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

Combined Financial Statements

December 31, 2013 and 2012

(With Independent Auditors' Report Thereon)

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

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

Independent Auditors' Report

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

We have audited the accompanying combined financial statements of Kaiser Foundation Health Plan, Inc. and Subsidiaries (Health Plans) and Kaiser Foundation Hospitals and Subsidiaries (Hospitals), which comprise the combined balance sheets as of December 31, 2013 and 2012, and the related combined statements of operations and changes in net worth, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

KPMG LLP

San Francisco, California
February 14, 2014

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

Combined Balance Sheets

December 31, 2013 and 2012

(In millions)

Assets	2013	2012
Current assets:		
Cash and cash equivalents	$ 151	$ 258
Current investments	6,134	6,267
Securities lending collateral	1,418	1,323
Broker receivables	288	779
Accounts receivable - net	1,537	1,485
Inventories and other current assets	1,091	1,185
Total current assets	10,619	11,297
Noncurrent investments	22,877	19,470
Land, buildings, equipment, and software - net	22,892	21,615
Other long-term assets	490	431
Total assets	$ 56,878	$ 52,813

Liabilities and Net Worth	2013	2012
Current liabilities:		
Accounts payable and accrued expenses	$ 2,447	$ 2,663
Medical claims payable	1,260	1,320
Due to associated medical groups	809	752
Payroll and related charges	1,654	1,419
Securities lending payable	1,418	1,323
Broker payables	616	1,180
Long-term debt subject to short-term remarketing arrangements - net	1,537	1,480
Other current debt	596	456
Other current liabilities	1,608	1,687
Total current liabilities	11,945	12,280
Long-term debt	5,526	5,752
Physicians' retirement plan liability	4,379	4,590
Pension and other retirement liabilities	9,822	13,749
Other long-term liabilities	2,157	2,158
Total liabilities	33,829	38,529
Net worth	23,049	14,284
Total liabilities and net worth	$ 56,878	$ 52,813

See accompanying notes to combined financial statements.

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

Combined Statements of Operations and Changes in Net Worth

Years ended December 31, 2013 and 2012

(In millions)

	2013	2012
Revenues:		
Members' dues	$ 36,247	$ 34,354
Medicare	13,010	12,285
Copays, deductibles, fees, and other	3,827	3,474
Total operating revenues	53,084	50,113
Expenses:		
Medical services	25,685	24,341
Hospital services	14,798	13,738
Outpatient pharmacy and optical services	5,288	5,137
Other benefit costs	3,201	3,124
Total medical and hospital services	48,972	46,340
Health Plan administration	2,312	2,068
Total operating expenses	51,284	48,408
Operating income	1,800	1,705
Other income and expense:		
Investment income - net	1,157	1,057
Interest expense	(153)	(135)
Total other income and expense	1,004	922
Income from continuing operations	2,804	2,627
Discontinued operations	(119)	(31)
Net income	2,685	2,596
Change in pension and other retirement liability charges	5,620	(1,482)
Change in net unrealized gains on investments	479	610
Change in restricted donations	(16)	16
Change in noncontrolling interest	(3)	49
Change in net worth	8,765	1,789
Net worth at beginning of year	14,284	12,495
Net worth at end of year	$ 23,049	$ 14,284

See accompanying notes to combined financial statements.

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

Combined Statements of Cash Flows

Years ended December 31, 2013 and 2012

(In millions)

	2013	2012
Cash flows from operating activities:		
Net income	$ 2,685	$ 2,596
Adjustments to reconcile net income to net cash provided from operating activities:		
Depreciation and software amortization	1,810	1,683
Other amortization	4	(6)
Gain recognized on investments - net	(767)	(723)
Loss on land, buildings, equipment, and software - net	176	11
Loss on extinguishment of debt	—	2
Changes in assets and liabilities:		
Accounts receivable - net	(51)	(25)
Other assets	79	(336)
Accounts payable and accrued expenses	(213)	242
Medical claims payable	(60)	25
Due to associated medical groups	90	(30)
Payroll and related charges	235	(36)
Pension and other retirement liabilities	1,098	482
Other liabilities	(39)	178
Net cash provided from operating activities	5,047	4,063
Cash flows from investing activities:		
Additions to land, buildings, equipment, and software	(3,294)	(3,460)
Proceeds from sales of land, buildings, and equipment	28	14
Proceeds from investments	34,977	44,409
Investment purchases	(37,017)	(47,106)
Decrease (increase) in securities lending collateral	(95)	41
Broker receivables / payables	(73)	100
Issuance of notes	(161)	(258)
Prepayment and repayment of notes receivable	111	46
Other investing	(104)	(119)
Physicians’ retirement plan liability	416	324
Net cash used in investing activities	(5,212)	(6,009)
Cash flows from financing activities:		
Issuance of debt	338	2,300
Prepayment and repayment of debt	(356)	(315)
Increase (decrease) in securities lending payable	95	(41)
Change in restricted donations	(16)	16
Change in noncontrolling interest	(3)	49
Net cash provided from financing activities	58	2,009
Net change in cash and cash equivalents	(107)	63
Cash and cash equivalents at beginning of year	258	195
Cash and cash equivalents at end of year	$ 151	$ 258
Supplemental cash flows disclosure:		
Cash paid for interest - net of capitalized amounts	$ 167	$ 124
Noncash investment transactions	$ 538	$ —

See accompanying notes to combined financial statements.

(1) Description of Business

The accompanying combined financial statements include Kaiser Foundation Health Plan, Inc. and Subsidiaries (Health Plans) and Kaiser Foundation Hospitals and Subsidiaries (Hospitals). Health Plans and Hospitals are primarily not-for-profit corporations whose capital is available for charitable, educational, research, and related purposes. Health Plans are primarily health maintenance organizations and are generally exempt from federal and state income taxes. Membership at both December 31, 2013 and 2012 was 9.1 million. At December 31, 2013 and 2012, the percentage of enrolled membership in California was approximately 78% and 77%, respectively. The principal operating subsidiary of Kaiser Foundation Hospitals is Kaiser Hospital Asset Management, Inc. (KHAM). The principal operating subsidiaries of Kaiser Foundation Health Plan, Inc. (Health Plan, Inc.) are:

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

In 2013, Health Plan, Inc. and HealthSpan Partners, an unrelated not-for-profit Ohio-based health system, entered into a definitive agreement to transfer the sole corporate membership of Kaiser Foundation Health Plan of Ohio to HealthSpan Partners. On October 1, 2013, the member substitution transaction was completed. Fair value of the proceeds from this transfer was not material. Management determined that as of September 30, 2013, the net assets of the disposed Ohio operations met held for sale and discontinued operations criteria in accordance with accounting principles generally accepted in the United States of America (GAAP). For all periods presented, the operating results for the Ohio region have been reclassified, as appropriate, from continuing operations and presented separately as discontinued operations in the combined statements of operations and changes in net worth. Management considered the then pending member substitution transaction as a triggering event for impairment of the long-lived assets of the Ohio region. Management determined that the carrying value of the disposed component was in excess of fair value and, accordingly, recorded a $59 million impairment of the Ohio region's long-lived assets in September 2013. The results of Ohio operations including operating revenues of $382 million for the year ended December 31, 2013 and $517 million for the year ended December 31, 2012 have been reclassified to discontinued operations. In addition, certain expenses related to the disposition of the Ohio operations totaling approximately $72 million were recorded in September 2013 and are included in discontinued operations in the combined statements of operations and changes in net worth.

