

**GUNDERSEN HEALTH SYSTEM - OBLIGATED**  
**STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (DETAIL) Page 1 of 2**  
September 30, 2015

Line	(000's omitted)										
	Col A	Col B	Col C	Col D	Col E	Col F	Col G	Col H	Col I	Col J	Col K
	ACTUAL 9/30/15	PRIOR 3MO AVG	VARIANCE \$	MONTH %	ACTUAL 9/30/14	VARIANCE \$	VARIANCE %	ACTUAL 9/30/15	ACTUAL 9/30/14	VARIANCE \$	VARIANCE %
<b>REVENUE</b>											
1	\$ 61,700	\$ 60,423	\$ 1,277	2.1%	\$ 57,445	\$ 4,255	7.4%	\$ 537,539	\$ 509,225	\$ 28,314	5.6%
2	20,349	21,275	(925)	-4.3%	20,131	218	1.1%	186,404	181,474	4,930	2.7%
3	-	11	(11)	-100.0%	63	(63)	-100.0%	(92)	131	(223)	-170.4%
4	2,205	2,948	(743)	-25.2%	3,315	(1,110)	-33.5%	24,037	22,397	1,640	7.3%
5	(32)	(123)	91	-73.5%	(697)	665	-95.4%	(2,037)	(2,004)	(33)	1.7%
6	\$ 84,222	\$ 84,534	\$ (312)	-0.4%	\$ 80,257	\$ 3,965	4.9%	\$ 745,851	\$ 711,222	\$ 34,629	4.9%
<b>EXPENSES</b>											
7	\$ 38,142	\$ 38,128	\$ (14)	0.0%	\$ 36,986	\$ (1,157)	-3.1%	\$ 340,433	\$ 334,903	\$ (5,530)	-1.7%
8	8,231	8,513	282	3.3%	8,071	(159)	-2.0%	81,123	78,137	(2,986)	-3.8%
9	\$ 46,373	\$ 46,641	\$ 268	0.6%	\$ 45,057	\$ (1,316)	-2.9%	\$ 421,556	\$ 413,040	\$ (8,516)	-2.1%
10	\$ 10,921	\$ 10,460	\$ (461)	-4.4%	\$ 10,306	\$ (615)	-6.0%	\$ 92,946	\$ 88,304	\$ (4,642)	-5.3%
11	8,085	7,010	(1,074)	-15.3%	7,179	(906)	-12.6%	64,501	59,701	(4,800)	-8.0%
12	4,460	4,466	6	0.1%	4,730	270	5.7%	40,564	40,148	(416)	-1.0%
13	2,227	2,243	16	0.7%	2,013	(214)	-10.6%	19,072	19,512	440	2.3%
14	2,806	3,176	369	11.6%	2,602	(204)	-7.9%	26,692	21,187	(5,505)	-26.0%
15	1,454	1,477	23	1.6%	1,499	45	3.0%	13,170	12,877	(293)	-2.3%
16	3,397	4,078	681	16.7%	4,317	920	21.3%	36,838	36,215	(623)	-1.7%
17	\$ 33,350	\$ 32,910	\$ (440)	-1.3%	\$ 32,646	\$ (704)	-2.2%	\$ 293,783	\$ 277,944	\$ (15,839)	-5.7%
18	\$ 79,723	\$ 79,551	\$ (172)	-0.2%	\$ 77,703	\$ (2,020)	-2.6%	\$ 715,339	\$ 690,984	\$ (24,355)	-3.5%
19	\$ 4,499	\$ 4,983	\$ (484)	-9.7%	\$ 2,554	\$ 1,945	76.1%	\$ 30,512	\$ 20,238	\$ 10,274	50.8%

**GUNDERSEN HEALTH SYSTEM - OBLIGATED**  
**STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (DETAIL) Page 2 of 2**  
 September 30, 2015

	Col A	Col B	Col C	Col D	Col E	Col F	Col G	Col H	Col I	Col J	Col K
	ACTUAL 9/30/15	PRIOR 3MO AVG	VARIANCE \$	MONTH %	ACTUAL 9/30/14	VARIANCE \$	ACTUAL 9/30/14	ACTUAL 9/30/15	YEAR TO DATE 9/30/14	YEAR TO DATE 9/30/14	VARIANCE \$
INCOME FROM OPERATIONS	\$ 4,499	\$ 4,983	\$ (484)	-9.7%	\$ 2,554	\$ 1,945	\$ 20,238	\$ 30,512	\$ 20,238	\$ 10,274	50.8%
NONOPERATING REVENUE/EXPENSE	\$ (9,689)	\$ (5,583)	\$ (4,106)	73.6%	\$ (6,275)	\$ (3,414)	\$ 11,984	\$ (12,675)	\$ 11,984	\$ (24,659)	-205.8%
Investment Income	\$ (9,689)	\$ (5,583)	\$ (4,106)	73.6%	\$ (6,275)	\$ (3,414)	\$ 11,984	\$ (12,675)	\$ 11,984	\$ (24,659)	-205.8%
NON-OPERATING REVENUE	\$ (5,190)	\$ (600)	\$ (4,590)	765.4%	\$ (3,721)	\$ (1,469)	\$ 32,222	\$ 17,837	\$ 32,222	\$ (14,385)	-44.6%
REVENUE IN EXCESS OF EXPENSES	\$ (6)	\$ (6)	\$ -	0.0%	\$ (6)	\$ -	\$ (58)	\$ (58)	\$ (58)	\$ -	0.0%
OTHER CHANGES IN UNRESTRICTED NET ASSETS	32	123	(91)	-74.0%	696	(664)	2,004	2,037	2,004	33	1.6%
Swap Contracts											
Equity Transfers to Affiliates											
Restrictions Released for PP & E											
Other Transfers - Unrestricted											
TOTAL CHANGES IN UNRESTRICTED NET ASSETS	\$ (5,164)	\$ (483)	\$ (4,681)	969.9%	\$ (3,031)	\$ (2,133)	\$ 34,168	\$ 19,781	\$ 34,168	\$ (14,387)	-42.1%
TEMPORARILY RESTRICTED NET ASSETS:											
Contributions	\$ 330	\$ 240	\$ 90	37.4%	\$ 414	\$ (84)	\$ 2,962	\$ 2,241	\$ 2,962	\$ (721)	-24.3%
Realized Gain (Loss) on Investments	33	47	(14)	-29.8%	83	(50)	660	875	660	215	32.6%
Unrealized Gain (Loss)	(314)	(235)	(79)	33.7%	(279)	(35)	(171)	(1,260)	(171)	(1,089)	638.3%
Campus Renewal Contributions											
Net assets released from Temp Restricted	(151)	(352)	201	-57.2%	(990)	839	(4,145)	(3,807)	(4,145)	338	-8.2%
Donor Restricted Transfers											
Other Revenue/Expense											
TOTAL CHANGES IN TEMP RESTRICTED NET ASSETS	\$ (102)	\$ (300)	\$ 198	-65.9%	\$ (772)	\$ 670	\$ (694)	\$ (1,951)	\$ (694)	\$ (1,257)	181.1%
PERMANENTLY RESTRICTED NET ASSETS											
Contributions	\$ 40	\$ 10	\$ 30	300.8%	\$ 1	\$ 39	\$ 49	\$ 148	\$ 49	\$ 99	204.5%
Realized Gain (Loss) on Investments	(44)	(5)	(39)	781.4%	(28)	(16)	233	(151)	233	(384)	-164.7%
Unrealized Gain (Loss)	(169)	(140)	(29)	20.7%	(193)	24	(355)	(422)	(355)	(67)	19.0%
Transfers from(to) Temporarily Restricted											
Other Revenue/Expense											
TOTAL CHANGES IN PERM RESTRICTED NET ASSETS	\$ (173)	\$ (135)	\$ (38)	28.0%	\$ (220)	\$ 47	\$ (73)	\$ (425)	\$ (73)	\$ (352)	481.3%
NET ASSETS, JANUARY 1											
ENDING NET ASSETS	\$ 848,417	\$ 790,519	\$ 57,898		\$ 865,822	\$ 823,920	\$ 41,902				7.3%
	\$ 865,822	\$ 823,920	\$ 41,902								5.1%

(000's omitted)

**GUNDERSEN HEALTH SYSTEM, INC.**  
**STATEMENT OF FINANCIAL POSITION**  
September 30, 2015

	Col A	Col B	Col C	Col D
	CURRENT MONTH	December 31, 2014	* VARIANCE	%
	\$	\$	\$	%
<b>ASSETS</b>				
Current Assets				
Cash & Cash Equivalents	134,974	145,925	(10,951)	-7.5%
Investments	518,134	492,696	25,438	5.2%
Current Portion of Investments Whose Use is Limited	9,089	9,089	-	0.0%
Patient accounts receivable, net	129,691	120,758	8,933	7.4%
Current portion of notes receivable from affiliates	400	411	(11)	-2.7%
Other Current Assets	45,199	44,666	533	1.2%
<b>Total current assets</b>	<b>\$ 837,487</b>	<b>\$ 813,545</b>	<b>\$ 23,942</b>	<b>2.9%</b>
Investments Whose Use is Limited				
Notes Receivable from Affiliates, net of current portion	37,929	37,252	677	1.8%
Property and Equipment, net	7,939	8,111	(171)	-2.1%
Other Noncurrent Assets	547,075	553,811	(6,737)	-1.2%
	20,561	23,870	(3,308)	-13.9%
<b>Total assets</b>	<b>\$ 1,450,991</b>	<b>\$ 1,436,589</b>	<b>\$ 14,402</b>	<b>1.0%</b>
<b>LIABILITIES &amp; NET ASSETS</b>				
Current Liabilities				
Accounts Payable	12,947	24,495	(11,548)	-47.1%
Accrued Liabilities	116,963	113,843	3,120	2.7%
Current maturities of long-term debt	6,983	7,215	(233)	-3.2%
Other	4,664	4,078	586	14.4%
<b>Total current liabilities</b>	<b>\$ 141,557</b>	<b>\$ 149,631</b>	<b>\$ (8,075)</b>	<b>-5.4%</b>
Long-Term Debt, net of current maturities				
Obligation Under Swap Contracts	389,429	389,361	69	0.0%
Other Noncurrent Liabilities	36,252	34,262	1,990	5.8%
	17,931	14,918	3,013	20.2%
<b>Total liabilities</b>	<b>\$ 585,169</b>	<b>\$ 588,172</b>	<b>\$ (3,003)</b>	<b>-0.5%</b>
Net Assets				
Unrestricted	839,191	819,411	19,780	2.4%
Temporarily Restricted	10,543	12,493	(1,950)	-15.6%
Permanently Restricted	16,088	16,513	(425)	-2.6%
<b>Total net assets</b>	<b>\$ 865,822</b>	<b>\$ 848,417</b>	<b>\$ 17,405</b>	<b>2.1%</b>
<b>Total liabilities and net assets</b>	<b>\$ 1,450,991</b>	<b>\$ 1,436,589</b>	<b>\$ 14,402</b>	<b>1.0%</b>

(000's omitted)

GUNDERSEN HEALTH SYSTEM - OBLIGATED  
TRENDED INCOME STATEMENT  
2015

	Col A	Col B	Col C	Col D	Col E	Col F	Col G	Col H	Col I	Col J	Col K	Col L	Col M
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	TOTAL
	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL	ACTUAL
REVENUE													
Net Patient Revenue	\$ 58,318	\$ 55,685	\$ 62,055	\$ 61,086	\$ 57,426	\$ 60,157	\$ 60,021	\$ 61,091	\$ 61,700	\$ 61,700	\$ 61,700	\$ 61,700	\$ 537,539
Net Cap and Premium Revenue	20,856	20,504	20,613	20,943	19,315	20,397	22,685	20,741	20,349	20,349	20,349	20,349	186,403
EHR Incentive Payments	-	-	(126)	-	-	34	-	-	-	-	-	-	(92)
Other Operating Revenue	2,540	2,711	2,856	2,766	2,114	2,969	3,115	2,760	2,205	2,205	2,205	2,205	24,038
Net Assets Released - PPE	(543)	(426)	(191)	(454)	(21)	(38)	(29)	(302)	(32)	(32)	(32)	(32)	(2,037)
<b>TOTAL OPERATING REVENUE &amp; GAINS</b>	<b>\$ 81,171</b>	<b>\$ 78,474</b>	<b>\$ 85,207</b>	<b>\$ 84,341</b>	<b>\$ 78,834</b>	<b>\$ 83,519</b>	<b>\$ 85,792</b>	<b>\$ 84,290</b>	<b>\$ 84,222</b>	<b>\$ 84,222</b>	<b>\$ 84,222</b>	<b>\$ 84,222</b>	<b>\$ 745,850</b>
EXPENSES													
Salaries and Wages	\$ 27,632	\$ 25,834	\$ 24,226	\$ 24,634	\$ 23,834	\$ 22,226	\$ 23,126	\$ 21,726	\$ 21,626	\$ 21,626	\$ 21,626	\$ 21,626	\$ 23,834
Benefits	\$ 37,333	\$ 36,188	\$ 38,133	\$ 38,198	\$ 38,055	\$ 37,597	\$ 38,364	\$ 38,423	\$ 38,142	\$ 38,142	\$ 38,142	\$ 38,142	\$ 340,433
	10,299	9,346	9,241	9,398	9,068	8,336	8,873	8,330	8,231	8,231	8,231	8,231	81,123
<b>TOTAL SALARIES AND BENEFITS</b>	<b>\$ 47,632</b>	<b>\$ 45,534</b>	<b>\$ 47,374</b>	<b>\$ 47,596</b>	<b>\$ 47,123</b>	<b>\$ 45,933</b>	<b>\$ 47,237</b>	<b>\$ 46,754</b>	<b>\$ 46,373</b>	<b>\$ 46,373</b>	<b>\$ 46,373</b>	<b>\$ 46,373</b>	<b>\$ 421,556</b>
Supplies	\$ 10,134	\$ 9,272	\$ 10,448	\$ 10,506	\$ 10,284	\$ 10,817	\$ 11,034	\$ 9,529	\$ 10,921	\$ 10,921	\$ 10,921	\$ 10,921	\$ 92,946
Purchased Health Services	7,283	7,707	7,576	7,957	4,865	6,720	7,285	7,026	8,085	8,085	8,085	8,085	64,502
Depreciation and Amortization	4,488	4,501	4,592	4,568	4,558	4,543	4,429	4,425	4,460	4,460	4,460	4,460	40,564
Facilities	1,842	2,011	2,423	1,975	1,975	2,407	2,120	2,203	2,227	2,227	2,227	2,227	19,072
Purchased Services	2,347	2,719	2,879	3,199	3,214	2,692	3,536	3,299	2,806	2,806	2,806	2,806	26,692
Interest	1,527	1,417	1,485	1,397	1,459	1,457	1,515	1,459	1,454	1,454	1,454	1,454	13,170
Other Expenses	3,830	4,412	4,495	4,255	4,215	4,086	4,214	3,934	3,397	3,397	3,397	3,397	36,838
<b>TOTAL NONPAYROLL EXPENSES</b>	<b>\$ 31,451</b>	<b>\$ 32,039</b>	<b>\$ 33,898</b>	<b>\$ 33,747</b>	<b>\$ 30,570</b>	<b>\$ 32,722</b>	<b>\$ 34,133</b>	<b>\$ 31,875</b>	<b>\$ 33,350</b>	<b>\$ 33,350</b>	<b>\$ 33,350</b>	<b>\$ 33,350</b>	<b>\$ 293,784</b>
<b>TOTAL EXPENSES</b>	<b>\$ 79,083</b>	<b>\$ 77,573</b>	<b>\$ 81,272</b>	<b>\$ 81,343</b>	<b>\$ 77,693</b>	<b>\$ 78,655</b>	<b>\$ 81,370</b>	<b>\$ 78,628</b>	<b>\$ 79,723</b>	<b>\$ 79,723</b>	<b>\$ 79,723</b>	<b>\$ 79,723</b>	<b>\$ 715,340</b>
<b>INCOME FROM OPERATIONS</b>	<b>\$ 2,088</b>	<b>\$ 901</b>	<b>\$ 3,935</b>	<b>\$ 2,998</b>	<b>\$ 1,141</b>	<b>\$ 4,865</b>	<b>\$ 4,422</b>	<b>\$ 5,662</b>	<b>\$ 4,499</b>	<b>\$ 4,499</b>	<b>\$ 4,499</b>	<b>\$ 4,499</b>	<b>\$ 30,511</b>
Operating Margin	2.6%	1.1%	4.6%	3.6%	1.4%	5.8%	5.2%	6.7%	5.3%	5.3%	5.3%	5.3%	4.1%
Target	2.2%	0.9%	4.4%	3.5%	5.9%	3.8%	2.3%	4.5%	3.1%	6.8%	3.6%	4.2%	3.8%
Prior Year Operating Margin	1.8%	0.7%	2.0%	3.7%	6.7%	3.9%	2.8%	0.4%	3.2%	8.9%	4.0%	12.1%	4.3%

**GUNDERSEN HEALTH SYSTEM- OBLIGATED**  
**FINANCIAL RATIOS AND VOLUMES**  
 September 30, 2015

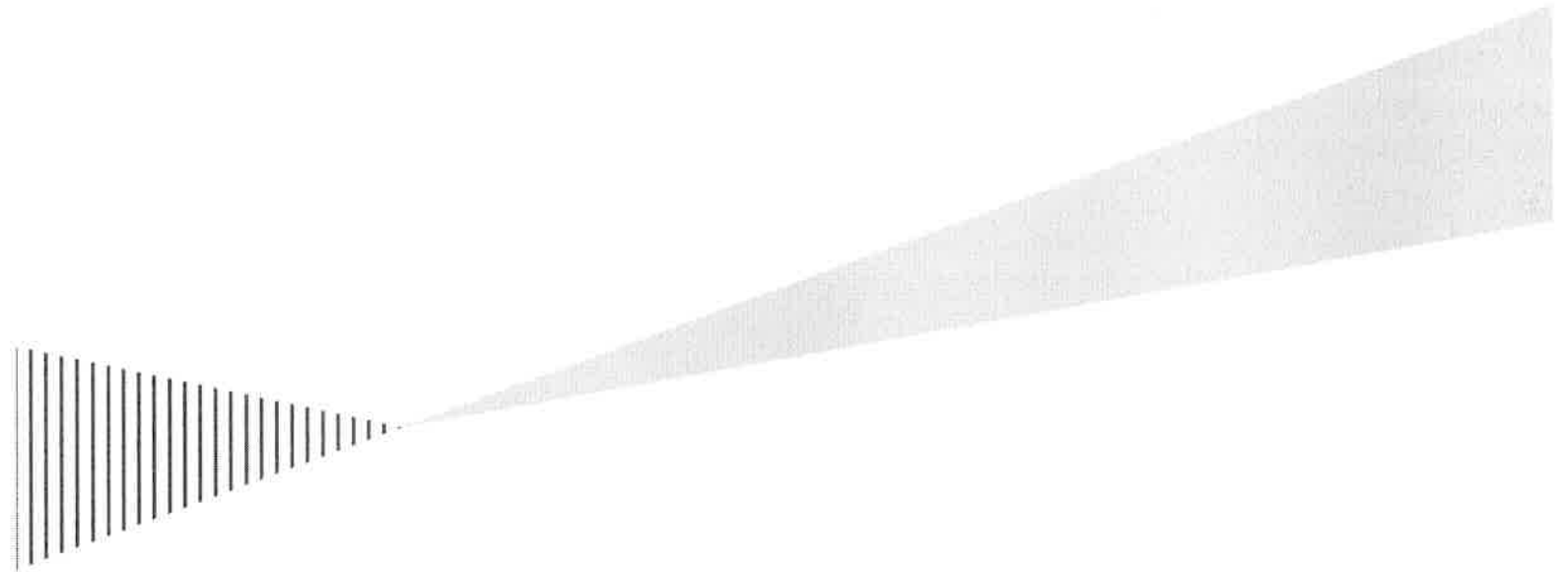
	Col A	Col B	Col C		Col D	Col E	Col F	Col G	Col H		Col I	Col J
	ACTUAL 9/30/15	PRIOR 3MO AVG	MONTHLY VARIANCE		ACTUAL 9/30/14	VARIANCE 9/30/15 TO 9/30/14	ACTUAL 9/30/15	TARGET	YEAR TO DATE VARIANCE		ACTUAL 9/30/14	VARIANCE 9/30/15 TO 9/30/14
			ACTUAL TO 3MO AVG	3MO AVG					ACTUAL TO TARGET	TARGET		
<b>FINANCIAL RATIOS</b>												
Operating Margin %	5.3%	5.9%	-0.6%		3.2%	2.1%	4.1%	3.4%	0.7%		2.8%	1.2%
Compensation Ratio	55.1%	55.2%	0.0%		56.1%	-1.1%	56.5%	56.4%	0.1%		58.1%	-1.6%
EBIDA %	1.0%				3.4%	-2.3%	9.8%	12.0%	-2.3%		11.8%	-1.9%
Days Cash-on-Hand							267	283	(16)		262	5
Days in Accounts Receivable							51	47	4		55	-4
Debt Service Coverage							5.5	4.8	0.7		4.9	0.6
Total Margin	-6.2%	-0.7%	-5.5%		-4.6%	-1.5%	2.4%	4.5%	-2.1%		4.5%	-2.1%
<b>VOLUMES</b>												
Clinic Visits - Medical and Assoc Staff	83,116	83,375	-0.3%		84,812	-2.0%	749,316	752,021	-0.4%		743,843	0.7%
Inpatient Surgical Cases	404	387	4.4%		393	2.8%	3,387	3,265	3.8%		3,167	6.9%
Outpatient Surgical Cases	1,057	1,090	-3.0%		1,032	2.4%	9,620	9,335	3.1%		9,256	3.9%
Patient Days	5,751	5,728	0.4%		5,758	-0.1%	51,647	47,803	8.0%		49,478	4.4%
Discharges	1,313	1,334	-1.6%		1,333	-1.5%	11,861	11,367	4.3%		11,472	3.4%
Admissions	1,290	1,335	-3.4%		1,351	-4.5%	11,796	11,710	0.7%		11,492	2.6%
Observations	232	226	2.7%		263	-11.8%	2,063	2,484	-17.0%		2,078	-0.7%
Combined Admissions & Observations	1,522	1,561	-2.5%		1,614	-5.7%	13,859	14,194	-2.4%		13,570	2.1%
<b>METRICS (per OG AGR)</b>												
Direct Expense	549,629	533,953	(15,675)		525,371	(24,258)	546,104				541,085	(5,019)
Med and Assoc FTE	0.18	0.19	0.01		0.19	0.01	0.19				0.18	(0.00)
Salary and Benefits	319,704	313,057	(6,647)		304,642	(15,062)	321,824				323,437	1,613
Supply Cost	75,292	70,211	(5,081)		69,681	(5,612)	70,957				69,148	(1,809)
Support Staff Work Hours	4,985	4,932	(53)		4,843	(143)	5,046				5,197	151



COMBINED FINANCIAL STATEMENTS

Gundersen Health System Obligated Group  
(Consisting of Gundersen Clinic, Ltd., Gundersen Lutheran Medical Center,  
Inc., Gundersen Lutheran Administrative Services, Inc., and Gundersen  
Lutheran Medical Foundation, Inc., Which Constitute an Obligated Group)  
Years Ended December 31, 2014 and 2013  
With Report of Independent Auditors

Ernst & Young LLP



Building a better  
working world

# Gundersen Health System Obligated Group

## Combined Financial Statements

Years Ended December 31, 2014 and 2013

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## Report of Independent Auditors

The Board of Trustees and the Board of Governors  
Gundersen Health System Obligated Group

We have audited the accompanying combined financial statements of Gundersen Clinic, Ltd.; Gundersen Lutheran Medical Center, Inc.; Gundersen Lutheran Administrative Services, Inc.; and Gundersen Lutheran Medical Foundation, Inc. (collectively, the Obligated Group), which comprise the combined balance sheets as of December 31, 2014 and 2013, and the related combined statements of operations, changes in net assets, 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 financial statements in conformity 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 financial statements that are free of material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the combined financial position of Gundersen Health System Obligated Group at December 31, 2014 and 2013, and the combined results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

*Ernst + Young LLP*

April 23, 2015

## Gundersen Health System Obligated Group

### Combined Balance Sheets (Dollars in Thousands)

	December 31	
	2014	2013
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 145,925	\$ 87,429
Investments	506,728	519,206
Current portion of investments whose use is limited	9,089	15,936
Patient accounts receivable, less allowance for uncollectible accounts of \$27,839 in 2014 and \$26,763 in 2013	120,758	116,214
Current portion of notes receivable from affiliates	411	426
Other current assets	44,666	42,630
Total current assets	827,577	781,841
Investments whose use is limited	22,485	5,745
Notes receivable from affiliates, net of current portion	8,111	11,572
Property and equipment, net	553,811	553,392
Other noncurrent assets	24,605	24,720
Total assets	\$ 1,436,589	\$ 1,377,270
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 24,107	\$ 28,880
Accrued payroll	48,178	46,953
Accrued liabilities	62,801	58,088
Current maturities of long-term debt and capital lease obligations	7,104	8,376
Other current liabilities	6,949	8,922
Total current liabilities	149,139	151,219
Long-term debt and capital lease obligations, net of current maturities	389,853	397,483
Obligation under swap contracts	34,262	23,469
Other noncurrent liabilities	14,918	14,580
Total liabilities	588,172	586,751
Net assets:		
Unrestricted	819,410	760,770
Temporarily restricted	12,494	13,320
Permanently restricted	16,513	16,429
	848,417	790,519
Total liabilities and net assets	\$ 1,436,589	\$ 1,377,270

See accompanying notes.

## Gundersen Health System Obligated Group

### Combined Statements of Operations

*(Dollars in Thousands)*

	Year Ended December 31	
	2014	2013
Operating revenue:		
Net patient revenue before provision for uncollectible accounts	\$ 696,019	\$ 632,841
Provision for uncollectible accounts <i>(Note 4)</i>	(3,311)	(23,295)
Net patient revenue	692,708	609,546
Capitation revenue	244,315	270,710
Other revenue	32,024	31,992
	969,047	912,248
Operating expenses:		
Salaries, wages, and benefits	550,639	517,167
Supplies	124,001	111,440
Purchased health services	78,756	92,684
Depreciation and amortization	53,878	44,437
Facilities	26,043	24,598
Purchased services	30,180	26,828
Interest	17,384	9,841
Other operating expenses	46,144	44,756
	927,025	871,751
Operating income	42,022	40,497
Nonoperating gains (losses):		
Investment return	27,522	49,932
Gain on sale of long-term investment	-	126
Change in fair value of swap contracts	(10,793)	18,021
Other nonoperating losses, net	(423)	(769)
	16,306	67,310
Revenue in excess of expenses	58,328	107,807
Net assets released from restrictions to purchase property and equipment	2,978	9,875
Transfers to affiliates	(2,588)	(13,539)
Amortization of accumulated gains related to swap contracts at the time of de-designation	(78)	(78)
Increase in unrestricted net assets	\$ 58,640	\$ 104,065

*See accompanying notes.*

## Gundersen Health System Obligated Group

### Combined Statements of Changes in Net Assets (Dollars in Thousands)

	<b>Year Ended December 31</b>	
	<b>2014</b>	<b>2013</b>
Unrestricted net assets:		
Revenue in excess of expenses	\$ 58,328	\$ 107,807
Net assets released from restrictions to purchase property and equipment	2,978	9,875
Amortization related to swap contracts prior to de-designation	(78)	(78)
Transfers to affiliates	(2,588)	(13,539)
Increase in unrestricted net assets	<u>58,640</u>	<u>104,065</u>
Temporarily restricted net assets:		
Contributions	4,497	8,250
Investment income	938	664
Net change in unrealized (losses) gains on investments	(4)	1,780
Net assets released from restriction	(6,257)	(13,430)
Decrease in temporarily restricted net assets	<u>(826)</u>	<u>(2,736)</u>
Permanently restricted net assets:		
Contributions	190	260
Investment gains	357	135
Net change in unrealized (losses) gains on investments	(463)	725
Increase in permanently restricted net assets	<u>84</u>	<u>1,120</u>
Increase in net assets	57,898	102,449
Net assets at beginning of year	790,519	688,070
Net assets at end of year	<u>\$ 848,417</u>	<u>\$ 790,519</u>

*See accompanying notes.*

## Gundersen Health System Obligated Group

### Combined Statements of Cash Flows (Dollars in Thousands)

	Year Ended December 31	
	2014	2013
<b>Operating activities</b>		
Increase in net assets	\$ 57,898	\$ 102,449
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	53,878	44,437
Provision for uncollectible accounts	3,311	23,295
Change in fair value of swap contracts	10,793	(18,021)
Realized and change in unrealized gains (losses) on investments, net	(14,106)	(39,843)
Gain on sale of long-term investment	—	(126)
Transfers to affiliates	2,588	13,539
Restricted contributions	(4,687)	(8,509)
Changes in operating assets and liabilities:		
Patient accounts receivable	(7,855)	(20,695)
Other current assets	(2,036)	(8,209)
Accounts payable, accrued, and other current liabilities	(808)	(5,488)
Other noncurrent assets and liabilities	83	291
Net cash provided by operating activities	99,059	83,120
<b>Investing activities</b>		
Purchases of investments, net	16,690	71,908
Purchases of property and equipment, net	(54,285)	(135,728)
Transfers to affiliates	(2,588)	(13,539)
Net proceeds from notes receivable from affiliates	3,476	(1,144)
Net cash used in investing activities	(36,707)	(78,503)
<b>Financing activities</b>		
Principal payments on long-term debt	(8,543)	(8,213)
Restricted contributions	4,687	8,509
Net cash (used in) provided by financing activities	(3,856)	296
Net increase in cash and cash equivalents	58,496	4,913
Cash and cash equivalents at beginning of year	87,429	82,516
Cash and cash equivalents at end of year	\$ 145,925	\$ 87,429
<b>Supplemental disclosures of cash flow information</b>		
Accrued amounts for the acquisition of property and equipment	\$ 5,691	\$ 12,638
Interest paid, net of capitalized interest of \$725 in 2014 and \$8,308 in 2013	\$ 16,807	\$ 9,234

*See accompanying notes.*

# Gundersen Health System Obligated Group

## Notes to Combined Financial Statements *(Dollars in Thousands)*

December 31, 2014

### **1. Organization and Basis of Presentation**

The combined financial statements include the financial results of Gundersen Clinic, Ltd. (the Clinic); Gundersen Lutheran Medical Center, Inc. (the Hospital); Gundersen Lutheran Administrative Services, Inc. (GLAS); and Gundersen Lutheran Medical Foundation, Inc. (the Foundation), all of which are members of an obligated group (the Obligated Group or Gundersen). The combined financial statements are prepared for the purpose of presenting the operating results of the Obligated Group and do not include all the entities controlled by Gundersen Lutheran Health System, Inc. (the Parent Corporation), which is the sole corporate member of the Obligated Group members but itself is not a member of the Obligated Group. The Parent Corporation and each of the Obligated Group members qualify as tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (the Code).

The Clinic provides comprehensive medical care to patients and conducts medical education and research programs primarily in Wisconsin with smaller facilities in Iowa and Minnesota. The Hospital is located in La Crosse, Wisconsin, and provides medical care to patients from La Crosse and surrounding communities. GLAS is engaged in various administrative transactions on behalf of the Parent Corporation and its affiliates in support of charitable health care activities. The Foundation enhances and supports quality health care with an emphasis on medical and health/wellness education as well as clinically based research and community outreach.

### **2. Summary of Significant Accounting Policies**

#### **Accounting Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. Although estimates, including uncollectible and contractual allowances on patient accounts receivable, third-party payor settlements, self-insured liabilities, and valuation of swap contracts, are considered to be fairly stated at the time that the estimates were made, actual results could differ from those estimates.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 2. Summary of Significant Accounting Policies (continued)

##### **Cash and Cash Equivalents**

Cash and cash equivalents include currency on hand, demand deposits with banks or other financial institutions, and short-term investments with original maturities of 90 days or less from the date of purchase. The Obligated Group maintains cash and cash equivalents on deposit at financial institutions, which at times exceed the limits insured by the Federal Deposit Insurance Corporation and thereby exposes the Obligated Group to potential risk of loss in the event the financial institution becomes insolvent. No losses have been incurred to date, and management does not consider the credit risk to be significant to the Obligated Group.

##### **Patient Accounts Receivable**

The collection of receivables from third-party payors and patients is the Obligated Group's primary source of cash for operations. The primary collection risks relate to uninsured patient accounts and patient deductibles and coinsurance on insurers' accounts. Patient receivables, including the portion that a third-party payor is responsible for, are carried at net realizable value, determined by the original charge for the service provided less an estimate made for contractual adjustments or discounts provided to third-party payors. Patient receivables due directly from the patients are carried on the accompanying combined balance sheets at the original charge for the service provided less amounts covered by third-party payors, allowances for other discounts, and an allowance for uncollectible receivables. The Obligated Group does not charge interest on past-due receivables. Receivables are written off after collection efforts have been followed in accordance with the Obligated Group's policies. Recoveries of receivables previously written off are recorded as a reduction of bad debt expense.

Accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectability of accounts receivable, the Obligated Group analyzes its past history and identifies trends for each of its major payor sources to estimate the appropriate allowance for doubtful accounts and provision for bad debts. The analysis is performed using a hindsight calculation that utilizes write-off data for all payor classes during a determined time period to calculate the allowance for uncollectible accounts at a point in time. Accounts receivable balances, without payment arrangements, over 365 days are fully allowed for.



## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

At December 31, 2014 and 2013, the allowance for uncollectible accounts was \$27,839 and \$26,763, respectively, which as a percent of accounts receivable, net of contractual adjustments, was 19% for both years.

#### **Investments and Investments Whose Use Is Limited**

Investments in equity securities with readily determinable fair values and investments in debt securities are measured at fair value in the combined balance sheets. Investments in equity and debt securities are classified as trading, and accordingly, all unrealized gains and losses are recorded as nonoperating investment return. The Obligated Group accounts for investment transactions on a settlement-date basis.

Investment securities are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of certain investments will occur in the near term and that such changes could materially affect the amounts reported in the combined financial statements.

Unrestricted investments are classified as current assets since they are available for operations. Certain investments are limited as to use under the terms of a bond indenture, state insurance regulations, unemployment fund agreements, collateral posted against swap valuations, and internally designated for medical education by the Board of Trustees and the Board of Governors. The Board of Trustees and the Board of Governors, at their discretion, can change these designations in the future.

#### **Inventories, Supplies, and Materials**

Inventories, supplies, and materials are valued at the lower of cost (first-in, first-out method) or market value and included in other current assets in the combined balance sheets.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 2. Summary of Significant Accounting Policies (continued)

##### Property and Equipment

Property and equipment are stated at cost, if purchased, or at fair value on the date received, if donated, less accumulated depreciation. During periods of construction, interest costs are capitalized to the respective property accounts.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Land improvements	5–15 years
Building	30–40 years
Building additions and improvements	10–25 years
Equipment and furniture	3–15 years

The Obligated Group assesses potential impairment to its long-lived assets when there is evidence that events or changes in circumstances have made recovery of an asset's carrying value unlikely. An impairment loss is indicated when the estimated total undiscounted future net cash flows is less than the carrying amounts. The loss recognized is the difference between the fair value and the carrying amount. No impairment loss was recognized at December 31, 2014 or 2013.

The Obligated Group capitalizes expenditures for additions and improvements, while replacements, maintenance, and repairs that do not improve the useful lives of the assets are expensed as incurred. The Obligated Group capitalizes interest on the financing of major capital, including projects financed with tax-exempt borrowings.

