,945)</b>    | <b>4,191,277</b>                    |

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)

|  | <b>Obligated<br/>Group</b> | <b>Other<br/>nonobligated</b> | <b>Eliminations</b> | <b>Allina<br/>Health<br/>System</b> |
|--|----------------------------|-------------------------------|---------------------|-------------------------------------|
| <b>Revenues:</b>                                       |                            |                               |                     |                                     |
| 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                           |
| <b>Expenses:</b>                                       |                            |                               |                     |                                     |
| 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)                            |
| <b>Nonoperating gains (losses):</b>                    |                            |                               |                     |                                     |
| 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 (deficit) 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)

|  | <u>Obligated<br/>Group</u> | <u>Other<br/>nonobligated</u> | <u>Eliminations</u>     | <u>Allina<br/>Health<br/>System</u> |
|--|----------------------------|-------------------------------|-------------------------|-------------------------------------|
| Unrestricted net assets:   |                            |                               |                         |                                     |
| Excess (deficit) 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  | <u>(1,620)</u>             | <u>(2,304)</u>                | <u>—</u>                | <u>(3,924)</u>                      |
| Increase (decrease) in unrestricted net assets                     | <u>71,239</u>              | <u>(1,100)</u>                | <u>—</u>                | <u>70,139</u>                       |
| 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  | <u>(351)</u>               | <u>(2,349)</u>                | <u>—</u>                | <u>(2,700)</u>                      |
| Increase (decrease) in temporarily restricted net assets           | <u>2,402</u>               | <u>3,311</u>                  | <u>(2,538)</u>          | <u>3,175</u>                        |
| 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 | <u>314</u>                 | <u>—</u>                      | <u>(314)</u>            | <u>—</u>                            |
| Increase (decrease) in permanently restricted net assets           | <u>1,539</u>               | <u>314</u>                    | <u>(314)</u>            | <u>1,539</u>                        |
| Increase (decrease) in net assets                                  | 75,180                     | 2,525                         | (2,852)                 | 74,853                              |
| Net assets at beginning of year                                    | <u>2,297,221</u>           | <u>214,155</u>                | <u>(198,093)</u>        | <u>2,313,283</u>                    |
| Net assets at end of year  | \$ <u><u>2,372,401</u></u> | <u><u>216,680</u></u>         | <u><u>(200,945)</u></u> | <u><u>2,388,136</u></u>             |

See accompanying independent auditors' report.