Independent Medical Groups (Medical Groups) cooperate with Health Plans and Hospitals in conducting the Kaiser Permanente Medical Care Program. Health Plans contracts with Hospitals and the Medical Groups to provide or arrange hospital and medical services for members. Hospitals also contracts with the Medical Groups for certain professional services. Contract payments to the Medical Groups represent a substantial portion of the expenses for medical services reported in these combined financial statements. Payments from Health Plans and Hospitals constitute substantially all of the revenues for the Medical

Groups. Because the Medical Groups are independent and not controlled by Health Plans and Hospitals, their operations are not included in these combined financial statements.

At December 31, 2013 and 2012, the percentages of Health Plans' and Hospitals' total labor force covered under collective bargaining agreements were approximately 69% and 68%, respectively. At December 31, 2013, approximately 11% of the workforce was covered under collective bargaining agreements that are scheduled to expire within one year. At December 31, 2013, approximately 2% of the workforce was working under an expired agreement, and approximately 1% of the workforce was working under a temporarily extended agreement.

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

For the year ended December 31, 2013, DCBI expenditures (at cost, net of approximately $1.1 billion of DCBI related revenue) were $2.0 billion, representing 3.7% of operating revenue. In comparison, for the year ended December 31, 2012, DCBI expenditures (at cost, net of $913 million of DCBI related revenue) were $2.0 billion, representing 3.9% of operating revenue. The calculation of DCBI expenditures is based on Health Plans' and Hospitals' direct and indirect costs and the services provided by Health Plans and Hospitals under DCBI programs.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

The financial statements of Health Plans and Hospitals are presented on a combined basis due to the operational interdependence of these organizations and because their governing boards and management are substantially the same. These combined financial statements have been prepared in accordance with GAAP. All material intercompany balances and transactions have been eliminated. Management has evaluated subsequent events through February 14, 2014, which is the date that these combined financial statements were issued.

(b) Cash and Cash Equivalents

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

(c) Investments

Investments include equity, U.S. Treasury, government agencies, money market funds, and other marketable debt securities and are reported at fair value. Investments are categorized as current

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

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

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

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

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

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

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

(d) Securities Lending Collateral and Payable

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

(e) Broker Receivables and Payables

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

(f) Inventory

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

(g) Land, Buildings, Equipment, and Software

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

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

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

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

(h) Medical Claims Payable

The cost of health care services is recognized in the period in which services are provided. Medical claims payable consists of unpaid health care expenses to third-party providers, which include an estimate of the cost of services provided to Health Plans' members by the third-party providers that have been incurred but not reported. The estimate for incurred but not reported claims is based on actuarial projections of costs using historical paid claims and other relevant data. Estimates are monitored and reviewed and, as settlements are made or estimates are revised, adjustments are reflected in current operations. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions, actual utilization of medical services, changes in membership and product mix, claim submission and processing patterns, and other relevant factors. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate amount of paid claims is dependent on future developments, management is of the opinion that the reserves for claims are adequate to cover such claims.

(i) Due to Associated Medical Groups

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

(j) Self-Insured Risks

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

(k) Premium Deficiency Reserves

Premium deficiency reserves and the related expense are recognized when it is probable that expected future health care and maintenance costs under a group of existing contracts will exceed anticipated future premiums and reinsurance recoveries over the contract period. If applicable, premium deficiency reserves extending beyond one year are shown as a long-term liability. Expected investment income and interest expense are included in the calculation of premium deficiency reserves, as appropriate. The level at which contracts are grouped for evaluation purposes is generally by geographic region. The methods for making such estimates and for establishing the resulting reserves are reviewed and updated, and any resulting adjustments are reflected in current operations. At December 31, 2013 and 2012, premium deficiency reserves were $22 million and $49 million, respectively. Given the inherent variability of such estimates, the actual liability could differ significantly from the calculated amount.

(l) Derivative Financial Instruments

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

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

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

(m) Revenue Recognition

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

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

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

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

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

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

The Health Information Technology for Economic and Clinical Health Act, part of the American Recovery and Reinvestment Act of 2009, created an incentive program, beginning in 2011, to promote the "meaningful use" of Electronic Health Records (EHR). To qualify, Medicare providers must attest to CMS that they are using certified EHR in a "meaningful" way by meeting objectives at established thresholds, as defined by CMS. Meaningful use revenues are recognized as grant revenue. Grant revenue is recognized when there is reasonable assurance that the grant will be received and that the organization will comply with the conditions attached to the grant. For the years ended December 31, 2013 and 2012, meaningful use revenues were $84 million and $180 million, respectively, and were recognized in copays, deductibles, fees, and other revenue. The amount recognized is based on management's best estimate and is subject to audit and potential retrospective adjustments.

Health Plans estimates accrued retrospective premium adjustments for certain group health insurance contracts based on claims experience and the provisions of the contract. Health Plans records accrued retrospective premiums as an adjustment to members' dues. For the years ended December 31, 2013 and 2012, the amount of net premiums written by Health Plans subject to the retrospective rating feature were $155 million and $340 million, respectively. During 2013 and 2012, revenue derived under these contracts was 0.4% and 1.0%, respectively, of total members' dues. During 2013 and 2012, retrospective dues adjustments were $0.8 million and $(8.0) million, respectively.

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

United States Office of Personnel Management is subject to audit and potential retrospective adjustments.

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

(n) Pension and Other Postretirement Benefits

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

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

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

(o) Donations and Grants Made or Received

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

(p) Use of Estimates

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

(q) Reclassifications

Certain reclassifications have been made in these combined financial statements to conform 2012 information to the 2013 presentation.

(r) Recently Issued Accounting Standards

During 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-06 *Other Expenses (Topic 720) Fees Paid to the Federal Government by Health Insurers* (a consensus of the FASB Emerging Issues Task Force). This guidance will be adopted by Health Plans and Hospitals in 2014. This accounting standard is applicable to the Health Insurance Providers (HIP) fee provided for in the Patient Protection and Affordable Care Act. Current guidance provides that the HIP fee will be assessed on Health Plans by the Internal Revenue Service (IRS) by August 31, 2014, and will be paid by September 30, 2014. The IRS assessment for 2014 will be based on the agency's calculation of Health Plans' net premiums in the data year of 2013 as a percentage of the total premiums for all U.S. health plans in the data year. Management has estimated the 2014 assessment on Health Plans to be approximately $300 million. In accordance with GAAP, management will record a liability for the estimated amount of this assessment in January 2014, and will amortize the related deferred cost to expense monthly.

During 2013, the FASB issued ASU No. 2013-06 *Not-for-Profit Entities (Topic 958) Services Received from Personnel of an Affiliate* (a consensus of the FASB Emerging Issues Task Force). This guidance will be adopted by Health Plans and Hospitals in 2015. Management has evaluated this accounting standard and does not expect it to have a significant effect on the combined financial statements.

(3) Fair Value Estimates

The carrying amounts reported in the balance sheets for cash and cash equivalents, securities lending collateral, broker receivables, accounts receivable - net, accounts payable and accrued expenses, medical

claims payable, due to associated medical groups, payroll and related charges, securities lending payable, and broker payables approximate fair value.

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

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

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

The fair value of long-term debt is based on level 2 inputs for debt with similar risk, terms, and remaining maturities. At December 31, 2013 and 2012, the carrying amount of long-term debt totaled $7.2 billion and $7.6 billion, respectively. At December 31, 2013 and 2012, the estimated fair value of long-term debt was approximately $7.2 billion and $7.9 billion, respectively.