##### Software Costs

Capitalized computer software costs include internally developed software. Costs incurred in developing and installing internal use software are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage, or post-implementation stage.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Derivative Financial Instruments**

The Obligated Group uses interest rate swap contracts as part of its risk management strategy to manage exposure to fluctuations in interest rates related to its variable rate debt. All derivative instruments are recorded at fair value in the combined balance sheets, with the changes in the fair values recorded in nonoperating gains (losses) in the combined statements of operations.

In April 2007, the Obligated Group de-designated its swaps, which formerly had been classified as cash flow hedges. Prior to the de-designation, changes in the fair value of the hedged interest rate swaps were included in other changes in unrestricted net assets. The accumulated gain in net assets prior to de-designation is being amortized over the remaining life of the term of debt.

##### **Insurance**

The provision for estimated self-insured professional liability, workers' compensation, and employee health care claims includes estimates of the ultimate costs for both reported and incurred but not reported (IBNR) claims. The accrual for self-insured professional liability, workers' compensation, and employee health care claims represents the estimated ultimate cost for both asserted and unasserted claims.

##### **Donated Assets and Services**

Unconditional promises to give cash and other assets to the Obligated Group are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets. When the terms of a donor restriction are met, temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets released from restriction. Donor contributions whose restrictions are met within the same year as received are reported as unrestricted contributions.

A large number of people contribute significant amounts of time to the Obligated Group without compensation. The combined financial statements do not reflect the value of those contributed services, because although substantial, no reliable basis exists for determining an appropriate amount.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Net Assets**

Resources are classified into three net asset categories as unrestricted, temporarily restricted, and permanently restricted, according to the absence or existence of donor-imposed restrictions. Unrestricted net assets represent amounts that have no donor-imposed restrictions. Temporarily restricted net assets are those assets whose use has been limited by donors to a specific purpose or time period. Permanently restricted net assets are those assets for which donors require the principal of the gift to be maintained in perpetuity in order to provide a permanent source of income.

##### **Net Patient Revenue**

Net patient revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered, excluding charges related to the Obligated Group's self-insured health benefits. Net patient revenue includes estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future years as final settlements are determined.

##### **Capitation Revenue and Purchased Health Services**

The Clinic and the Hospital provide health care services to enrollees of the Gundersen Lutheran Health Plan (the Health Plan), an affiliate controlled by the Parent Corporation, under a capitation arrangement. The health care services covered by the Health Plan are paid for primarily on a capitated basis determined as a percentage of the member premiums, which transfers most insurance risk to the Clinic and Hospital under a provider reimbursement agreement. Net capitation revenue is recognized in the year in which health care coverage is provided and is recorded net of amounts paid to other medical service providers. Although the majority of services are provided to Health Plan enrollees by the Hospital and Clinic, certain services are provided by out-of-network providers on a contracted fee-for-service basis. A reserve is recorded for out-of-network care rendered but not reported as of each year-end.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 2. Summary of Significant Accounting Policies (continued)

##### **Charity and Uncompensated Care**

The Clinic and the Hospital provide health care services to patients who meet certain criteria under their charity care policies without charge or at amounts less than established rates. The Clinic and Hospital maintain records to identify and monitor the level of community care provided. These records include the amount of costs incurred for services and supplies furnished under the charity care policy. Since the Clinic and the Hospital do not pursue collection of these amounts, they are not reported as patient revenue.

##### **Electronic Health Record Incentive Payments**

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicare and Medicaid incentive program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments depends on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement, or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional Medicaid incentive payments.

The Obligated Group accounts for HITECH incentive payments as a gain contingency. Income from Medicare incentive payments is recognized as revenue after the Obligated Group has demonstrated that it complied with the meaningful use criteria over the entire applicable compliance period and the cost report period that will be used to determine that the final incentive payment has ended. The Obligated Group recognized revenue from Medicaid incentive payments after it adopted certified EHR technology. Incentive payments totaling \$3,631 and \$5,790 for 2014 and 2013, respectively, are included in operating revenue in the combined statements of operations. Income from incentive payments is subject to retrospective adjustment as the incentive payments are calculated using Medicare cost data that is subject to audit. In addition, the Obligated Group's compliance with the meaningful use criteria is subject to audit by government agencies.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Performance Indicator**

The performance indicator is revenue in excess of expenses. Changes in unrestricted net assets, which are excluded from revenue in excess of expenses, consistent with industry practice, include net assets released from restrictions to purchase property and equipment, transfers to affiliates, and amortization of accumulated gains on swap contracts at the time of de-designation.

##### **Income Tax**

The Obligated Group has reviewed its tax positions for all open years and has concluded that no liabilities exist for uncertain tax positions at December 31, 2014 and 2013. The Obligated Group's income tax returns are no longer subject to examination for 2008 and prior.

##### **New Accounting Standard**

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. The ASU, which was issued jointly with the International Accounting Standards Board (IASB), provides guidance that will supersede nearly all previously issued revenue recognition standards under U.S. generally accepted accounting principles, including those related to the presentation of the provision for doubtful accounts. When an entity provides services to patients, the ASU requires the entity to recognize revenue at an amount that reflects the consideration to which it expects to be entitled in exchange for those services, after assessing for collectability. The guidance is expected to be effective for the Obligated Group on January 1, 2017. Management is in the process of reviewing the new guidance but does not anticipate it will have any material impact on the Obligated Group's combined financial statements.

#### **3. Net Patient Revenue**

The Clinic and the Hospital derive patient revenue primarily from patients covered under the Medicare and Medicaid programs, agreements with commercial insurers, and managed care organizations, as well as from private pay patients. The basis for payment under agreements with commercial insurers and managed care organizations includes prospectively determined rates, discounts from established charges, and allowable cost.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 3. Net Patient Revenue (continued)

The Clinic participates in the Medicare and Medicaid programs and is reimbursed based on fee schedules. The Hospital also participates in the Medicare and Medicaid programs, under which substantially all inpatient services rendered to program beneficiaries are paid for based on prospectively determined amounts per discharge depending on the individual patient's diagnostic-related grouping of medical conditions. The Hospital's Medicare outpatient services are predominantly paid based on prospectively determined amounts for each service provided depending on the ambulatory payment classification assigned to each service. Amounts recorded by the Hospital for estimated cost report settlements can differ from actual settlements based on the results of subsequent cost report audits. In addition, the Hospital appeals certain settlements related to Medicare and other programs. Changes in estimated reimbursement related to prior periods, primarily related to the Medicare program, resulted in an increase in net patient service revenue of \$2,264 and \$964 for 2014 and 2013, respectively.

For self-pay patients, management determines an allowance for uncollectible accounts by identifying amounts at risk, based on historical collection experience, aging of accounts, and current economic conditions. The Obligated Group also has policies to provide a discount from established charges to uninsured patients.

The Obligated Group has determined, based on an assessment at the reporting-entity level, that patient revenue is primarily recorded prior to assessing the patient's ability to pay, and as such, the entire provision for uncollectible accounts is recorded as a deduction from patient revenue in the combined statements of operations.

Patient service revenue, net of contractual expense (but before the provision for bad debts), recognized from the Obligated Group's major payor sources is summarized as follows:

	<u>2014</u>	<u>2013</u>
Third-party payors	\$ 672,937	\$ 593,134
Self-pay payors	23,082	39,707
	<u>\$ 696,019</u>	<u>\$ 632,841</u>

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **3. Net Patient Revenue (continued)**

The Medicare program accounted for 26% of the Obligated Group's net patient revenue for 2014 and 2013. Potential changes in the Medicare program and reduction of funding levels could have a material adverse effect on the Clinic and the Hospital in the near term.

#### **4. Charity Care**

The Clinic and the Hospital provide medical care without charge or at reduced charges to residents of the communities they serve by providing services to patients who are uninsured or underinsured. The cost of providing charity care has been estimated by applying a cost to gross charges ratio to the gross uncompensated charges associated with providing charity care to patients. For 2014 and 2013, cost of providing charity care is estimated to be \$7,187 and \$10,827, respectively.

During 2014, the Obligated Group changed its process for estimating whether a patient ultimately will qualify for charity care by considering the patient's socio-economic, demographic and other nonfinancial information, in addition to financial information. As a result, \$7,300 of patient accounts that had been expensed as a provision for uncollectible accounts in 2014 and prior years was reclassified from provision for uncollectible accounts to charity care in 2014. The reclassification did not impact net patient revenue, operating income, or revenue in excess of expenses as previously reported.



## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 5. Investments Whose Use Is Limited and Investment Return

Certain investments as of December 31 are limited as to use for the following purposes:

	2014	2013
Board-designated for medical education	\$ 3,747	\$ 3,747
Minimum funding as required by the Wisconsin Office of the Commissioner of Insurance (Note 11)	10,215	8,649
Minimum funding as required by the Wisconsin Unemployment Reserve Fund	3,339	3,327
Collateral posted against insurance claims	1,850	650
Principal and interest payments under a bond indenture	252	248
Collateral posted against swap valuations (Note 9)	12,171	5,060
	\$ 31,574	\$ 21,681

Investment return on all investments, including those investments whose use is limited, consists of the following for the years ended December 31:

	2014	2013
Dividends and interest	\$ 14,244	\$ 13,267
Gain on sale of long-term investment	-	126
Net realized gains	2,435	6,241
Net change in unrealized gains and losses	11,671	33,728
	\$ 28,350	\$ 53,362

Investment return is reported in the combined statements of operations and changes in net assets as follows:

	2014	2013
Nonoperating gains, net	\$ 27,522	\$ 50,058
Temporarily restricted net assets	934	2,444
Permanently restricted net assets	(106)	860
	\$ 28,350	\$ 53,362

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 6. Fair Value Measurements and Investments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e., an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy in Accounting Standards Codification 820, *Fair Value Measurement*, are described below:

- Level 1 – Unadjusted quoted prices in active markets that are accessible to the reporting entity at the measurement date for identical assets and liabilities.
- Level 2 – Inputs other than quoted prices in active markets for identical assets and liabilities that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:
  - Quoted prices for similar assets and liabilities in active markets
  - Quoted prices for identical or similar assets or liabilities in markets that are not active
  - Observable inputs other than quoted prices that are used in the valuation of the asset or liabilities (e.g., interest rate and yield curve quotes at commonly quoted intervals)
  - Inputs that are derived principally from or corroborated by observable market data by correlation or other means
- Level 3 – Unobservable inputs for the asset or liability (i.e., supported by little or no market activity). Level 3 inputs include management’s own assumption about the assumptions that market participants would use in pricing the asset or liability including assumptions about risk.

Gundersen Health System Obligated Group

Notes to Combined Financial Statements (continued)  
(Dollars in Thousands)

**6. Fair Value Measurements and Investments (continued)**

The level in the fair value hierarchy within which the fair value measurement is classified is determined based on the lowest level of input that is significant to the fair value measure in its entirety.

The following tables present the financial instruments measured at fair value on a recurring basis at December 31, 2014 and 2013, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	December 31, 2014			Total Value
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Cash equivalents	\$ 23,001	\$ 456	\$ —	\$ 23,457
Common stock	21,806	—	—	21,806
Equity mutual funds	187,710	—	—	187,710
Equity mutual funds – foreign government	34,027	—	—	34,027
Asset-backed securities	57,590	6,454	—	64,044
Fixed income securities:				
U.S. government and agency obligations	—	80,801	—	80,801
Corporate bonds	1,229	—	—	1,229
Residential mortgage-backed securities	—	98,444	—	98,444
Instruments measured at fair value	<u>\$ 325,363</u>	<u>\$ 186,155</u>	<u>\$ —</u>	511,518
Certificate of deposit				26,050
Investments recorded on an equity basis				734
Total investments, including investments whose use is limited				<u>\$ 538,302</u>
<b>Liabilities</b>				
Obligation under swap contracts	\$ —	\$ 34,262	\$ —	\$ 34,262

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 6. Fair Value Measurements and Investments (continued)

	December 31, 2013			
	Level 1	Level 2	Level 3	Total Value
<b>Assets</b>				
Cash equivalents	\$ 19,659	\$ 310	\$ —	\$ 19,969
Common stock	43,195	—	—	43,195
Equity mutual funds	122,948	—	—	122,948
Equity mutual funds – foreign government	63,324	—	—	63,324
Asset-backed securities	—	13,125	—	13,125
Fixed income securities:				
U.S. government and agency obligations	92,826	—	—	92,826
Corporate bonds	—	71,976	—	71,976
Residential mortgage-backed securities	—	69,767	—	69,767
Commercial mortgage-backed securities	—	17,707	—	17,707
Instruments measured at fair value	<u>\$ 341,952</u>	<u>\$ 172,885</u>	<u>\$ —</u>	<u>514,837</u>
Certificate of deposit				26,050
Total investments, including investments whose use is limited				<u>\$ 540,887</u>
<b>Liabilities</b>				
Obligation under swap contracts	\$ —	\$ 23,469	\$ —	\$ 23,469

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses are reasonable estimates of fair value due to the short-term nature of these financial instruments. The carrying value of pledges (Level 2) approximates its fair value at December 31, 2014 and 2013.

At December 31, 2014 and 2013, the fair value of fixed interest long-term debt (Level 2), based on quoted market prices for the same or similar instruments, was \$271,655 and \$253,574, respectively, compared with its carrying value of \$253,565 and \$260,145, respectively. Fair value of variable-rate long-term debt (Level 2) approximated its carrying value at both December 31, 2014 and 2013.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 6. Fair Value Measurements and Investments (continued)

The fair value for obligation under swap contracts is determined through the use of widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flow of each derivative. The analysis reflects the contractual terms of the interest rate swaps, including the period to maturity, and uses observable market-based inputs, such as interest rate curves. In addition, credit value adjustments are included to reflect both the Obligated Group's nonperformance risk and the respective counterparty's nonperformance risk.

The Obligated Group pays annual fixed rates ranging from 3.26% to 3.79% and receives cash flows based on 67% of the London Interbank Offered Rate (LIBOR). At December 31, 2014 and 2013, the Obligated Group's fair value of obligations under interest rate swap contracts of \$34,262 and \$23,469, respectively, was recorded net of an adjustment for the credit value (CVA) of the Obligated Group of \$1,974 and \$1,442, respectively.

#### 7. Property and Equipment

Property and equipment as of December 31 consist of the following:

	<u>2014</u>	<u>2013</u>
Land and land improvements	\$ 23,868	\$ 23,710
Buildings and building improvements	581,403	366,220
Capitalized software	29,080	29,489
Equipment and furniture	285,076	299,131
Capitalized leases	8,918	8,798
	<u>928,345</u>	<u>727,348</u>
Less accumulated depreciation and amortization	400,118	420,063
	<u>528,227</u>	<u>307,285</u>
Construction-in-progress	25,584	246,107
	<u>\$ 553,811</u>	<u>\$ 553,392</u>

The Obligated Group capitalizes payroll and payroll-related costs associated with the development of software for internal use. In 2014 and 2013, \$312 and \$1,080, respectively, of payroll and payroll-related costs were capitalized.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 8. Long-Term Debt and Capital Lease Obligations

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

	2014	2013
Wisconsin Health and Educational Facilities Authority (WHEFA), Series 2012 (Gundersen), annual interest from 2.0% to 5.0%, principal due in varying amounts through 2044	\$ 69,685	\$ 69,845
WHEFA Bonds, Series 2011A (Gundersen), annual interest from 1.00% to 5.25%, principal due in varying amounts through 2039	143,880	150,300
WHEFA Series 2011B (Gundersen), adjustable demand, principal due starting in 2038 (average annual interest rate in 2014 and 2013 of 0.08% and 0.12%, respectively)	40,000	40,000
WHEFA Series 2009A (Gundersen), adjustable demand, principal due in varying amounts through 2033 (average annual interest rate in 2014 and 2013 of 1.00% and 1.03%, respectively)	45,305	45,305
WHEFA Series 2009B (Gundersen), adjustable demand, principal due in varying amounts through 2033 (average annual interest rate in 2014 and 2013 of 1.00% and 1.03%, respectively)	33,410	33,410
WHEFA Series 2008B (Gundersen), adjustable demand, principal due in varying amounts through 2033 (average annual interest rate in 2014 and 2013 of 0.87% and 0.90%, respectively)	61,400	61,400
Capital lease obligations	765	2,607
Unamortized premium	2,512	2,992
Total long-term debt and capital lease obligations	396,957	405,859
Less current maturities	7,286	8,376
	\$ 389,671	\$ 397,483

In September 2011, the Hospital, the Clinic, GLAS, and the Foundation entered into a Restated Master Trust Indenture with a bank that established an Obligated Group, which currently includes the Hospital, the Clinic, GLAS, and the Foundation. Each Obligated Group member is jointly and severally liable for the payment of all obligations issued under the Restated Master Trust Indenture, which are secured ratably by a pledge of the unrestricted receivables of the Obligated Group. The Restated Master Trust Indenture contains, among other things, provisions placing restrictions on additional debt, asset transfers, and liens and requires the maintenance of a debt service coverage ratio. Additional covenants, including liquidity and capitalization, are included in other loan agreements relating to the obligations.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### **8. Long-Term Debt and Capital Lease Obligations (continued)**

In September 2012, WHEFA issued Series 2012 bonds on behalf of the Obligated Group in an aggregate par amount of \$70,000 and bear interest at fixed rates. The bonds are subject to optional, mandatory, extraordinary redemption and purchase in lieu of redemption prior to maturity. The proceeds have been used to finance new construction.

In September 2011, WHEFA issued Series 2011A and Series 2011B bonds on behalf of the Obligated Group. The Series 2011A bonds were issued in an aggregate par amount of \$162,430 and bear interest at fixed rates. The Series 2011B bonds were issued in an aggregate amount of \$40,000 and bear interest at variable rates that are initially set weekly. The Series 2011B bonds are subject to optional and mandatory tender and are supported by an irrevocable direct pay letter of credit issued by a bank, which expires in September 2016. Under the terms of the agreement with the bank, the Obligated Group may elect to convert any liquidity draw made under the letter of credit into a bank loan that amortizes in equal quarterly installments over a three-year period, commencing no sooner than 367 days after the date of the draw, provided that there is no event of default and the representations made at the time of the draw are accurate.

In May 2009, WHEFA issued Series 2009A and Series 2009B bonds on behalf of GLAS in the aggregate amount of \$78,715. The proceeds of those bonds were used to refund the Series 2003B and Series 2003C bonds. In March 2011, the Obligated Group caused a tender of the Series 2009A and Series 2009B bonds, which were placed directly with a bank. Under the terms of the agreement with the bank, GLAS was required to purchase the Series 2009A and Series 2009B bonds from the bank in March 2014. In March 2015, the date by which GLAS is required to repurchase the Series 2009A and Series 2009B bonds was extended to March 2, 2020 and March 2, 2021, respectively.

In May 2008, WHEFA issued Series 2008A and Series 2008B bonds on behalf of GLAS in the aggregate amount of \$89,300 bearing interest at a variable rate. In August 2010, the Obligated Group caused a tender of the Series 2008A and Series 2008B bonds, which were placed directly with a bank. Under the terms of the agreement with the bank, GLAS was required to purchase the Series 2008B bonds from the bank in August 2013. In September 2011, the Series 2008A bonds were refunded with proceeds of the Series 2011A bonds and Series 2011B bonds. In March 2015, the date by which GLAS is required to repurchase the Series 2008B bonds was extended to March 1, 2019.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 8. Long-Term Debt and Capital Lease Obligations (continued)

At December 31, 2014, the aggregate maturities and sinking fund requirements of long-term debt, for each of the five subsequent years and thereafter, assuming that all bonds are successfully remarketed with the original maturity dates and the Obligated Group is able to renew the letter of credit, which expires in September 2016, are as follows:

2015	\$ 6,905
2016	7,160
2017	7,395
2018	7,715
2019	7,960
Thereafter	356,545
	\$ 393,680

The Obligated Group's capital lease obligations for software and equipment will expire over the next five years. Future commitments under capital leases in effect as of December 31, 2014, for each of the five subsequent years are as follows.

2015	\$ 226
2016	226
2017	226
2018	142
2019	4
Total	824
Amount representing interest	59
Present value of minimum lease payments	765
Current portion	199
Long term portion	\$ 566



## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 9. Derivative Financial Instruments

The Obligated Group has entered into interest rate swaps, which are recorded at fair value as noncurrent liabilities in the combined balance sheets as of December 31, as follows:

	2014	2013
Notional amount \$33,000 Series 2009B (previously Series 2003C), fixed annual rate 3.50%, variable interest equal to 67% of the one-month LIBOR	\$ 5,896	\$ 4,189
Notional amount \$40,470 Series 2011B (previously Series 2000B), fixed annual rate 3.26%, variable interest equal to 67% of the one-month LIBOR	6,022	4,251
Notional amount \$44,750 Series 2009A (previously Series 2003B), fixed annual rate 3.28%, variable interest equal to 67% of the one-month LIBOR	8,026	4,840
Notional amount \$60,725 Series 2008B, fixed annual rate 3.79%, variable interest equal to 67% of the one-month LIBOR	14,318	10,189
	\$ 34,262	\$ 23,469

The decrease (increase) in the liability of the swap contracts of \$(10,793) and \$18,021 for 2014 and 2013, respectively, was recorded as an unrealized (loss) gain and is included in nonoperating gains (losses) in the combined statements of operations.

Derivative transactions contain credit risk in the event the parties are unable to meet the terms of the contract; credit risk is generally limited to the fair value due from counterparties on outstanding contracts. At December 31, 2014, the counterparties had a Standard & Poor's credit quality rating of A-.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **9. Derivative Financial Instruments (continued)**

The interest rate swap contracts contain collateral provisions applicable to both parties to mitigate credit risk. The collateral provided by the Obligated Group to the counterparties was \$12,171 and \$5,060 as of December 31, 2014 and 2013, respectively, and is included in investments whose use is limited in the combined balance sheets.

The net settlements for the interest rate swap contracts of \$6,060 and \$6,010 for 2014 and 2013, respectively, are included in interest expense in the combined statements of operations.

#### **10. Retirement Plan**

The Obligated Group maintains a defined contribution and 401(k) plan covering substantially all of its employees. Retirement plan expense was \$53,108 and \$45,861 for 2014 and 2013, respectively. The Obligated Group contributes matching funding on a monthly basis, with the remainder contributed annually. At December 31, 2014 and 2013, the total liability for employer contributions was \$41,425 and \$34,892, respectively, and is included in accrued liabilities in the combined balance sheets.

#### **11. Insurance**

The Clinic is self-insured for Wisconsin professional liability up to base limits of insurance coverage (\$1,000 per claim and \$3,000 annually on an occurrence basis at both December 31, 2014 and 2013). Additionally, under the Wisconsin professional liability, self-insured limits are in place per physician/certified registered nurse anesthetist (CRNA) (\$1,000 per physician/CRNA per claim and \$3,000 annually per physician/CRNA on an occurrence basis at both December 31, 2014 and 2013). The Clinic has established a professional liability insurance plan and irrevocable trust as required by Wisconsin statutes. The funding requirements of the plan are established annually based on third-party actuarial calculations, as prescribed by the Commissioner of Insurance for the State of Wisconsin. All professional liability claims or judgments occurring in Wisconsin in excess of the base level of coverage are paid from the Injured Patients and Families Compensation Fund, which insures all claims incurred regardless of when the claim is filed. The Injured Patients and Families Compensation Fund has no upper limit on losses.

The Clinic has purchased professional liability insurance on a claims-made basis to cover Iowa and Minnesota risks, including umbrella and excess coverage to minimize exposure.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 11. Insurance (continued)

The Hospital has purchased professional liability insurance on a claims-made basis to cover claim losses. The Hospital is also insured through the Injured Patients and Families Compensation Fund for losses on professional liability claims (\$1000 per claim and \$3,000 annually at December 31, 2014 and 2013). The Injured Patients and Families Compensation Fund has no upper limit on losses.

The Obligated Group maintains self-insurance programs for health care costs of its active employees. The Obligated Group has purchased stop-loss insurance with an annual deductible of \$700 per individual. In addition, the Obligated Group is insured for workers' compensation exposures under an incurred loss retrospective rating plan.

The liability for professional and general liability, workers' compensation, and employee health insurance claims is based on actual claims to date and a projection of the estimated future liability for such claims and IBNR claims. At December 31, 2014 and 2013, the total recorded liability was \$21,961 and \$19,359, respectively, of which a current portion of \$12,842 and \$11,091, respectively, is included in accrued liabilities, and the noncurrent portion of \$9,119 and \$8,268, respectively, is included in other noncurrent liabilities in the combined balance sheets. At December 31, 2014 and 2013, the estimated receivable related to insurance recoveries of \$1,052 and \$861, respectively, is included in other current assets in the combined balance sheets.

#### 12. Commitments and Contingencies

The Obligated Group has leases for equipment and satellite office facilities, which are classified as operating leases. Rental expense under these operating leases totaled \$5,545 and \$4,921 for 2014 and 2013, respectively. Future commitments under operating leases in effect as of December 31, 2014, for each of the five subsequent years and thereafter are as follows:

2015	\$	1,409
2016		1,098
2017		835
2018		707
2019		413
Thereafter		842
	\$	<u>5,304</u>

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **12. Commitments and Contingencies (continued)**

The Clinic and the Hospital are defendants in legal proceedings arising in the ordinary course of business. Although the outcome of these proceedings cannot be determined, management of the Obligated Group considers it unlikely that the disposition of these proceedings will have a material adverse effect on the combined financial position or operations of the Obligated Group. However, there can be no assurance that this will be the case.

The Clinic, Hospital, and GLAS have entered into an agreement with the city of La Crosse in conjunction with the city's establishment of Tax Incremental Financing District No. 14 (TIF 14). The agreement requires the construction of one or more parking ramps that will accommodate 1,000 vehicles, with qualifying costs not to exceed \$18,500. At December 31, 2009, a 537-vehicle ramp adjacent to the Clinic was completed. In 2010, a second ramp was completed to satisfy the requirement of available vehicle space and is considered for the tax incentives offered under the TIF 14 agreement. This ramp is adjacent to the area designated for the new hospital described below as part of a campus renewal plan. Additionally, the agreement creates property tax incentives for further taxable development on the Obligated Group La Crosse campus by the Obligated Group and other developers. The benefit that the Obligated Group will derive from participation in TIF 14 depends on the size of future development over the next 20 years.

The Obligated Group has established a campus renewal plan, which includes the addition of a 400,000 square foot, six-story hospital building on the main campus, adjacent to the existing Hospital facility. The hospital addition, which began in January 2011, was placed in service in January 2014. This initial phase is projected to cost \$218,000 under a guaranteed maximum price contract with a general contractor. The Obligated Group is funding this addition with cash flow from operations, debt financing, and fund-raising.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 12. Commitments and Contingencies (continued)

##### Compliance with Laws and Regulations

The health care industry is governed by various laws and regulations of federal, state, and local governments. These laws and regulations are subject to ongoing government review and interpretation and include matters such as licensure, accreditation, reimbursement for patient services, and referrals for Medicare and Medicaid beneficiaries. Compliance with these laws and regulations is required for participation in government health care programs. Certain governmental agencies routinely investigate and pursue allegations concerning possible overpayments resulting from violation of fraud and abuse statutes by health care providers. These investigations may result in settlements involving fines and penalties as well as repayment of improper reimbursement. The Obligated Group has implemented procedures for monitoring and enforcing compliance with laws and regulations and is not aware of instances of noncompliance.

While management believes that the Obligated Group is in material compliance with fraud and abuse laws and regulations as well as other applicable government laws and regulations, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Changes in reimbursement from the Medicare program, including reduction of funding levels, could have a material adverse effect on the Obligated Group.

#### 13. Concentration of Credit Risk

The Clinic and the Hospital grant credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. Amounts due from various payors and patients as of December 31 included in net patient accounts receivable are as follows:

	<u>2014</u>	<u>2013</u>
Medicare	13%	15%
Medicaid	4	3
Commercial insurance, private pay, and other	83	82
	<u>100%</u>	<u>100%</u>

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 14. Functional Expenses

Expenses related to providing patient care are as follows for the years ended December 31:

	<u>2014</u>	<u>2013</u>
Health care services	\$ 745,664	\$ 700,253
General and administrative, including fund-raising	181,361	171,498
	<u>\$ 927,025</u>	<u>\$ 871,751</u>

#### 15. Related-Party Transactions

The Clinic and the Hospital have an agreement with the Health Plan to provide health care services to the Health Plan's insured enrollees. The Clinic and the Hospital are paid on a fully capitated basis. Reinsurance contracts exist for medical and hospital expenses in excess of \$700 per enrollee per contract year. Capitation revenue recorded by the Clinic and the Hospital that was earned under the agreement with the Health Plan totaled \$244,315 and \$270,710 for 2014 and 2013, respectively. At December 31, 2014 and 2013, amounts due to the Health Plan were \$4,938 and \$2,782, respectively, and are included in other current liabilities in the combined balance sheets.

Under terms of an administrative services agreement with the Health Plan, the Obligated Group provides substantially all general and administrative services necessary for the Health Plan's operations at amounts that are intended to approximate cost. The cost of these services to the Health Plan was \$11,082 and \$12,554 in 2014 and 2013, respectively, and is deducted from the Obligated Group's expenses in the combined statements of operations. Amounts due from the Health Plan as of December 31, 2014 and 2013, related to the administrative services agreement were \$1,720 and \$2,377, respectively, and are included in other current assets in the combined balance sheets.

The Health Plan leases office space from the Obligated Group. Rental payments were \$306 for 2014 and 2013.

At December 31, 2014 and 2013, notes receivable from affiliates totaling \$8,522 and \$11,998, respectively, which are recorded net of allowances for uncollectible amounts of \$144, represent loans to affiliates to finance their activities. Notes receivable from affiliates have terms ranging from 1 to 15 years, with annual interest rates ranging from 3.8% to 6.0%.

Gundersen Health System Obligated Group

Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

**16. Restricted Net Assets**

Temporarily restricted net assets as of December 31 are available for the following purposes or periods:

	<u>2014</u>	<u>2013</u>
Education	\$ 1,181	\$ 1,062
Research	1,639	1,299
Community and affiliate programs	1,041	869
Buildings and equipment	7,895	9,431
Other	409	381
Time restrictions for future periods	328	278
	<u>\$ 12,493</u>	<u>\$ 13,320</u>

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

	<u>2014</u>	<u>2013</u>
Education	\$ 5,520	\$ 5,368
Research	4,666	4,663
Community health initiatives	2,527	2,559
General operations	3,800	3,839
	<u>\$ 16,513</u>	<u>\$ 16,429</u>

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 17. Pledges

The timing of receipt of pledges at December 31 is estimated as follows:

2015	\$	2,549
2016		2,069
2017		1,197
2018		738
2019		581
Thereafter		<u>1,863</u>
		8,997
Present value discount and allowances for uncollectible pledges		<u>(1,033)</u>
	\$	<u><u>7,964</u></u>

Pledges receivable were discounted at annual rates ranging from 3.72% to 4.56% at December 31, 2014. Pledges due within one year are recorded in other current assets, and all other pledges are recorded in other noncurrent assets.

#### 18. Subsequent Events

The Obligated Group has evaluated events and transactions that have occurred subsequent to December 31, 2014, through April 23, 2015, the date on which the combined financial statements were issued. During this period, there were no subsequent events requiring recognition or disclosure in the combined financial statements, except for the bond repurchase dates that have been extended, as disclosed in Note 8.



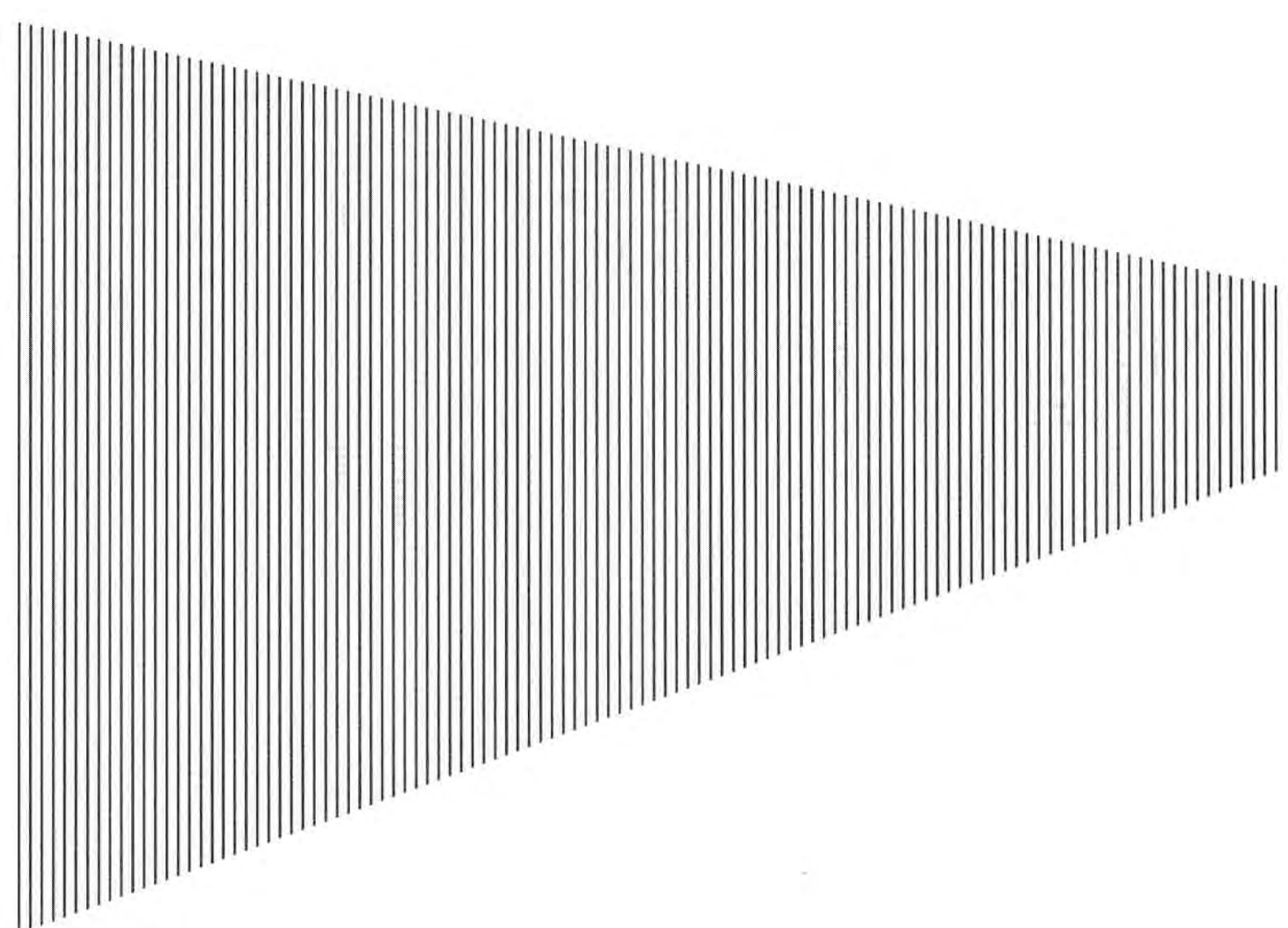
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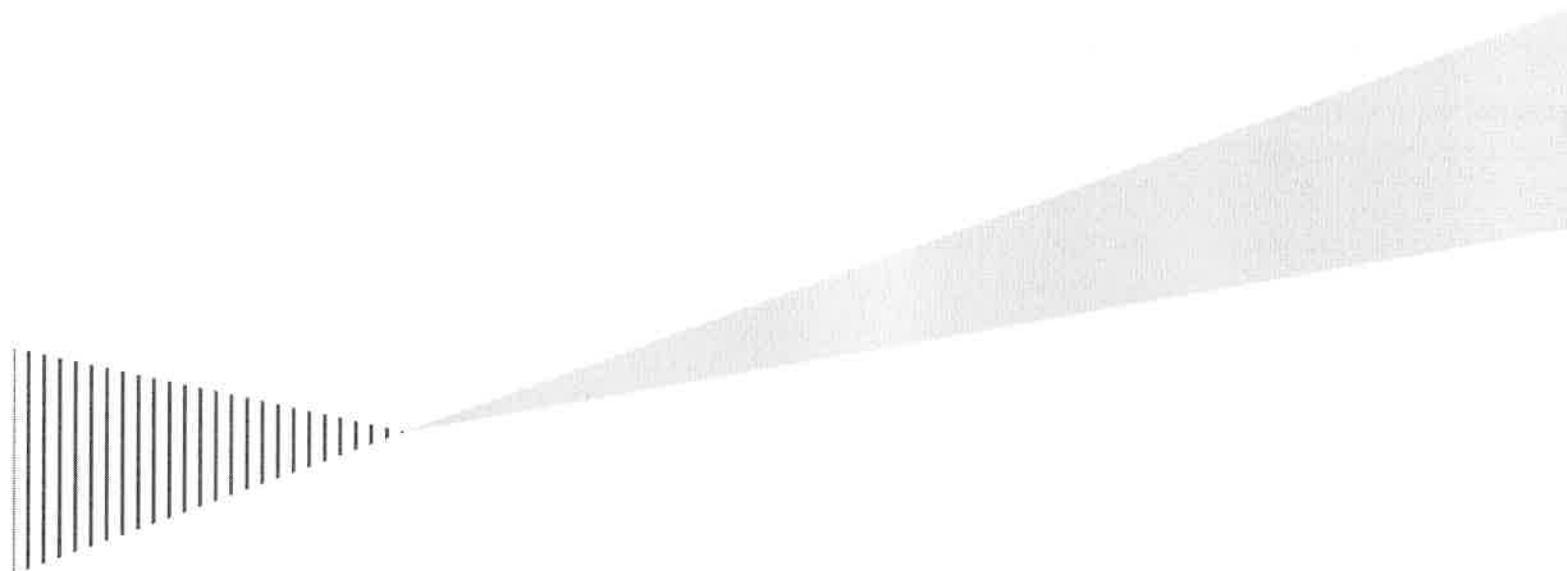




COMBINED FINANCIAL STATEMENTS

Gundersen Health System Obligated Group  
(Consisting of Gundersen Clinic, Ltd., Gundersen Lutheran Medical Center,  
Inc., Gundersen Lutheran Administrative Services, Inc., and Gundersen  
Lutheran Medical Foundation, Inc., Which Comprise an Obligated Group)  
Years Ended December 31, 2013 and 2012  
With Report of Independent Auditors

Ernst & Young LLP



Building a better  
working world

Gundersen Health System Obligated Group

Combined Financial Statements

Years Ended December 31, 2013 and 2012

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## Report of Independent Auditors

The Board of Trustees and the Board of Governors  
Gundersen Health System Obligated Group

We have audited the accompanying combined financial statements of Gundersen Clinic, Ltd.; Gundersen Lutheran Medical Center, Inc.; Gundersen Lutheran Administrative Services, Inc.; and Gundersen Lutheran Medical Foundation, Inc. (collectively, the Obligated Group), which comprise the combined balance sheets as of December 31, 2013 and 2012, and the related combined statements of operations, changes in net assets, 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 financial statements in conformity 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 financial statements that are free of material misstatement, whether due to fraud or error.

### Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the combined financial position of Gundersen Health System Obligated Group at December 31, 2013 and 2012, and the combined results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

*Ernst & Young LLP*

April 24, 2014

Gundersen Health System Obligated Group

Combined Balance Sheets  
(Dollars in Thousands)

	December 31	
	2013	2012
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 87,429	\$ 82,516
Investments	519,206	494,090
Current portion of investments whose use is limited	15,936	17,447
Patient accounts receivable, less allowance for uncollectible accounts of \$26,763 in 2013 and \$35,459 in 2012	116,214	118,814
Current portion of notes receivable from affiliates	426	1,574
Other current assets	42,630	34,421
Total current assets	<u>781,841</u>	<u>748,862</u>
Investments whose use is limited	5,745	61,927
Notes receivable from affiliates, net of current portion	11,572	9,280
Property and equipment, net	553,392	456,452
Other noncurrent assets	24,720	23,022
Total assets	<u>\$ 1,377,270</u>	<u>\$ 1,299,543</u>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 28,880	\$ 27,561
Accrued payroll	46,953	45,194
Accrued liabilities	58,088	67,846
Current maturities of long-term debt and capital lease obligations	8,376	6,420
Other current liabilities	8,922	7,729
Total current liabilities	<u>151,219</u>	<u>154,750</u>
Long-term debt and capital lease obligations, net of current maturities	397,483	402,034
Obligation under swap contracts	23,469	41,490
Other noncurrent liabilities	14,580	13,199
Total liabilities	<u>586,751</u>	<u>611,473</u>
Net assets:		
Unrestricted	760,770	656,705
Temporarily restricted	13,320	16,056
Permanently restricted	16,429	15,309
	<u>790,519</u>	<u>688,070</u>
Total liabilities and net assets	<u>\$ 1,377,270</u>	<u>\$ 1,299,543</u>

See accompanying notes.

## Gundersen Health System Obligated Group

### Combined Statements of Operations (Dollars in Thousands)

	Year Ended December 31	
	2013	2012
Operating revenue:		
Net patient revenue before provision for uncollectible accounts	\$ 632,841	\$ 616,413
Provision for uncollectible accounts	(23,295)	(32,576)
Net patient revenue	609,546	583,837
Capitation revenue	270,710	268,172
Other revenue	31,992	30,179
	912,248	882,188
Operating expenses:		
Salaries, wages, and benefits	517,167	501,483
Supplies	111,440	103,828
Purchased health services	92,684	88,101
Depreciation and amortization	44,437	41,787
Facilities	24,598	21,400
Purchased services	26,828	27,568
Interest	9,841	9,152
Other operating expenses	44,756	45,497
	871,751	838,816
Operating income	40,497	43,372
Nonoperating gains (losses):		
Investment return	49,932	37,819
Gain on sale of long-term investment	126	4,408
Change in fair value of swap contracts	18,021	(1,333)
Other nonoperating losses, net	(769)	(1,109)
	67,310	39,785
Revenue in excess of expenses	107,807	83,157
Net assets released from restrictions to purchase property and equipment	9,875	1,454
Transfers to affiliates	(13,539)	(10,981)
Amortization of accumulated gains related to swap contracts at the time of de-designation	(78)	(78)
Increase in unrestricted net assets	\$ 104,065	\$ 73,552

*See accompanying notes.*



Gundersen Health System Obligated Group

Combined Statements of Changes in Net Assets  
(Dollars in Thousands)

	<b>Year Ended December 31</b>	
	<b>2013</b>	<b>2012</b>
Unrestricted net assets:		
Revenue in excess of expenses	\$ 107,807	\$ 83,157
Net assets released from restrictions to purchase property and equipment	9,875	1,454
Amortization related to swap contracts prior to de-designation	(78)	(78)
Transfers to affiliates	(13,539)	(10,981)
Increase in unrestricted net assets	<u>104,065</u>	<u>73,552</u>
Temporarily restricted net assets:		
Contributions	8,250	8,776
Investment income	664	890
Net change in unrealized gains (losses) on investments	1,780	361
Net assets released from restriction	(13,430)	(5,314)
(Decrease) increase in temporarily restricted net assets	<u>(2,736)</u>	<u>4,713</u>
Permanently restricted net assets:		
Contributions	260	257
Investment gain (loss)	135	(69)
Net change in unrealized gains (losses) on investments	725	444
Increase in permanently restricted net assets	<u>1,120</u>	<u>632</u>
Increase in net assets	102,449	78,897
Net assets at beginning of year	688,070	609,173
Net assets at end of year	<u>\$ 790,519</u>	<u>\$ 688,070</u>

See accompanying notes.

## Gundersen Health System Obligated Group

### Combined Statements of Cash Flows (Dollars in Thousands)

	Year Ended December 31	
	2013	2012
<b>Operating activities</b>		
Increase in net assets	\$ 102,449	\$ 78,897
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	44,437	41,787
Provision for uncollectible accounts	23,295	32,576
Change in fair value of swap contracts	(18,021)	1,333
Realized and change in unrealized gains (losses) on investments, net	(39,843)	(24,876)
Gain on sale of long-term investment	(126)	(4,408)
Transfers to affiliates	13,539	10,981
Restricted contributions	(8,509)	(9,033)
Changes in operating assets and liabilities:		
Patient accounts receivable	(20,695)	(31,290)
Other current assets	(8,209)	12,853
Accounts payable, accrued, and other current liabilities	(5,488)	(1,578)
Other noncurrent assets and liabilities	291	(4,072)
Net cash provided by operating activities	83,120	103,170
<b>Investing activities</b>		
Purchases of investments, net	71,908	(35,764)
Purchases of property and equipment, net	(135,728)	(126,143)
Transfers to affiliates	(13,539)	(10,981)
Net proceeds from notes receivable from affiliates	(1,144)	8,522
Net cash used in investing activities	(78,503)	(164,366)
<b>Financing activities</b>		
Proceeds from issuance of long-term debt	-	70,000
Principal payments on long-term debt	(8,213)	(5,865)
Restricted contributions	8,509	9,033
Net cash provided by financing activities	296	73,168
Net increase in cash and cash equivalents	4,913	11,972
Cash and cash equivalents at beginning of year	82,516	70,544
Cash and cash equivalents at end of year	\$ 87,429	\$ 82,516
<b>Supplemental disclosures of cash flow information</b>		
Accrued amounts for the acquisition of property and equipment	\$ 12,638	\$ 14,346
Interest paid, net of capitalized interest of \$8,308 in 2013 and \$7,133 in 2012	\$ 9,234	\$ 8,221

See accompanying notes.

# Gundersen Health System Obligated Group

## Notes to Combined Financial Statements *(Dollars in Thousands)*

December 31, 2013

### **1. Organization and Basis of Presentation**

The combined financial statements include the financial results of Gundersen Clinic, Ltd. (the Clinic); Gundersen Lutheran Medical Center, Inc. (the Hospital); Gundersen Lutheran Administrative Services, Inc. (GLAS); and Gundersen Lutheran Medical Foundation, Inc. (the Foundation), all of which are members of an obligated group (the Obligated Group or Gundersen). The combined financial statements are prepared for the purpose of presenting the operating results of the Obligated Group and do not include all the entities controlled by Gundersen Lutheran Health System, Inc. (the Parent Corporation), which is the sole corporate member of the Obligated Group members but itself is not a member of the Obligated Group. The Parent Corporation and each of the Obligated Group members qualify as tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (the Code).

The Clinic provides comprehensive medical care to patients and conducts medical education and research programs primarily in Wisconsin with smaller facilities in Iowa and Minnesota. The Hospital is located in La Crosse, Wisconsin, and provides medical care to patients from La Crosse and surrounding communities. GLAS is engaged in various administrative transactions on behalf of the Parent Corporation and its affiliates in support of charitable health care activities. The Foundation enhances and supports quality health care with an emphasis on medical and health/wellness education as well as clinically based research and community outreach.

### **2. Summary of Significant Accounting Policies**

#### **Accounting Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. Although estimates, including uncollectible and contractual allowances on patient accounts receivable, third-party payor settlements, self-insured liabilities, and valuation of swap contracts, are considered to be fairly stated at the time that the estimates were made, actual results could differ from those estimates.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Cash and Cash Equivalents**

Cash and cash equivalents include currency on hand, demand deposits with banks or other financial institutions, and short-term investments with original maturities of 90 days or less from the date of purchase. The Obligated Group maintains cash and cash equivalents on deposit at financial institutions, which at times exceed the limits insured by the Federal Deposit Insurance Corporation and thereby exposes the Obligated Group to potential risk of loss in the event the financial institution becomes insolvent. No losses have been incurred to date, and management does not consider the credit risk to be significant to the Obligated Group.

##### **Patient Accounts Receivable**

The collection of receivables from third-party payors and patients is the Obligated Group's primary source of cash for operations. The primary collection risks relate to uninsured patient accounts and patient deductibles and coinsurance on insurers' accounts. Patient receivables, including the portion that a third-party payor is responsible for, are carried at net realizable value, determined by the original charge for the service provided less an estimate made for contractual adjustments or discounts provided to third-party payors. Patient receivables due directly from the patients are carried on the accompanying combined balance sheets at the original charge for the service provided less amounts covered by third-party payors, allowances for other discounts, and an allowance for uncollectible receivables. The Obligated Group does not charge interest on past due receivables. Receivables are written off after collection efforts have been followed in accordance with the Obligated Group's policies. Recoveries of receivables previously written off are recorded as a reduction of bad debt expense.

Accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectibility of accounts receivable, the Obligated Group analyzes its past history and identifies trends for each of its major payor sources to estimate the appropriate allowance for doubtful accounts and provision for bad debts. The analysis is performed using a hindsight calculation that utilizes write-off data for all payor classes during a determined time period to calculate the allowance for uncollectible accounts at a point in time. Accounts receivable balances, without payment arrangements, over 365 days are fully allowed for.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

At December 31, 2013 and 2012, the allowance for uncollectible accounts was \$26,763 and \$35,459, respectively, which as a percent of accounts receivable, net of contractual adjustments, was 19% and 23%, respectively. The allowance for doubtful accounts decreased from 2012 to 2013 due to improved collection processes and lower estimated allowances required on outstanding receivables.

#### **Investments and Investments Whose Use Is Limited**

Investments in equity securities with readily determinable fair values and investments in debt securities are measured at fair value in the combined balance sheets. Investments in equity and debt securities are classified as trading, and accordingly, all unrealized gains and losses are recorded as nonoperating investment return. The Obligated Group accounts for investment transactions on a settlement-date basis.

Investment securities are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of certain investments will occur in the near term and that such changes could materially affect the amounts reported in the combined financial statements.

Unrestricted investments are classified as current assets since they are available for operations. Certain investments are limited as to use under the terms of a bond indenture, state insurance regulations, unemployment fund agreements, collateral posted against swap valuations, and internally designated for medical education by the Board of Trustees and the Board of Governors. The Board of Trustees and the Board of Governors, at their discretion, can change these designations in the future.

#### **Inventories, Supplies, and Materials**

Inventories, supplies, and materials are valued at the lower of cost (first-in, first-out method) or market value and included in other current assets in the combined balance sheets.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 2. Summary of Significant Accounting Policies (continued)

##### Property and Equipment

Property and equipment are stated at cost, if purchased, or at fair value on the date received, if donated, less accumulated depreciation. During periods of construction, interest costs are capitalized to the respective property accounts.

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Land improvements	5–15 years
Building	30–40 years
Building additions and improvements	10–25 years
Equipment and furniture	3–15 years

The Obligated Group assesses potential impairment to its long-lived assets when there is evidence that events or changes in circumstances have made recovery of an asset's carrying value unlikely. An impairment loss is indicated when the estimated total undiscounted future net cash flows is less than the carrying amounts. The loss recognized is the difference between the fair value and the carrying amount. No impairment loss was recognized at December 31, 2013 and 2012.

The Obligated Group capitalizes expenditures for additions and improvements, while replacements, maintenance, and repairs that do not improve the useful lives of the assets are expensed as incurred. The Obligated Group capitalizes interest on the financing of major capital, including projects financed with tax-exempt borrowings.

##### Software Costs

Capitalized computer software costs include internally developed software. Costs incurred in developing and installing internal use software are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage, or post-implementation stage.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Derivative Financial Instruments**

The Obligated Group uses interest rate swap contracts as part of its risk management strategy to manage exposure to fluctuations in interest rates related to its variable rate debt. All derivative instruments are recorded at fair value in the combined balance sheets, with the changes in the fair values recorded in nonoperating gains (losses) in the combined statements of operations.

In April 2007, the Obligated Group de-designated its swaps, which formerly had been classified as cash flow hedges. Prior to the de-designation, changes in the fair value of the hedged interest rate swaps were included in other changes in unrestricted net assets. The accumulated gain in net assets prior to de-designation is being amortized over the remaining life of the term of debt.

##### **Insurance**

The provision for estimated self-insured professional liability, workers' compensation, and employee health care claims includes estimates of the ultimate costs for both reported and incurred but not reported (IBNR) claims. The accrual for self-insured professional liability, workers' compensation, and employee health care claims represents the estimated ultimate cost for both asserted and unasserted claims.

##### **Donated Assets and Services**

Unconditional promises to give cash and other assets to the Obligated Group are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets. When the terms of a donor restriction are met, temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets released from restriction. Donor contributions whose restrictions are met within the same year as received are reported as unrestricted contributions.

A large number of people contribute significant amounts of time to the Obligated Group without compensation. The combined financial statements do not reflect the value of those contributed services, because although substantial, no reliable basis exists for determining an appropriate amount.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Net Assets**

Resources are classified into three net asset categories as unrestricted, temporarily restricted, and permanently restricted, according to the absence or existence of donor-imposed restrictions. Unrestricted net assets represent amounts that have no donor-imposed restrictions. Temporarily restricted net assets are those assets whose use has been limited by donors to a specific purpose or time period. Permanently restricted net assets are those assets for which donors require the principal of the gift to be maintained in perpetuity in order to provide a permanent source of income.

##### **Net Patient Revenue**

Net patient revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered, excluding charges related to the Obligated Group's self-insured health benefits. Net patient revenue includes estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future years as final settlements are determined.

##### **Capitation Revenue and Purchased Health Services**

The Clinic and the Hospital provide health care services to enrollees of the Gundersen Lutheran Health Plan (the Health Plan), an affiliate controlled by the Parent Corporation, under a capitation arrangement. The health care services covered by the Health Plan are paid for primarily on a capitated basis determined as a percentage of the member premiums, which transfers most insurance risk to the Clinic and Hospital under a provider reimbursement agreement. Net capitation revenue is recognized in the year in which health care coverage is provided and is recorded net of amounts paid to other medical service providers. Although the majority of services are provided to Health Plan enrollees by the Hospital and Clinic, certain services are provided by out-of-network providers on a contracted fee-for-service basis. A reserve is recorded for out-of-network care rendered but not reported as of each year-end.



## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Charity and Uncompensated Care**

The Clinic and the Hospital provide health care services to patients who meet certain criteria under their charity care policies without charge or at amounts less than established rates. The Clinic and Hospital maintain records to identify and monitor the level of community care provided. These records include the amount of costs incurred for services and supplies furnished under the charity care policy. Since the Clinic and the Hospital do not pursue collection of these amounts, they are not reported as patient revenue.

##### **Electronic Health Record Incentive Payments**

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicare and Medicaid incentive program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments depends on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement, or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional Medicaid incentive payments.

The Obligated Group accounts for HITECH incentive payments as a gain contingency. Income from Medicare incentive payments is recognized as revenue after the Obligated Group has demonstrated that it complied with the meaningful use criteria over the entire applicable compliance period and the cost report period that will be used to determine the final incentive payment has ended. The Obligated Group recognized revenue from Medicaid incentive payments after it adopted certified EHR technology. Incentive payments totaling \$5,790 and \$6,868 for 2013 and 2012, respectively, are included in operating revenue in the combined statements of operations. Income from incentive payments is subject to retrospective adjustment as the incentive payments are calculated using Medicare cost data that is subject to audit. In addition, the Obligated Group's compliance with the meaningful use criteria is subject to audit by government agencies.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) *(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Performance Indicator**

The performance indicator is revenue in excess of expenses. Changes in unrestricted net assets, which are excluded from revenue in excess of expenses, consistent with industry practice, include net assets released from restrictions to purchase property and equipment, transfers to affiliates, and amortization of accumulated gains on swap contracts at the time of de-designation.

##### **Income Tax Matters**

The Obligated Group has reviewed its tax positions for all open years and has concluded that no liabilities exist for uncertain tax positions at December 31, 2013 and 2012. The Obligated Group's income tax returns are no longer subject to examination for 2007 and prior.

##### **Reclassifications**

During 2013, the Obligated Group implemented a new general ledger chart of accounts, which improved the financial statement reporting process. Certain prior year amounts in the combined financial statements have been reclassified to conform to the 2013 presentation. These reclassifications had no effect on the change in net assets or net assets as previously reported.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **3. Net Patient Revenue**

The Clinic and the Hospital derive patient revenue primarily from patients covered under the Medicare and Medicaid programs, agreements with commercial insurers, and managed care organizations, as well as from private pay patients. The basis for payment under agreements with commercial insurers and managed care organizations includes prospectively determined rates, discounts from established charges, and allowable cost.

The Clinic participates in the Medicare and Medicaid programs and is reimbursed based on fee schedules. The Hospital also participates in the Medicare and Medicaid programs, under which substantially all inpatient services rendered to program beneficiaries are paid for based on prospectively determined amounts per discharge depending on the individual patient's diagnostic-related grouping of medical conditions. The Hospital's Medicare outpatient services are predominantly paid based on prospectively determined amounts for each service provided depending on the ambulatory payment classification assigned to each service. Amounts recorded by the Hospital for estimated cost report settlements can differ from actual settlements based on the results of subsequent cost report audits. In addition, the Hospital appeals certain settlements related to Medicare and other programs. Changes in estimated reimbursement related to prior periods, primarily related to the Medicare program, resulted in an increase in net patient service revenue of \$964 and \$2,488 for 2013 and 2012, respectively.

For self-pay patients, management determines an allowance for uncollectible accounts by identifying amounts at risk, based on historical collection experience, aging of accounts, and current economic conditions. The Obligated Group also has policies to provide a discount from established charges to uninsured patients.

The Obligated Group has determined, based on an assessment at the reporting-entity level, that patient revenue is primarily recorded prior to assessing the patient's ability to pay, and as such, the entire provision for uncollectible accounts is recorded as a deduction from patient revenue in the combined statements of operations.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 3. Net Patient Revenue (continued)

Patient service revenue, net of contractual expense (but before the provision for bad debts), recognized from the Obligated Group's major payor sources is summarized as follows for the years ended December 31:

	<u>2013</u>	<u>2012</u>
Third-party payors	\$ 593,134	\$ 577,409
Self-pay payors	39,707	39,004
	<u>\$ 632,841</u>	<u>\$ 616,413</u>

The Medicare program accounted for 26% and 23% of the Obligated Group's net patient revenue for 2013 and 2012, respectively. Potential changes in the Medicare program and reduction of funding levels could have a material adverse effect on the Clinic and the Hospital in the near term.

#### 4. Charity Care

The Clinic and the Hospital provide medical care without charge or at reduced charges to residents of the communities they serve by providing services to patients who are uninsured or underinsured. The cost of providing charity care has been estimated by applying a cost to gross charges ratio to the gross uncompensated charges associated with providing charity care to patients. For 2013 and 2012, cost of providing charity care is estimated to be \$6,763 and \$5,138, respectively.

Gundersen Health System Obligated Group

Notes to Combined Financial Statements (continued)  
(Dollars in Thousands)

**5. Investments Whose Use Is Limited and Investment Return**

Certain investments as of December 31 are limited as to use for the following purposes:

	2013	2012
Board designated for medical education	\$ 3,747	\$ 3,747
Minimum funding as required by the Wisconsin Office of the Commissioner of Insurance (Note 11)	8,649	9,546
Minimum funding as required by the Wisconsin Unemployment Reserve Fund	3,327	3,071
Collateral posted against insurance claims	650	1,375
Principal and interest payments under a bond indenture	248	233
Collateral posted against swap valuations (Note 9)	5,060	19,153
Held for future capital expenditures under bond indenture	-	42,249
	\$ 21,681	\$ 79,374

Investment return consists of the following for the years ended December 31:

	2013	2012
Dividends and interest	\$ 13,267	\$ 14,569
Gain on sale of long-term investment	126	4,408
Net realized gains	6,241	10,112
Net change in unrealized gains and losses	33,728	14,764
	\$ 53,362	\$ 43,853

Investment return is reported in the combined statements of operations and changes in net assets as follows for the years ended December 31:

	2013	2012
Nonoperating gains, net	\$ 50,058	\$ 42,227
Temporarily restricted net assets	2,444	1,251
Permanently restricted net assets	860	375
	\$ 53,362	\$ 43,853

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 6. Fair Value Measurements and Investments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e., an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy in Accounting Standards Codification 820, *Fair Value Measurement*, are described below:

- Level 1 – Unadjusted quoted prices in active markets that are accessible to the reporting entity at the measurement date for identical assets and liabilities.
- Level 2 – Inputs other than quoted prices in active markets for identical assets and liabilities that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:
  - Quoted prices for similar assets and liabilities in active markets
  - Quoted prices for identical or similar assets or liabilities in markets that are not active
  - Observable inputs other than quoted prices that are used in the valuation of the asset or liabilities (e.g., interest rate and yield curve quotes at commonly quoted intervals)
  - Inputs that are derived principally from or corroborated by observable market data by correlation or other means
- Level 3 – Unobservable inputs for the asset or liability (i.e., supported by little or no market activity). Level 3 inputs include management's own assumption about the assumptions that market participants would use in pricing the asset or liability including assumptions about risk.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 6. Fair Value Measurements and Investments (continued)

The level in the fair value hierarchy within which the fair value measurement is classified is determined based on the lowest level of input that is significant to the fair value measure in its entirety.

The following tables present the financial instruments measured at fair value on a recurring basis at December 31, 2013 and 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	December 31, 2013			
	Level 1	Level 2	Level 3	Total Value
<b>Assets</b>				
Cash equivalents	\$ 19,659	\$ 310	\$ —	\$ 19,969
Common stock	43,195	—	—	43,195
Equity mutual funds	122,948	—	—	122,948
Equity mutual funds – foreign government	63,324	—	—	63,324
Asset-backed securities	—	13,125	—	13,125
Fixed income securities:				
U.S. government and agency obligations	92,826	—	—	92,826
Corporate bonds	—	71,976	—	71,976
Residential mortgage-backed securities	—	69,767	—	69,767
Commercial mortgage-backed securities	—	17,707	—	17,707
Instruments measured at fair value	341,952	172,885	—	514,837
Certificate of deposit	26,050	—	—	26,050
Total investments and investments whose use is limited	<u>\$ 368,002</u>	<u>\$ 172,885</u>	<u>\$ —</u>	<u>\$ 540,887</u>
<b>Liabilities</b>				
Obligation under swap contracts	\$ —	\$ 23,469	\$ —	\$ 23,469

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 6. Fair Value Measurements and Investments (continued)

	December 31, 2012			
	Level 1	Level 2	Level 3	Total Value
<b>Assets</b>				
Cash equivalents	\$ 73,224	\$ —	\$ —	\$ 73,224
Common stock	16,860	—	—	16,860
Equity mutual funds	162,457	—	—	162,457
Equity mutual funds – foreign government	10,672	—	—	10,672
Asset-backed securities	—	2,026	—	2,026
Fixed income securities:				
U.S. government and agency obligations	72,829	40,414	—	113,243
Corporate bonds	—	58,767	—	58,767
Residential mortgage-backed securities	—	90,322	—	90,322
Commercial mortgage-backed securities	—	19,992	—	19,992
Instruments measured at fair value	336,042	211,521	—	547,563
Certificate of deposit	25,900	—	—	25,900
Total investments and investments whose use is limited	\$ 361,942	\$ 211,521	\$ —	\$ 573,463
<b>Liabilities</b>				
Obligation under swap contracts	\$ —	\$ 41,490	\$ —	\$ 41,490

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses are reasonable estimates of fair value due to the short-term nature of these financial instruments. The carrying value of pledges (Level 2) approximates its fair value at December 31, 2013 and 2012.

At December 31, 2013 and 2012, fair value of fixed interest long-term debt (Level 2), based on quoted market prices for the same or similar instruments, was \$253,574 and \$284,300, respectively, compared with its carrying value of \$260,145 and \$266,565, respectively. Fair value of variable rate long-term debt (Level 2) approximated its carrying value at both December 31, 2013 and 2012.



## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 6. Fair Value Measurements and Investments (continued)

The fair value for obligation under swap contracts is determined through the use of widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flow of each derivative. The analysis reflects the contractual terms of the interest rate swaps, including the period to maturity, and uses observable market-based inputs, such as interest rate curves. In addition, credit value adjustments are included to reflect both the Obligated Group's nonperformance risk and the respective counterparty's nonperformance risk. The Obligated Group pays annual fixed rates ranging from 3.26% to 3.79% and receives cash flows based on 67% of the London Interbank Offered Rate (LIBOR). At December 31, 2013 and 2012, the Obligated Group's fair value of obligations under interest rate swap contracts of \$23,469 and \$41,490, respectively, was recorded net of a credit value adjustment (CVA) of \$1,442 and \$2,597, respectively.

#### 7. Property and Equipment

Property and equipment as of December 31 consist of the following:

	2013	2012
Land and land improvements	\$ 23,710	\$ 22,225
Buildings and building improvements	366,220	347,550
Capitalized software	29,489	68,317
Equipment and furniture	299,131	287,006
Capitalized leases	8,798	—
	727,348	725,098
Less accumulated depreciation and amortization	420,063	420,617
	307,285	304,481
Construction-in-progress	246,107	151,971
	\$ 553,392	\$ 456,452

Depreciation expense was \$44,437 and \$41,787 for 2013 and 2012, respectively.

The Obligated Group capitalizes payroll and payroll-related costs associated with the development of software for internal use. In 2013 and 2012, \$1,080 and \$578, respectively, of payroll and payroll-related costs were capitalized.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 8. Long-Term Debt and Capital Lease Obligations

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

	2013	2012
Wisconsin Health and Educational Facilities Authority (WHEFA), Series 2012 (Gundersen), annual interest from 2.0% to 5.0%, principal due in varying amounts through 2044	\$ 69,845	\$ 70,000
WHEFA Bonds, Series 2011A (Gundersen), annual interest from 1.00% to 5.25%, principal due in varying amounts through 2039	150,300	156,565
WHEFA Series 2011B (Gundersen), adjustable demand, principal due starting in 2038 (average annual interest rate in 2013 and 2012 of 0.12% and 0.18%, respectively)	40,000	40,000
WHEFA Series 2009A (Gundersen), adjustable demand, principal due in varying amounts through 2033 (average annual interest rate in 2013 and 2012 of 1.03% and 1.06%, respectively)	45,305	45,305
WHEFA Series 2009B (Gundersen), adjustable demand, principal due in varying amounts through 2033 (average annual interest rate in 2013 and 2012 of 1.03% and 1.06%, respectively)	33,410	33,410
WHEFA Series 2008B (Gundersen), adjustable demand, principal due in varying amounts through 2033 (average annual interest rate in 2013 and 2012 of 0.90% and 1.04%, respectively)	61,400	61,400
Capital lease obligations	2,607	—
Unamortized premium	2,992	1,774
Total long-term debt and capital lease obligations	405,859	408,454
Less current maturities	8,376	6,420
	\$ 397,483	\$ 402,034

In September 2011, the Hospital, the Clinic, GLAS, and the Foundation entered into a Restated Master Trust Indenture with a bank that established an Obligated Group, which currently includes the Hospital, the Clinic, GLAS, and the Foundation. Each Obligated Group member is jointly and severally liable for the payment of all obligations issued under the Restated Master Trust Indenture, which are secured ratably by a pledge of the unrestricted receivables of the Obligated Group. The Restated Master Trust Indenture contains, among other things, provisions placing restrictions on additional debt, asset transfers, and liens and requires the maintenance of a debt service coverage ratio. Additional covenants, including liquidity and capitalization, are included in other loan agreements relating to the obligations.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **8. Long-Term Debt and Capital Lease Obligations (continued)**

In September 2012, WHEFA issued Series 2012 bonds on behalf of the Obligated Group in an aggregate par amount of \$70,000 and bear interest at fixed rates. The bonds are subject to optional, mandatory, extraordinary redemption and purchase in lieu of redemption prior to maturity. The proceeds have been used to finance new construction.

In September 2011, WHEFA issued Series 2011A and Series 2011B bonds on behalf of the Obligated Group. The Series 2011A bonds were issued in an aggregate par amount of \$162,430 and bear interest at fixed rates. The Series 2011B bonds were issued in an aggregate amount of \$40,000 and bear interest at variable rates that are initially set weekly. The Series 2011B bonds are subject to optional and mandatory tender and are supported by an irrevocable direct pay letter of credit issued by a bank, which expires in September 2016. Under the terms of the agreement with the bank, the Obligated Group may elect to convert any liquidity draw made under the letter of credit into a bank loan that amortizes in equal quarterly installments over a three-year period, commencing no sooner than 367 days after the date of the draw, provided that there is no event of default and the representations made at the time of the draw are accurate.

In May 2008, WHEFA issued Series 2008A and Series 2008B bonds on behalf of GLAS in the aggregate amount of \$89,300 bearing interest at a variable rate. In August 2010, the Obligated Group caused a tender of the Series 2008A and Series 2008B bonds, which were placed directly with a bank. Under the terms of the agreement with the bank, GLAS was required to purchase the Series 2008B bonds from the bank in August 2013. The Series 2008A bonds were refunded with proceeds of the Series 2011A bonds and Series 2011B bonds in September 2011. In October 2012, the date that GLAS was required to repurchase the Series 2008B bonds was extended to October 1, 2015.

Gundersen Health System Obligated Group

Notes to Combined Financial Statements (continued)  
(Dollars in Thousands)

**8. Long-Term Debt and Capital Lease Obligations (continued)**

In May 2009, WHEFA issued Series 2009A and Series 2009B bonds on behalf of GLAS in the aggregate amount of \$78,715. The proceeds of those bonds were used to refund the Series 2003B and Series 2003C bonds. In March 2011, the Obligated Group caused a tender of the Series 2009A and Series 2009B bonds, which were placed directly with a bank. Under the terms of the agreement with the bank, GLAS was required to purchase the Series 2009A and Series 2009B bonds from the bank in March 2014. In October 2012, the date that GLAS was required to repurchase the Series 2009A and Series 2009B bonds was extended to October 1, 2017.

At December 31, 2013, the aggregate maturities and sinking fund requirements of long-term debt, for each of the five subsequent years and thereafter, assuming that all bonds are successfully remarketed with the original maturity dates and the Obligated Group is able to renew the letter of credit, which expires in September 2016, are as follows:

2014	\$	6,580
2015		6,905
2016		7,160
2017		7,395
2018		7,715
Thereafter		364,505
		\$ 400,260

The Obligated Groups capital lease obligations for software and equipment will expire over the next five years. Future commitments under capital leases in effect as of December 31, 2013, for each of the five subsequent years are as follows.

2014	\$	1,986
2015		199
2016		199
2017		199
2018		115
Total		2,698
Amount representing interest		91
Present value of minimum lease payments		2,607
Current portion		1,796
Long term		\$ 811

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 9. Derivative Financial Instruments

The Obligated Group has entered into interest rate swaps, which are recorded at fair value as noncurrent liabilities in the combined balance sheets as of December 31, as follows:

	2013	2012
Notional amount \$33,000 Series 2009B (previously Series 2003C), fixed annual rate 3.50%, variable interest equal to 67% of the one-month LIBOR	\$ 4,189	\$ 7,350
Notional amount \$40,470 Series 2011B (previously Series 2000B), fixed annual rate 3.26%, variable interest equal to 67% of the one-month LIBOR	4,251	7,778
Notional amount \$44,750 Series 2009A (previously Series 2003B), fixed annual rate 3.28%, variable interest equal to 67% of the one-month LIBOR	4,840	9,340
Notional amount \$60,725 Series 2008B, fixed annual rate 3.79%, variable interest equal to 67% of the one-month LIBOR	10,189	17,022
	\$ 23,469	\$ 41,490

The increase (decrease) in the value of the swap contracts of \$18,021 and (\$1,333) for 2013 and 2012, respectively, was recorded as an unrealized gain (loss) and is included in nonoperating gains (losses) in the combined statements of operations.

Derivative transactions contain credit risk in the event the parties are unable to meet the terms of the contract; credit risk is generally limited to the fair value due from counterparties on outstanding contracts. At December 31, 2013, the counterparties had a Standard & Poor's credit quality rating of A-.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### **9. Derivative Financial Instruments (continued)**

The interest rate swap contracts contain collateral provisions applicable to both parties to mitigate credit risk. The collateral provided by the Obligated Group to the counterparties was \$5,060 and \$19,153 as of December 31, 2013 and 2012, respectively, and is included in investments whose use is limited in the combined balance sheets.

The net settlements for the interest rate swap contracts of \$6,010 and \$5,945 for 2013 and 2012, respectively, are included in interest expense in the combined statements of operations.

#### **10. Retirement Plan**

The Obligated Group maintains a defined contribution and 401(k) plan covering substantially all of its employees. Retirement plan expense was \$45,861 and \$47,985 for 2013 and 2012, respectively. The Obligated Group contributes matching funding on a monthly basis, with the remainder contributed annually. At December 31, 2013 and 2012, the total liability for employer contributions was \$34,892 and \$37,534, respectively, and is included in accrued liabilities in the combined balance sheets.

#### **11. Insurance**

The Clinic is self-insured for Wisconsin professional liability up to base limits of insurance coverage (\$1,000 per claim and \$3,000 annually on an occurrence basis at December 31, 2013 and 2012). Additionally, under the Wisconsin professional liability, self-insured limits are in place per physician/certified registered nurse anesthetist (CRNA) (\$1,000 per physician/CRNA per claim and \$3,000 annually per physician/CRNA on an occurrence basis at December 31, 2013 and 2012). The Clinic has established a professional liability insurance plan and irrevocable trust as required by Wisconsin statutes. The funding requirements of the plan are established annually based on third-party actuarial calculations, as prescribed by the Commissioner of Insurance for the State of Wisconsin. All professional liability claims or judgments occurring in Wisconsin in excess of the base level of coverage are paid from the Injured Patients and Families Compensation Fund, which insures all claims incurred regardless of when the claim is filed. The Injured Patients and Families Compensation Fund has no upper limit on losses.

The Clinic has purchased professional liability insurance on a claims-made basis to cover Iowa and Minnesota risks, including umbrella and excess coverage to minimize exposure.

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 11. Insurance (continued)

The Hospital has purchased professional liability insurance on a claims-made basis to cover claim losses. The Hospital is also insured through the Injured Patients and Families Compensation Fund for losses on professional liability claims (\$1,000 per claim and \$3,000 annually at December 31, 2013 and 2012). The Injured Patients and Families Compensation Fund has no upper limit on losses.

The Obligated Group maintains self-insurance programs for health care costs of its active employees. The Obligated Group has purchased stop-loss insurance with an annual deductible of \$700 per individual. In addition, the Obligated Group is insured for workers' compensation exposures under an incurred loss retrospective rating plan.

The liability for professional and general liability, workers' compensation, and employee health insurance claims is based on actual claims to date and a projection of the estimated future liability for such claims and IBNR claims. At December 31, 2013 and 2012, the total recorded liability was \$19,359 and \$21,452, respectively, of which a current portion of \$11,091 and \$12,270, respectively, is included in accrued liabilities, and the noncurrent portion of \$8,268 and \$9,182, respectively, is included in other noncurrent liabilities in the combined balance sheets. At December 31, 2013 and 2012, the estimated receivable related to insurance recoveries of \$861 and \$2,451, respectively, is included in other current assets in the combined balance sheets.

#### 12. Commitments and Contingencies

The Obligated Group has leases for equipment and satellite office facilities, which are classified as operating leases. Rental expense under these operating leases totaled \$4,921 and \$4,855 for 2013 and 2012, respectively. Future commitments under operating leases in effect as of December 31, 2013, for each of the five subsequent years and thereafter are as follows:

2014	\$	1,635
2015		964
2016		756
2017		553
2018		447
Thereafter		1,017
	\$	<u>5,372</u>

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) *(Dollars in Thousands)*

#### **12. Commitments and Contingencies (continued)**

The Clinic and the Hospital are defendants in legal proceedings arising in the ordinary course of business. Although the outcome of these proceedings cannot be determined, management of the Obligated Group considers it unlikely that the disposition of these proceedings will have a material adverse effect on the financial position or operations of the Obligated Group. However, there can be no assurance that this will be the case.

The Clinic, Hospital, and GLAS have entered into an agreement with the city of La Crosse in conjunction with the city's establishment of Tax Incremental Financing District No. 14 (TIF 14). The agreement requires the construction of one or more parking ramps that will accommodate 1,000 vehicles, with qualifying costs not to exceed \$18,500. At December 31, 2009, a 537-vehicle ramp adjacent to the Clinic was completed. In 2010, a second ramp was completed to satisfy the requirement of available vehicle space and is considered for the tax incentives offered under the TIF 14 agreement. This ramp is adjacent to the area designated for the new hospital described below as part of a campus renewal plan. Additionally, the agreement creates property tax incentives for further taxable development on the Obligated Group La Crosse campus by the Obligated Group and other developers. The benefit that the Obligated Group will derive from participation in TIF 14 depends on the size of future development over the next 20 years.

The Obligated Group has established a campus renewal plan, which includes the addition of a 400,000 square foot, six-story hospital building on the main campus, adjacent to the existing Hospital facility. The hospital addition, which began in January 2011, was placed in service January 2014. This initial phase is projected to cost \$218,000 under a guaranteed maximum price contract with a general contractor. The Obligated Group is funding this addition with cash flow from operations, debt financing, and fund-raising.



## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

#### 12. Commitments and Contingencies (continued)

##### Compliance with Laws and Regulations

The health care industry is governed by various laws and regulations of federal, state, and local governments. These laws and regulations are subject to ongoing government review and interpretation and include matters such as licensure, accreditation, reimbursement for patient services, and referrals for Medicare and Medicaid beneficiaries. Compliance with these laws and regulations is required for participation in government health care programs. Certain governmental agencies routinely investigate and pursue allegations concerning possible overpayments resulting from violation of fraud and abuse statutes by health care providers. These investigations may result in settlements involving fines and penalties as well as repayment of improper reimbursement. The Obligated Group has implemented procedures for monitoring and enforcing compliance with laws and regulations and is not aware of instances of noncompliance.

While management believes that the Obligated Group is in material compliance with fraud and abuse laws and regulations as well as other applicable government laws and regulations, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Changes in reimbursement from the Medicare program, including reduction of funding levels, could have a material adverse effect on the Obligated Group.

#### 13. Concentration of Credit Risk

The Clinic and the Hospital grant credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. Amounts due from various payors and patients as of December 31 included in net patient accounts receivable are as follows:

	<u>2013</u>	<u>2012</u>
Medicare	15%	9%
Medicaid	3	2
Commercial insurance, private pay, and other	82	89
	<u>100%</u>	<u>100%</u>

## Gundersen Health System Obligated Group

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 14. Functional Expenses

Expenses related to providing patient care are as follows for the years ended December 31:

	<u>2013</u>	<u>2012</u>
Health care services	\$ 700,253	\$ 668,988
General and administrative, including fund-raising	171,498	169,828
	<u>\$ 871,751</u>	<u>\$ 838,816</u>

#### 15. Related-Party Transactions

The Clinic and the Hospital have an agreement with the Health Plan to provide health care services to the Health Plan's insured enrollees. The Clinic and the Hospital are paid on a fully capitated basis. Reinsurance contracts exist for medical and hospital expenses in excess of \$700 per enrollee per contract year. Capitation revenue recorded by the Clinic and the Hospital that was earned under the agreement with the Health Plan totaled \$270,710 and \$268,172 for 2013 and 2012, respectively. At December 31, 2013 and 2012, amounts due to the Health Plan were \$2,782 and \$1,967, respectively, and are included in other current liabilities in the combined balance sheets.

Under terms of an administrative services agreement with the Health Plan, the Obligated Group provides substantially all general and administrative services necessary for the Health Plan's operations at amounts that are intended to approximate cost. The cost of these services to the Health Plan was \$12,554 and \$11,369 in 2013 and 2012, respectively, and is deducted from the Obligated Group's expenses in the combined statements of operations. Amounts due from the Health Plan as of December 31, 2013 and 2012, related to the administrative services agreement were \$2,377 and \$1,434, respectively, and are included in other current assets in the combined balance sheets.

The Health Plan leases office space from the Obligated Group. Rental payments were \$306 for 2013 and 2012.

Gundersen Health System Obligated Group

Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

**15. Related-Party Transactions (continued)**

At December 31, 2013 and 2012, notes receivable from affiliates totaling \$11,998 and \$10,854, respectively, which are recorded net of allowances for uncollectible amounts of \$144, represent loans to affiliates to finance their activities. Notes receivable from affiliates have terms ranging from 1 to 15 years, with annual interest rates ranging from 3.8% to 6.0%.

**16. Restricted Net Assets**

Temporarily restricted net assets as of December 31 are available for the following purposes or periods:

	<u>2013</u>	<u>2012</u>
Purpose restrictions:		
Education	\$ 1,062	\$ 750
Research	1,299	599
Community and affiliate programs	869	687
Buildings and equipment	9,431	13,422
Other	381	364
Time restrictions for future periods	278	234
	<u>\$ 13,320</u>	<u>\$ 16,056</u>

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

	<u>2013</u>	<u>2012</u>
Education	\$ 5,368	\$ 4,915
Research	4,663	4,639
Community health initiatives	2,559	2,340
General operations	3,839	3,415
	<u>\$ 16,429</u>	<u>\$ 15,309</u>

Gundersen Health System Obligated Group

Notes to Combined Financial Statements (continued)  
*(Dollars in Thousands)*

**17. Pledges**

The timing of receipt of pledges at December 31 is estimated as follows:

	<b>2013</b>	<b>2012</b>
Within one year	\$ 219	\$ 312
One to five years	6,014	4,194
After five years	5,101	5,046
	<b>11,334</b>	<b>9,552</b>
Present value discount and allowances for uncollectible pledges	(1,591)	(1,309)
	<b>\$ 9,743</b>	<b>\$ 8,243</b>

Pledges receivable were discounted at annual rates ranging from 3.70% to 4.87% at December 31, 2013, and from 3.63% to 5.60% at December 31, 2012. Pledges due within one year are recorded in other current assets, and all other pledges are recorded in other noncurrent assets.

**18. Subsequent Events**

The Obligated Group has evaluated events and transactions that have occurred subsequent to December 31, 2013 through April 24, 2014, the date on which the combined financial statements were issued. During this period, there were no subsequent events requiring recognition or disclosure in the combined financial statements.

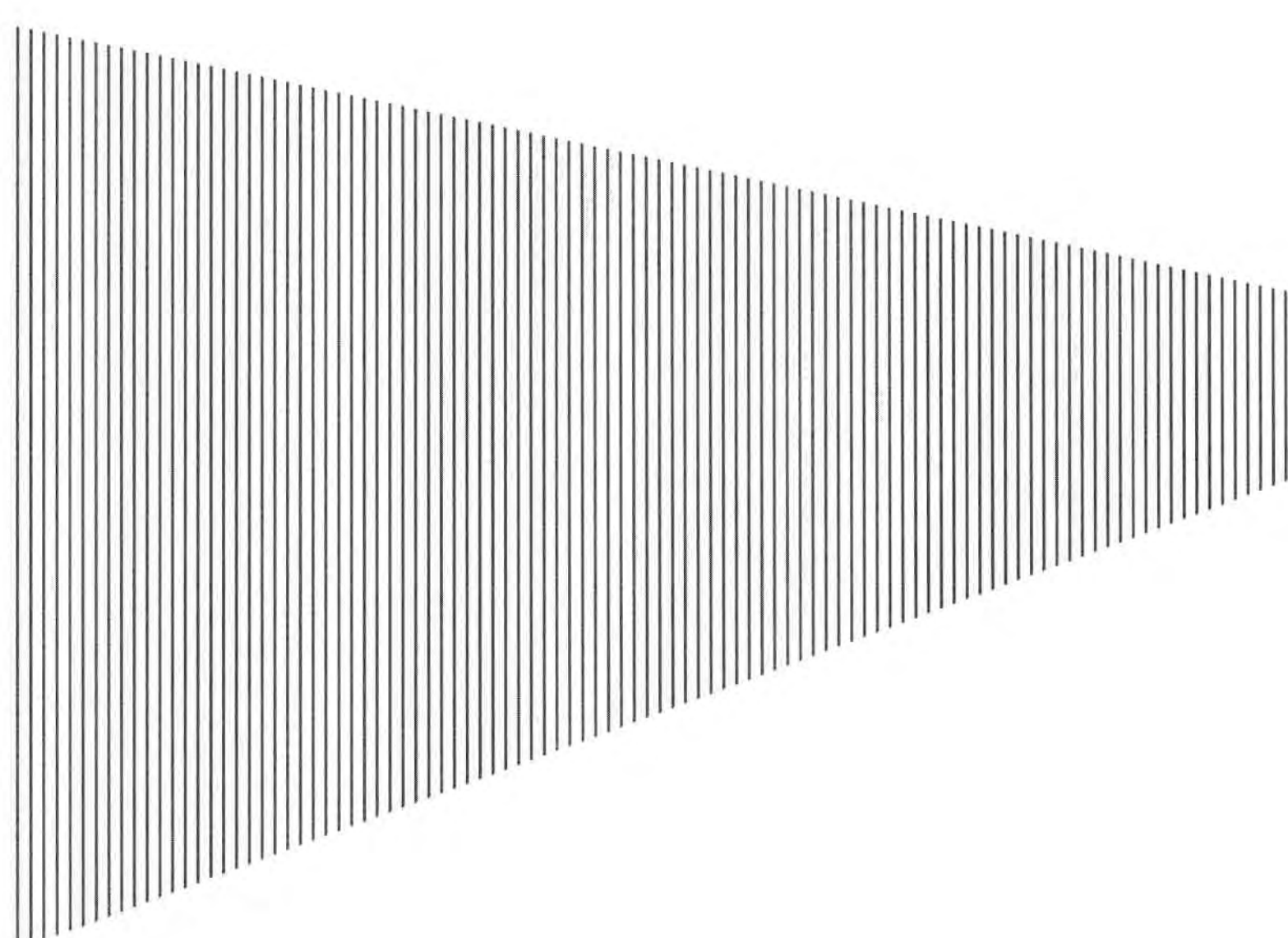
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COMBINED FINANCIAL STATEMENTS

Gundersen Lutheran  
(Consisting of Gundersen Clinic, Ltd., Gundersen Lutheran  
Medical Center, Inc., Gundersen Lutheran Administrative  
Services, Inc., and Gundersen Lutheran Medical  
Foundation, Inc., which comprise an Obligated Group)  
Years Ended December 31, 2012 and 2011  
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Gundersen Lutheran

Combined Financial Statements

Years Ended December 31, 2012 and 2011

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## Report of Independent Auditors

The Board of Trustees and the Board of Governors  
Gundersen Lutheran

We have audited the accompanying combined financial statements of Gundersen Clinic, Ltd.; Gundersen Lutheran Medical Center, Inc.; Gundersen Lutheran Administrative Services, Inc; and Gundersen Lutheran Medical Foundation, Inc. (collectively, Gundersen Lutheran), which comprise the combined balance sheets as of December 31, 2012 and 2011, and the related combined statements of operations, changes in net assets, 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 financial statements in conformity 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 financial statements that are free of material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the combined financial position of Gundersen Lutheran at December 31, 2012 and 2011, and the combined results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the combined financial statements, effective January 1, 2012, Gundersen Lutheran changed the presentation of the provision for uncollectible accounts as a result of the adoption of the amendments to the Financial Accounting Standards Board (FASB) Accounting Standards Codification resulting from Accounting Standards Update No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*.

*Ernst & Young LLP*

April 30, 2013

Gundersen Lutheran  
 Combined Balance Sheets  
 (Dollars in Thousands)

	December 31	
	2012	2011
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 82,516	\$ 70,544
Investments	494,089	418,439
Current portion of investments whose use is limited	17,447	10,722
Patient accounts receivable, less allowance for uncollectible accounts of \$35,459 in 2012 and \$29,248 in 2011	119,689	122,637
Current portion of notes receivable from affiliates	1,574	1,296
Other	33,547	45,187
Total current assets	748,862	668,825
Investments whose use is limited	61,927	79,254
Notes receivable from affiliates, net of current portion	9,280	12,910
Property and equipment, net	456,452	372,096
Other noncurrent assets	23,022	23,504
Total assets	\$ 1,299,543	\$ 1,156,589
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 27,562	\$ 23,704
Accrued liabilities	108,664	113,963
Current maturities of long-term debt	6,420	5,865
Other	16,448	14,138
Total current liabilities	159,094	157,670
Long-term debt, net of current maturities	400,260	336,680
Obligation under swap contracts	41,490	40,157
Other noncurrent liabilities	10,629	12,909
Total liabilities	611,473	547,416
Net assets:		
Unrestricted	656,705	583,153
Temporarily restricted	16,056	11,343
Permanently restricted	15,309	14,677
	688,070	609,173
Total liabilities and net assets	\$ 1,299,543	\$ 1,156,589

See accompanying notes.

Gundersen Lutheran

Combined Statements of Operations  
(Dollars in Thousands)

	Year Ended December 31	
	2012	2011
Operating revenue:		
Net patient revenue before provision for uncollectible accounts	\$ 616,413	\$ 596,869
Provision for uncollectible accounts	(32,576)	(33,192)
Net patient revenue	583,837	563,677
Capitation revenue	268,172	250,769
Other revenue	30,117	27,588
	<u>882,126</u>	<u>842,034</u>
Operating expenses:		
Salaries, wages, and benefits	500,813	488,440
Supplies	103,485	95,543
Purchased health services	88,101	85,803
Depreciation and amortization	41,787	38,775
Facilities	26,324	31,961
Purchased services	30,787	27,415
Interest	9,152	9,314
Other	38,305	37,521
	<u>838,754</u>	<u>814,772</u>
Operating income	43,372	27,262
Nonoperating gains (losses):		
Investment return	37,819	10,785
Gain on sale of long-term investment	4,408	22,351
Change in fair value of swap contracts	(1,333)	(19,604)
Loss on extinguishment of debt	-	(2,868)
Other nonoperating losses, net	(1,109)	(910)
	<u>39,785</u>	<u>9,754</u>
Revenue in excess of expenses	83,157	37,016
Net assets released from restrictions to purchase property and equipment	1,454	2,914
Transfers to affiliates	(10,981)	(930)
Amortization of accumulated gains related to swap contracts at the time of de-designation	(78)	(77)
Increase in unrestricted net assets	<u>\$ 73,552</u>	<u>\$ 38,923</u>

See accompanying notes.

Gundersen Lutheran

Combined Statements of Changes in Net Assets  
(Dollars in Thousands)

	Year Ended December 31	
	2012	2011
Unrestricted net assets:		
Revenue in excess of expenses	\$ 83,157	\$ 37,016
Net assets released from restrictions to purchase property and equipment	1,454	2,914
Amortization related to swap contracts prior to de-designation	(78)	(77)
Transfers to affiliates	(10,981)	(930)
Increase in unrestricted net assets	<u>73,552</u>	<u>38,923</u>
Temporarily restricted net assets:		
Contributions	8,776	12,385
Investment income	890	593
Net change in unrealized gains/losses on investments	361	(404)
Net assets released from restriction	(5,314)	(5,940)
Increase (decrease) in temporarily restricted net assets	<u>4,713</u>	<u>6,634</u>
Permanently restricted net assets:		
Contributions	257	647
Investment loss	(69)	(47)
Net change in unrealized gains/losses on investments	444	(312)
Increase in permanently restricted net assets	<u>632</u>	<u>288</u>
Increase in net assets	78,897	45,845
Net assets at beginning of year	609,173	563,328
Net assets at end of year	<u>\$ 688,070</u>	<u>\$ 609,173</u>

See accompanying notes.

Gundersen Lutheran

Combined Statements of Cash Flows  
(Dollars in Thousands)

	Year Ended December 31	
	2012	2011
<b>Operating activities</b>		
Increase in net assets	\$ 78,897	\$ 45,845
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	41,713	38,818
Impairment and loss on disposal of equipment	—	4,403
Provision for uncollectible accounts	32,576	33,113
Change in fair value of swap contracts	1,333	19,604
Realized and change in unrealized gains/losses on investments, net	(24,876)	1,887
Gain on sale of long-term investment	(4,408)	(22,351)
Loss on extinguishment of debt	—	2,868
Transfers to affiliates	10,981	930
Restricted contributions	(9,033)	(13,032)
Changes in operating assets and liabilities:		
Patient accounts receivable	(29,628)	(54,176)
Other current assets	11,640	(14,897)
Accounts payable, accrued, and other current liabilities	869	23,354
Other noncurrent assets and liabilities	(1,798)	(9,092)
Net cash provided by operating activities	108,266	57,274
<b>Investing activities</b>		
Sale of long-term investment	—	108,265
Purchases of investments, net	(35,764)	(127,016)
Purchases of property and equipment, net	(126,069)	(83,017)
Transfers to affiliates	(10,981)	(930)
Net proceeds from (investment in) notes receivable from affiliates	3,352	(7,184)
Net cash used in investing activities	(169,462)	(109,882)
<b>Financing activities</b>		
Proceeds from issuance of long-term debt	70,000	202,430
Principal payments on long-term debt	(5,865)	(108,429)
Restricted contributions	9,033	13,032
Net cash provided by financing activities	73,168	107,033
Net increase in cash and cash equivalents	11,972	54,425
Cash and cash equivalents at beginning of year	70,544	16,119
Cash and cash equivalents at end of year	\$ 82,516	\$ 70,544
<b>Supplemental disclosures of cash flow information</b>		
Accrued amounts for the acquisition of property and equipment	\$ 14,346	\$ 7,851
Interest paid, net of capitalized interest of \$7,133 in 2012 and \$2,017 in 2011	\$ 8,221	\$ 8,604

See accompanying notes.

# Gundersen Lutheran

## Notes to Combined Financial Statements *(Dollars in Thousands)*

December 31, 2012

### **1. Organization and Basis of Presentation**

The combined financial statements include the financial results of Gundersen Clinic, Ltd. (the Clinic), Gundersen Lutheran Medical Center, Inc. (the Hospital), Gundersen Lutheran Administrative Services, Inc. (GLAS) and Gundersen Lutheran Medical Foundation, Inc. (the Foundation), all of which are members of an obligated group (the Obligated Group or Gundersen Lutheran). The combined financial statements are prepared for the purpose of presenting the operating results of the Obligated Group and do not include all the entities controlled by Gundersen Lutheran Health System, Inc. (the Parent Corporation), which is the sole corporate member of the Obligated Group members but itself is not a member of the Obligated Group. The Parent Corporation and each of the Obligated Group members qualify as tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (the Code).

The Clinic provides comprehensive medical care to patients and conducts medical education and research programs primarily in Wisconsin with smaller facilities in Iowa and Minnesota. The Hospital is located in La Crosse, Wisconsin, and provides medical care to patients from La Crosse and surrounding communities. GLAS is engaged in various administrative transactions on behalf of the Parent Corporation and its affiliates in support of charitable health care activities. The Foundation enhances and supports quality health care with an emphasis on medical and health/wellness education as well as clinically based research and community outreach.

### **2. Summary of Significant Accounting Policies**

#### **Accounting Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. Although estimates, including uncollectible and contractual allowances on patient accounts receivable, third-party payor settlements, self-insured liabilities, and valuation of swap contracts, are considered to be fairly stated at the time that the estimates were made, actual results could differ from those estimates.

Certain reclassifications were made to the 2011 combined financial statements to conform to the classifications used in 2012. The reclassifications had no impact on the revenue in excess of expenses and increase in net assets previously reported.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Cash and Cash Equivalents**

Cash and cash equivalents include currency on hand, demand deposits with banks or other financial institutions, and short-term investments with original maturities of 90 days or less from the date of purchase. The Obligated Group maintains cash and cash equivalents on deposit at financial institutions, which at times exceed the limits insured by the Federal Deposit Insurance Corporation, and thereby exposes the Obligated Group to potential risk of loss in the event the financial institution becomes insolvent. No losses have been incurred to date and management does not consider the credit risk to be significant to the Obligated Group.

##### **Patient Accounts Receivable**

The collection of receivables from third-party payors and patients is the Obligated Group's primary source of cash for operations. The primary collection risks relate to uninsured patient accounts and patient deductibles and coinsurance on insurers' accounts. Patient receivables, including the portion that a third-party payor is responsible for, are carried at net realizable value, determined by the original charge for the service provided less an estimate made for contractual adjustments or discounts provided to third-party payors. Patient receivables due directly from the patients are carried on the accompanying combined balance sheets at the original charge for the service provided less amounts covered by third-party payors, allowances for other discounts, and an allowance for uncollectible receivables. Management determines an allowance for uncollectible accounts by identifying amounts at risk, based on historical collection experience, aging of accounts, and considering current economic conditions. The Obligated Group does not charge interest on past due receivables. Receivables are written off after collection efforts have been followed in accordance with the Obligated Group's policies. Recoveries of receivables previously written off are recorded as a reduction of bad debt expense.

Accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectability of accounts receivable, the Obligated Group analyzes its past history and identifies trends for each of its major payor sources to estimate the appropriate allowance for doubtful accounts and provision for bad debts. The analysis is performed using a hindsight calculation that utilizes write-off data for all payor classes during a determined time period to calculate the allowance for uncollectible accounts at a point in time. Accounts receivable balances over 365 days are fully allowed for.



## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

At December 31, 2012 and 2011, the allowance for uncollectible accounts was \$35,459 and \$29,248, respectively, which as a percent of accounts receivable, net of contractual adjustments, was 23% and 19%, respectively.

#### **Investments and Investments Whose Use is Limited**

Investments in equity securities with readily determinable fair values and investments in debt securities are measured at fair value in the combined balance sheets. Investments in equity and debt securities are classified as trading, and accordingly, all unrealized gains and losses are recorded as nonoperating investment return. The Obligated Group accounts for investment transactions on a settlement-date basis.

Investment securities are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of certain investments will occur in the near term and that such changes could materially affect the amounts reported in the combined financial statements.

Unrestricted investments are classified as current assets since they are available for operations. Certain investments are limited as to use under the terms of a bond indenture, state insurance regulations, unemployment fund agreements, collateral posted against swap valuations, and internally designated for medical education by the Board of Trustees and the Board of Governors. The Board of Trustees and the Board Governors can, at their discretion, can change these designations in the future.

#### **Inventories, Supplies, and Materials**

Inventories, supplies, and materials are valued at the lower of cost (first-in, first-out method) or market value and included in other current assets in the combined balance sheets.

#### **Property and Equipment**

Property and equipment are stated at cost, if purchased, or at fair value on the date received, if donated, less accumulated depreciation. During periods of construction, interest costs are capitalized to the respective property accounts.

Gundersen Lutheran

Notes to Combined Financial Statements (continued)  
*(Dollars in Thousands)*

**2. Summary of Significant Accounting Policies (continued)**

Depreciation is provided on a straight-line basis over the following estimated useful lives:

Land improvements	5-15 years
Building	30- 40 years
Building additions and improvements	10- 25 years
Equipment and furniture	3-15 years

The Obligated Group assesses potential impairment to its long-lived assets when there is evidence that events or changes in circumstances have made recovery of an assets carrying value unlikely. An impairment loss is indicated when the estimated total undiscounted future net cash flows is less than the carrying amounts. The loss recognized is the difference between the fair value and the carrying amount. At December 31, 2012, no impairment loss was recorded. At December 31, 2011, an impairment loss of \$3,853 was recorded related to equipment.

The Obligated Group capitalizes expenditures for additions and improvements while replacements, maintenance, and repairs that do not improve the useful lives of the assets are expensed as incurred. The Obligated Group capitalizes interest on the financing of major capital, including projects financed with tax-exempt borrowings.

**Software Costs**

Capitalized computer software costs include internally developed software. Costs incurred in the development and installation of internal use software are expensed or capitalized depending on whether they are incurred in the preliminary project stage, application development stage, or post-implementation stage.

**Derivative Financial Instruments**

The Obligated Group uses interest rate swap contracts as part of its risk management strategy to manage exposure to fluctuations in interest rates related to its variable-rate debt. All derivative instruments are recorded at fair value in the combined balance sheets, with the changes in the fair values recorded in nonoperating gain/loss in the combined statements of operations.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

In April 2007, the Obligated Group de-designated its swaps, which formerly had been classified as cash flow hedges. Prior to the de-designation, changes in the fair value of the hedged interest rate swaps were included in other changes in unrestricted net assets. The accumulated gain in net assets prior to de-designation is being amortized over the remaining life of the term of debt.

#### **Insurance**

The provision for estimated self-insured professional liability, workers' compensation, and employee health care claims includes estimates of the ultimate costs for both reported and incurred but not reported (IBNR) claims. The accrual for self-insured professional liability, workers' compensation and employee health care claims represents the estimated ultimate cost for both asserted and unasserted claims.

#### **Donated Assets and Services**

Unconditional promises to give cash and other assets to the Obligated Group are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets. When the terms of a donor restriction are met, temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets released from restriction. Donor contributions whose restrictions are met within the same year as received are reported as unrestricted contributions.

A large number of people contribute significant amounts of time to Gundersen Lutheran without compensation. The combined financial statements do not reflect the value of those contributed services, because although substantial, no reliable basis exists for determining an appropriate amount.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Net Assets**

Resources are classified into three net asset categories as unrestricted, temporarily restricted, and permanently restricted, according to the absence or existence of donor-imposed restrictions. Unrestricted net assets represent amounts that have no donor-imposed restrictions. Temporarily restricted net assets are those assets whose use has been limited by donors to a specific purpose or time period. Permanently restricted net assets are those assets for which donors require the principal of the gift to be maintained in perpetuity in order to provide a permanent source of income.

##### **Net Patient Revenue**

Net patient revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered, excluding charges related to the Obligated Group's self-insured health benefits. Net patient revenue includes estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future years as final settlements are determined.

##### **Capitation Revenue and Purchased Health Services**

The Clinic and the Hospital provide health care services to enrollees of the Gundersen Lutheran Health Plan (the Health Plan), an affiliate controlled by the Parent Corporation, under a capitation arrangement. The health care services covered by the Health Plan are paid for primarily on a capitated basis determined as a percentage of the member premiums, which transfers most insurance risk to the Clinic and Hospital under a provider reimbursement agreement. Net capitation revenue is recognized in the year in which health care coverage is provided and is recorded net of amounts paid to other medical service providers. Although the majority of services are provided to Health Plan enrollees by the Hospital and Clinic, certain services are provided by out-of-network providers on a contracted fee-for-service basis. A reserve is recorded for out-of-network care rendered but not reported as of each year-end.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Charity and Uncompensated Care**

The Clinic and the Hospital provide health care services to patients who meet certain criteria under their charity care policies without charge or at amounts less than established rates. The Clinic and Hospital maintain records to identify and monitor the level of community care provided. These records include the amount of costs incurred for services and supplies furnished under the charity care policy. Since the Clinic and the Hospital do not pursue collection of these amounts, they are not reported as patient revenue.

##### **Electronic Health Record Incentive Payments**

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicare and Medicaid incentive program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement, or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional Medicaid incentive payments.

The Obligated Group accounts for HITECH incentive payments as a gain contingency. Income from Medicare incentive payments is recognized as revenue after the Obligated Group has demonstrated that it complied with the meaningful use criteria over the entire applicable compliance period and the cost report period that will be used to determine the final incentive payment has ended. The Obligated Group recognized revenue from Medicaid incentive payments after it adopted certified EHR technology. Incentive payments totaling \$6,868 and \$5,940 for 2012 and 2011, respectively, are included in operating revenue in the combined statements of operations. Income from incentive payments is subject to retrospective adjustment as the incentive payments are calculated using Medicare cost data that is subject to audit. In addition, the Obligated Group's compliance with the meaningful use criteria is subject to audit by the federal government.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 2. Summary of Significant Accounting Policies (continued)

##### **Performance Indicator**

The performance indicator is revenue in excess of expenses. Changes in unrestricted net assets, which are excluded from revenue in excess of expenses, consistent with industry practice, include net assets released from restrictions to purchase property and equipment, transfers to affiliates, and amortization of accumulated gains on swap contracts at the time of de-designation.

##### **Fair Value Measurement**

The fair value measurements and disclosures topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) defines fair value, establishes a framework for measuring fair value and expands disclosures of fair value measurements, which applies to all assets and liabilities that are measured on a fair value basis.

##### **Income Tax Matters**

The Obligated Group has reviewed its tax positions for all open years and has concluded that no liabilities exist for uncertain tax positions at December 31, 2012 and 2011. The Obligated Group's income tax returns are no longer subject to examination for 2006 and prior.

##### **New Accounting Pronouncements**

Effective January 1, 2012, Gundersen Lutheran adopted Accounting Standards Update (ASU) No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, which was issued by the FASB in July 2011. The ASU amends ASC 954, *Health Care Entities*, and requires certain health care entities to reclassify the provision for uncollectible accounts associated with patient revenue from an operating expense to a deduction from patient revenue.

Gundersen Lutheran also has enhanced disclosures about its policies for recognizing revenue and assessing bad debts and qualitative and quantitative information about changes in the allowance for uncollectible accounts.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

Effective January 1, 2012, Gundersen Lutheran adopted ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS)* (ASU 2011-04), which was issued by the FASB in May 2011. The amendments in ASU 2011-04 result in common fair value measurement and disclosure requirements in GAAP and IFRS. The guidance also changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. The adoption of this guidance did not have a material impact on the Obligated Group's combined financial statements.

#### **3. Net Patient Revenue**

The Clinic and the Hospital derive patient revenue primarily from patients covered under the Medicare and Medicaid programs, agreements with commercial insurers, and managed care organizations, as well as from private pay patients. The basis for payment under agreements with commercial insurers and managed care organizations includes prospectively determined rates, discounts from established charges and allowable cost.

The Clinic participates in the Medicare and Medicaid programs and is reimbursed based on fee schedules. The Hospital also participates in the Medicare and Medicaid programs, under which substantially all inpatient services rendered to program beneficiaries, are paid for based on prospectively determined amounts per discharge depending on the individual patient's diagnostic-related grouping (DRG) of medical conditions. The Hospital's Medicare outpatient services are predominantly paid based on prospectively determined amounts for each service provided depending on the ambulatory payment classification (APC) assigned to each service. Amounts recorded by the Hospital for estimated cost report settlements can differ from actual settlements based on the results of subsequent cost report audits. In addition, the Hospital appeals certain settlements related to Medicare and other programs. Changes in estimated reimbursement related to prior periods, primarily related to the Medicare program, increased net patient service revenue by approximately \$2,488 and \$826 for the years ended December 31, 2012 and 2011, respectively. Receivables from settlements recorded in patient accounts receivable were \$874 and \$1,662 at December 31, 2012 and 2011, respectively.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 3. Net Patient Revenue (continued)

For self-pay patients, management determines an allowance for uncollectible accounts by identifying amounts at risk, based on historical collection experience, aging of accounts, and considering current economic conditions. Gundersen Lutheran also has policies to provide a discount from established charges to uninsured patients.

Gundersen Lutheran has determined, based on an assessment at the reporting-entity level, that patient revenue is primarily recorded prior to assessing the patient's ability to pay and as such, the entire provision for uncollectible accounts is recorded as a deduction from patient revenue in the combined statements of operations.

Patient service revenue, net of contractual expense (but before the provision for bad debts), recognized from Gundersen Lutheran's major payor sources is summarized as follows:

	<u>2012</u>	<u>2011</u>
Third-party payors	\$ 577,409	\$ 561,417
Self-pay payors	<u>39,004</u>	<u>35,452</u>
	<u>\$ 616,413</u>	<u>\$ 596,869</u>

The Medicare program accounted for 23% and 21% of the Obligated Group's net patient revenue for 2012 and 2011, respectively. Potential changes in the Medicare program and reduction of funding levels could have an adverse effect on the Clinic and the Hospital in the near term.