At December 31, 2013 and 2012, Health Plans and Hospitals held derivative financial instruments including interest rate swaps, as well as futures, swaps, and forwards held within investment portfolios. The estimated fair values of derivative instruments were determined using level 2 inputs, including

available market information and valuation methodologies, primarily discounted cash flows. Additional description and the fair value of derivative instruments are contained in the *Derivative Instruments* note.

(4) Investments

Management's methods for estimating fair value of financial instruments is discussed in the *Fair Value Estimates* note.

At December 31, 2013, the estimated fair value of current investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	$ 16	$ —	$ —	$ 16
Debt securities issued by the U.S. government	—	1,963	—	1,963
Debt securities issued by U.S. government agencies and corporations	—	225	—	225
Debt securities issued by U.S. states and political subdivisions of states	—	80	—	80
Foreign government debt securities	—	17	—	17
U.S. corporate debt securities	—	1,462	—	1,462
Foreign corporate debt securities	—	853	—	853
U.S. agency mortgage-backed securities	—	343	—	343
Non-U.S. agency mortgage-backed securities	—	484	—	484
Other asset-backed securities	—	356	—	356
Short-term investment funds	—	335	—	335
Total	$ 16	$ 6,118	$ —	$ 6,134

At December 31, 2013, the estimated fair value of noncurrent investments by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	$ 3,729	$ 38	$ —	$ 3,767
Foreign equity securities	2,283	1,508	17	3,808
Global equity funds	—	840	—	840
Debt securities issued by the U.S. government	—	961	—	961
Debt securities issued by U.S. government agencies and corporations	—	215	—	215
Debt securities issued by U.S. states and political subdivisions of states	—	225	—	225
Foreign government debt securities	—	922	8	930
U.S. corporate debt securities	3	3,711	—	3,714
Foreign corporate debt securities	—	1,512	—	1,512
U.S. agency mortgage-backed securities	—	923	—	923
Non-U.S. agency mortgage-backed securities	—	373	13	386
Other asset-backed securities	—	386	—	386
Short-term investment funds	—	775	—	775
Other	70	313	2	385
Alternative investments:				
Absolute return	—	1,510	612	2,122
Private equity	—	—	1,316	1,316
Risk parity	—	—	612	612
Total	$ 6,085	$ 14,212	$ 2,580	$ 22,877

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

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	$ 14	$ —	$ —	$ 14
Debt securities issued by the U.S. government	—	2,150	—	2,150
Debt securities issued by U.S. government agencies and corporations	—	125	—	125
Debt securities issued by U.S. states and political subdivisions of states	—	148	—	148
Foreign government debt securities	—	19	—	19
U.S. corporate debt securities	—	1,472	—	1,472
Foreign corporate debt securities	—	772	—	772
U.S. agency mortgage-backed securities	—	653	—	653
Non-U.S. agency mortgage-backed securities	—	313	—	313
Other asset-backed securities	—	283	—	283
Short-term investment funds	—	318	—	318
Total	$ 14	$ 6,253	$ —	$ 6,267

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

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
U.S. equity securities	$ 3,133	$ 13	$ —	$ 3,146
Foreign equity securities	1,886	885	18	2,789
Global equity funds	—	996	—	996
Debt securities issued by the U.S. government	—	1,192	—	1,192
Debt securities issued by U.S. government agencies and corporations	—	94	—	94
Debt securities issued by U.S. states and political subdivisions of states	—	206	—	206
Foreign government debt securities	—	468	5	473
U.S. corporate debt securities	—	2,481	4	2,485
Foreign corporate debt securities	—	1,375	—	1,375
U.S. agency mortgage-backed securities	—	1,521	—	1,521
Non-U.S. agency mortgage-backed securities	—	180	14	194
Other asset-backed securities	—	386	—	386
Short-term investment funds	—	692	—	692
Other	10	312	2	324
Alternative investments:				
Absolute return	—	1,427	569	1,996
Private equity	—	—	965	965
Risk parity	—	—	636	636
Total	$ 5,029	$ 12,228	$ 2,213	$ 19,470

At December 31, 2013, debt and equity securities available-for-sale were as follows (in millions):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. equity securities	$ 2,759	$ 1,024	$ —	$ 3,783
Foreign equity securities	3,019	789	—	3,808
Global equity funds	535	305	—	840
Debt securities issued by the U.S. government	2,915	9	—	2,924
Debt securities issued by U.S. government agencies and corporations	436	4	—	440
Debt securities issued by U.S. states and political subdivisions of states	282	23	—	305
Foreign government debt securities	931	16	—	947
U.S. corporate debt securities	5,014	162	—	5,176
Foreign corporate debt securities	2,319	46	—	2,365
U.S. agency mortgage-backed securities	1,240	26	—	1,266
Non-U.S. agency mortgage-backed securities	850	20	—	870
Other asset-backed securities	737	5	—	742
Short-term investment funds	1,110	—	—	1,110
Other	380	5	—	385
Total	$ 22,527	$ 2,434	$ —	$ 24,961

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

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
U.S. equity securities	$ 2,601	$ 559	$ —	$ 3,160
Foreign equity securities	2,349	447	(7)	2,789
Global equity funds	721	275	—	996
Debt securities issued by the U.S. government	3,304	38	—	3,342
Debt securities issued by U.S. government agencies and corporations	216	3	—	219
Debt securities issued by U.S. states and political subdivisions of states	306	48	—	354
Foreign government debt securities	441	51	—	492
U.S. corporate debt securities	3,665	292	—	3,957
Foreign corporate debt securities	2,018	129	—	2,147
U.S. agency mortgage-backed securities	2,110	64	—	2,174
Non-U.S. agency mortgage-backed securities	483	24	—	507
Other asset-backed securities	662	7	—	669
Short-term investment funds	1,010	—	—	1,010
Other	299	25	—	324
Total	$ 20,185	$ 1,962	$ (7)	$ 22,140

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

	2013		2012	
	Amortized cost	Fair value	Amortized cost	Fair value
Due in one year or less	$ 1,965	$ 1,971	$ 1,971	$ 1,991
Due after one year through five years	6,767	6,851	5,859	6,006
Due after five years through ten years	2,414	2,459	1,352	1,447
Due after ten years	2,241	2,371	2,077	2,401
U.S. agency mortgage-backed securities	1,240	1,266	2,110	2,174
Non-U.S. agency mortgage-backed securities	850	870	483	507
Other asset-backed securities	737	742	662	669
Total	$ 16,214	$ 16,530	$ 14,514	$ 15,195

For the year ended December 31, 2013, the reconciliation of investments with fair value measurements using significant unobservable inputs (level 3) was as follows (in millions):

	Equity securities	Debt securities	Alternative investments	Total
Beginning balance	$ 18	$ 25	$ 2,170	$ 2,213
Total net gains (losses):				
Realized	2	(1)	120	121
Unrealized	3	(1)	—	2
Purchases	4	14	392	410
Sales	(10)	(7)	(142)	(159)
Settlements	—	(7)	—	(7)
Ending balance	$ 17	$ 23	$ 2,540	$ 2,580
Total realized and unrealized year-to-date net gains related to assets held at December 31, 2013	$ 4	$ —	$ 125	$ 129

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

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

Transfers between fair value input levels, if any, are recorded at the end of the reporting period. Transfers between fair value input levels occur when valuation inputs used to record or disclose assets or liabilities change from one level of the valuation hierarchy to another. During the years ended December 31, 2013 and 2012, there were no transfers between assets with inputs with quoted prices in active markets for identical assets (level 1) and assets with inputs with significant other observable inputs (level 2).

Noncurrent investments include specific funds held in trust accounts related to collateral requirements for certain reinsurance agreements. At December 31, 2013 and 2012, the values of these funds were $29 million and $31 million, respectively.

Absolute return investments use advanced investment strategies, including derivatives, to generate positive long-term risk adjusted returns. Private equity investments consist of funds that make direct investments in private companies. Risk parity funds use risk as the primary factor to allocate investments among asset classes. Management meets with alternative investment fund managers periodically to assess portfolio performance and reporting and exercises oversight over fund managers. At December 31, 2013, Hospitals had original commitments related to alternative investments of $3.2 billion, of which $1.5 billion was invested, leaving $1.7 billion of remaining commitments. At December 31, 2012, Hospitals had original commitments related to alternative investments of $2.0 billion, of which $1.1 billion was invested, leaving $875 million of remaining commitments.

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

	2013	2012
Other-than-temporary impairment	$ (498)	$ (258)
Recognized gains	1,391	921
Recognized losses	(170)	(152)
Income from equity method alternative investments	235	203
Interest, dividends, and other income - net	562	629
Derivative income (loss)	(8)	16
Total investment income - net	1,512	1,359
Less investment income included in operating income	(355)	(302)
Investment income - net	$ 1,157	$ 1,057

For the years ended December 31, 2013 and 2012, Health Plans and Hospitals recorded impairment of certain investments in accordance with the policy described in the note *Summary of Significant Accounting Policies - Investments*. During 2013, there was $12 million of impairment of alternative investments. During 2012, there was no impairment of alternative investments.

Absolute return, risk parity, and private equity investments include redemption restrictions. Absolute return and risk parity investments require 10 to 90 day written notice of intent to withdraw and are often subject to the approval and capital requirements of the fund manager. Absolute return investments of $161 million are subject to a remaining 12 month lock-up period. Private equity agreements do not include provisions for redemption. Distributions will be received as the underlying investments of the funds are liquidated, which is expected over the next 11 years.

(5) Derivative Instruments

(a) Interest Rate Swaps

At December 31, 2013 and 2012, Health Plans and Hospitals had 11 agreements to manage interest rate fluctuations (Interest Rate Swaps) with a total notional amount of $1.2 billion for each period. At December 31, 2013 and 2012, the fair values of these agreements were $(160) million and $(301) million, respectively, and were recorded in other long-term liabilities. For the years ended December 31, 2013 and 2012, Health Plans and Hospitals recorded approximately $36 million and $37 million, respectively, in interest expense relating to the Interest Rate Swaps. For the years ended December 31, 2013 and 2012, net changes in fair values totaled $141 million and $2 million, respectively, and were recorded in investment income - net.

These derivatives contain reciprocal provisions whereby if Health Plans' and Hospitals' or the counterparties' credit rating was to decline to certain levels, provisions would be triggered requiring Health Plans and Hospitals or the counterparties to provide certain collateral. At December 31, 2013 and 2012, no collateral was required to be posted by either Health Plans and Hospitals or the counterparties.

(b) Derivatives Held in Investment Portfolios

At December 31, 2013 and 2012, Health Plans' and Hospitals' portfolio managers held $5 million and $(10) million, respectively, of futures, forwards, options, and swaps to attempt to protect investments against volatility. For the years ended December 31, 2013 and 2012, net changes in fair values totaled $(5) million and $(27) million, respectively, and were recorded in investment income - net. For the years ended December 31, 2013 and 2012, gains (losses) resulting from derivative settlements totaled $(144) million and $41 million, respectively, and were recorded in investment income - net.

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

Management's methods for estimating fair value of financial instruments is discussed in the *Fair Value Estimates* note.

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

(In millions)

Derivatives not designated as hedging instruments	Statement of operations category	Gain (loss) recognized in income on derivatives for years ended December 31, 2013	2012
Interest rate swaps - related to debt	Investment income - net	$ 141	$ 2
Interest rate swaps - other	Investment income - net	3	2
Options, rights, and warrants	Investment income - net	1	1
Futures and forwards	Investment income - net	(9)	(30)
		$ 136	$ (25)

**Information on Derivative Settlement Costs
Recognized in Income**

(In millions)

Derivatives not designated as hedging instruments	Statement of operations category	Gain (loss) recognized in income on derivatives for years ended December 31, 2013	2012
Interest rate swaps - related to debt	Interest expense	$ (36)	$ (37)
Interest rate swaps - other	Investment income - net	(4)	5
Futures and forwards	Investment income - net	(132)	44
Options, rights, and warrants	Investment income - net	(8)	(8)
		$ (180)	$ 4

Information on Fair Value of Derivative Instruments – Assets

(In millions)

Derivatives not designated as hedging instruments	Balance sheet category	Fair value at December 31, 2013	2012
Interest rate swaps - other	Noncurrent investments	$ 9	$ 2
Futures and forwards	Noncurrent investments	15	47
Options, rights, and warrants	Noncurrent investments	6	2
		$ 30	$ 51

Information on Fair Value of Derivative Instruments – Liabilities

(In millions)

Derivatives not designated as hedging instruments	Balance sheet category	Fair value at December 31, 2013	Fair value at December 31, 2012
Interest rate swaps - related to debt	Other long-term liabilities	$ 160	$ 301
Interest rate swaps - other	Other long-term liabilities	6	2
Futures and forwards	Other long-term liabilities	16	58
Options, rights, and warrants	Other long-term liabilities	3	1
		$ 185	$ 362

(6) Accounts Receivable - net

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

	2013	2012
Members' dues	$ 613	$ 593
Patient services	368	316
Medicare	351	403
Other	314	297
	1,646	1,609
Allowances for bad debt	(109)	(124)
Total	$ 1,537	$ 1,485

(7) Inventories and Other Current Assets

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

	2013	2012
Inventories - net	$ 773	$ 766
Prepaid expenses	308	407
Other	10	12
Total	$ 1,091	$ 1,185

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

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

	2013	2012
Land	$ 1,792	$ 1,646
Buildings and improvements	26,835	24,754
Furniture, equipment, and software	9,357	8,644
Construction and software development in progress	3,063	3,535
	41,047	38,579
Accumulated depreciation and amortization	(18,155)	(16,964)
Total	$ 22,892	$ 21,615

Health Plans and Hospitals capitalize interest costs on borrowings incurred during the construction, upgrade, or development of qualifying assets. Capitalized interest is added to the cost of the underlying assets and is depreciated or amortized over the useful lives of the assets. During 2013 and 2012, Health Plans and Hospitals capitalized $88 million and $94 million, respectively, of interest in connection with various capital projects.

Asset retirement obligations relate primarily to the following: leased building restoration, building materials containing asbestos, leaded wall shielding, storage tanks (above ground and below ground), chillers or cooling tower chemicals, mercury in large fixed-components, and hard drives requiring data wiping prior to disposal. At December 31, 2013 and 2012, the liability for asset retirement obligations was $86 million and $83 million, respectively. During 2013 and 2012, amortization and other adjustments of the associated assets totaled $11 million and $5 million, respectively. At December 31, 2013 and 2012, the unamortized asset related to this retirement obligation was $12 million and $17 million, respectively.