Gundersen Lutheran

Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

**4. Charity Care**

The Clinic and the Hospital provide medical care without charge or at reduced charges to residents of the communities they serve by providing services to patients who are uninsured or underinsured. The cost of providing charity care has been estimated by applying a cost to gross charges ratio to the gross uncompensated charges associated with providing charity care to patients. For 2012 and 2011, cost of providing charity care is estimated to be \$5,138 and \$4,500, respectively.

**5. Investments Whose Use is Limited and Investment Return**

Certain investments as of December 31 are limited as to use for the following purposes:

	<u>2012</u>	<u>2011</u>
Board designated for medical education	\$ 3,747	\$ 3,747
Minimum funding as required by the Wisconsin Office of the Commissioner of Insurance (Note 12)	9,546	11,758
Minimum funding as required by the Wisconsin Unemployment Reserve Fund	3,071	3,064
Collateral posted against insurance claims	1,375	1,375
Principal and interest payments under a bond indenture	233	262
Collateral posted against swap valuations (Note 10)	19,153	18,071
Held for future capital expenditures under bond indenture	42,249	51,699
	<u>\$ 79,374</u>	<u>\$ 89,976</u>

Investment return consists of the following for the years ended December 31:

	<u>2012</u>	<u>2011</u>
Dividends and interest	\$ 14,567	\$ 12,502
Equity in earnings of long-term investment	4,408	—
Net realized gains	10,112	2,386
Net change in unrealized gains (losses)	14,764	(4,273)
	<u>\$ 43,851</u>	<u>\$ 10,615</u>

Gundersen Lutheran

Notes to Combined Financial Statements (continued)  
*(Dollars in Thousands)*

**5. Investments Whose Use is Limited and Investment Return (continued)**

Investment return (loss) is reported in the combined statements of operations and changes in net assets as follows:

	<u>2012</u>	<u>2011</u>
Nonoperating gains, net	\$ 37,819	\$ 10,785
Temporarily restricted net assets	1,251	189
Permanently restricted net assets	375	(359)
	<u>\$ 39,445</u>	<u>\$ 10,615</u>

**6. Fair Value Measurements and Investments**

The Obligated Group follows ASC 820, which defines fair value, establishes a framework for measuring fair value, and requires disclosures about fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. In that regard, a fair value hierarchy was established for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is as follows:

Fair value for financial instruments included in Level 1 is based on unadjusted quoted prices for identical assets or liabilities in an active market that the Obligated Group has the ability to access.

Fair value for financial instruments included in Level 2 is based on pricing inputs that are either directly observable or that can be derived or supported from observable data as of the reporting date. Level 2 inputs may include quoted prices for similar assets or liabilities in nonactive markets or pricing models whose inputs are observable for substantially the full term of the asset or liability. Investments are valued through the use of third-party pricing services that use evaluated bid prices adjusted for specific bond characteristics and market sentiment.

Gundersen Lutheran

Notes to Combined Financial Statements (continued)  
(Dollars in Thousands)

**6. Fair Value Measurements and Investments (continued)**

Fair value for Level 3 financial liabilities is determined through the use of widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flow of each derivative. The analysis reflects the contractual terms of the interest-rate swaps, including the period to maturity, and uses observable market-based inputs, such as interest-rate curves. In addition, credit value adjustments are included to reflect both the Obligated Group's nonperformance risk and the respective counterparty's nonperformance risk. The Obligated Group pays annual fixed rates ranging from 3.26% to 3.79% and receives cash flows based on 67% of the London Inter Bank Offered Rate (LIBOR). At December 31, 2012 and 2011, the Obligated Group's fair value of obligations under interest rate swap contracts of \$41,490 and \$40,157, respectively, was recorded net of a credit value adjustment (CVA), of \$2,597 and \$3,961, respectively.

The following tables present the financial instruments measured at fair value on a recurring basis at December 31, 2012 and 2011, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	December 31, 2012			
	Level 1	Level 2	Level 3	Total Value
<b>Assets</b>				
Cash equivalents	\$ 73,224	\$ —	\$ —	\$ 73,224
Common stock	16,860	—	—	16,860
Equity mutual funds	162,457	—	—	162,457
Equity mutual funds – foreign	10,672	—	—	10,672
Asset-backed securities	—	2,026	—	2,026
Fixed income securities:				
U.S. government and agency obligations	72,829	40,414	—	113,243
Corporate bonds	—	58,767	—	58,767
Residential mortgage-backed securities	—	90,322	—	90,322
Commercial mortgage-backed securities	—	19,992	—	19,992
Instruments measured at fair value	263,213	284,350	—	527,571
Certificate of deposit	25,900	—	—	25,900
Total investments and investments whose use is limited	\$ 289,113	\$ 284,350	\$ —	\$ 573,463
<b>Liabilities</b>				
Obligation under swap contracts	\$ —	\$ —	\$ 41,490	\$ 41,490

Gundersen Lutheran

Notes to Combined Financial Statements (continued)  
(Dollars in Thousands)

6. Fair Value Measurements and Investments (continued)

	December 31, 2011			
	Level 1	Level 2	Level 3	Total Value
<b>Assets</b>				
Cash equivalents	\$ 61,506	\$ —	\$ —	\$ 61,506
Common stock	17,017	—	—	17,017
Equity mutual funds	93,862	—	—	93,862
Equity mutual funds – foreign	26,968	—	—	26,968
Fixed-income mutual funds	9,882	—	—	9,882
Fixed-income mutual funds – foreign	445	—	—	445
Fixed income securities:				
U.S. government and agency obligations	72,604	67,901	—	140,505
Corporate bonds	—	93,908	—	93,908
Residential mortgage-backed securities	—	49,203	—	49,203
Commercial mortgage-backed securities	—	4,219	—	4,219
Instruments measured at fair value	282,284	215,231	—	497,515
Certificate of deposit	10,900	—	—	10,900
Total investments and investments whose use is limited	\$ 293,184	\$ 215,231	\$ —	\$ 508,415
<b>Liabilities</b>				
Obligation under swap contracts	\$ —	\$ —	\$ 40,157	\$ 40,157

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses are reasonable estimates of fair value due to the short-term nature of these financial instruments. The carrying value of pledges (Level 2) approximates its fair value at December 31, 2012 and 2011.

At December 31, 2012 and 2011, fair value of fixed-interest long-term debt (Level 2), based on quoted market prices for the same or similar instruments, was approximately \$284,300 and \$165,900, respectively, compared with its carrying value of \$266,565 and \$162,430, respectively. Fair value of variable-rate long-term debt (Level 2) approximated its carrying value at both December 31, 2012 and 2011.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 7. Long-Term Investment

In April 2011, Gundersen Lutheran sold its 48.5% interest in Logistics Health Incorporated (LHI) to OptumHealth, a division of United Health Group. In connection with this transaction, the Obligated Group received consideration of \$108,265, including \$6,435 of anticipated escrow distribution, and realized a gain of \$22,351. The purchase agreement also provides for receipt of additional amounts, based on LHI achieving specific performance benchmarks. In 2012, as a result of achieving certain performance benchmarks in 2011, Gundersen Lutheran recorded a gain on sale of long-term investment of \$4,408 in its combined statements of operations.

#### 8. Property and Equipment

Property and equipment as of December 31 consists of the following:

	2012	2011
Land and land improvements	\$ 22,225	\$ 20,460
Buildings and building improvements	347,550	333,129
Capitalized software	68,317	67,850
Equipment and furniture	287,006	286,503
	725,098	707,942
Less accumulated depreciation	420,617	401,636
	304,481	306,306
Construction-in-progress	151,971	65,790
	\$ 456,452	\$ 372,096

Depreciation expense was \$41,713 and \$38,703 for 2012 and 2011, respectively.

The Obligated Group capitalizes payroll and payroll-related costs associated with the development of software for internal use. In 2012 and 2011, the Obligated Group capitalized \$578 and \$2,829, respectively, of payroll and payroll-related costs.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 9. Long-Term Debt

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

	2012	2011
Wisconsin Health and Educational Facilities Authority (WHEFA), Series 2012 (Gundersen Lutheran), annual interest from 2.0% to 5.0%, principal due in varying amounts through 2044	\$ 70,000	\$ —
WHEFA Bonds, Series 2011A (Gundersen Lutheran), annual interest from 1.0% to 5.25%, principal due in varying amounts through 2039	156,565	162,430
WHEFA Series 2011B (Gundersen Lutheran), Adjustable Demand, principal due starting in 2038 (average annual interest rate in 2012 and 2011 of 0.18% and 0.14%, respectively)	40,000	40,000
WHEFA Series 2009A (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2033 (average annual interest rate in 2012 and 2011, of 1.06% and 0.89%, respectively)	45,305	45,305
WHEFA Series 2009B (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2033 (average annual interest rate in 2012 and 2011, of 1.06% and 0.89%, respectively)	33,410	33,410
WHEFA Series 2008B (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2033 (average annual interest rate in 2012 and 2011 of 1.03% and 1.06%, respectively)	61,400	61,400
Total long-term debt	406,680	342,545
Less current maturities	6,420	5,865
	\$ 400,260	\$ 336,680

In September 2012, WHEFA issued Series 2012 bonds on behalf of GLAS in an aggregate par amount of \$70,000 and bear interest at fixed rates. The bonds are subject to optional, mandatory, extraordinary redemption and purchase in lieu of redemption prior to maturity. The proceeds have been used to finance new construction.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **9. Long-Term Debt (continued)**

In September 2011, the Hospital, the Clinic, GLAS and the Foundation entered into a Restated Master Trust Indenture with a bank that established an Obligated Group, which currently includes the Hospital, the Clinic, GLAS, and the Foundation. Each Obligated Group member is jointly and severally liable for the payment of all obligations issued under the Restated Master Trust Indenture, which are secured ratably by a pledge of the unrestricted receivables of the Obligated Group. The Restated Master Trust Indenture contains, among other things, provisions placing restrictions on additional debt, asset transfers, and liens and requires the maintenance of a debt service coverage ratio. Additional covenants, including liquidity and capitalization, are included in other loan agreements relating to the obligations.

In September 2011, the Authority issued Series 2011A and Series 2011B bonds on behalf of the Obligated Group. The Series 2011A bonds were issued in an aggregate par amount of \$162,430 and bear interest at fixed rates. The Series 2011B bonds were issued in an aggregate amount of \$40,000 and bear interest at variable rates that are initially set weekly. The Series 2011B bonds are subject to optional and mandatory tender and are supported by an irrevocable direct pay letter of credit issued by a bank, which expires in September 2016. Under the terms of the agreement with the bank, the Obligated Group may elect to convert any liquidity draw made under the letter of credit into a bank loan that amortizes in equal quarterly installments over a three-year period, commencing no sooner than 367 days after the date of the draw, provided that there is no event of default and the representations made at the time of the draw are accurate. The proceeds of the Series 2011A bonds and the Series 2011B bonds were used to currently refund the Series 2000A bonds, Series 2000B bonds, and Series 2008A bonds and finance new construction.

In September 2011, the Obligated Group defeased the Series 2003A bonds by depositing funds into an escrow account in an amount sufficient to pay the principal and interest on the Series 2003A bonds as they become due in the ordinary course and to pay the principal amount outstanding on February 15, 2013, which was the redemption date. As a result of the defeasance, the related bond documents were legally discharged.

In 2011, the Obligated Group accounted for the refunding of the Series 2000A bonds, Series 2000B bonds, and Series 2008A bonds, the legal defeasance of the Series 2003A bonds, and the tendering of the Series 2009A and Series 2009B bonds as an extinguishment and recorded a loss on extinguishment of debt of \$2,868 in the combined statements of operations.

Gundersen Lutheran

Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

**9. Long-Term Debt (continued)**

In May 2008, the Authority issued Series 2008A and Series 2008B bonds on behalf of GLAS in the aggregate amount of \$89,300 bearing interest at a variable rate. In August 2010, the Obligated Group caused a tender of the Series 2008A and Series 2008B bonds, which were placed directly with a bank. Under the terms of the agreement with the bank, GLAS was required to purchase the Series 2008B bonds from the bank in August 2013. The Series 2008A bonds were refunded with proceeds of the Series 2011A bonds and Series 2011B bonds in September 2011. In October 2012, the date which GLAS was required to repurchase the Series 2008B bonds was extended to October 1, 2015.

In May 2009, the Authority issued Series 2009A and Series 2009B bonds on behalf of GLAS in the aggregate amount of \$78,715. The proceeds of those bonds were used to refund the Series 2003B and Series 2003C bonds. In March 2011, the Obligated Group caused a tender of the Series 2009A and Series 2009B bonds, which were placed directly with a bank. Under the terms of the agreement with the bank, GLAS was required to purchase the Series 2009A and Series 2009B bonds from the bank in March 2014. In October 2012, the date which GLAS was required to repurchase the Series 2009A and Series 2009B bonds was extended to October 1, 2017. At December 31, 2012, the aggregate maturities and sinking fund requirements of long-term debt, for each of the five subsequent years and thereafter, assuming that all bonds are successfully remarketed with the original maturity dates and the Obligated Group is able to renew the letter of credit, which expires in September 2016, are as follows:

2013	\$	6,420
2014		6,580
2015		6,905
2016		7,160
2017		7,395
Thereafter		<u>372,220</u>
	\$	<u>406,680</u>



Gundersen Lutheran

Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

**10. Derivative Financial Instruments**

The Obligated Group has entered into interest rate swaps, which are recorded at fair value as noncurrent liabilities in the combined balance sheets as of December 31, as follows:

	<u>2012</u>	<u>2011</u>
Notional amount \$33,000 Series 2009B (previously Series 2003C), fixed rate 3.50%, variable interest equal to 67% of the one-month LIBOR that averaged .24% and 0.23% in 2012 and 2011, respectively	\$ 7,350	\$ 7,073
Notional amount \$40,470 Series 2011B (previously Series 2000B), fixed rate 3.26%, variable interest equal to 67% of the one-month LIBOR that averaged .24% and 0.23% in 2012 and 2011, respectively	7,778	7,377
Notional amount \$44,750 Series 2009A (previously Series 2003B), fixed rate 3.28%, variable interest equal to 67% of the one-month LIBOR that averaged .24% and 0.23% in 2012 and 2011, respectively	9,340	9,421
Notional amount \$60,725 Series 2008B, fixed rate 3.79%, variable interest equal to 67% of the one-month LIBOR that averaged .24% and 0.23% in 2012 and 2011, respectively	17,022	16,286
	<u>\$ 41,490</u>	<u>\$ 40,157</u>

The decrease in the value of the swap contracts of \$1,333 and \$19,604 for 2012 and 2011, respectively, was recorded as an unrealized loss and is included in nonoperating gain (loss) in the combined statements of operations.

Derivative transactions contain credit risk in the event the parties are unable to meet the terms of the contract; credit risk is generally limited to the fair value due from counterparties on outstanding contracts. At December 31, 2012, the counterparties had a Standard & Poor's credit quality rating of A-.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### **10. Derivative Financial Instruments (continued)**

The interest rate swap contracts contain collateral provisions applicable to both parties to mitigate credit risk. The collateral provided by the Obligated Group to the counterparties was \$19,153 and \$18,071 as of December 31, 2012 and 2011, respectively, and is included in investments whose use is limited in the combined balance sheets.

The net settlements for the interest rate swap contracts of \$5,945 and \$5,960 for 2012 and 2011, respectively, are included in interest expense in the combined statements of operations.

#### **11. Retirement Plan**

The Obligated Group maintains a defined contribution and 401(k) plan covering substantially all of its employees. Retirement plan expense was \$47,985 and \$47,225 for 2012 and 2011, respectively. Gundersen Lutheran contributes matching funding on a monthly basis with the remainder contributed annually. At December 31, 2012 and 2011, the total liability for employer contributions was \$37,534 and \$48,268, respectively, and is included in accrued liabilities in the combined balance sheets.

#### **12. Insurance**

The Clinic is self-insured for Wisconsin professional liability up to base limits of insurance coverage (\$1,000 per claim and \$3,000 annually on an occurrence basis at December 31, 2012 and 2011). Additionally, under the Wisconsin professional liability, self-insured limits are in place per physician/Certified Registered Nurse Anesthetist (CRNA) (\$1,000 per physician/CRNA per claim and \$3,000 annually per physician/CRNA on an occurrence basis at December 31, 2012 and 2011). The Clinic has established a professional liability insurance plan and irrevocable trust as required by Wisconsin statutes. The funding requirements of the plan are established annually based on third-party actuarial calculations, as prescribed by the Commissioner of Insurance for the State of Wisconsin. All professional liability claims or judgments occurring in Wisconsin in excess of the base level of coverage are paid from the Injured Patients' and Families Compensation Fund, which insures all claims incurred regardless of when the claim is filed. The Injured Patients and Families Compensation Fund has no upper limit on losses.

The Clinic has purchased professional liability insurance on a claims-made basis to cover Iowa and Minnesota risks, including umbrella and excess coverage to minimize exposure.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 12. Insurance (continued)

The Hospital has purchased professional liability insurance on a claims-made basis to cover claim losses. The Hospital is also insured through the Injured Patients and Families Compensation Fund for losses on professional liability claims (\$1,000 per claim and \$3,000 annually at December 31, 2012 and 2011). The Injured Patients' and Families Compensation Fund has no upper limit on losses.

The Obligated Group maintains self-insurance programs for health care costs of its active employees. The Obligated Group has purchased stop-loss insurance with an annual deductible of \$600 per individual. In addition, the Obligated Group is insured for workers' compensation exposures under an incurred loss retrospective rating plan.

The liability for professional and general liability, workers' compensation, and employee health insurance claims is based on actual claims to date and a projection of the estimated future liability for such claims and IBNR claims. At December 31, 2012 and 2011, the total recorded liability was \$21,452 and \$24,051, respectively, of which a current portion of \$12,270 and \$19,867, respectively, is included in accrued liabilities, and the noncurrent portion of \$9,182 and \$4,184, respectively, is included in other noncurrent liabilities in the combined balance sheets. At December 31, 2012 and 2011, the estimated receivable related to insurance recoveries of \$2,451 and \$2,257, respectively, is included in other current assets in the combined balance sheets.

#### 13. Commitments and Contingencies

The Obligated Group has leases for equipment and satellite office facilities, which are classified as operating leases. Rental expense under these operating leases totaled \$4,855 and \$4,464 for 2012 and 2011, respectively. Future commitments under operating leases in effect as of December 31, 2012, for each of the five subsequent years and thereafter are as follows:

2013	\$	1,550
2014		1,156
2015		728
2016		580
2017		410
Thereafter		1,144
	\$	<u>5,568</u>

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued) *(Dollars in Thousands)*

#### **13. Commitments and Contingencies (continued)**

The Clinic and the Hospital are defendants in legal proceedings arising in the ordinary course of business. Although the outcome of these proceedings cannot be determined, management of the Obligated Group considers it unlikely that the disposition of these proceedings will have a material adverse effect on the financial position or operations of the Obligated Group. However, there can be no assurance that this will be the case.

The Clinic, Hospital, and GLAS have entered into an agreement with the city of La Crosse in conjunction with the city's establishment of Tax Incremental Financing District No. 14 (TIF 14). The agreement requires the construction of one or more parking ramps that will accommodate 1,000 vehicles, with qualifying costs not to exceed \$18,500. At December 31, 2009, a 537-vehicle ramp adjacent to the Clinic was completed. In 2010, a second ramp was completed to satisfy the requirement of available vehicle space and is considered for the tax incentives offered under the TIF 14 agreement. This ramp is adjacent to the area designated for the new hospital described below as part of a campus renewal plan. Additionally, the agreement creates property tax incentives for further taxable development on the Gundersen Lutheran La Crosse campus by Gundersen Lutheran and other developers. The benefit that Gundersen Lutheran will derive from participation in TIF 14 is dependent on the size of future development over the next 20 years.

The Obligated Group has established a campus renewal plan, which includes the addition of a 400,000 square foot, six-story hospital building on the main campus, adjacent to the existing Hospital facility. The hospital addition, which began in January 2011, is scheduled to be completed in late 2013. This initial phase is projected to cost \$218,000 under a guaranteed maximum price contract with a general contractor. The Obligated Group is funding this addition with cash flow from operations, debt financing, and fundraising.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

#### 13. Commitments and Contingencies (continued)

##### Compliance With Laws and Regulations

The health care industry is governed by various laws and regulations of federal, state, and local governments. These laws and regulations are subject to ongoing government review and interpretation and include matters such as licensure, accreditation, reimbursement for patient services, and referrals for Medicare and Medicaid beneficiaries. Compliance with these laws and regulations is required for participation in government health care programs. Certain governmental agencies routinely investigate and pursue allegations concerning possible overpayments resulting from violation of fraud and abuse statutes by health care providers. These investigations may result in settlements involving fines and penalties as well as repayment of improper reimbursement. The Obligated Group has implemented procedures for monitoring and enforcing compliance with laws and regulations and is not aware of instances of noncompliance.

While management believes that the Obligated Group is in material compliance with fraud and abuse laws and regulations as well as other applicable government laws and regulations, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Changes in reimbursement from the Medicare program, including reduction of funding levels, could have an adverse effect on the Obligated Group.

#### 14. Concentration of Credit Risk

The Clinic and the Hospital grant credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. Amounts due from various payors and patients as of December 31 included in net patient accounts receivable are as follows:

	<u>2012</u>	<u>2011</u>
Medicare	9%	12%
Medicaid	2	4
Commercial insurance, private pay, and other	89	84
	<u>100%</u>	<u>100%</u>

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 15. Functional Expenses

Expenses related to providing patient care are as follows for the years ended December 31:

	<u>2012</u>	<u>2011</u>
Health care services	\$ 668,988	\$ 648,432
General and administrative, including fundraising	169,766	166,340
	<u>\$ 838,754</u>	<u>\$ 814,772</u>

#### 16. Related-Party Transactions

The Clinic and the Hospital have an agreement with the Gundersen Lutheran Health Plan, Inc. (Health Plan) to provide health care services to the Health Plan's insured enrollees. The Clinic and the Hospital are paid on a fully capitated basis. Reinsurance contracts exist for medical and hospital expenses in excess of \$600 per enrollee per contract year. Capitation revenue recorded by the Clinic and the Hospital which was earned under the agreement with the Health Plan totaled \$268,172 and \$250,769 for 2012 and 2011, respectively. At December 31, 2012 and 2011, amounts due (to) from the Health Plan were \$(1,967) and \$2,772, respectively, and are included in other current liabilities or other current assets in the combined balance sheets.

Under terms of an administrative services agreement with the Health Plan, the Obligated Group provides substantially all general and administrative services necessary for the Health Plan's operations at amounts that are intended to approximate cost. The cost of these services to the Health Plan was approximately \$11,369 and \$10,992 in 2012 and 2011, respectively, and is deducted from the Obligated Group's expenses in the combined statements of operations. Amounts due from the Health Plan as of December 31, 2012 and 2011, related to the administrative services agreement were \$1,434 and \$1,363, respectively, and are included in other current assets in the combined balance sheets.

The Health Plan leases office space from the Obligated Group. Rental payments were \$306 for 2012 and 2011.

Gundersen Lutheran

Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

**16. Related-Party Transactions (continued)**

At December 31, 2012 and 2011, notes receivable from affiliates totaling \$10,854 and \$14,206, respectively, which are recorded net of allowances for uncollectible amounts of \$144 and \$347, respectively, represent loans to affiliates to finance their activities. Notes receivable from affiliates have terms ranging from 1 to 15 years, with annual interest rates ranging from 3% to 6%.

**17. Restricted Net Assets**

Temporarily restricted net assets as of December 31 are available for the following purposes or periods:

	2012	2011
Purpose restrictions:		
Education	\$ 750	\$ 954
Research	599	186
Community and affiliate programs	687	563
Buildings and equipment	13,422	8,860
Other	364	342
Time restrictions for future periods	234	438
	\$ 16,056	\$ 11,343

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

	2012	2011
Education	\$ 4,915	\$ 4,724
Research	4,639	4,513
Community health initiatives	2,340	2,275
General operations	3,415	3,165
	\$ 15,309	\$ 14,677

Gundersen Lutheran

Notes to Combined Financial Statements (continued)  
*(Dollars in Thousands)*

**18. Pledges**

The timing of receipt of pledges at December 31 is estimated as follows::

	<u>2012</u>	<u>2011</u>
Within one year	\$ 312	\$ 1
One to five years	4,194	5,858
After five years	5,046	4,114
	<u>9,552</u>	<u>9,973</u>
Present value discount and allowances for uncollectible pledges	(1,309)	(1,152)
	<u>\$ 8,243</u>	<u>\$ 8,821</u>

Pledges receivable were discounted at annual rates ranging from 3.63% to 5.60% at December 31, 2012 and from 4.61% to 5.69% at December 31, 2011. Pledges due within one year are recorded in other current assets and all other pledges are recorded in other noncurrent assets.

**19. Subsequent Events**

The Obligated Group has evaluated events and transactions that have occurred subsequent to December 31, 2012 through April 30, 2013, the date on which the combined financial statements were issued. During this period, there were no subsequent events requiring recognition or disclosure in the combined financial statements.



Ernst & Young LLP

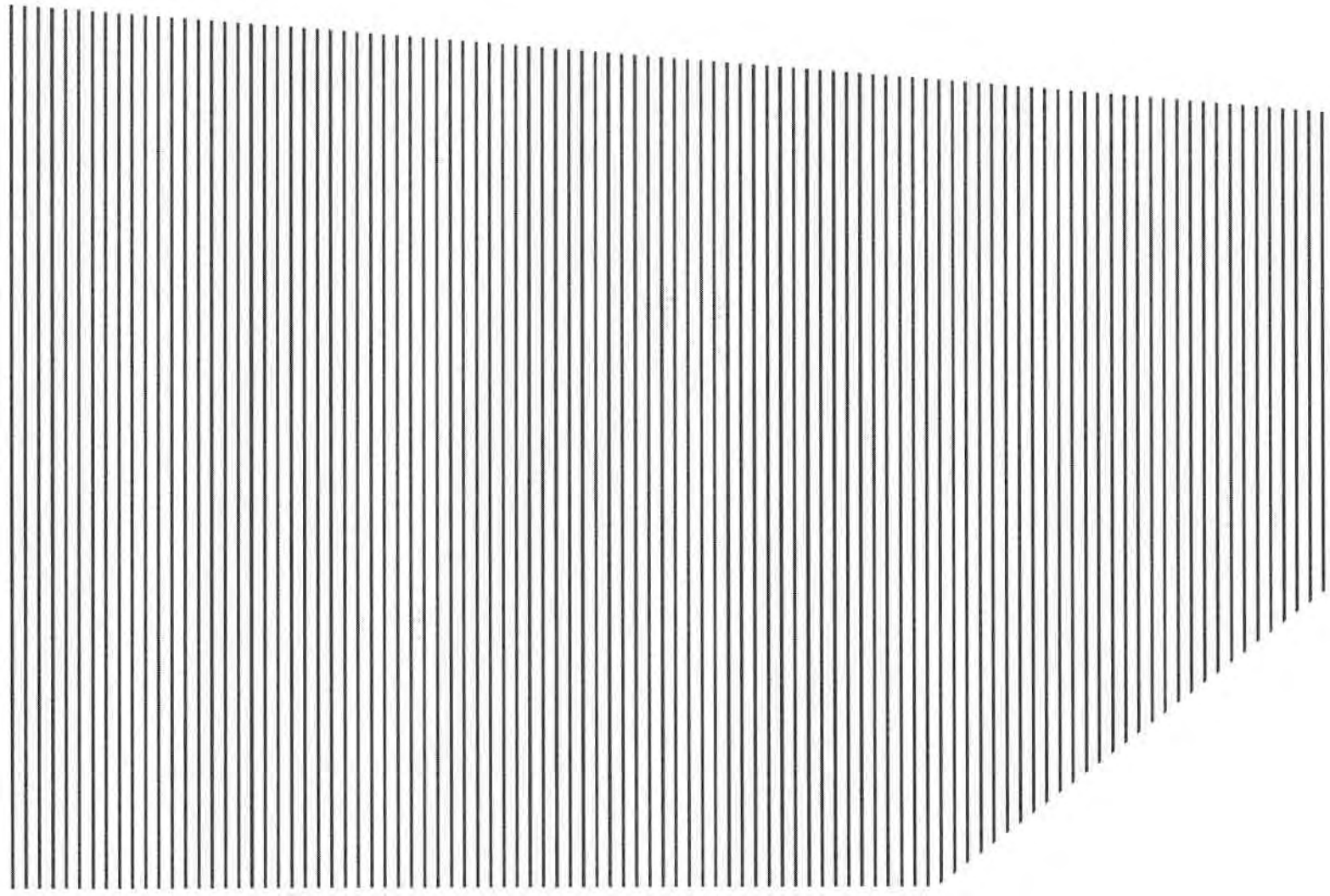
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COMBINED FINANCIAL STATEMENTS

Gundersen Lutheran  
(Consisting of Gundersen Clinic, Ltd., Gundersen Lutheran  
Medical Center, Inc., Gundersen Lutheran Administrative  
Services, Inc., and Gundersen Lutheran Medical  
Foundation, Inc., which comprise an Obligated Group)  
Years Ended December 31, 2011 and 2010  
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

Gundersen Lutheran

Combined Financial Statements

Years Ended December 31, 2011 and 2010

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## Report of Independent Auditors

The Board of Trustees and the Board of Governors  
Gundersen Lutheran

We have audited the accompanying combined balance sheet of Gundersen Clinic, Ltd.; Gundersen Lutheran Medical Center, Inc.; Gundersen Lutheran Administrative Services, Inc.; and Gundersen Lutheran Medical Foundation, Inc., which comprise an Obligated Group (collectively, Gundersen Lutheran) as of December 31, 2011, and the related combined statements of operations, changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of Gundersen Lutheran's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Gundersen Lutheran for the year ended December 31, 2010, were audited by other auditors whose report dated August 24, 2011, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of Gundersen Lutheran's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Gundersen Lutheran's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2011 combined financial statements referred to above present fairly, in all material respects, the combined financial position of Gundersen Lutheran at December 31, 2011, and the combined results of its operations and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

*Ernst & Young LLP*

May 29, 2012

Gundersen Lutheran

Combined Balance Sheets  
(Dollars in Thousands)

	December 31	
	2011	2010
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 70,544	\$ 16,119
Investments	418,439	368,902
Current portion of investments whose use is limited	10,722	—
Patient accounts receivable, less allowance for uncollectible accounts of \$29,248 in 2011 and \$19,236 in 2010	122,637	101,574
Current portion of notes receivable from affiliates	1,296	1,228
Other	45,187	22,148
Total current assets	<u>668,825</u>	<u>509,971</u>
Investments whose use is limited	79,254	18,350
Long-term investment	—	90,090
Notes receivable from affiliates, net of current portion	12,910	5,794
Property and equipment, net	372,096	332,300
Other noncurrent assets	23,504	16,713
Total assets	<u>\$ 1,156,589</u>	<u>\$ 973,218</u>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 23,704	\$ 17,359
Accrued liabilities	113,963	107,563
Current maturities of long-term debt	5,865	7,626
Other	14,138	9,876
Total current liabilities	<u>157,670</u>	<u>142,424</u>
Long-term debt, net of current maturities	336,680	238,050
Obligation under swap contracts	40,157	20,553
Other noncurrent liabilities	12,909	8,863
Total liabilities	<u>547,416</u>	<u>409,890</u>
Net assets:		
Unrestricted	583,153	544,230
Temporarily restricted	11,343	4,709
Permanently restricted	14,677	14,389
	<u>609,173</u>	<u>563,328</u>
Total liabilities and net assets	<u>\$ 1,156,589</u>	<u>\$ 973,218</u>

See accompanying notes.

## Gundersen Lutheran

### Combined Statements of Operations (Dollars in Thousands)

	Year Ended December 31	
	2011	2010
Operating revenue:		
Net patient revenue	\$ 596,869	\$ 583,117
Capitation revenue	250,769	231,106
Electronic Health Record incentive payments	5,940	—
Other revenue	21,648	17,597
	875,226	831,820
Operating expenses:		
Salaries, wages, and benefits	484,694	473,066
Supplies	95,543	94,391
Purchased health services	85,803	74,035
Depreciation and amortization	38,818	35,784
Provision for uncollectible accounts	33,113	29,564
Facilities	31,961	27,006
Purchased services	27,415	23,591
Interest	9,314	9,574
Other	41,303	33,098
	847,964	800,109
Operating income	27,262	31,711
Nonoperating gain (loss):		
Investment return	10,785	38,230
Gain on sale of long-term investment	22,351	—
Change in fair value of swap contracts	(19,604)	(7,386)
Loss on extinguishment of debt	(2,868)	—
Other nonoperating expenses	(910)	(2,388)
	9,754	28,456
Revenue in excess of expenses	37,016	60,167
Net assets released from restrictions to purchase property and equipment	2,914	2,671
Transfers to affiliates	(930)	(25)
Other transfers	—	3,199
Amortization of accumulated gains related to swap contracts at the time of de-designation	(77)	(77)
Increase in unrestricted net assets	\$ 38,923	\$ 65,935

*See accompanying notes.*

Gundersen Lutheran

Combined Statements of Changes in Net Assets

(Dollars in Thousands)

	Year Ended December 31	
	2011	2010
Unrestricted net assets:		
Revenue in excess of expenses	\$ 37,016	\$ 60,167
Net assets released from restrictions to purchase property and equipment	2,914	2,671
Other transfers	—	3,199
Amortization related to swap contracts prior to de-designation	(77)	(77)
Transfers to affiliates	(930)	(25)
Increase in unrestricted net assets	<u>38,923</u>	<u>65,935</u>
Temporarily restricted net assets:		
Contributions	12,385	6,108
Investment income	593	267
Net change in unrealized gains/losses on investments	(404)	1,008
Net assets released from restriction	(5,940)	(4,878)
Other transfers	—	(3,199)
Increase (decrease) in temporarily restricted net assets	<u>6,634</u>	<u>(694)</u>
Permanently restricted net assets:		
Contributions	647	464
Investment loss	(47)	(96)
Net change in unrealized gains/losses on investments	(312)	471
Increase in permanently restricted net assets	<u>288</u>	<u>839</u>
Increase in net assets	45,845	66,080
Net assets at beginning of year	563,328	497,248
Net assets at end of year	<u>\$ 609,173</u>	<u>\$ 563,328</u>

See accompanying notes.