(9) Medical Claims Payable

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

	2013	2012
Balances at January 1	$ 1,320	$ 1,295
Incurred related to:		
Current year	7,194	6,926
Prior years	(172)	(109)
Total incurred	7,022	6,817
Paid related to:		
Current year	6,148	5,831
Prior years	934	961
Total paid	7,082	6,792
Balances at December 31	$ 1,260	$ 1,320

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

(10) Other Liabilities

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

	2013	2012
Self-insured risks	$ 400	$ 397
Dues collected in advance	496	510
Medicare liabilities	34	80
Postretirement benefits	122	99
Physicians' retirement plan liability	143	134
TBA commitments	49	160
Other	364	307
Total	$ 1,608	$ 1,687

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

	2013	2012
Self-insured risks	$ 1,395	$ 1,288
Derivatives liability	185	362
Due to associated medical groups	282	249
Other	295	259
Total	$ 2,157	$ 2,158

(11) Debt

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

	2013	2012
Tax-exempt revenue bonds and taxable bonds and notes:		
0.03% to 3.90% variable rate due through 2052	$ 3,991	$ 3,731
3.25% to 5.38% fixed rate due through 2045	3,666	3,955
Others at various rates due through 2026	2	2
Total	$ 7,659	$ 7,688
Other current debt:		
Commercial paper	$ 438	$ 100
Current portion of long-term debt	158	356
Long-term debt subject to short-term remarketing arrangements - net	1,537	1,480
Long-term debt classified as a long-term liability	5,526	5,752
Total	$ 7,659	$ 7,688

During 2013, Hospitals redeemed $278 million of fixed-rate bonds and $60 million of variable-rate bonds using taxable commercial paper proceeds and retired $18 million of tax-exempt variable rate debt. During 2012, Hospitals issued $1.0 billion of fixed-rate taxable bonds and $1.0 billion of tax-exempt revenue bonds, of which $908 million was tax-exempt fixed-rate debt and $100 million was tax-exempt variable rate debt. Additionally, during 2012, Hospitals remarketed $200 million of put bonds and the transaction was accounted for as an extinguishment and reoffering. During 2012, Hospitals retired $15 million of bonds that matured in 2012 and refunded $100 million of fixed-rate bonds using taxable commercial paper proceeds.

At December 31, 2013 and 2012, at the holder's option, repurchase of variable rate demand bonds totaling $3.5 billion and $3.6 billion, respectively, may be required at earlier than stated maturity. These bonds may be remarketed rather than repurchased. To date, all such bonds have been remarketed. Health Plans and Hospitals have provided self liquidity for the variable rate demand bonds with put options. Additionally, at both December 31, 2013 and 2012, management had the ability to finance the acquisition of up to $1.5 billion of any unremarketed bonds that are put, using available credit facilities. At both December 31, 2013

and 2012, $1.5 billion of these variable rate demand bonds were classified in current liabilities. These amounts were net of $1.5 billion of available long-term credit facilities.

Variable rates for these bonds are determined by market rates for similar obligations. At December 31, 2013 and 2012, $68 million and $79 million, respectively, of the above tax-exempt fixed-rate revenue bonds represented a net unamortized premium balance.

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

2014	$	671
2015		30
2016		121
2017		18
2018		18
Thereafter		6,733
Total	$	7,591

At December 31, 2013, Hospitals had certain bonds that require mandatory tender by the holder on a date certain as follows: $205 million in 2016 and $275 million in 2017. Hospitals intends to remarket these bonds until final maturity of the bonds. Long-term bonds of $75 million that require mandatory tender by the holder in 2014 have been reflected in the 2014 amount in the schedule above.

Credit Facility

Hospitals’ credit facility of $1.5 billion terminates in August 2016. Various interest rate options are available under this facility. Any revolving borrowings mature on the termination date. Hospitals pays facility fees, which range from 0.065% to 0.125% per annum, depending upon Hospitals’ long-term senior unsecured debt rating. At December 31, 2013, the facility fee was at an annual rate of 0.08%. At December 31, 2013 and 2012, no amounts were outstanding under this credit facility.

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

Taxable Commercial Paper Program

Hospitals maintains a commercial paper program providing for the issuance of up to $1.5 billion in aggregate maturity value of short-term indebtedness. The commercial paper is issued in denominations of $100,000 and will bear such interest rates, if interest-bearing, or will be sold at such discount from their face amounts, as agreed upon by Hospitals and the dealer acting in connection with the commercial paper program. The commercial paper may be issued with varying maturities up to a maximum of 270 days from

the date of issuance. At December 31, 2013 and 2012, commercial paper of $438 million and $100 million, respectively, were outstanding under this program and are included within other current debt.

(12) Pension Plans

(a) Defined Benefit Plan

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

For financial reporting purposes, the projected unit credit method is used. At December 31, 2013 and 2012, substantially all pension fund assets were held in a group trust. At December 31, 2013 and 2012, the trust's assets were invested primarily in fixed-income and equity securities, with approximately 14% and 11% of trust assets, net of liabilities, respectively, invested in alternative investments.

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

	2013	2012
Change in projected benefit obligation (PBO):		
Benefit obligation at beginning of year	$ 13,872	$ 10,692
Service cost	1,046	819
Interest cost	599	548
Special termination benefits	20	—
Plan amendments	—	1
Net actuarial loss (gain)	(2,075)	2,100
Benefits paid	(498)	(288)
Benefit obligation at end of year	$ 12,964	$ 13,872
Accumulated benefit obligation at end of year	$ 9,664	$ 10,348
Change in Health Plans' and Hospitals' share of trust assets:		
Fair value of plan assets at beginning of year	$ 7,329	$ 5,452
Actual return on plan assets	816	782
Contributions	856	1,383
Benefits paid	(498)	(288)
Fair value of plan assets at end of year	$ 8,503	$ 7,329
Funded status	$ (4,461)	$ (6,543)
Amounts recognized in the balance sheet consist of:		
Noncurrent assets	$ —	$ —
Current liabilities	—	—
Pension and other retirement liabilities	(4,461)	(6,543)
	$ (4,461)	$ (6,543)
Amounts recognized in net worth:		
Net actuarial loss	$ 3,004	$ 5,727
Prior service cost	20	35
	$ 3,024	$ 5,762

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

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

	2013	2012
Service cost	$ 1,046	$ 819
Interest cost	599	548
Expected return on plan assets	(553)	(461)
Special termination benefits	20	—
Amortization of net actuarial loss	385	279
Amortization of prior service cost	15	15
Net pension expense	1,512	1,200
Other changes in plan assets and PBO recognized in net worth:		
Net actuarial loss (gain)	(2,338)	1,779
Prior service cost	—	1
Amortization of net actuarial loss	(385)	(279)
Amortization of prior service cost	(15)	(15)
Total recognized in net worth	(2,738)	1,486
Total recognized in net periodic benefit cost and net worth	$ (1,226)	$ 2,686

During 2014, $140 million and $15 million in estimated net actuarial loss and prior service cost, respectively, will be amortized from net worth into net pension expense.

Actuarial assumptions used were as follows:

	2013	2012
Weighted average discount rate at January 1 for calculating pension expense	4.35%	5.10%
Weighted average discount rate for calculating December 31 PBO	5.15%	4.35%
Weighted average salary scale for calculating pension expense and December 31 PBO	4.60%	4.60%
Expected long-term rate of return on plan assets for calculating pension expense	7.50%	7.75%

During 2014, management expects to contribute approximately $940 million to its pension plan.

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

2014	$	482
2015		527
2016		582
2017		633
2018		684
2019 - 2023		3,885

Explanation of Investment Strategies and Policies

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

Capital Market Assumption Methodology

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

At December 31, 2013, the estimated fair value of total pension trust assets - net by level was as follows (in millions):

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
Assets:				
Cash and cash equivalents	$ 71	$ 998	$ —	$ 1,069
Broker receivables	—	310	—	310
Securities lending collateral	—	1,434	—	1,434
U.S. equity securities	3,669	67	—	3,736
Foreign equity securities	4,161	1,552	—	5,713
Global equity funds	—	320	—	320
Debt securities issued by the U.S. government	—	681	—	681
Debt securities issued by U.S. government corporations and agencies	—	58	—	58
Debt securities issued by U.S. states and political subdivisions of states	—	169	—	169
Foreign government debt securities	—	402	—	402
U.S. corporate debt securities	—	3,535	—	3,535
Non-U.S. corporate debt securities	—	1,012	—	1,012
U.S. agency mortgage-backed securities	—	300	—	300
Non-U.S. agency mortgage-backed securities	—	90	—	90
Other	—	594	3	597
Alternative investments:				
Absolute return	—	851	774	1,625
Private equity	—	—	985	985
Risk parity	—	—	255	255
Total assets	7,901	12,373	2,017	22,291
Liabilities:				
Broker payables	—	405	—	405
Securities lending payable	—	1,434	—	1,434
Other liabilities	27	125	—	152
Total liabilities	27	1,964	—	1,991
Fair value of pension trust assets - net	$ 7,874	$ 10,409	$ 2,017	$ 20,300

At December 31, 2013, Health Plans’ and Hospitals’ share of pension trust assets was 41.9%, or $8.5 billion. The remaining share of pension trust assets is for Medical Groups and a related party associated with Medical Groups.

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

	Quoted prices in active markets for identical assets level 1	Significant other observable inputs level 2	Significant unobservable inputs level 3	Total
Assets:				
Cash and cash equivalents	$ 69	$ 367	$ —	$ 436
Broker receivables	—	689	—	689
Securities lending collateral	—	1,496	—	1,496
U.S. equity securities	3,014	348	—	3,362
Foreign equity securities	3,430	1,461	2	4,893
Global equity funds	—	340	—	340
Debt securities issued by the U.S. government	—	1,433	—	1,433
Debt securities issued by U.S. government corporations and agencies	—	153	—	153
Debt securities issued by U.S. states and political subdivisions of states	—	160	—	160
Foreign government debt securities	—	351	1	352
U.S. corporate debt securities	—	2,635	—	2,635
Non-U.S. corporate debt securities	—	719	1	720
U.S. agency mortgage-backed securities	—	762	—	762
Non-U.S. agency mortgage-backed securities	—	135	—	135
Other	1	700	—	701
Alternative investments:				
Absolute return	—	658	716	1,374
Private equity	—	—	624	624
Total assets	6,514	12,407	1,344	20,265
Liabilities:				
Broker payables	—	951	—	951
Securities lending payable	—	1,496	—	1,496
Other liabilities	33	329	—	362
Total liabilities	33	2,776	—	2,809
Fair value of pension trust assets - net	$ 6,481	$ 9,631	$ 1,344	$ 17,456

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

For the year ended December 31, 2013, the reconciliation of assets with fair value measurements using significant unobservable inputs (level 3) was as follows (in millions):

	Equity securities	Debt securities	Alternative investments	Total
Beginning balance	$ 2	$ 2	$ 1,340	$ 1,344
Transfers into level 3	—	—	—	—
Changes related to actual return on plan assets	(1)	—	138	137
Purchases, sales, and settlements - net	(1)	1	536	536
Ending balance	$ —	$ 3	$ 2,014	$ 2,017
Total year-to-date net gains related to assets held at December 31, 2013	$ —	$ —	$ 138	$ 138

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

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

During the years ended December 31, 2013 and 2012, there were no significant transfers of assets with inputs with quoted prices in active markets for identical assets (level 1) and assets with inputs with significant other observable inputs (level 2).

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

	2013 and 2012 Target Range	2013 ELTRA	2012 ELTRA
Cash and cash equivalents	0%-3%	3.00%	3.00%
Equity securities	45%-55%	8.90%	9.35%
Debt securities	30%-45%	4.55%	5.75%
Alternative investments	10%-20%	8.20%	8.00%
Total	100%	7.50%	7.75%

Alternative investments, which include absolute return, risk parity, and private equity, held in the pension trust are reported at net asset value as a practical expedient for fair value. Absolute return investments use advanced investment strategies, including derivatives, to generate positive long-term risk adjusted returns. Private equity investments consist of funds that make direct investments in private companies. Risk parity funds use risk as the primary factor to allocate investments among asset classes. At December 31, 2013, the trust had original commitments related to alternative investments of $2.6 billion, of which $911 million was invested, leaving $1.7 billion of remaining commitments. At December 31, 2012, the trust had original commitments related to alternative investments of $1.3 billion, of which $598 million was invested, leaving $730 million of remaining commitments.

Absolute return, risk parity, and private equity investments include redemption restrictions. Absolute return and risk parity investments require 10 to 90 day written notice of intent to withdraw and are often subject to the approval and capital requirements of the fund manager. Absolute return investments of $127 million are subject to a remaining 12 month lock-up period. Private equity agreements do not include provisions for redemption. Distributions will be received as the underlying investments of the funds are liquidated, which is expected over the next 11 years.

(b) Defined Contribution Plans

Health Plans and Hospitals have defined contribution plans for eligible employees. Employer contributions and costs are typically based on a percentage of covered employees' eligible compensation. During 2013 and 2012, there were no required employee contributions. For the years ended December 31, 2013 and 2012, plan expense, primarily employer contributions, was $238 million and $220 million, respectively.

(c) Multi-Employer Plans

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

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

Health Plans' and Hospitals' participation in these plans for the annual period ended December 31, 2013 is outlined in the table below. The "EIN/PN" column provides the Employee Identification Number (EIN) and the three-digit plan number (PN), if applicable. Unless otherwise noted, the most recent Pension Protection Act (PPA) zone status available in 2013 and 2012 is for the plan's year-end in 2012 and 2011, respectively. The zone status is based on information that Health Plans and Hospitals obtained from publicly available information provided by the United States Department of Labor. Among other factors, plans in the red zone are generally less than 65% funded, plans in the yellow zone are between 65% and 80% funded, and plans in the green zone are at least 80% funded. The "FIP/RP Status Pending/Implemented" column indicates plans for which a financial improvement plan (FIP) or a rehabilitation plan (RP) is either pending or has been implemented. The "Health Plans' and Hospitals' Contributions to Plan Exceeded More Than 5% of Total Contributions" columns represent those plans where Health Plans and Hospitals were listed in the plans' Forms 5500 as providing more than 5 percent of the total contributions for the plan years listed. The last column lists the expiration dates of the collective bargaining agreements to which the plans are subject. There have been no significant changes that affect the comparability of 2013 and 2012 employer expense.