## Gundersen Lutheran

### Combined Statements of Cash Flows

*(Dollars in Thousands)*

	Year Ended December 31	
	2011	2010
<b>Operating activities</b>		
Increase in net assets	\$ 45,845	\$ 66,080
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	38,818	35,784
Impairment and loss on disposal of equipment	4,403	—
Provision for uncollectible accounts	33,113	29,564
Change in fair value of swap contracts	19,604	7,386
Realized and change in unrealized gains/losses on investments, net	1,887	(17,784)
Equity in earnings of long-term investment	—	(11,340)
Gain on sale of long-term investment	(22,351)	—
Loss on extinguishment of debt	2,868	—
Transfers to affiliates	930	25
Restricted contributions	(13,032)	(3,135)
Changes in operating assets and liabilities:		
Patient accounts receivable	(54,176)	(33,223)
Other current assets	(14,897)	(3,237)
Accounts payable, accrued, and other current liabilities	23,354	7,245
Other noncurrent assets and liabilities	(9,092)	3,298
Net cash provided by operating activities	57,274	80,663
<b>Investing activities</b>		
Sale of long-term investment	108,265	—
Purchases of investments, net	(127,016)	(19,888)
Purchases of property and equipment, net	(83,017)	(62,568)
Transfers to affiliates	(930)	(25)
Net (investment in) proceeds from notes receivable from affiliates	(7,184)	302
Net cash used in investing activities	(109,882)	(82,179)
<b>Financing activities</b>		
Proceeds from issuance of long-term debt	202,430	—
Principal payments on long-term debt	(108,429)	(16,287)
Restricted contributions	13,032	3,135
Net cash provided by (used in) financing activities	107,033	(13,152)
Net increase (decrease) in cash and cash equivalents	54,425	(14,668)
Cash and cash equivalents at beginning of year	16,119	30,787
Cash and cash equivalents at end of year	\$ 70,544	\$ 16,119
<b>Supplemental disclosures of cash flow information</b>		
Accrued amounts for the acquisition of property and equipment	\$ 7,851	\$ 3,536
Interest paid, net of capitalized interest of \$2,017 in 2011 and \$500 in 2010	\$ 8,604	\$ 7,740

*See accompanying notes.*

## Gundersen Lutheran

### Notes to Combined Financial Statements *(Dollars in Thousands)*

December 31, 2011

#### **1. Organization and Basis of Presentation**

The combined financial statements include the financial results of Gundersen Clinic, Ltd. (the Clinic), Gundersen Lutheran Medical Center, Inc. (the Hospital), Gundersen Lutheran Administrative Services, Inc. (GLAS) and Gundersen Lutheran Medical Foundation, Inc. (the Foundation), all of which are members of an obligated group (the Obligated Group). The combined financial statements are prepared for the purpose of presenting the operating results of the Obligated Group and do not include all the entities controlled by Gundersen Lutheran Health System, Inc. (the Parent Corporation), which is the sole corporate member of the Obligated Group members but itself is not a member of the Obligated Group. The Parent Corporation and each of the Obligated Group members qualify as tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (the Code).

The Clinic provides comprehensive medical care to patients and conducts medical education and research programs primarily in Wisconsin with smaller facilities in Iowa and Minnesota. The Hospital is located in La Crosse, Wisconsin, and provides medical care to patients from La Crosse and surrounding communities. GLAS is engaged in various administrative transactions on behalf of the affiliates of the Parent Corporation in support of charitable health care activities. The Foundation is organized to enhance and support quality health care with an emphasis on medical and health/wellness education as well as clinically based research and community outreach.

#### **2. Summary of Significant Accounting Policies**

##### **Accounting Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. Although estimates, including uncollectible and contractual allowances on patient accounts receivable, third-party payor settlements, self-insured liabilities, and valuation of swap contracts, are considered to be fairly stated at the time that the estimates were made, actual results could differ from those estimates.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Cash and Cash Equivalents**

Cash and cash equivalents include currency on hand, demand deposits with banks or other financial institutions, and short-term investments with original maturities of 90 days or less from the date of purchase. The Obligated Group maintains cash and cash equivalents on deposit at financial institutions, which at times exceed the limits insured by the Federal Deposit Insurance Corporation, and thereby exposes the Obligated Group to potential risk of loss in the event the financial institution becomes insolvent. No losses have been incurred to date and management does not consider the credit risk to be significant to the Obligated Group.

##### **Patient Accounts Receivable**

The collection of receivables from third-party payors and patients is the Obligated Group's primary source of cash for operations. The primary collection risks relate to uninsured patient accounts and patient deductibles and coinsurance on insurers' accounts. Patient receivables, including the portion that a third-party payor is responsible for, are carried at net realizable value, determined by the original charge for the service provided less an estimate made for contractual adjustments or discounts provided to third-party payors. Patient receivables due directly from the patients are carried at the original charge for the service provided less amounts covered by third-party payers, allowances for other discounts, and an allowance for uncollectible receivables. Management determines an allowance for uncollectible accounts by identifying amounts at risk, based on historical collection experience, aging of accounts, and considering current economic conditions. The Obligated Group does not charge interest on past due receivables. Receivables are written off after collection efforts have been followed in accordance with the Obligated Group's policies. Recoveries of receivables previously written off are recorded as a reduction of bad debt expense.

##### **Investments and Investments Whose Use is Limited**

Investments in equity securities with readily determinable fair values and investments in debt securities are measured at fair value in the combined balance sheets. Investments in equity and debt securities are classified as trading, and accordingly, all unrealized gains and losses are recorded as nonoperating investment return. The Obligated Group accounts for investment transactions on a settlement-date basis.

Gundersen Lutheran

Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

**2. Summary of Significant Accounting Policies (continued)**

Investment securities are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of certain investments will occur in the near term and that such changes could materially affect the amounts reported in the combined financial statements.

Unrestricted investments are classified as current assets since they are available for operations. Certain investments are limited as to use under the terms of a bond indenture, state insurance regulations, unemployment fund agreements, collateral posted against swap valuations, and internally designated for medical education by the Board of Trustees and the Board of Governors. The Board of Trustees and the Board Governors can, at their discretion, change these designations in the future.

**Inventories, Supplies, and Materials**

Inventories, supplies, and materials are valued at the lower of cost (first-in, first-out method) or market value and included in other current assets in the combined balance sheets.

**Property and Equipment**

Property and equipment are stated at cost, if purchased, or at fair value on the date received, if donated, less accumulated depreciation. During periods of construction, interest costs are capitalized to the respective property accounts. Depreciation is provided on a straight-line basis over the following estimated useful lives:

Land improvements	5–10 years
Building	30–40 years
Building additions and improvements	10–25 years
Equipment and furniture	3–15 years

The Obligated Group assesses potential impairment to its long-lived assets when there is evidence that events or changes in circumstances have made recovery of an assets carrying value unlikely. An impairment loss is indicated when the estimated total undiscounted future net cash flows is less than the carrying amounts. The loss recognized is the difference between the fair value and the carrying amount. In 2011, an impairment loss of \$3,853 was recorded with respect to equipment. No impairment loss was recognized in 2010.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Derivative Financial Instruments**

The Obligated Group uses interest rate swap contracts as part of its risk management strategy to manage exposure to fluctuations in interest rates related to its variable-rate debt. All derivative instruments are recorded at fair value in the combined balance sheets, with the changes in the fair values recorded in nonoperating gain/loss in the combined statements of operations.

In April 2007, the Obligated Group de-designated its swaps, which formerly had been classified as cash flow hedges. Prior to the de-designation, changes in the fair value of the hedged interest rate swaps were included in other changes in unrestricted net assets. The accumulated gain in net assets prior to de-designation is being amortized over the remaining life of the term of debt.

##### **Insurance**

The provision for estimated self-insured professional liability, workers' compensation, and employee health care claims includes estimates of the ultimate costs for both reported and incurred but not reported (IBNR) claims. The accrual for self-insured professional liability, workers' compensation and employee health care claims represents the estimated ultimate cost for both asserted and unasserted claims.

##### **Donated Assets and Services**

Unconditional promises to give cash and other assets to the Obligated Group are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets. When the terms of a donor restriction are met, temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets released from restriction. Donor contributions whose restrictions are met within the same year as received are reported as unrestricted contributions.

A large number of people contribute significant amounts of time to the activities of Gundersen Lutheran without compensation. The combined financial statements do not reflect the value of those contributed services, because although substantial, no reliable basis exists for determining an appropriate amount.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued) *(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Net Assets**

Resources are classified for reporting purposes into three net asset categories as unrestricted, temporarily restricted and permanently restricted, according to the absence or existence of donor-imposed restrictions. Unrestricted net assets represent amounts that have no donor-imposed restrictions. Temporarily restricted net assets are those assets whose use has been limited by donors to a specific purpose or time period. Permanently restricted net assets are those assets for which donors require the principal of the gift to be maintained in perpetuity in order to provide a permanent source of income.

##### **Net Patient Revenue**

Net patient revenue is reported at estimated net realizable amounts from patients, third-party payers, and others for services rendered, excluding charges related to the Obligated Group's self insured health benefits. Net patient revenue includes estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future years as final settlements are determined.

##### **Capitation Revenue and Purchased Health Services**

The Clinic and the Hospital provide health care services to enrollees of the Gundersen Lutheran Health Plan (the Health Plan), an affiliate controlled by the Parent Corporation, under a capitation arrangement. The health care services covered by the Health Plan are paid for primarily on a capitated basis determined as a percentage of the member premiums, which transfers most insurance risk to the Clinic and Hospital under a provider reimbursement agreement. Net capitation revenue is recognized in the year in which health care coverage is provided and is recorded net of amounts paid to other medical service providers. Although the majority of services are provided to Health Plan enrollees by the Hospital and Clinic, certain services are provided by out-of-network providers on a contracted fee-for-service basis. A reserve is recorded for out-of-network care rendered but not reported as of each year end.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Charity and Uncompensated Care**

The Clinic and the Hospital provide health care services to patients who meet certain criteria under their charity care policies without charge or at amounts less than established rates. The Clinic and Hospital maintain records to identify and monitor the level of community care provided. These records include the amount of costs incurred for services and supplies furnished under the charity care policy. Since the Clinic and the Hospital do not pursue collection of these amounts, they are not reported as patient revenue.

##### **Electronic Health Record Incentive Payments**

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicare and Medicaid incentive program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional Medicaid incentive payments.

The Obligated Group accounts for HITECH incentive payments as a gain contingency. Income from Medicare incentive payments is recognized as revenue after the Obligated Group has demonstrated that it complied with the meaningful use criteria over the entire applicable compliance period and the cost report period that will be used to determine the final incentive payment has ended. The Obligated Group recognized revenue from Medicaid incentive payments after it adopted certified EHR technology. Incentive payments totaling \$5,940 for 2011 are included in operating revenue in the combined statements of operations. Income from incentive payments is subject to retrospective adjustment as the incentive payments are calculated using Medicare cost data that is subject to audit. In addition, the Obligated Group's compliance with the meaningful use criteria is subject to audit by the federal government.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### **2. Summary of Significant Accounting Policies (continued)**

##### **Performance Indicator**

The performance indicator is revenue in excess of expenses. Changes in unrestricted net assets, which are excluded from revenue in excess of expenses, consistent with industry practice, include net assets released from restrictions to purchase property and equipment, transfers to affiliates, and amortization of accumulated gains on swap contracts at the time of de-designation.

##### **Fair Value Measurement**

The fair value measurements and disclosures topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) defines fair value, establishes a framework for measuring fair value and expands disclosures of fair value measurements, which applies to all assets and liabilities that are measured on a fair value basis.

##### **Income Tax Matters**

The Obligated Group has reviewed its tax positions for all open years and has concluded that no liabilities exist for uncertain tax positions as of December 31, 2011 and 2010. The Obligated Group's income tax returns are no longer subject to examination for 2006 and prior.

##### **New Accounting Pronouncements**

In August 2010, Accounting Standards Update (ASU) 2010-23, *Measuring Charity Care for Disclosure*, was issued. ASU 2010-23 is effective for years beginning after December 15, 2010, and addresses the diversity in the accounting for charity care disclosures, which some entities determine on the basis of a cost measurement, while others use a revenue measurement. ASU 2010-23 requires that the measurement of charity care for disclosure purposes be based on the direct and indirect costs of providing the charity care. The adoption of this new guidance did not have a material impact on the Obligated Group's combined financial statements.



## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

#### 2. Summary of Significant Accounting Policies (continued)

In August 2010, ASU 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*, was issued. ASU 2010-24 is effective for years beginning after December 15, 2010, and addresses the diversity in the accounting for medical professional and other insured liabilities and their related anticipated insurance recoveries by health care entities, which in the past either netted insurance recoveries against the accrued liability or presented the anticipated insurance recovery and the liability on a gross basis. The ASU clarifies that a health care entity should not net insurance recoveries against a related claim liability. The amount of the claim liability should be determined without consideration of insurance recoveries. The adoption of this guidance did not have a material impact on the Obligated Group's combined financial statements.

#### Pending Accounting Guidance Not Yet Adopted

In July 2011, the FASB issued ASU No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and Allowance for Doubtful Accounts for Certain Health Care Entities*. The ASU amends ASC 954, *Health Care Entities*, and requires certain health care entities to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue. Entities also are required to enhance disclosures about their policies for recognizing revenue and assessing bad debts. In addition, the guidance requires disclosure of qualitative and quantitative information about changes in the allowance for uncollectible accounts. This guidance is effective for the Obligated Group for 2012. Management is evaluating the impact that this ASU will have on its combined financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS)* (ASU 2011-04). The amendments in ASU 2011-04 result in common fair value measurement and disclosure requirements in GAAP and IFRS. The guidance also changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. This new guidance is effective for the Obligated Group for 2012. The adoption of this standard in 2012 is not expected to have a material impact on the Obligated Group's combined financial position or results of operations.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **3. Net Patient Revenue**

The Clinic and the Hospital derive patient revenue primarily from patients covered under the Medicare and Medicaid programs, agreements with commercial insurers, and managed care organizations, as well as from private pay patients. The basis for payment under agreements with commercial insurers and managed care organizations includes prospectively determined rates, discounts from established charges and allowable cost.

The Clinic participates in the Medicare and Medicaid programs and is reimbursed based on fee schedules. The Hospital also participates in the Medicare and Medicaid programs, under which substantially all inpatient services rendered to program beneficiaries are paid for based on prospectively determined amounts per discharge depending on the individual patient's diagnostic-related grouping (DRG) of medical conditions. The Hospital's Medicare outpatient services are predominantly paid based on prospectively determined amounts for each service provided depending on the ambulatory payment classification (APC) assigned to each service.

Amounts recorded by the Hospital for estimated cost report settlements can differ from actual settlements based on the results of subsequent cost report audits. In addition, the Hospital appeals certain settlements related to Medicare and other programs. Changes in estimated reimbursement related to prior periods, primarily related to the Medicare program, increased net patient service revenue by approximately \$826 and \$245 for the years ended December 31, 2011 and 2010, respectively. Receivables from settlements recorded in patient accounts receivable were \$1,662 and \$1,540 at December 31, 2011 and 2010, respectively.

The Medicare program accounted for 15% and 16% percent of the Obligated Group's net patient revenue for 2011 and 2010, respectively. Potential changes in the Medicare program and reduction of funding levels could have an adverse effect on the Clinic and the Hospital.

#### **4. Charity Care**

The Clinic and the Hospital provide medical care without charge or at reduced charges to residents of the communities they serve by providing services to patients who are uninsured or underinsured. The cost of providing charity care has been estimated by applying a cost to gross charges ratio to the gross uncompensated charges associated with providing charity care to patients. For 2011 and 2010, cost of providing charity care is estimated to be \$4,500 and \$3,900, respectively.

Gundersen Lutheran

Notes to Combined Financial Statements (continued)  
(Dollars in Thousands)

**5. Investments Whose Use is Limited and Investment Return**

Certain investments as of December 31 are limited as to use for the following purposes:

	<u>2011</u>	<u>2010</u>
Board designated for medical education	\$ 3,747	\$ 3,061
Minimum funding as required by the Wisconsin Office of the Commissioner of Insurance (Note 12)	11,758	10,824
Minimum funding as required by the Wisconsin Unemployment Reserve Fund	3,064	2,825
Collateral posted against insurance claims	1,375	—
Principal and interest payments under a bond indenture	262	1,640
Collateral posted against swap valuations (Note 10)	18,071	—
Held for future capital expenditures under bond indenture	51,699	—
	<u>\$ 89,976</u>	<u>\$ 18,350</u>

Investment return consists of the following for the years ended December 31:

	<u>2011</u>	<u>2010</u>
Dividends and interest	\$ 12,502	\$ 10,756
Equity in earnings of long-term investment	—	11,340
Net realized gains	2,386	782
Net change in unrealized gains/losses	(4,273)	17,002
	<u>\$ 10,615</u>	<u>\$ 39,880</u>

Investment return is reported in the combined statements of operations and changes in net assets as follows for the years ended December 31:

	<u>2011</u>	<u>2010</u>
Nonoperating gains	\$ 10,785	\$ 38,230
Temporarily restricted net assets	189	1,275
Permanently restricted net assets	(359)	375
	<u>\$ 10,615</u>	<u>\$ 39,880</u>

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **6. Fair Value Measurements and Investments**

The Obligated Group follows ASC 820, which defines fair value, establishes a framework for measuring fair value, and requires disclosures about fair value measurements. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. In that regard, a fair value hierarchy was established for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is as follows:

Fair value for financial instruments included in Level 1 is based on unadjusted quoted prices for identical assets or liabilities in an active market that the Obligated Group has the ability to access.

Fair value for financial instruments included in Level 2 is based on pricing inputs that are either directly observable or that can be derived or supported from observable data as of the reporting date. Level 2 inputs may include quoted prices for similar assets or liabilities in nonactive markets or pricing models whose inputs are observable for substantially the full term of the asset or liability. Investments are valued through the use of third-party pricing services that use evaluated bid prices adjusted for specific bond characteristics and market sentiment.

Fair value for Level 3 financial liabilities is determined through the use of widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flow of each derivative. The analysis reflects the contractual terms of the interest-rate swaps, including the period to maturity, and uses observable market-based inputs, such as interest-rate curves. In addition, credit value adjustments are included to reflect both the Obligated Group's nonperformance risk and the respective counterparty's nonperformance risk. The Obligated Group pays annual fixed rates ranging from 3.26% to 3.79% and receives cash flows based on 67% of the London Inter Bank Offered Rate (LIBOR). As of December 31, 2011 and 2010, the Obligated Group's fair value of obligations under interest rate swap contracts was net of a CVA of \$3,961 and \$867, respectively.

Gundersen Lutheran

Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

**6. Fair Value Measurements and Investments (continued)**

The following tables present the financial instruments measured at fair value on a recurring basis at December 31, 2011 and 2010, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	December 31, 2011			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Cash equivalents	\$ 61,506	\$ –	\$ –	\$ 61,506
Common stock	17,017	–	–	17,017
Equity mutual funds	93,862	–	–	93,862
Equity mutual funds – foreign	26,968	–	–	26,968
Fixed-income mutual funds	9,882	–	–	9,882
Fixed-income mutual funds – foreign	445	–	–	445
Fixed income securities:				
U.S. government and agency obligations	72,604	67,901	–	140,505
Corporate bonds	–	93,908	–	93,908
Residential mortgage-backed securities	–	49,203	–	49,203
Commercial mortgage-backed securities	–	4,219	–	4,219
Instruments measured at fair value	282,284	215,231	–	497,515
Certificate of deposit	10,900	–	–	10,900
Total investments and investments whose use is limited	\$ 293,184	\$ 215,231	\$ –	\$ 508,415
<b>Liabilities</b>				
Obligation under swap contracts	\$ –	\$ –	\$ 40,157	\$ 40,157

Gundersen Lutheran

Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

6. Fair Value Measurements and Investments (continued)

	December 31, 2010			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Cash equivalents	\$ 15,457	\$ —	\$ —	\$ 15,457
Common stock	17,785	—	—	17,785
Equity mutual funds	7,933	—	—	7,933
Fixed income mutual funds	83,968	25,027	—	108,995
Fixed-income securities:				
U.S. government and agency obligations	3,201	95,420	—	98,621
Corporate bonds	—	37,646	—	37,646
Residential mortgage-backed securities	—	82,870	—	8,2870
Commercial mortgage-backed securities	—	7,045	—	7,045
Instruments measured at fair value	128,344	248,008	—	376,352
Certificate of deposit	10,900	—	—	10,900
Total investments and investments whose use is limited	\$ 139,244	\$ 248,008	\$ —	\$ 387,252
<b>Liabilities</b>				
Obligation under swap contracts	\$ —	\$ —	\$ 20,553	\$ 20,553

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses are reasonable estimates of fair value due to the short-term nature of these financial instruments. The carrying value of pledges approximates its fair value at December 31, 2011 and 2010.

Fair value of fixed-interest long-term debt, based on quoted market prices for the same or similar instruments, was \$165,900 compared with its carrying value of \$162,430 at December 31, 2011. Fair value of variable-rate long-term debt approximated its carrying value at December 31, 2011 and 2010.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 7. Long-term Investment

In April 2011, the Obligated Group sold its 48.5% interest in Logistics Health Incorporated (LHI) to OptumHealth, a division of United Health Group. In connection with this transaction, the Obligated Group received a consideration of \$108,265, including \$6,435 of anticipated escrow distribution, and realized a gain of \$22,351. The purchase agreement also provides for receipt of up to an additional \$27,885, based on LHI achieving specific performance benchmarks through 2013, none of which has been recognized in the Obligated Group's 2011 combined financial statements. On May 25, 2012, the Obligated Group received \$4,286 of additional consideration, which will be recognized as a gain in 2012, based on LHI achieving specific performance benchmarks in 2011. Prior to April 2011, the Obligated Group accounted for its interest in LHI using the equity method under which the Obligated Group's share of the net income was recognized in nonoperating gains in the combined statements of operations and added to its investment account. Dividends and distributions received were treated as a reduction of the investment account.

#### 8. Property and Equipment

Property and equipment as of December 31 consists of the following:

	2011	2010
Land and land improvements	\$ 20,460	\$ 20,371
Buildings and building improvements	333,129	331,235
Equipment and furniture	354,353	311,502
	707,942	663,108
Less accumulated depreciation	401,636	365,238
	306,306	297,870
Construction-in-progress	65,790	34,430
	\$ 372,096	\$ 332,300

Depreciation expense was \$38,775 and \$35,515 for 2011 and 2010, respectively.

The Obligated Group capitalizes payroll and payroll-related costs associated with the development of software for internal use. In 2011 and 2010, the Obligated Group capitalized \$2,829 and \$3,061, respectively, of payroll and payroll-related costs.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### 9. Long-Term Debt

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

	<b>2011</b>	<b>2010</b>
Wisconsin Health and Educational Facilities Authority (WHEFA) Bonds, Series 2011A (Gundersen Lutheran), interest from 1.0% to 5.25%, principal due in varying amounts through 2039	<b>\$ 162,430</b>	\$ —
WHEFA Series 2011B (Gundersen Lutheran), Adjustable Demand, principal due starting in 2038 (average annual interest rate in 2011 of 0.14%)	<b>40,000</b>	—
WHEFA Series 2009A (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2033 (average annual interest rate in 2011 and 2010, of 0.89% and 0.26%, respectively)	<b>45,305</b>	45,305
WHEFA Series 2009B (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2033 (average annual interest rate in 2011 and 2010, of 0.89% and 0.26%, respectively)	<b>33,410</b>	33,410
WHEFA Series 2008A (Gundersen Lutheran), refunded in 2011	—	26,425
WHEFA Series 2008B (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2033 (average annual interest rate in 2011 and 2010, of 1.06% and 0.52%, respectively)	<b>61,400</b>	61,400
WHEFA Series 2003A (Gundersen Lutheran), defeased in 2011	—	10,925
WHEFA Series 2000A and Series 2000B (Gundersen Lutheran), refunded in 2011	—	67,965
Other	—	246
Total long-term debt	<b>342,545</b>	245,676
Less current maturities	<b>5,865</b>	7,626
	<b>\$ 336,680</b>	\$ 238,050



## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **9. Long-Term Debt (continued)**

In September 2011, the Hospital, the Clinic, GLAS and the Foundation entered into a Restated Master Trust Indenture with a bank that established an Obligated Group, which currently includes the Hospital, the Clinic, GLAS, and the Foundation. Each Obligated Group member is jointly and severally liable for the payment of all obligations issued under the Restated Master Trust Indenture, which are secured ratably by a pledge of the unrestricted receivables of the Obligated Group. The Restated Master Trust Indenture contains, among other things, provisions placing restrictions on additional debt, asset transfers, and liens and requiring the maintenance of a debt service coverage ratio. Additional covenants, including liquidity and capitalization, are included in other loan agreements relating to the obligations.

In May 2008, the Wisconsin Health and Educational Facilities Authority (Authority) issued Series 2008A and Series 2008B bonds on behalf of GLAS in the aggregate amount of \$89,300 bearing interest at a variable rate. In August 2010, the Obligated Group caused a tender of the Series 2008A and Series 2008B bonds, which were placed directly with a bank. Under the terms of the agreement with the bank, GLAS is required to purchase the Series 2008B bonds from the bank in August 2013. The Series 2008A bonds were refunded with proceeds of the Series 2011A bonds and Series 2011B bonds in September 2011.

In May 2009, the Authority issued Series 2009A and Series 2009B bonds on behalf of GLAS in the aggregate amount of \$78,715. The proceeds of those bonds were used to refund the Series 2003B and Series 2003C bonds. In March 2011, the Obligated Group caused a tender of the Series 2009A and Series 2009B bonds, which were placed directly with a bank. Under the terms of the agreement with the bank, GLAS is required to purchase the Series 2009A and Series 2009B bonds from the bank in March 2014.

In September 2011, the Authority issued Series 2011A and Series 2011B bonds on behalf of GLAS. The Series 2011A bonds were issued in an aggregate par amount of \$162,430 and bear interest at fixed rates. The Series 2011B bonds were issued in an aggregate amount of \$40,000 and bear interest at variable rates that are initially set weekly. The Series 2011B bonds are subject to optional and mandatory tender and are supported by an irrevocable direct pay letter of credit issued by a bank, which expires in September 2016. Under the terms of the agreement with the bank, GLAS may elect to convert any liquidity draw made under the letter of credit into a bank loan that amortizes in equal quarterly installments over a three-year period, commencing no sooner than 367 days after the date of the draw, provided that there is no event of default and the representations made at the time of the draw are accurate.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 9. Long-Term Debt (continued)

The proceeds of the Series 2011A bonds and the Series 2011B bonds were used to: currently refund the Series 2000A bonds, Series 2000B bonds, and Series 2008A bonds, and finance new construction.

In September 2011, the Obligated Group also defeased the Series 2003A bonds by depositing funds into an escrow account in an amount sufficient to pay the principal and interest on the Series 2003A bonds as they become due in the ordinary course and to pay the principal amount outstanding on February 15, 2013, which is the redemption date. As a result of the defeasance, the related bond documents were legally discharged.

In 2011, the Obligated Group accounted for the refunding of the Series 2000A bonds, Series 2000B bonds, and Series 2008A bonds, the legal defeasance of the Series 2003A bonds, and the tendering of the Series 2009A and Series 2009B bonds as an extinguishment and recorded a loss on extinguishment of debt of \$2,868 in the combined statements of operations.

At December 31, 2011, the aggregate maturities and sinking fund requirements of long-term debt, for each of the five subsequent years and thereafter, assuming that all bonds are successfully remarketed with the original maturity dates and the Obligated Group is able to renew the letter of credit, which expires in September 2016, are as follows:

2012	\$	5,865
2013		6,265
2014		6,420
2015		6,740
2016		6,995
Thereafter		<u>310,260</u>
	\$	<u><u>342,545</u></u>

Gundersen Lutheran

Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

**10. Derivative Financial Instruments**

The Obligated Group has entered into interest rate swaps, which are recorded at fair value as noncurrent liabilities in the combined balance sheets as of December 31, as follows:

	<u>2011</u>	<u>2010</u>
Notional amount \$33,000 Series 2009B (previously Series 2003C), fixed rate 3.51%, variable interest equal to 67% of the one-month LIBOR averaged 0.23% and 0.27% in 2011 and 2010, respectively	\$ 7,073	\$ 3,737
Notional amount \$40,470 Series 2000B (now associated with the Series 2011B ), fixed rate 3.26%, variable interest equal to 67% of the one-month LIBOR averaged 0.23% and 0.27% in 2011 and 2010, respectively	7,377	3,556
Notional amount \$44,750 Series 2009A (previously Series 2003B), fixed rate 3.28%, variable interest equal to 67% of the one-month LIBOR averaged 0.23% and 0.27% in 2011 and 2010, respectively	9,421	4,073
Notional amount \$60,725 Series 2008B, fixed rate 3.79%, variable interest equal to 67% of the one-month LIBOR averaged 0.23% and 0.27% in 2011 and 2010, respectively	16,286	9,187
	<u>\$ 40,157</u>	<u>\$ 20,553</u>

The decrease in the value of the swap contracts of \$19,604 and \$7,386 for 2011 and 2010, respectively, was recorded as an unrealized loss and is included in nonoperating gain (loss) in the combined statements of operations.

Derivative transactions contain credit risk in the event the parties are unable to meet the terms of the contract; credit risk is generally limited to the fair value due from counterparties on outstanding contracts. At December 31, 2011, the counterparties had a Standard & Poor's credit quality rating of A-.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued) (Dollars in Thousands)

#### **10. Derivative Financial Instruments (continued)**

The interest rate swap contracts contain collateral provisions applicable to both parties to mitigate credit risk. The collateral provided by the Obligated Group to the counterparties was \$18,071 as of December 31, 2011. There was no collateral provided by the Obligated Group to counterparties as of December 31, 2010.

The net settlements for the interest rate swap contracts of \$5,960 and \$5,906 for 2011 and 2010, respectively, are included in interest expense in the combined statements of operations.

#### **11. Retirement Plan**

The Obligated Group maintains a defined contribution and 401(k) plan covering substantially all of its employees. Retirement plan expense was \$47,225 and \$45,303 for 2011 and 2010, respectively. The Obligated Group funds the plan annually. At December 31, 2011 and 2010, the total liability for employer contributions was \$48,268 and \$46,319, respectively, and is included in accrued liabilities in the combined balance sheets.

#### **12. Insurance**

The Clinic is self-insured for Wisconsin professional liability up to base limits of insurance coverage (\$1,000 per claim and \$3,000 annually on an occurrence basis at December 31, 2011 and 2010). Additionally, under the Wisconsin professional liability, self-insured limits are in place per physician/Certified Registered Nurse Anesthetist (CRNA) (\$1,000 per physician/CRNA per claim and \$3,000 annually per physician/CRNA on an occurrence basis at December 31, 2011 and 2010). The Clinic has established a professional liability insurance plan and irrevocable trust as required by Wisconsin statutes. The funding requirements of the plan are established annually based on third-party actuarial calculations, as prescribed by the Commissioner of Insurance for the State of Wisconsin. All professional liability claims or judgments occurring in Wisconsin in excess of the base level of coverage are paid from the Injured Patients' and Families Compensation Fund, which insures all claims incurred regardless of when the claim is filed. The Injured Patients' and Families Compensation Fund has no upper limit on losses.

The Clinic has purchased professional liability insurance on a claims-made basis to cover Iowa and Minnesota risks, including umbrella and excess coverage to minimize exposure.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 12. Insurance (continued)

The Hospital has purchased professional liability insurance on a claims-made basis to cover claim losses. The Hospital is also insured through the Injured Patients' and Families Compensation Fund for losses on professional liability claims (\$1,000 per claim and \$3,000 annually at December 31, 2011 and 2010). The Injured Patients' and Families Compensation Fund has no upper limit on losses.

The Obligated Group maintains self-insurance programs for health care costs of its active employees. The Obligated Group has purchased stop-loss insurance with an annual deductible of \$500 per individual. In addition, the Obligated Group is insured for workers' compensation exposures under an incurred loss retrospective rating plan.

The estimated liability for professional and general liability, workers' compensation, and employee health insurance claims is based on actual claims to date and a projection of the estimated future liability for such claims and incurred but not reported (IBNR) claims. At December 31, 2011 and 2010, the total recorded liability was \$24,051 and \$15,877, respectively, of which a current portion of \$19,867 and \$12,374, respectively, is included in accrued liabilities in the combined balance sheets. At December 31, 2011, the estimated receivable related to insurance recoveries of \$2,257 is included in other current assets in the combined balance sheets. No amount was receivable at December 31, 2010.

#### 13. Commitments and Contingencies

The Obligated Group has leases for equipment and satellite office facilities, which are classified as operating leases. Rental expense under these operating leases totaled \$4,464 and \$4,601 for 2011 and 2010, respectively.

Future commitments under operating leases in effect as of December 31, 2011, for each of the five subsequent years and thereafter are as follows:

2012	\$	1,598
2013		1,266
2014		955
2015		630
2016		500
Thereafter		1,368
	\$	<u>6,317</u>

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **13. Commitments and Contingencies (continued)**

The Clinic and the Hospital are defendants in legal proceedings arising in the ordinary course of business. Although the outcome of these proceedings cannot be determined, management of the Obligated Group considers it unlikely that the disposition of these proceedings will have a material adverse effect on the financial position or operations of the Obligated Group. However, there can be no assurance that this will be the case.

The Clinic, Hospital and GLAS have entered into an agreement with the City of La Crosse in conjunction with the city's establishment of Tax Incremental Financing District No. 14 (TIF 14). The agreement requires the construction of one or more parking ramps that will accommodate 1,000 vehicles, with qualifying costs not to exceed \$18,500. At December 31, 2009, a 537-vehicle ramp adjacent to the Clinic was completed. In 2010, a second ramp was completed to satisfy the requirement of available vehicle space, but was not considered for the tax incentives offered under the TIF 14 agreement. This ramp is adjacent to the area designated for the new hospital described below as part of a campus renewal plan. Additionally, the agreement creates property tax incentives for further taxable development on the Gundersen Lutheran La Crosse campus by Gundersen Lutheran and other developers. The benefit that Gundersen Lutheran will derive from participation in TIF 14 is dependent on the size of future development over the next 20 years.

The Obligated Group has established a campus renewal plan, which includes the addition of a 400,000 square foot, six-story hospital building on the main campus, adjacent to the existing Hospital facility. The hospital addition, which began in January 2011, is scheduled to be completed in late 2013. This initial phase is projected to cost \$218,000 under a guaranteed maximum price contract with a general contractor. The Obligated Group is funding this addition with cash flow from operations, debt financing, and fundraising.

## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### **13. Commitments and Contingencies (continued)**

##### **Compliance With Laws and Regulations**

The health care industry is governed by various laws and regulations of federal, state, and local governments. These laws and regulations are subject to ongoing government review and interpretation, and include matters such as licensure, accreditation, reimbursement for patient services, and referrals for Medicare and Medicaid beneficiaries. Compliance with these laws and regulations is required for participation in government healthcare programs. Certain governmental agencies routinely investigate and pursue allegations concerning possible overpayments resulting from violation of fraud and abuse statutes by healthcare providers. These investigations may result in settlements involving fines and penalties as well as repayment of improper reimbursement. The Obligated Group has implemented procedures for monitoring and enforcing compliance with laws and regulations and is not aware of instances of noncompliance. While management believes that the Obligated Group is in material compliance with fraud and abuse laws and regulations as well as other applicable government laws and regulations, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Changes in reimbursement from the Medicare program, including reduction of funding levels, could have an adverse effect on the Obligated Group.

##### **Health Care Reform**

In March 2010, President Obama signed the Patient Protection and Affordable Care Act (PPACA) into law. PPACA will result in sweeping changes across the health care industry, including how care is provided and paid for. A primary goal of this comprehensive reform legislation is to extend health care coverage to approximately 32 million uninsured legal U.S. residents through a combination of public program expansion and private sector health insurance reforms. To fund the expansion of insurance coverage, the legislation contains measures designed to promote quality and cost efficiency in health care delivery and to generate budgetary savings in the Medicare and Medicaid programs. Given that the final regulations and interpretive guidelines have yet to be published, the Obligated Group is unable to fully predict the impact of PPACA on its operations and financial results. The U.S. Supreme Court has heard arguments on the constitutionality of major portions of PPACA and is currently in deliberations. To the extent that any significant elements of the law are overturned, additional uncertainty is introduced into the prediction of operation and financial impacts.