Pension Fund	EIN-PN	Pension Protection Act Zone Status		FIP/RP Status Pending / Implemented	(in millions) Health Plans' and Hospitals' Contributions December 31,		Surcharge Imposed	Health Plans' and Hospitals' Contributions to Plan Exceeded More Than 5% of Total Contributions [1]		Expiration Date of Collective Bargaining Agreement
		2013	2012		2013	2012		2012	2011	
IUOE Stationary Engineers Local 39 Pension Fund	946118939 -001	Green	Green	N/A	$ 9	$ 9	No	Yes	Yes	9/17/2015
Southern California United Food and Commercial Workers Unions and Drug Employers Pension Fund	516029925 -001	Red	Red	Implemented	4	3	Yes	Yes	Yes	2/1/2017
Oregon Retail Employees Pension Trust[2]	936074377 -001	Red	Red	Implemented	3	3	Yes	Yes	Yes	9/30/2015- 10/31/2015
Carpenters Pension Trust Fund for Northern California	946050970	Red	Red	Implemented	5	5	No	No	No	6/30/2015
Other	Various	Green	Green		13	14		No	No	5/2014- 12/2016
Other	Various	Yellow	Yellow		2	2		No	No	6/2014- 6/2015
Total Expense					$ 36	$ 36				

(1) Forms 5500 information was available for all plan years ended in 2012. The majority of plans have a plan year end of December 31.

(2) Includes UFCW Local 555 Pharmacy Techs and Radiologists expiring September 30, 2015 and October 31, 2015, respectively.

(13) Postretirement Benefits Other than Pensions

(a) Defined Benefit Plan

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

In September 2013, Health Plans and Hospitals modified its postretirement health care and life insurance benefit plans for substantially all non-union represented employees. Health Plans and Hospitals will provide premium subsidies and health reimbursement accounts to affected future retirees to help pay for retiree medical costs. This modification has been accounted for as a negative plan amendment and resulted in a reduction in liability for postretirement benefits other than pension of $1.2 billion. On September 30, 2013, Health Plans' and Hospitals' postretirement health care and life insurance liability was remeasured as a result of this modification, and actuarial assumptions were updated, leading to different assumptions for discount rate and health care trend rates for the nine months ended September 30, 2013 versus the three months ended December 31, 2013.

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

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

	2013	2012
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 7,305	$ 7,101
Service cost	276	345
Interest cost	308	340
Plan amendments	(1,206)	(1,945)
Benefits paid or provided	(91)	(85)
Net actuarial loss (gain)	(1,109)	1,549
Benefit obligation at end of year	$ 5,483	$ 7,305
Change in plan assets:		
Fair value of plan assets at beginning of year	$ —	$ —
Contributions	91	85
Benefits paid or provided	(91)	(85)
Fair value of plan assets at end of year	$ —	$ —
Funded status	$ (5,483)	$ (7,305)
Amounts recognized in the balance sheet consist of:		
Noncurrent assets	$ —	$ —
Current liabilities	(122)	(99)
Pension and other retirement liabilities	(5,361)	(7,206)
	$ (5,483)	$ (7,305)
Amounts recognized in net worth:		
Net actuarial loss	$ 2,815	$ 4,123
Prior service credit	(2,763)	(1,807)
	$ 52	$ 2,316

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

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

	2013	2012
Service cost	$ 276	$ 345
Interest cost	308	340
Amortization of prior service credit	(250)	(113)
Amortization of net actuarial loss	199	175
Amortization of transition obligation	—	3
Postretirement benefits expense	533	750
Other changes in plan assets and benefit obligations recognized in net worth:		
Amortization of transition obligation	—	(3)
Reduction in transition obligation due to plan change	—	(3)
Prior service credit	(1,206)	(1,942)
Amortization of prior service credit	250	113
Net actuarial loss (gain)	(1,109)	1,549
Amortization of net actuarial loss	(199)	(175)
Total recognized in net worth	(2,264)	(461)
Total recognized in net periodic benefit cost and net worth	$ (1,731)	$ 289

During 2014, $152 million and $(353) million in estimated net actuarial loss and prior service credit, respectively, will be amortized from net worth into postretirement benefits expense.

During 2013 and 2012, the employer contributions and benefits paid or provided were $91 million and $85 million, respectively. During 2013 and 2012, there were no participant contributions from active employees.

Actuarial assumptions used were as follows:

	2013	2012
Weighted average discount rate for calculating postretirement benefits expense from January 1 to June 30	4.60%	5.25%
Weighted average discount rate for calculating postretirement benefits expense from July 1 to September 30	4.60%	4.90%
Weighted average discount rate for calculating postretirement benefits expense from September 30 to December 31	5.30%	4.90%
Weighted average discount rate for calculating December 31 accumulated postretirement benefit obligation	5.25%	4.60%

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

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

The following were the assumed health care cost trend rates used to determine the December 31, 2012 benefit obligation and postretirement benefits expense for the six months ended December 31, 2012 and nine months ended September 30, 2013:

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

The following were the assumed health care cost trend rates used to determine the December 31, 2013 benefit obligation and postretirement benefits expense for the three months ended December 31, 2013:

	Basic medical Pre-65/Post-65	Prescription drug Pre-65/Post-65	Medicare Part D	Dental	Medicare Part A&B	Medicare Part C	Supplemental medical Pre-65/Post-65
Initial trend rate - 2013	7.00% / 6.00%	6.00% / 6.00%	-10.00%	4.50%	5.50%	-5.00%	7.00% / 6.00%
Ultimate trend rate	4.50% / 4.50%	4.50% / 4.50%	4.50%	4.50%	4.50%	4.50%	4.50% / 4.50%
First year at ultimate trend rate	2026 / 2022	2025 / 2025	2025	2013	2020	2018	2026 / 2022

A 1% increase in the health care medical trend rate would increase the benefit obligation by $736 million and the service cost plus interest by $86 million. A decrease of 1% in the health care medical trend rate would decrease the benefit obligation by $597 million and the service cost plus interest by $68 million.

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

2014	$	122
2015		146
2016		171
2017		199
2018		227
2019 - 2023		1,577

(b) Multi-Employer Plans

Health Plans and Hospitals participate in multi-employer union-administered retiree medical health and welfare plans that provide benefits to some union employees. Benefits for retirees under these plans are negotiated as part of the collective bargaining process. For the years ended December 31, 2013 and 2012, Health Plans' and Hospitals' employer expense for both current and retiree benefits was $68 million and $64 million, respectively.

(14) Physicians' Retirement Plan

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

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

	2013	2012
Physicians' retirement plan liability at January 1	$ 4,724	$ 3,943
Service cost	269	207
Interest cost	210	199
Net actuarial loss (gain)	(552)	497
Benefits paid	(129)	(122)
Physicians' retirement plan liability at December 31	$ 4,522	$ 4,724
Accumulated benefit obligation at end of year	$ 3,419	$ 3,626
Change in plan assets:		
Fair value of plan assets at the beginning of year	$ —	$ —
Actual return on plan assets	—	—
Company contributions	129	122
Benefits paid	(129)	(122)
Fair value of plan assets at end of year	$ —	$ —
Funded status	$ (4,522)	$ (4,724)
Amounts recognized in the balance sheet consist of:		
Noncurrent assets	$ —	$ —
Current liabilities	(143)	(134)
Noncurrent liability	(4,379)	(4,590)
	$ (4,522)	$ (4,724)
Amounts recognized in net worth:		
Net actuarial loss	$ 859	$ 1,477

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

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

For purposes of the physicians' retirement plan expense, the expected return on assets is the portion of investment income that represents the expected return on the investments designated for the physicians' retirement plan. This amount is recorded as a reduction in the expense for the physicians' retirement plan and is excluded from investment income - net, as described below and in the *Summary of Significant Accounting Policies - Investments* note.

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

	2013	2012
Service cost	$ 269	$ 207
Interest cost	210	199
Amortization of net actuarial loss	66	40
Total benefit expense	545	446
Expected return on assets - investment income included in operating expenses	(355)	(302)
Net benefit expense	190	144
Other changes in projected benefit obligations recognized in net worth		
Net actuarial loss (gain)	(552)	497
Amortization of net actuarial loss	(66)	(40)
Total recognized in net worth	(618)	457
Total recognized in net periodic benefit cost and net worth	$ (428)	$ 601

During 2014, $25 million in estimated net actuarial loss will be amortized from net worth into net benefit expense.

Actuarial assumptions used were as follows:

	2013	2012
Weighted average discount rate at January 1 for calculating benefit expense	4.45%	5.10%
Weighted average discount rate for calculating December 31 benefit obligation	5.25%	4.45%
Weighted average salary scale for calculating pension expense and December 31 benefit obligation	4.90%	4.90%
Expected long-term rate of return on designated investments for calculating benefit expense	7.50%	7.75%

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

2014	$	143
2015		159
2016		177
2017		195
2018		211
2019 - 2023		1,297

(15) Commitments and Contingencies

(a) Leases

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

At December 31, 2013, minimum commitments under noncancelable leases extending beyond one year were as follows (in millions):

2014	$	297
2015		278
2016		216
2017		150
2018		109
Thereafter		389
Total	$	1,439

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

For both the years ended December 31, 2013 and 2012, total lease expense for all leases was $432 million.

(b) Purchase Commitments

Health Plans and Hospitals have entered into long-term agreements that require certain minimum purchases of goods and services. These commitments are at levels that are consistent with normal business requirements. Health Plans has committed to directing most of its purchasing volume for selected products through an outside agency and has committed to at least $1 billion in purchasing per annum through March 31, 2017. During 2013 and 2012, Health Plans' total purchases through this outside agency exceeded $1 billion. Should the $1 billion level not be achieved, financial penalties would be assessed at an established percentage of any shortfalls. In addition, should the purchasing volume for certain product categories be redirected from the outside agency, a financial

penalty would be assessed at an established percentage. In management's judgment, there is a remote probability of material financial penalties under this contract.

At December 31, 2013, minimum purchase commitments, excluding contracts that count towards the $1 billion per annum commitment noted above, extending beyond one year were as follows (in millions):

2014	$	136
2015		117
2016		93
2017		59
2018		15
Thereafter		23
Total	$	443

During 2013 and 2012, Health Plans' and Hospitals' total purchases under these contracts with minimum purchase commitments were $271 million and $385 million, respectively.

(c) Surety Instruments and Standby Letters of Credit

In the normal course of business, Health Plans and Hospitals contract to perform certain financial obligations that require a guarantee from a third party. This guarantee creates a contingent liability to the entity that provides that guarantee. At December 31, 2013 and 2012, Health Plans and Hospitals had entered into surety instruments and standby letters of credit that totaled $89 million and $88 million, respectively.

Health Plan, Inc. and Hospitals also guarantee payment of workers' compensation liabilities of certain Medical Groups under self-insurance programs. The majority of such liabilities are recorded as other long-term liabilities of Health Plan, Inc., as payment is provided for under the applicable medical service agreements. In addition to amounts accrued, at December 31, 2013 and 2012, pursuant to such guarantees, Health Plan, Inc. and Hospitals are contingently liable for approximately $170 million and $160 million, respectively, of certain Medical Groups' self-insured workers' compensation liabilities.

(d) Hospital Seismic Safety Act

In 1994, the California legislature enacted Senate Bill 1953, which requires that California hospitals evaluate and upgrade acute care facilities to meet the requirements of the Hospital Seismic Safety Act of 1983. Hospitals has applied for and has been granted certain extensions to the seismic compliance deadlines under Senate Bills 449, 1661, or 90 through January 1, 2015. Management believes that it is probable all planned replacement facilities will be timely completed with the existing extensions by January 1, 2015, as applicable. At this time, management believes the possibility of a material impact on the operations of Health Plans and Hospitals from failure to comply with California hospital seismic safety law is remote.

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

(e) Regulatory

Health Plans are required to periodically file financial statements with regulatory agencies in accordance with statutory accounting and reporting practices. Health Plans must comply with the various states' minimum regulatory net worth requirements generally under the regulation of the California Department of Managed Health Care and various state departments of insurance. Such requirements are generally based on tangible net equity or risk-based capital, and for California are calculated on the basis of combined net worth of Health Plans and Hospitals. At December 31, 2013 and 2012, the regulatory net worth, so defined, exceeded the aggregate regulatory minimum requirements by approximately $22 billion and $13 billion, respectively.

Health Plans' regulated subsidiaries maintain investments in various states where they are licensed. At December 31, 2013 and 2012, $4 million and $5 million, respectively, in securities were held to satisfy various state regulatory requirements.

Health Plans and Hospitals are subject to numerous and complex laws and regulations of federal, state, and local governments, and accreditation requirements. Compliance with such laws, regulations, and accreditation requirements can be subject to retrospective review and interpretation, as well as regulatory actions. These laws and regulations include, but are not necessarily limited to, requirements of tax exemption, government reimbursement, government program participation, privacy and security, false claims, anti-kickback, accreditation, healthcare reform, controlled substances, facilities, and professional licensure. In recent years, government activity has increased with respect to compliance and enforcement actions.

In the ordinary course of our business operations, we are subject to periodic reviews, investigations, and audits by various federal, state, and local regulatory agencies and accreditation agencies, including, without limitation, Centers for Medicare and Medicaid Services, Department of Managed Health Care, Office of Personnel Management, Occupational Safety and Health Administration, Internal Revenue Service, National Committee for Quality Assurance, and state departments of insurance.

Health Plans' and Hospitals' compliance with the wide variety of rules and regulations and accreditation requirements applicable to our business may result in certain remediation activities and regulatory fines and penalties, which could be substantial. Where appropriate, reserves have been established for such sanctions. While management believes these reserves are adequate, the outcome of legal and regulatory matters is inherently uncertain, and it is possible that one or more of the legal

or regulatory matters currently pending or threatened could have a material adverse effect on our combined financial position or results of operations.

(f) ***Litigation***

Health Plans and Hospitals are involved in lawsuits and various governmental investigations, audits, reviews, and administrative proceedings arising, for the most part, in the ordinary course of business operations. Lawsuits have been brought under a wide range of laws and include, but are not limited to, business disputes, employment and retaliation claims, claims alleging professional liability, improper disclosure of personal information, labor disputes, administrative regulations, the False Claims Act, information privacy and HIPAA laws, mental health parity laws, and consumer protection laws. In addition, Health Plan, Inc. has been served with a “whistleblower” lawsuit regarding the accuracy of its Medicare Advantage bid submissions for the contract years 2008 and 2009. Management does not believe it is probable that this lawsuit will result in a material liability for Health Plan, Inc. In addition, Health Plans indemnify the Medical Groups against various claims, including professional liability claims.

Health Plans and Hospitals record reserves for legal proceedings and regulatory matters where available information indicates that at the date of the combined financial statements a loss is probable and the amount can be reasonably estimated. While such reserves reflect management’s best estimate of the probable loss for such matters, Health Plans and Hospitals’ recorded amounts may differ materially from the actual amount of any such losses.

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