Gundersen Lutheran

Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

**14. Concentration of Credit Risk**

The Clinic and the Hospital grant credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. Amounts due from various payers and patients as of December 31 included in net patient accounts receivable are as follows:

	<u>2011</u>	<u>2010</u>
Medicare	12%	15%
Medicaid	4	4
Commercial insurance, private pay, and other	84	81
	<u>100%</u>	<u>100%</u>

**15. Functional Expenses**

Expenses related to providing patient care are as follows for the years ended December 31:

	<u>2011</u>	<u>2010</u>
Health care services	\$ 681,624	\$ 645,487
General and administrative, including fundraising	166,340	154,622
	<u>\$ 847,964</u>	<u>\$ 800,109</u>

**16. Related-Party Transactions**

The Clinic and the Hospital have an agreement with the Gundersen Lutheran Health Plan, Inc. (Health Plan) to provide health care services to the Health Plan's insured enrollees. The Clinic and the Hospital are paid on a fully capitated basis. Reinsurance contracts exist for medical and hospital expenses in excess of \$500 per enrollee per contract year. Capitation revenue recorded by the Clinic and the Hospital which was earned under the agreement with the Health Plan totaled \$250,769 and \$231,106 for 2011 and 2010, respectively. At December 31, 2011 and 2010, amounts due from (to) the Health Plan were \$2,772 and \$(541), respectively, and are included in other current assets in the combined balance sheets.



## Gundersen Lutheran

### Notes to Combined Financial Statements (continued)

*(Dollars in Thousands)*

#### 16. Related-Party Transactions (continued)

Under terms of an administrative services agreement with the Health Plan, the Obligated Group provides substantially all general and administrative services necessary for the Health Plan's operations at amounts that are intended to approximate cost. The cost of these services to the Health Plan was approximately \$10,992 and \$10,339 in 2011 and 2010, respectively. Amounts due from the Health Plan as of December 31, 2011 and 2010, related to the administrative services agreement were \$1,363 and \$1,208, respectively, and are included in net patient revenue in the combined statements of operations.

The Health Plan leases office space from the Obligated Group. Rental payments were approximately \$300 for 2011 and 2010.

At December 31, 2011 and 2010, notes receivable from affiliates totaling \$14,206 and \$7,022, respectively, which are recorded net of allowances for uncollectible amounts of \$347 and \$269, respectively, represent loans to affiliates to finance their activities. Notes receivable from affiliates have terms ranging from 1 to 15 years, with annual interest rates ranging from 3.0% to 6.0%.

#### 17. Restricted Net Assets

Temporarily restricted net assets as of December 31 are available for the following purposes or periods:

	<u>2011</u>	<u>2010</u>
Purpose restrictions:		
Education	\$ 954	\$ 955
Research	186	377
Community and affiliate programs	563	481
Buildings and equipment	8,860	2,095
Other	342	341
Time restrictions for future periods	438	460
	<u>\$ 11,343</u>	<u>\$ 4,709</u>

Gundersen Lutheran

Notes to Combined Financial Statements (continued)

(Dollars in Thousands)

**17. Restricted Net Assets (continued)**

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

	<u>2011</u>	<u>2010</u>
Education	\$ 4,724	\$ 4,638
Research	4,513	4,173
Community health initiatives	2,275	2,194
General operations	3,165	3,384
	<u>\$ 14,677</u>	<u>\$ 14,389</u>

**18. Pledges**

At December 31, 2011, pledges receivable, discounted at annual rates ranging from 4.61% to 5.69%, totaled \$9,973. The timing of receipt of pledges is estimated as follows:

Within one year	\$ 1
One to five years	5,858
After five years	<u>4,114</u>
	9,973
Less present value discount and allowances for uncollectible pledges	<u>(1,152)</u>
	<u>\$ 8,821</u>

**19. Subsequent Events**

The Obligated Group has evaluated events and transactions that have occurred subsequent to December 31, 2011 through May 29, 2012, the date on which the combined financial statements were available to be issued.

During this period, there were no subsequent events requiring recognition or disclosure in the combined financial statements, other than the additional consideration received related to the sale of the Obligated Group's interest in LHI (see Note 7).

Ernst & Young LLP

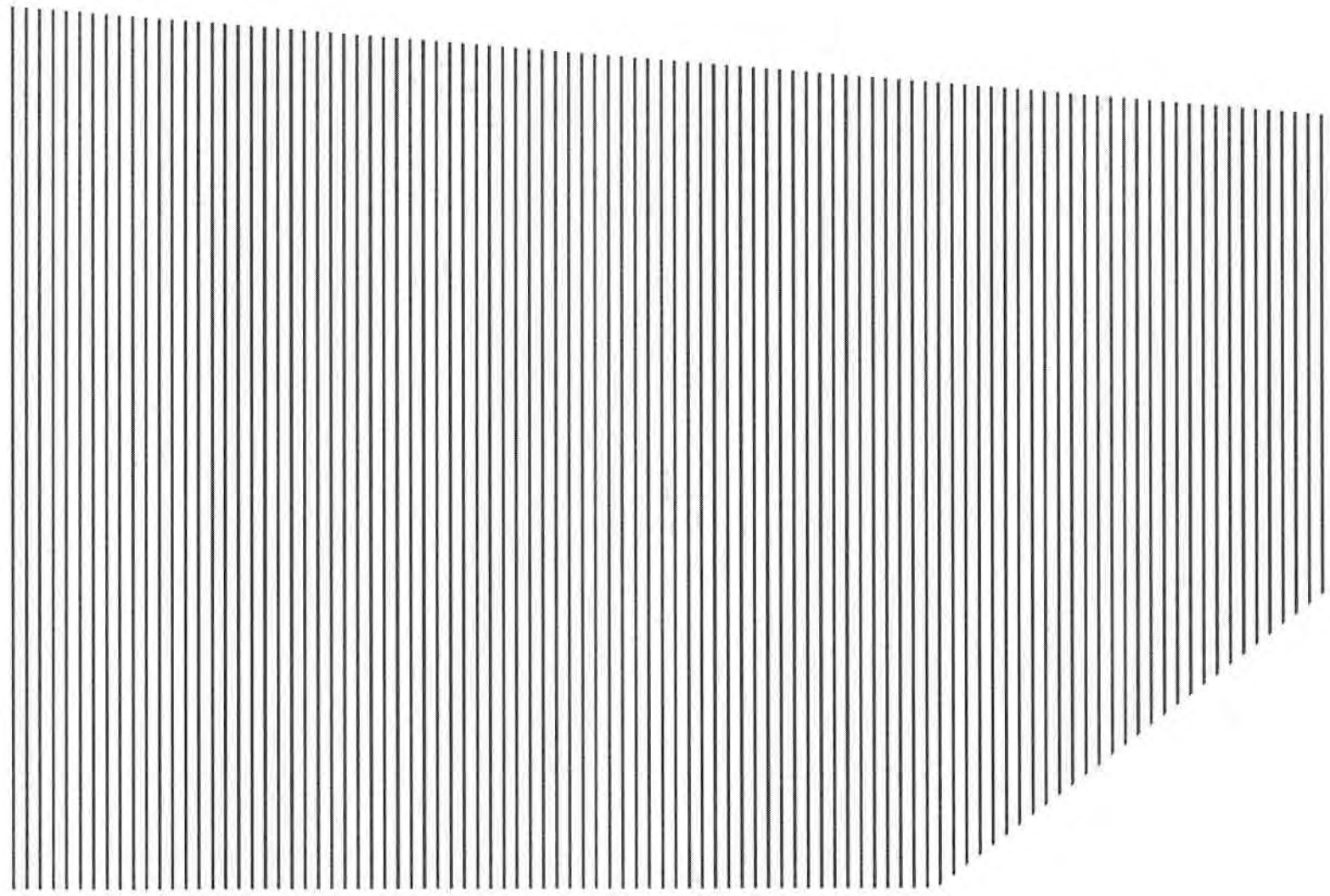
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# **Gundersen Lutheran**

(consisting of Gundersen Clinic, Ltd.,  
Gundersen Lutheran Medical Center, Inc.,  
Gundersen Lutheran Administrative Services, Inc.,  
and Gundersen Lutheran Medical Foundation, Inc.,  
which comprise an Obligated Group)

Combined Financial Report  
December 31, 2010

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## Independent Auditor's Report

The Board of Trustees and the Board of Governors  
Gundersen Lutheran  
La Crosse, Wisconsin

We have audited the accompanying combined balance sheets of Gundersen Clinic, Ltd.; Gundersen Lutheran Medical Center, Inc.; Gundersen Lutheran Administrative Services, Inc.; and Gundersen Lutheran Medical Foundation, Inc., which comprise an Obligated Group (collectively, Gundersen Lutheran) as of December 31, 2010 and 2009, and the related combined statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Gundersen Lutheran's management. Our responsibility is to express an opinion on these 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Gundersen Lutheran as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the combined financial statements, the 2010 and 2009 financial statements have been restated to correct certain misstatements.

*McGladrey & Pullen, LLP*

La Crosse, Wisconsin  
March 25, 2011, except as to Note 3  
to the combined financial statements,  
which is as of August 24, 2011

**Gundersen Lutheran**  
**Combined Balance Sheets**  
**(In Thousands)**

	<b>December 31,</b>	
<b>Assets</b>	<b>2010</b>	<b>2009</b>
	<b>(restated)</b>	<b>(restated)</b>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 16,119	\$ 30,787
Investments	358,459	319,227
Patient accounts receivable, less allowance for uncollectible accounts of \$19,236 in 2010 and \$19,079 in 2009	101,574	97,915
Current portion of notes receivable from affiliates	1,228	689
Other	22,148	19,179
<b>Total current assets</b>	<b>499,528</b>	<b>467,797</b>
Investments Whose Use Is Limited	28,793	30,353
Long-Term Investment	90,090	78,750
Notes Receivable From Affiliates, net of current portion	5,794	6,635
Property and Equipment, net	332,300	305,248
Other Noncurrent Assets	16,713	14,957
<b>Total assets</b>	<b>\$ 973,218</b>	<b>\$ 903,740</b>
 <b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 17,359	\$ 11,903
Accrued liabilities	107,563	103,851
Current maturities of long-term debt	7,626	7,287
Other	9,876	11,799
<b>Total current liabilities</b>	<b>142,424</b>	<b>134,840</b>
Long-Term Debt, net of current maturities	238,050	254,676
Obligation Under Swap Contracts	20,553	13,167
Other Noncurrent Liabilities	8,863	3,809
<b>Total liabilities</b>	<b>409,890</b>	<b>406,492</b>
 Commitment and Contingencies (Note 14)		
<b>Net Assets</b>		
Unrestricted	544,230	478,295
Temporarily restricted	4,709	5,403
Permanently restricted	14,389	13,550
<b>Total net assets</b>	<b>563,328</b>	<b>497,248</b>
<b>Total liabilities and net assets</b>	<b>\$ 973,218</b>	<b>\$ 903,740</b>

See Notes to Combined Financial Statements.



**Gundersen Lutheran**  
**Combined Statements of Operations**  
**(In Thousands)**

	Years Ended December 31,	
	2010 (restated)	2009 (restated)
<b>Operating revenue:</b>		
Net patient revenue	\$ 583,117	\$ 554,145
Capitation revenue	231,106	203,674
Other revenue	17,597	19,922
<b>Total operating revenue</b>	<b>831,820</b>	<b>777,741</b>
<b>Expenses:</b>		
Salaries, wages and benefits	473,066	459,003
Supplies	94,391	90,192
Purchased health services	74,035	64,851
Depreciation and amortization	35,784	36,182
Other	33,098	35,623
Provision for uncollectible accounts	29,564	28,254
Facilities	27,006	26,999
Purchased services	23,591	24,041
Interest	9,574	10,988
<b>Total operating expenses</b>	<b>800,109</b>	<b>776,133</b>
<b>Income from operations</b>	<b>31,711</b>	<b>1,608</b>
Investment return	30,844	69,342
Other nonoperating expenses	(2,388)	(3,195)
<b>Revenue in excess of expenses</b>	<b>60,167</b>	<b>67,755</b>
<b>Other changes in unrestricted net assets:</b>		
Net assets released from restrictions to purchase property and equipment	2,671	269
Other transfers	3,199	-
Amortization related to interest rate swaps prior to de-designation	(77)	(78)
Transfers to affiliates	(25)	(751)
<b>Increase in unrestricted net assets</b>	<b>\$ 65,935</b>	<b>\$ 67,195</b>

See Notes to Combined Financial Statements.

**Gundersen Lutheran**

**Combined Statements of Changes in Net Assets  
(In Thousands)**

	Years Ended December 31,	
	2010 (restated)	2009 (restated)
<b>Unrestricted net assets:</b>		
Revenue in excess of expenses	\$ 60,167	\$ 67,755
Net assets released from restrictions to purchase property and equipment	2,671	269
Other transfers	3,199	-
Amortization related to interest rate swaps prior to de-designation	(77)	(78)
Transfers to affiliates	(25)	(751)
<b>Increase in unrestricted net assets</b>	<b>65,935</b>	<b>67,195</b>
<b>Temporarily restricted net assets:</b>		
Contributions	6,108	2,696
Investment income (loss)	267	(967)
Net change in unrealized gains on investments	1,008	2,996
Net assets released from restriction	(4,878)	(4,225)
Other transfers	(3,199)	-
<b>Increase (decrease) in temporarily restricted net assets</b>	<b>(694)</b>	<b>500</b>
<b>Permanently restricted net assets:</b>		
Contributions	464	228
Investment loss	(96)	(489)
Net change in unrealized gains on investments	471	1,219
<b>Increase in permanently restricted net assets</b>	<b>839</b>	<b>958</b>
<b>Increase in net assets</b>	<b>66,080</b>	<b>68,653</b>
Net assets at beginning of year	497,248	428,595
Net assets at end of year	<b>\$ 563,328</b>	<b>\$ 497,248</b>

See Notes to Combined Financial Statements.

**Gundersen Lutheran**

**Combined Statements of Cash Flows  
(In Thousands)**

	<b>Years Ended December 31,</b>	
	<b>2010 (restated)</b>	<b>2009 (restated)</b>
<b>Cash Flows From Operating Activities</b>		
Increase in net assets	\$ 66,080	\$ 68,653
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	35,784	36,182
Provision for uncollectible accounts	29,564	28,254
Unrealized (gains) losses on interest rate swaps	7,386	(23,993)
Realized and change in unrealized (gains) and losses on investments, net	(17,784)	(35,281)
Equity earnings from long-term investment	(11,340)	-
Loss on extinguishment of debt	-	2,390
Transfers to affiliates	25	751
Restricted contributions	(3,135)	(497)
Changes in operating assets and liabilities:		
Patient accounts receivable	(33,223)	(14,827)
Other current assets	(3,237)	410
Accounts payable, accrued and other current liabilities	7,245	53,916
Other noncurrent assets and liabilities	3,298	(6,982)
<b>Net cash provided by operating activities</b>	<b>80,663</b>	<b>108,976</b>
<b>Cash Flows From Investing Activities</b>		
Purchase of long-term investment	-	(78,750)
Purchases of property and equipment, net	(62,568)	(40,663)
Net (purchases) sales of investments	(19,888)	38,736
Transfers to affiliates	(25)	(751)
Net proceeds from notes receivable from affiliates	302	315
<b>Net cash used in investing activities</b>	<b>(82,179)</b>	<b>(81,113)</b>
<b>Cash Flows From Financing Activities</b>		
Proceeds from issuance of bonds	-	78,715
Principal payments on long-term debt and capital lease obligations	(7,050)	(84,600)
Net proceeds from (payment of) notes payable	(9,237)	1,807
Restricted contributions	3,135	497
<b>Net cash used in financing activities</b>	<b>(13,152)</b>	<b>(3,581)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(14,668)</b>	<b>24,282</b>
Cash and cash equivalents, beginning of year	30,787	6,505
Cash and cash equivalents, end of year	\$ 16,119	\$ 30,787
<b>Supplemental Disclosures of Cash Flow Information</b>		
Interest paid, net of capitalized interest 2010 \$500; 2009 \$486	\$ 7,740	\$ 9,406

See Notes to Combined Financial Statements.

## Gundersen Lutheran

### Notes to Combined Financial Statements (Dollars in Thousands)

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#### Note 1. Organization and Basis of Presentation

The combined financial statements include the financial results of the nonprofit organizations listed below, all of which are members of an obligated group (the Obligated Group):

- Gundersen Clinic, Ltd. (the Clinic)
- Gundersen Lutheran Medical Center, Inc. (the Hospital)
- Gundersen Lutheran Administrative Services, Inc. (GLAS)
- Gundersen Lutheran Medical Foundation, Inc. (the Foundation)

The combined financial statements are prepared for the purpose of presenting the operating results of the Obligated Group and do not include all the entities controlled by Gundersen Lutheran Health System, Inc. (the Parent Corporation). The Parent Corporation, which is not a member of the Obligated Group, is the sole corporate member of the Clinic, the Hospital, GLAS and the Foundation. The Parent Corporation, the Clinic, the Hospital, GLAS and the Foundation qualify as tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code (the Code).

The Clinic provides comprehensive medical care to patients and conducts medical education and research programs in Wisconsin, Iowa and Minnesota. The Hospital is located in La Crosse, Wisconsin, and provides medical care to patients from La Crosse and surrounding communities. GLAS is engaged in various administrative transactions on behalf of the affiliates of the Parent Corporation in support of charitable health care activities. The Foundation is organized to enhance and support quality health care with an emphasis on medical and health/wellness education as well as clinically based research and community outreach.

#### Note 2. Summary of Significant Accounting Policies

**Accounting estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time that the estimates were made, actual results could differ from those estimates. Key estimates include uncollectible and contractual allowances on patient accounts receivable, third-party payor settlements, self-insured liabilities, and valuation of interest rate swap agreements.

**Cash and cash equivalents:** Cash and cash equivalents include currency on hand, demand deposits with banks or other financial institutions, and short-term investments with original maturities of 90 days or less from the date of purchase. Certain temporary cash investments which are components of the Obligated Group's investment portfolio are excluded from cash and cash equivalents.

The Obligated Group maintains cash and cash equivalents on deposit at financial institutions, which at times exceed the limits insured by the Federal Deposit Insurance Corporation. This exposes the Obligated Group to potential risk of loss in the event the financial institution becomes insolvent.

**Patient accounts receivable:** The collection of receivables from third-party payors and patients is the Obligated Group's primary source of cash for operations. The primary collection risks relate to uninsured patient accounts and patient deductibles and coinsurance on insurers accounts. Patient receivables, where a third-party payor is responsible for paying the amount, are carried at a net amount determined by the original charge for the service provided, less an estimate made for contractual adjustments or discounts provided to third-party payors.

Gundersen Lutheran

Notes to Combined Financial Statements  
(Dollars in Thousands)

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**Note 2. Summary of Significant Accounting Policies (Continued)**

Patient receivables due directly from the patients are carried at the original charge for the service provided less amounts covered by third-party payors, allowances for other discounts, and an allowance for uncollectible receivables. Management determines the allowance for uncollectible accounts by identifying amounts at risk, by historical collection experience, aging of accounts, and considering current economic conditions. The Obligated Group does not charge interest on receivables. Receivables are written off after collection efforts have been followed in accordance with the Obligated Group's policies. Recoveries of receivables previously written off are recorded as a reduction of bad debt expense.

Receivables or payables related to estimated settlements on various payor contracts, primarily Medicare, are reported as a component of patient accounts receivable.

**Investments and investments whose use is limited:** Investments in equity securities with readily determinable fair values and investments in debt securities are measured at fair value in the combined balance sheets.

Investments in equity and debt securities are classified as trading, and accordingly, all unrealized gains and losses are recorded as nonoperating investment return. Investment securities are exposed to various risks, such as interest rate, credit and overall market volatility, and there is a reasonable possibility of material changes in fair value in the near term.

Unrestricted investments are classified as current assets since they are available for operations. Certain investments are limited as to use under the terms of a bond indenture, state insurance regulations, unemployment fund agreements, donor-imposed restrictions, and internally designated for medical education by the Board of Trustees and the Board of Governors. The Board of Trustees and the Board Governors can, at their discretion, change these designations in the future.

Equity investments where the Obligated Group has significant influence as defined by generally accepted accounting principles are accounted for by the equity method of accounting under which the Obligated Group's share of the net income (loss) on these investments is recognized as nonoperating investment return in the combined statements of operations and added to (deducted from) the investment account. Dividends and distributions received are treated as a reduction of the investment account. These investments are included in long-term investments in the accompanying combined balance sheets.

**Inventories, supplies and materials:** Inventories, supplies and materials are valued at the lower of cost (first-in, first-out method) or market and included in other current assets in the combined balance sheets.

**Property and equipment:** Property and equipment are stated at cost, if purchased, or at fair market value on the date received, if donated, less accumulated depreciation. Capitalized interest cost incurred on borrowed funds during the period of construction on capital assets is capitalized as a component of the cost of acquiring those assets. Depreciation is provided on a straight-line basis over the following estimated useful lives:

Land improvements	5 – 10 years
Buildings	30 – 40 years
Building additions and improvements	10 – 25 years
Equipment and furniture	3 – 15 years

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

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**Note 2. Summary of Significant Accounting Policies (Continued)**

The Obligated Group assesses potential impairment to its long-lived assets when there is evidence that events or changes in circumstances have made recovery of an assets carrying value unlikely. An impairment loss is indicated when the sum of expected undiscounted future net cash flows is less than the carrying amounts. The loss recognized is the difference between the fair value and the carrying amount. There was no loss recognized for the years ended December 31, 2010 and 2009.

**Derivative financial instruments:** The Obligated Group uses interest rate swap instruments as part of its risk management strategy to manage exposure to fluctuations in interest rates. All derivative instruments are recorded at fair value in the combined balance sheets, which resulted in liabilities at each year-end.

The derivatives and hedging topic of the FASB Accounting Standards Codification provides guidance on accounting and reporting for the changes in the fair value (i.e., gains or losses) of a derivative instrument. Subsequent to adopting this topic of the Codification during fiscal year 2007, the Obligated Group de-designated its swaps, which formerly had been classified as cash flow hedges. Prior to the de-designation, changes in the fair value of the hedged interest rate swaps were included in other changes in unrestricted net assets. Subsequent to the de-designation, changes in the fair value of interest rate swaps are included in investment return. Also, the increase in net assets prior to de-designation is being amortized over the remaining life of the swap agreements.

**Insurance:** The provision for estimated self-insured professional liability and employee health care claims includes estimates of the ultimate costs for both reported and incurred but not reported (IBNR) claims. The accrual for self-insured professional liability and employee health care claims represents the estimated liability for asserted and unasserted claims. Claims liabilities in excess of the self-insurance retention limits are offset against insurance recoveries.

**Asset retirement obligations:** At December 31, 2010 and 2009, the long-term liability related to the Obligated Group's asset retirement obligations was \$1,679 and \$1,622, respectively.

**Donated assets and services:** Unconditional promises to give cash and other assets to the Obligated Group are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets. When the terms of a donor restriction are met, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the combined statements of operations or combined statements of changes in net assets as net assets released from restriction. Donor contributions whose restrictions are met within the same year as received are reported as unrestricted contributions.

Donor contributions received by the Foundation, whose restrictions are met by other members of the Obligated Group, are reported as other transfers from temporarily restricted net assets to unrestricted net assets even though the Foundation has not distributed such contributions.

A large number of people have contributed significant amounts of time to the activities of Gundersen Lutheran without compensation. The combined financial statements do not reflect the value of those contributed services, because although clearly substantial, no reliable basis exists for determining an appropriate amount.

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

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**Note 2. Summary of Significant Accounting Policies (Continued)**

**Net assets:** Resources are classified for reporting purposes into three net asset categories as unrestricted, temporarily restricted and permanently restricted, according to the absence or existence of donor-imposed restrictions. Unrestricted net assets represent amounts which have no donor-imposed restrictions and include amounts designated by the Foundation's Board of Directors, at their discretion for a specific purpose. Temporarily restricted net assets are those assets whose use has been limited by donors to a specific purpose or time period. Permanently restricted net assets are those for which donors require the principal of the gift to be maintained in perpetuity and provide a permanent source of income.

**Net patient revenue:** Net patient revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered, excluding charges related to the Obligated Group's self insured health benefits. Net patient revenue includes estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future years as final settlements are determined.

**Capitation revenue:** The Clinic and the Hospital provide health care services to enrollees of the Gundersen Lutheran Health Plan (the Health Plan), an affiliate controlled by the Parent Corporation, under a capitation arrangement. The health care services covered by the Health Plan are primarily paid for on a capitated basis determined as a percentage of the member premiums, which transfers most insurance risk to the Clinic and Hospital under a provider reimbursement agreement. Capitation revenue is recognized in the year in which health care coverage is provided.

**Charity and uncompensated care:** The Clinic and the Hospital provide health care services to patients who meet certain criteria under their charity care policies without charge or at amounts less than established rates. Since the Clinic and the Hospital do not pursue collection of these amounts, they are not reported as patient revenue.

**Other revenue:** Other revenue represents income from operations of the Foundation and several components of Clinic and Hospital income from service contracts and other operating revenue. Other revenue includes net assets released from restrictions of \$2,201 and \$3,951 in 2010 and 2009, respectively.

**Performance indicator:** The performance indicator is revenue in excess of expenses. Changes in unrestricted net assets, which are excluded from revenue in excess of expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, the cumulative effect of change in accounting principles and contributions of long-lived assets (including assets acquired by contributions which by donor restriction were to be used for the purpose of acquiring assets) and amortization related to interest rate swaps prior to de-designation.

**Income from operations:** The combined statements of operations include income from operations. Changes in unrestricted net assets, which are excluded from income from operations include investment return and other income (loss) which management views as outside of normal activity.

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

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**Note 2. Summary of Significant Accounting Policies (Continued)**

**Fair value measurement:** The fair value measurements and disclosures topic of the FASB Accounting Standards Codification defines fair value, establishes a framework for measuring fair value and expands disclosures of fair value measurements, which applies to all assets and liabilities that are measured on a fair value basis.

**Income tax matters:** The Obligated Group adopted the provisions relating to uncertain tax positions of the FASB Accounting Standards Codification on January 1, 2007. The Codification clarifies the accounting for uncertainty in income taxes recognized in an organization's financial statements and prescribes a recognition threshold and measurement for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. The Obligated Group has reviewed its tax positions for all open years and has concluded that no liabilities exist as of December 31, 2010 and 2009. The Obligated Group's income tax returns are no longer subject to examination for the fiscal years ended December 31, 2006, and prior.

**Reclassifications:** Certain items on the accompanying combined balance sheet and statements of operations and changes in net assets for the year ended December 31, 2009 have been reclassified to be consistent with classifications adopted during the year ended December 31, 2010. The reclassifications had no impact on total assets, change in net assets or total net assets.

**Pending Accounting Pronouncements:** In August 2010, Accounting Standards Update (ASU) 2010-23, *Measuring Charity Care for Disclosure*, was issued. ASU 2010-23 is effective for fiscal years beginning after December 15, 2010. ASU 2010-23 addresses the diversity in the accounting for charity care disclosures, which some entities determine on the basis of a cost measurement, while others use a revenue measurement. ASU 2010-23 requires that the measurement of charity care for disclosure purposes be based on the direct and indirect costs of providing the charity care. Management is evaluating the impact this ASU may have on its combined financial statements

In August 2010, ASU 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*, was issued. ASU 2010-24 is effective for fiscal years beginning after December 15, 2010. ASU 2010-24 addresses the diversity in the accounting for medical malpractice and similar liabilities and their related anticipated insurance recoveries by health care entities that mostly have netted insurance recoveries against the accrued liability, although some have presented the anticipated insurance recovery and the liability on a gross basis. The ASU clarifies that a health care entity should not net insurance recoveries against a related claim liability; the amount of the claim liability should be determined without consideration of insurance recoveries. Management is evaluating the impact this ASU may have on its combined financial statements.

**Subsequent events:** The Obligated Group has evaluated subsequent events through March 25, 2011, the date on which the combined financial statements were issued, except as to Note 3 which is as of August 24, 2011.



**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

**Note 3. Restatement of Previously Issued Financial Statements**

Gundersen Lutheran has determined that it had not properly used data and facts that existed at the time the 2010 and 2009 combined financial statements were originally prepared. As a result, Gundersen Lutheran recorded adjustments in the following areas and in the following amounts to correct these errors.

**2010 Restatement Adjustments**

	Increase/(Decrease)				
	Assets	Liabilities	Net Assets	Operating Revenue	Operating Expenses
Existence and collectibility of patient accounts receivable	\$ 4,740	\$ -	\$ -	\$ 4,740	\$ -
Self-insured liabilities	-	(640)	-	-	(640)
Other miscellaneous	640	-	-	640	-
	5,380	(640)	-	5,380	(640)
Reclassification	2,585	2,585	-	9,272	9,272
Close current year income effect into net assets	-	-	6,020	-	-
	7,965	1,945	6,020	\$ 14,652	\$ 8,632
Effect of 2009 restatement adjustments	(6,352)	9,718	(16,070)		
	<u>\$ 1,613</u>	<u>\$ 11,663</u>	<u>\$ (10,050)</u>		

**2009 Restatement Adjustments**

	Increase/(Decrease)				
	Assets	Liabilities	Net Assets	Operating Revenue	Operating Expenses
Existence and collectibility of patient accounts receivable	\$ (11,800)	\$ -	\$ -	\$ (11,800)	\$ -
Self-insured liabilities	-	4,270	-	-	4,270
	(11,800)	4,270	-	(11,800)	4,270
Reclassification	5,448	5,448	-	9,050	9,050
Close current year income effect into net assets	-	-	(16,070)	-	-
	<u>\$ (6,352)</u>	<u>\$ 9,718</u>	<u>\$ (16,070)</u>	<u>\$ (2,750)</u>	<u>\$ 13,320</u>

All information presented in the financial statements and the related notes include all such restatements.

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

**Note 3. Restatement of Previously Issued Financial Statements (Continued)**

The following tables set forth the previously reported amounts and the restated amounts in the accompanying statements:

**Combined Balance Sheets**

	2010 as Previously Reported	2010 Restated	2009 as Previously Reported	2009 Restated
<b>Assets</b>				
Patient accounts receivable	\$ 100,231	\$ 101,574	\$ 104,267	\$ 97,915
Other current assets	21,878	22,148	19,179	19,179
All other assets	849,496	849,496	786,646	786,646
<b>Total assets</b>	<b>\$ 971,605</b>	<b>\$ 973,218</b>	<b>\$ 910,092</b>	<b>\$ 903,740</b>
<b>Liabilities and Net Assets</b>				
Accrued liabilities	\$ 96,800	\$ 107,563	\$ 94,613	\$ 103,851
Other noncurrent liabilities	7,963	8,863	3,329	3,809
All other liabilities	293,464	293,464	298,832	298,832
<b>Total liabilities</b>	<b>398,227</b>	<b>409,890</b>	<b>396,774</b>	<b>406,492</b>
<b>Net Assets</b>				
Unrestricted	554,280	544,230	494,365	478,295
Temporarily and permanently restricted	19,098	19,098	18,953	18,953
<b>Total net assets</b>	<b>573,378</b>	<b>563,328</b>	<b>513,318</b>	<b>497,248</b>
<b>Total liabilities and net assets</b>	<b>\$ 971,605</b>	<b>\$ 973,218</b>	<b>\$ 910,092</b>	<b>\$ 903,740</b>

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

**Note 3. Restatement of Previously Issued Financial Statements (Continued)**

**Combined Statements of Operations**

	2010 as Previously Reported	2010 Restated	2009 as Previously Reported	2009 Restated
Operating revenue:				
Net patient revenue	\$ 578,746	\$ 583,117	\$ 566,183	\$ 554,145
Capitation revenue	219,112	231,106	192,380	203,674
Other revenue	19,310	17,597	21,928	19,922
<b>Total operating revenue</b>	<b>817,168</b>	<b>831,820</b>	<b>780,491</b>	<b>777,741</b>
Expenses:				
Salaries, wages and benefits	473,835	473,066	457,551	459,003
Supplies	96,374	94,391	92,198	90,192
Purchased health services	63,071	74,035	51,457	64,851
Other	32,678	33,098	35,143	35,623
All other expenses	125,519	125,519	126,464	126,464
<b>Total operating expenses</b>	<b>791,477</b>	<b>800,109</b>	<b>762,813</b>	<b>776,133</b>
<b>Income from operations</b>	<b>25,691</b>	<b>31,711</b>	<b>17,678</b>	<b>1,608</b>
Investment return and other nonoperating	28,456	28,456	66,147	66,147
<b>Revenue in excess of expenses</b>	<b>54,147</b>	<b>60,167</b>	<b>83,825</b>	<b>67,755</b>
Other changes in unrestricted net assets	5,768	5,768	(560)	(560)
<b>Increase in unrestricted net assets</b>	<b>\$ 59,915</b>	<b>\$ 65,935</b>	<b>\$ 83,265</b>	<b>\$ 67,195</b>

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

**Note 3. Restatement of Previously Issued Financial Statements (Continued)**

**Combined Statements of Cash Flows**

	2010 as Previously Reported	2010 Restated	2009 as Previously Reported	2009 Restated
<b>Cash Flows From Operating Activities</b>				
Increase in net assets	\$ 60,060	\$ 66,080	\$ 84,723	\$ 68,653
Other adjustments to reconcile increase in net assets to net cash provided by operating activities	40,500	40,500	7,806	7,806
<b>Changes in operating assets and liabilities:</b>				
Patient accounts receivable	(25,528)	(33,223)	(21,179)	(14,827)
Other current assets	(2,967)	(3,237)	410	410
Accounts payable, accrued and other current liabilities	5,721	7,245	44,678	53,916
Other noncurrent assets and liabilities	2,877	3,298	(7,462)	(6,982)
<b>Net cash provided by operating activities</b>	<b>80,663</b>	<b>80,663</b>	<b>108,976</b>	<b>108,976</b>
<b>Net cash used in investing activities</b>	<b>(82,179)</b>	<b>(82,179)</b>	<b>(81,113)</b>	<b>(81,113)</b>
<b>Net cash used in financing activities</b>	<b>(13,152)</b>	<b>(13,152)</b>	<b>(3,581)</b>	<b>(3,581)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(14,668)</b>	<b>(14,668)</b>	<b>24,282</b>	<b>24,282</b>
Cash and cash equivalents, beginning of year	30,787	30,787	6,505	6,505
Cash and cash equivalents, end of year	<b>\$ 16,119</b>	<b>\$ 16,119</b>	<b>\$ 30,787</b>	<b>\$ 30,787</b>

**Subsequent Events**

In April 2011, LHI was acquired by OptumHealth, a division of UnitedHealth Group. As a result of this transaction, Gundersen received approximately \$106 million in May 2011 and realized a gain of approximately \$21 million inclusive of \$6 million of anticipated escrow distributions in 2012. The purchase agreement also provides for receipt of up to an additional \$28 million based on LHI achieving specific performance benchmarks through 2013. This transaction in April 2011 had no effect on the Obligated Group's 2010 and 2009 combined financial statements.

Annually, the Health Plan receives notification of a final settlement with CMS for its participation in the Medicare Advantage program. As part of the capitation arrangement between the Health Plan and the Obligated Group, any adjustment to premiums from CMS is incorporated into the capitated revenue recorded from the Health Plan. This notification is typically received in July each year and is treated as a change in estimate to the current period's financial statements as the Obligated Group does not have information available to estimate the impact of this final settlement. In July 2011, the Obligated Group received notification that the final settlement for 2010 is a reduction of revenue of approximately \$1,783. In July 2010, the Obligated Group received notification that the final settlement for 2009 was additional revenue of approximately \$2,877. No adjustment for these settlements has been made as a result of the restatements described above.

As described in Note 11, the interest rate swap contracts contain collateral provisions applicable to both parties to mitigate credit risk, which are adjusted weekly. There was no collateral provided by the Obligated Group to counterparties as of December 31, 2010. The changes in interest rates subsequent to year-end have resulted in the Obligated Group providing \$8.5 million in collateral to counterparties.

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
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**Note 4. Net Patient Revenue**

The Clinic and the Hospital derive patient revenue primarily from patients covered under the Medicare and Medicaid programs, agreements with commercial insurers and managed care organizations, as well as from private pay patients. The basis for payment under agreements with commercial insurers and managed care organizations includes prospectively determined rates, discounts from established charges and allowable cost.

The Clinic participates in the Medicare and Medicaid programs and is reimbursed based on fee schedules. The Hospital also participates in the Medicare and Medicaid programs, under which substantially all inpatient services rendered to program beneficiaries, are paid for based on prospectively determined amounts per discharge depending on the individual patient's diagnostic-related grouping (DRG) of medical conditions. The Hospital's Medicare outpatient services are predominantly paid based on prospectively determined amounts for each service provided, depending on the ambulatory payment classification (APC) assigned to each service.

Amounts recorded by the Hospital for estimated cost report settlements can differ from actual settlements based on the results of subsequent cost report audits. In addition, the Hospital appeals certain settlements related to Medicare and other programs. For 2010 and 2009, successful appeals and settlements of Medicare cost reports and final settlements of other reimbursement arrangements resulted in an increase (decrease) in net patient revenue of approximately \$245 and \$(91), respectively.

The Medicare program accounted for 16 percent of the Obligated Group's net patient revenue for 2010 and 2009. Potential changes in the Medicare program and reduction of funding levels could have an adverse effect on the Clinic and the Hospital.

**Note 5. Charity Care and Community Benefits**

The Clinic and the Hospital provide medical care without charge or at reduced charges to residents of the communities they serve by providing services to patients who are uninsured or underinsured and by absorbing the difference between public program payments (primarily Medicare and Medicaid) and the related costs of providing such services.

Forgone charges from providing charity care were \$7,969 and \$4,949 for 2010 and 2009, respectively.

**Note 6. Investments Whose Use Is Limited and Investment Return**

Certain investments as of December 31 are limited as to use for the following purposes:

	2010	2009
Board designated	\$ 3,061	\$ 2,401
Restricted by donors	10,443	13,561
Minimum funding as required by the Wisconsin Office of the Commissioner of Insurance (Note 13)	10,824	9,862
Minimum funding as required by the Wisconsin Unemployment Reserve Fund	2,825	2,777
Principal and interest payments under a bond indenture	1,640	1,752
	<u>\$ 28,793</u>	<u>\$ 30,353</u>

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

**Note 6. Investments Whose Use Is Limited and Investment Return (Continued)**

Investment return consists of the following for the years ended December 31:

	2010	2009
Dividends and interest	\$ 10,756	\$ 12,827
Earnings from long-term investment	11,340	-
Net realized gains (losses)	782	(9,476)
Net change in unrealized gains and losses	17,002	44,757
Net change in swap agreements	(7,386)	23,993
	\$ 32,494	\$ 72,101

Investment return is reported in the combined statements of operations and changes in net assets as follows for the years ended December 31:

	2010	2009
Unrestricted investment return	\$ 30,844	\$ 69,342
Temporarily restricted investment return	267	(967)
Permanently restricted investment return	(96)	(489)
Net change in temporarily restricted unrealized gains and losses	1,008	2,996
Net change in permanently restricted unrealized gains and losses	471	1,219
	\$ 32,494	\$ 72,101

**Note 7. Fair Value Measurements and Investments**

As discussed in Note 2, the fair value measurements and disclosures topic of the FASB Accounting Standards Codification defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

The standard defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. In that regard, the standard establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

- Level 1: Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

**Note 7. Fair Value Measurements and Investments (Continued)**

Following is a description of the Obligated Group's valuation methodologies for assets and liabilities measured at fair value. Fair value for Level 1 is based upon quoted market prices. Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources, including market participants, dealers and brokers. Fair value for Level 3 is based on unobservable market data. Other noncurrent assets classified as Level 3 are valued using the percentage of fair value of the trusts that the Foundation has rights to receive distributions from. The fair value of credit valuation adjustments (CVAs) for derivative financial instruments, which consist of obligations under swap contracts, is determined by an independent third party utilizing a discounted cash flow methodology for valuing derivative financial instruments. The valuations reflect a credit spread adjustment to the London Interbank Offered Rate (LIBOR) discount curve in order to reflect CVAs for nonperformance risk. The credit spread adjustment is derived from other comparably rated entities' bonds priced in the market. As of December 31, 2010 and 2009, the Obligated Group's fair value of obligations under interest rate swap contracts was net of a CVA of \$867 and \$455, respectively.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Obligated Group believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

The following tables present the financial instruments carried at fair value as of December 31, 2010 and 2009, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

	December 31, 2010			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Cash Equivalents	\$ 15,457	\$ -	\$ -	\$ 15,457
Common Stock	17,785	-	-	17,785
Equity Mutual Funds	7,933	-	-	7,933
Fixed Income Securities				
Mutual Funds	83,968	25,027	-	108,995
U.S. Government and Agency Obligations	3,201	95,420	-	98,621
Corporate Bonds	-	37,646	-	37,646
Residential Mortgage Backed Securities	-	82,870	-	82,870
Commercial Mortgage Backed Securities	-	7,045	-	7,045
<b>Instruments measured at fair value</b>	<b>128,344</b>	<b>248,008</b>	<b>-</b>	<b>376,352</b>
Other noncurrent assets	-	-	5,685	5,685
<b>Total assets at fair value</b>	<b>\$ 128,344</b>	<b>\$ 248,008</b>	<b>\$ 5,685</b>	<b>\$ 382,037</b>
<b>Instruments measured at fair value</b>				<b>\$ 376,352</b>
Certificate of Deposit				10,900
<b>Total Investments and Investments Whose Use is Limited</b>				<b>\$ 387,252</b>
<b>Liabilities</b>				
Obligation under swap contracts	\$ -	\$ -	\$ 20,553	\$ 20,553

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
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**Note 7. Fair Value Measurements and Investments (Continued)**

	December 31, 2009			Total Fair Value
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Cash Equivalents	\$ 7,132	\$ -	\$ -	\$ 7,132
Common Stock	16,827	-	-	16,827
Equity Mutual Funds	7,081	-	-	7,081
Fixed Income Securities				
Mutual Funds	91,585	31,105	-	122,690
U.S. Government and Agency Obligations	15,580	38,067	-	53,647
Corporate Bonds	-	37,007	-	37,007
Residential Mortgage Backed Securities	-	87,579	-	87,579
Commercial Mortgage Backed Securities	-	7,567	-	7,567
<b>Instruments measured at fair value</b>	<b>138,205</b>	<b>201,325</b>	<b>-</b>	<b>339,530</b>
Other noncurrent assets	-	-	5,293	5,293
<b>Total assets at fair value</b>	<b>\$ 138,205</b>	<b>\$ 201,325</b>	<b>\$ 5,293</b>	<b>\$ 344,823</b>
<b>Instruments measured at fair value</b>				339,530
Certificate of Deposit				10,050
<b>Total Investments and Investments Whose Use is Limited</b>				<b>\$ 349,580</b>
<b>Liabilities</b>				
Obligation under swap contracts	\$ -	\$ -	\$ 13,167	\$ 13,167

Certain investments were reclassified between Levels 1 and 2 of the fair value hierarchy to be consistent with valuation methods applied during the year ended December 31, 2010.

The following table is a roll-forward of the combined balance sheet amounts for financial instruments classified by the Obligated Group within Level 3 of the valuation hierarchy defined above:

	Other Assets	Other Long-Term Liabilities	Total
Fair value January 1, 2009	\$ 4,547	\$ (37,160)	\$ (32,613)
Change in value of financial instruments held at December 31, 2009	746	23,993	24,739
Fair value at December 31, 2009	5,293	(13,167)	(7,874)
Change in value of financial instruments held at December 31, 2010	392	(7,386)	(6,994)
Fair value at December 31, 2010	\$ 5,685	\$ (20,553)	\$ (14,868)



**Gundersen Lutheran**

**Notes to Combined Financial Statements  
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**Note 7. Fair Value Measurements and Investments (Continued)**

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses are reasonable estimates of fair value due to the short-term nature of these financial instruments.

Fair value of long-term debt, based on quoted market prices for the same or similar instruments, approximates carrying value.

**Note 8. Long-Term Investment**

The Obligated Group's investment in companies that are accounted for on the equity method of accounting consists of a 48.5 percent interest in the voting stock of Logistics Health Incorporated (LHI), an occupational health and wellness company. The investment at December 31, 2010 and 2009, was \$90,090 and \$78,750, respectively.

At December 31, 2010 and 2009, the carrying value of the investment exceeded the Obligated Group's share of the underlying equity of LHI by \$90,435 and \$90,447, respectively. The excess relates to the value of future earnings and cash flow potential of the operations of this company. The Obligated Group performs an impairment test on an annual basis using a discounted cash flows analysis. During 2010 and 2009, there was no impairment of the investment in LHI.

At December 31, 2010, LHI had outstanding options that, if in the aggregate were converted and exercised, would reduce the Obligated Group's ownership interest to 42.9 percent.

**Note 9. Property and Equipment**

Property and equipment as of December 31 consists of the following:

	2010	2009
Land and land improvements	\$ 20,371	\$ 20,262
Buildings and building improvements	331,235	302,596
Equipment and furniture	311,502	285,138
	<u>663,108</u>	<u>607,996</u>
Less accumulated depreciation	365,238	330,150
	<u>297,870</u>	<u>277,846</u>
Construction in progress	34,430	27,402
	<u>\$ 332,300</u>	<u>\$ 305,248</u>

Depreciation expense was \$35,515 and \$35,933 for 2010 and 2009, respectively.

The Obligated Group capitalizes payroll and payroll-related costs associated with the development of software for internal use. For the years ended December 31, 2010 and 2009, Obligated Group capitalized approximately \$3,061 and none, respectively, of payroll and payroll-related costs.

**Gundersen Lutheran**  
**Notes to Combined Financial Statements**  
**(Dollars in Thousands)**

**Note 10. Long-Term Debt**

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

	2010	2009
Wisconsin Health and Educational Facilities Authority (WHEFA) bonds:		
Series 2009A (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2033 (average annual interest rate in 2010 and 2009 of 0.26% and 0.25%, respectively)	\$ 45,305	\$ 45,305
Series 2009B (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2033 (average annual interest rate in 2010 and 2009 of 0.26% and 0.25%, respectively)	33,410	33,410
Series 2008A (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2020 (average annual interest rate in 2010 and 2009 of 0.52% and 0.30%, respectively)	26,425	27,075
Series 2008B (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2033 (average annual interest rate in 2010 and 2009 of 0.52% and 0.30%, respectively)	61,400	61,400
Series 2003A (Gundersen Lutheran), interest from 3.25% to 5.0%, principal due in varying amounts through 2016	10,925	12,705
Series 2000A and Series 2000B (Gundersen Lutheran), Adjustable Demand, principal due in varying amounts through 2029 (average annual interest rate for Series A and B in 2010 and 2009 of 0.52% and 1.58%, respectively)	67,965	72,575
Other	246	9,493
Total long-term debt	245,676	261,963
Less current maturities	7,626	7,287
	<u>\$ 238,050</u>	<u>\$ 254,676</u>

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

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**Note 10. Long-Term Debt (Continued)**

On April 1, 1993, the Hospital entered into a Master Trust Indenture agreement with a national bank for the issuance of indebtedness. This agreement established an Obligated Group, which currently includes the Hospital, the Clinic, GLAS, and the Foundation. Each Obligated Group member is jointly and severally liable for the payment of all indebtedness issued under the Master Trust Indenture, which is secured by pledged revenues of the Obligated Group under the agreement. The Obligated Group is required to meet certain operating and performance covenants and is limited in the amount of additional debt that can be incurred.

The Obligated Group initially issued Series 2008A and Series 2008B bonds under a Bank Letter of Credit in the aggregate amount of \$89,300. During 2010, the Obligated Group entered into an agreement with a national bank which converted these bonds from the variable rate demand obligation (VRDO) mode to a direct placement. This agreement names a national bank as the majority holder of these bonds as of the date of the agreement. They remained the majority holder as of December 31, 2010. The 2008A and 2008B Bonds are not publicly traded and cannot be put back to the Obligated Group during the term of the Continuing Covenants Agreement. The agreement has a three-year maturity, but can be extended by one year if requested by the Obligated Group and agreed to by the national bank. The Series 2008A and Series 2008B Bond Indentures were amended to include a new LIBOR-based Index Floating Rate mode.

In May 2009, the Obligated Group issued Series 2009A and Series 2009B bonds under a bank letter of credit in the aggregate amount of \$78,715. The proceeds of these bonds were used to refund the Series 2003B and Series 2003C bonds. The bank letter of credit can be drawn upon by the bond trustee for payment of principal and interest on any of the Series 2009 bonds that are tendered for purchase and not remarketed. Draws under the letter of credit would be payable over a five-year period. The letter of credit has a three-year maturity and expires in May 2012. Subsequent to year end, the Obligated Group entered into an agreement with a national bank under a direct placement with terms similar to the agreement for the Series 2008 bonds described above.

In conjunction with the issuance of the Series 2000A and 2000B bonds, the Obligated Group entered into two standby bond purchase agreements (the Agreements) with a bank. Under the terms of the Agreements, if the debt cannot be remarketed, the bank is required to purchase the outstanding bonds. The Agreements expire on May 16, 2013. If the bank decides not to renew the Agreements and the Obligated Group is unable to obtain a substitute liquidity facility, the bank is required to purchase the bonds, provided the Obligated Group has used its "best efforts" to obtain a substitute liquidity facility. Draws under the letter of credit for the purchase of bonds would be payable over a five-year period.

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

**Note 10. Long-Term Debt (Continued)**

At December 31, 2010, the aggregate maturities and sinking fund requirements of long-term debt, for each of the five subsequent years and thereafter, assuming that all bonds are successfully remarketed with the original maturity dates and the Obligated Group is able to renew the letters of credit, standby bond purchase agreements, and Continuing Covenants Agreement which expire on various dates between May 2012 and September 2013, are as follows:

2011	\$	7,626
2012		7,835
2013		8,200
2014		8,570
2015		8,985
Thereafter		204,460
		\$ 245,676

The master trust indenture and other loan agreements covering these obligations contain, among other things, provisions placing restrictions on additional borrowings and leases and requiring the maintenance of debt service coverage and other ratios.

**Note 11. Derivative Financial Instruments**

The Obligated Group has entered into interest rate swaps, which are recorded at fair value as noncurrent liabilities in the combined balance sheets as of December 31, as follows:

	2010	2009
Notional amount \$33,000 Series 2009B (previously Series 2003C), fixed rate 3.5%, variable interest equal to 67% of the one-month LIBOR averaged 0.27% and 0.33% in 2010 and 2009, respectively	\$ 3,737	\$ 2,414
Notional amount \$40,470 Series 2000B, fixed rate 3.26%, variable interest equal to 67% of the one-month LIBOR averaged 0.27% and 0.33% in 2010 and 2009, respectively	3,556	1,956
Notional amount \$44,750 of Series 2009A (previously Series 2003B), fixed rate 3.28%, variable interest equal to 67% of the one-month LIBOR averaged 0.27% and 0.33% in 2010 and 2009, respectively	4,073	2,220
Notional amount \$60,725 Series 2008B, fixed rate 3.79%, variable interest equal to 67% of the one-month LIBOR averaged 0.27% and 0.33% in 2010 and 2009, respectively	9,187	6,577
	\$ 20,553	\$ 13,167

A decrease of \$7,386 and an increase of \$23,993 for the years ended December 31, 2010 and 2009, respectively, in the value of the swaps was recorded as an unrealized gain (loss) and is included in investment return in the combined statements of operations.

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

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**Note 11. Derivative Financial Instruments (Continued)**

Derivative transactions contain credit risk in the event the parties are unable to meet the terms of the contract; credit risk is generally limited to the fair value due from counterparties on outstanding contracts. At December 31, 2010, the counterparties had a Standard & Poor's credit quality rating of A.

The interest rate swap contracts contain collateral provisions applicable to both parties to mitigate credit risk. There was no collateral provided by the Obligated Group to counterparties as of December 31, 2010 and 2009. The related amounts payable to counterparties under the interest rate swap contracts is included in other noncurrent liabilities in the combined balance sheets and the change in fair value is included in investment return. See Note 6.

The net settlements recorded for derivative instruments in the combined statements of operations increased interest expense for the years ended December 31, 2010 and 2009 by approximately \$5,906 and \$5,775, respectively.

**Note 12. Retirement Plan**

The Obligated Group maintains a defined contribution and 401(k) plan covering substantially all of its employees. Retirement plan expense was \$45,303 and \$44,606 for 2010 and 2009, respectively. The Obligated Group funds the plan annually. At December 31, 2010 and 2009, the total liability for employer contributions was \$46,319 and \$45,355, respectively.

**Note 13. Insurance**

The Clinic is self-insured for Wisconsin professional liability up to base limits of insurance coverage (\$1,000 per claim and \$3,000 annually on an occurrence basis at December 31, 2010 and 2009). Additionally, under the Wisconsin professional liability, self-insured limits are in place per physician/CRNA (\$1000 per physician/CRNA per claim and \$3,000 annually per physician/CRNA on an occurrence basis at December 31, 2010). The Clinic has established a professional liability insurance plan and irrevocable trust as required by Wisconsin statutes. The funding requirements of the plan are established annually based on third-party actuarial calculations, as prescribed by the Commissioner of Insurance for the State of Wisconsin. All professional liability claims or judgments occurring in Wisconsin in excess of the base level of coverage are paid from the Injured Patients' and Families Compensation Fund, which insures all claims incurred regardless of when the claim is filed. The Injured Patients' and Families Compensation Fund has no upper limit on losses.

The Clinic has purchased professional liability insurance on a claims-made basis to cover Iowa or Minnesota risks, including umbrella and excess coverage to minimize exposure.

The Hospital has purchased professional liability insurance on a claims-made basis to cover claim losses. The Hospital is also insured through the Injured Patients' and Families Compensation Fund for losses on professional liability claims (\$1,000 per claim and \$3,000 annually at December 31, 2010 and 2009). The Injured Patients' and Families Compensation Fund has no upper limit on losses.

The Obligated Group maintains self-insurance programs for health care costs of its active employees. The Obligated Group has purchased stop-loss insurance with an annual deductible of \$500 per individual. In addition, the Obligated Group is insured for workers' compensation exposures under an incurred loss retrospective rating plan. The total premium is composed of a minimum premium, which is based on a percentage of payroll expense, plus incurred losses up to a policy maximum of \$10,700. The policy covers a loss of \$350 per incident.

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

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**Note 13. Insurance (Continued)**

The estimated liability for professional and general liability, workers' compensation, and employee health insurance claims is based on actual claims to date and a projection of the estimated future liability for such claims. At December 31, 2010 and 2009, the total liability was \$15,877 (restated) and \$16,714 (restated), respectively, of which the current portion of \$12,374 (restated) and \$16,092 (restated), respectively, is included in accrued liabilities in the combined balance sheets.

**Note 14. Commitments and Contingencies**

The Obligated Group has leases for equipment and satellite office facilities, which are classified as operating leases. Rental expense under these operating leases totaled \$4,601 and \$4,529 for 2010 and 2009, respectively.

Future commitments under operating leases in effect as of December 31, 2010, for each of the five subsequent years and thereafter are as follows:

Years ending December 31:

2011	\$	785
2012		757
2013		718
2014		511
2015		462
Thereafter		1,803
	<u>\$</u>	<u>5,036</u>

The Clinic and the Hospital are defendants in legal proceedings arising in the ordinary course of business. Although the outcome of these proceedings cannot be presently determined, in the opinion of management, disposition of these proceedings will not have a material adverse effect on the financial position or operations of the Clinic or the Hospital. However, there can be no assurance that this will be the case.

The Clinic, Hospital and GLAS have entered into an agreement with the City of La Crosse in conjunction with the city's establishment of Tax Incremental Financing District No. 14 (TIF 14). The agreement requires the construction of one or more parking ramps that will accommodate 1,000 vehicles, with qualifying costs not to exceed \$18,500. At December 31, 2009, a 537-vehicle ramp adjacent to the Clinic has been completed. At the end of 2010, a second ramp has been completed to satisfy the requirement of available vehicle space, but is not being considered for the tax incentives offered under the TIF 14 agreement. This ramp is adjacent to the area designated for the new hospital described below as part of the Campus Renewal Plan. Additionally, the agreement creates property tax incentives for further taxable development on the Gundersen Lutheran La Crosse campus by Gundersen Lutheran and other developers. The benefit that Gundersen Lutheran will derive from participation in TIF 14 is dependent on the size of future development over the next 20 years.

The Obligated Group has established a Campus Renewal Plan which includes the addition of a 400,000 square foot, six-story hospital building on the main campus, adjacent to the existing Hospital facility. Construction of the hospital addition began in January 2011. The first phase of construction is scheduled to run through 2013 and the hospital addition is anticipated to open in the fourth quarter of 2013. This initial phase is projected to cost \$218 million under a guaranteed maximum price contract with a general contractor. The Obligated Group expects to fund this addition with a combination of cash flow from operations, borrowings and fundraising.

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

**Note 14. Commitments and Contingencies (Continued)**

**Compliance with laws and regulations:** The healthcare industry is governed by various laws and regulations of federal, state and local governments. These laws and regulations are subject to ongoing government review and interpretation, and include matters such as licensure, accreditation, reimbursement for patient services and referrals for Medicare and Medicaid beneficiaries. Compliance with these laws and regulations is required for participation in government healthcare programs. Certain governmental agencies routinely investigate and pursue allegations concerning possible overpayments resulting from violation of fraud and abuse statutes by healthcare providers. These investigations may result in settlements involving fines and penalties as well as repayment of improper reimbursement. The Obligated Group has implemented procedures for monitoring and enforcing compliance with laws and regulations and is not aware of instances of noncompliance.

**Health care reform:** In March 2010, President Obama signed the Patient Protection and Affordable Care Act (PPACA) into law. PPACA will result in sweeping changes across the health care industry, including how care is provided and paid for. A primary goal of this comprehensive reform legislation is to extend health care coverage to approximately 32 million uninsured legal U.S. residents through a combination of public program expansion and private sector health insurance reforms. To fund the expansion of insurance coverage, the legislation contains measures designed to promote quality and cost efficiency in health care delivery and to generate budgetary savings in the Medicare and Medicaid programs. Given that the final regulations and interpretive guidelines have yet to be published, the Obligated Group is unable to fully predict the impact of PPACA on its operations and financial results. There are multiple lawsuits challenging the constitutionality of major portions of PPACA; to the extent that any significant elements of the law are overturned, additional uncertainty is introduced into the prediction of operation and financial impacts.

**Note 15. Concentration of Credit Risk**

The Clinic and the Hospital grant credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. Amounts due from various payors and patients as of December 31 included in net patient accounts receivable are as follows:

	2010	2009
Medicare	15%	15%
Medicaid	4%	6%
Commercial insurance, private pay and other	81%	79%
	100%	100%

**Note 16. Functional Expenses**

Expenses related to providing patient care are as follows for the years ended December 31:

	2010 (restated)	2009 (restated)
Health care services	\$ 645,487	\$ 620,928
General and administrative, including fundraising	154,622	155,205
	\$ 800,109	\$ 776,133

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

**Note 17. Related-Party Transactions**

The Clinic and the Hospital have an agreement with the Gundersen Lutheran Health Plan, Inc. (Health Plan) to provide health care services to the Health Plan's insured enrollees. The Clinic and the Hospital are paid on a fully capitated basis. Reinsurance contracts exist for medical and hospital expenses in excess of \$375 per enrollee per contract year. Capitation revenue recorded by the Clinic and the Hospital which was earned under the agreement with the Health Plan totaled \$231,106 (restated) and \$203,674 (restated) for 2010 and 2009, respectively. At December 31, 2010 and 2009, amounts due (to) from the Health Plan were \$(541) and \$1,464, respectively.

Under terms of an administrative services agreement with the Health Plan, the Obligated Group provides substantially all general and administrative services necessary for the Health Plan's operations at amounts that are intended to approximate cost. The cost of these services to the Health Plan was approximately \$10,339 and \$9,744 in 2010 and 2009, respectively. Amounts due from the Health Plan as of December 31, 2010 and 2009, related to the administrative services agreement were \$1,208 and \$1,277, respectively.

At December 31, 2010 and 2009, notes receivable from affiliates totaling \$7,022 and \$7,324, respectively, which are recorded net of allowances for uncollectible amounts of \$269 and \$269, respectively, represent loans to affiliates to finance their activities. Notes receivable from affiliates have terms ranging from 4 to 13 years, with annual interest rates ranging from 3.4 percent to 6.0 percent.

**Note 18. Restricted Net Assets**

Temporarily restricted net assets as of December 31 are available for the following purposes or periods:

	2010	2009
Purpose restrictions:		
Education	\$ 955	\$ 941
Research	377	306
Community and affiliate programs	481	2,753
Buildings and equipment	2,095	767
Split interest agreements	341	202
Time restrictions for future periods	460	434
	<u>\$ 4,709</u>	<u>\$ 5,403</u>

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

	2010	2009
Education	\$ 4,638	\$ 4,486
Research	4,173	3,792
Community health initiatives	2,194	2,115
General operations	3,384	3,157
	<u>\$ 14,389</u>	<u>\$ 13,550</u>



## Gundersen Lutheran

### Notes to Combined Financial Statements (Dollars in Thousands)

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#### Note 19. Endowment

The Obligated Group's endowment consists of donor-restricted endowment funds held by the Foundation. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

**Interpretation of relevant law:** The Foundation's Board of Directors has interpreted the UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by the UPMIFA, namely acting in good faith with the care that an ordinarily prudent person in a like position would exercise under similar circumstances. In accordance with the UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the organization and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the organization
7. The investment policies of the organization

**Funds with deficiencies:** From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Foundation to retain as a fund of perpetual duration. These deficiencies have resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and/or continued appropriation for certain programs that was deemed prudent by the Board of Directors. Deficiencies of this nature, which are reported in unrestricted net assets, were \$0 and \$1,529 in 2010 and 2009, respectively.

**Return objectives and risk parameters:** The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment, while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy, the total endowment assets are invested in a manner that is intended to produce results that equal or exceed a mix of the S&P 500 Index and the Barclays Capital Intermediate Government/Credit Index. Actual returns in any given year may vary from this amount.

**Strategies employed for achieving objectives:** To satisfy its long-term rate-of-return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

**Gundersen Lutheran**

**Notes to Combined Financial Statements  
(Dollars in Thousands)**

**Note 19. Endowment (Continued)**

**Spending policy and how the investment objectives relate to spending policy:** The Foundation has a policy of appropriating for distribution each year a conservative percentage of its temporarily restricted endowment funds, which consist of the investment earnings on their permanently restricted endowment funds. This is consistent with the Foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

**Changes in endowment net assets:** In 2010 and 2009, the endowment net asset activity by type of fund consisted of the following:

	Year Ended December 31, 2010		
	Temporarily Restricted Fund	Permanently Restricted Fund	Total
	Endowment net assets, beginning of year	\$ 314	\$ 13,550
Investment return:			
Dividends and interest	368	-	368
Net realized losses	(127)	(96)	(223)
Net change in unrealized gains	999	471	1,470
Total investment return	1,240	375	1,615
Contributions	-	434	434
Other revenue	-	24	24
Appropriation of endowment assets for expenditure	(1,044)	6	(1,038)
Endowment net assets, end of year	\$ 510	\$ 14,389	\$ 14,899

	Year Ended December 31, 2009		
	Temporarily Restricted Fund	Permanently Restricted Fund	Total
	Endowment net assets, beginning of year	\$ 181	\$ 12,592
Investment return:			
Dividends and interest	400	-	400
Net realized losses	(1,388)	(489)	(1,877)
Net changes in unrealized gains	2,975	1,219	4,194
Total investment return	1,987	730	2,717
Contributions	-	202	202
Other revenue	-	21	21
Appropriation of endowment assets for expenditure	(1,854)	5	(1,849)
Endowment net assets, end of year	\$ 314	\$ 13,550	\$ 13,864



**Independent Auditor's Report  
on the Supplementary Information**

The Board of Trustees and the Board of Governors  
Gundersen Lutheran  
La Crosse, Wisconsin

Our audit was made for the purpose of forming an opinion on the basic combined financial statements taken as a whole. The combining information is presented for purposes of additional analysis of the basic combined financial statements rather than to present the financial position and changes in net assets of the individual organizations. The combining information has been subjected to the auditing procedures applied in the audit of the basic combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic combined financial statements taken as a whole.

*McGladrey & Pullen, LLP*

La Crosse, Wisconsin  
March 25, 2011, except as to Note 3  
to the combined financial statements,  
which is as of August 24, 2011

## Gundersen Lutheran

### Combining Balance Sheet (Restated)

December 31, 2010

(In Thousands)

Assets	Gundersen Lutheran Medical Center, Inc.	Gundersen Clinic, Ltd.	Gundersen Lutheran Administrative Services, Inc.
<b>Current Assets</b>			
Cash and cash equivalents	\$ 452	\$ 5,334	\$ 7,628
Investments	-	-	334,791
Patient accounts receivable, less allowance for uncollectible accounts	44,082	57,492	-
Current portion of notes receivable from affiliates	500	17	711
Interaffiliate balances	468,625	133,488	296,603
Other	3,545	3,823	15,133
<b>Total current assets</b>	<b>517,204</b>	<b>200,154</b>	<b>654,866</b>
Investments Whose Use Is Limited	-	10,824	4,465
Long-Term Investment	-	-	90,090
Notes Receivable From Affiliates, net of current portion	-	-	5,794
Property and Equipment, net	85,005	167,854	78,310
Other Noncurrent Assets	290	137	8,250
<b>Total assets</b>	<b>\$ 602,499</b>	<b>\$ 378,969</b>	<b>\$ 841,775</b>
<b>Liabilities and Net Assets</b>			
<b>Current Liabilities</b>			
Accounts payable	\$ (62)	\$ 169	\$ 16,884
Accrued liabilities	14,751	17,029	75,294
Current maturities of long-term debt	-	246	7,380
Interaffiliate balances	109,774	316,002	473,055
Other	849	7,534	1,248
<b>Total current liabilities</b>	<b>125,312</b>	<b>340,980</b>	<b>573,861</b>
Long-Term Debt, net of current maturities	-	-	238,050
Obligation Under Swap Contracts	-	-	20,553
Other Noncurrent Liabilities	1,144	4,937	2,263
<b>Total liabilities</b>	<b>126,456</b>	<b>345,917</b>	<b>834,727</b>
<b>Net Assets</b>			
Unrestricted	476,043	33,052	7,048
Temporarily restricted	-	-	-
Permanently restricted	-	-	-
<b>Total net assets</b>	<b>476,043</b>	<b>33,052</b>	<b>7,048</b>
<b>Total liabilities and net assets</b>	<b>\$ 602,499</b>	<b>\$ 378,969</b>	<b>\$ 841,775</b>

Gundersen Lutheran Medical Foundation, Inc.	Eliminating Entries	Combined
\$ 2,705	\$ -	\$ 16,119
24,590	(922)	358,459
-	-	101,574
-	-	1,228
2,579	(901,295)	-
2,366	(2,719)	22,148
<u>32,240</u>	<u>(904,936)</u>	<u>499,528</u>
12,582	922	28,793
-	-	90,090
-	-	5,794
1,131	-	332,300
8,097	(61)	16,713
<u>\$ 54,050</u>	<u>\$ (904,075)</u>	<u>\$ 973,218</u>

\$ 3,148	\$ (2,780)	\$ 17,359
489	-	107,563
-	-	7,626
2,464	(901,295)	-
245	-	9,876
<u>6,346</u>	<u>(904,075)</u>	<u>142,424</u>
-	-	238,050
-	-	20,553
519	-	8,863
<u>6,865</u>	<u>(904,075)</u>	<u>409,890</u>

25,948	2,139	544,230
6,848	(2,139)	4,709
14,389	-	14,389
<u>47,185</u>	<u>-</u>	<u>563,328</u>
<u>\$ 54,050</u>	<u>\$ (904,075)</u>	<u>\$ 973,218</u>

**Gundersen Lutheran**

**Combining Statement of Operations and Changes in Net Assets (Restated)  
Year Ended December 31, 2010  
(In Thousands)**

	Gundersen Lutheran Medical Center, Inc.	Gundersen Clinic, Ltd.	Gundersen Lutheran Administrative Services, Inc.
<b>Operating revenue:</b>			
Net patient revenue	\$ 288,698	\$ 364,023	\$ -
Capitation revenue	113,814	117,292	-
Other revenue	7,260	8,523	5,639
<b>Total operating revenue</b>	<b>409,772</b>	<b>489,838</b>	<b>5,639</b>
<b>Expenses:</b>			
Salaries, wages and benefits	138,162	278,168	99,777
Supplies	46,043	46,462	1,512
Purchased health services	37,844	36,191	-
Depreciation and amortization	8,361	13,656	13,574
Other	91,272	96,567	(147,999)
Provision for uncollectible accounts	13,977	15,103	469
Facilities	4,859	11,552	11,166
Purchased services	16,180	9,584	17,547
Interest	-	22	9,552
<b>Total operating expenses</b>	<b>356,698</b>	<b>507,305</b>	<b>5,598</b>
<b>Income (loss) from operations</b>	<b>53,074</b>	<b>(17,467)</b>	<b>41</b>
<b>Nonoperating income (expense):</b>			
Interest, dividends, and realized gains and losses	19,451	3,143	-
Net change in unrealized gains and losses on investments	11,128	1,625	-
Gain (loss) on swap contracts	(6,426)	(960)	-
Other non operating	(1,660)	-	-
Loss on employee early retirements	(1,334)	(199)	-
<b>Revenue in excess of (less than) expenses</b>	<b>74,233</b>	<b>(13,858)</b>	<b>41</b>
<b>Other changes in unrestricted net assets:</b>			
Net assets released from restrictions to purchase property and equipment	-	-	-
Other transfers	(81,718)	(11,282)	93,000
Amortization related to interest rate swaps prior to de-designation	-	-	(77)
Transfers to affiliates	-	-	(25)
<b>Increase (decrease) in unrestricted net assets</b>	<b>(7,485)</b>	<b>(25,140)</b>	<b>92,939</b>
<b>Temporarily restricted net assets:</b>			
Contributions	-	-	-
Investment income (loss)	-	-	-
Net change in unrealized gains on investments	-	-	-
Net assets released from restriction	-	-	-
Other transfers	-	-	-
<b>Increase (decrease) in temporarily restricted net assets</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Permanently restricted net assets:</b>			
Contributions	-	-	-
Investment loss	-	-	-
Net change in unrealized gains on investments	-	-	-
<b>Increase in permanently restricted net assets</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Increase (decrease) in net assets</b>	<b>(7,485)</b>	<b>(25,140)</b>	<b>92,939</b>
Net assets at beginning of year	483,528	58,192	(85,891)
Net assets at end of year	<b>\$ 476,043</b>	<b>\$ 33,052</b>	<b>\$ 7,048</b>

Gundersen Lutheran Medical Foundation, Inc.	Eliminating Entries	Combined
\$ -	\$ (69,604)	\$ 583,117
-	-	231,106
21,110	(24,935)	17,597
21,110	(94,539)	831,820
13,549	(56,590)	473,066
578	(204)	94,391
-	-	74,035
193	-	35,784
5,681	(12,423)	33,098
15	-	29,564
184	(755)	27,006
311	(20,031)	23,591
-	-	9,574
20,511	(90,003)	800,109
599	(4,536)	31,711
114	-	22,708
2,769	-	15,522
-	-	(7,386)
-	805	(855)
-	-	(1,533)
3,482	(3,731)	60,167
-	2,671	2,671
-	3,199	3,199
-	-	(77)
-	-	(25)
3,482	2,139	65,935
6,108	-	6,108
267	-	267
1,008	-	1,008
(5,938)	1,060	(4,878)
-	(3,199)	(3,199)
1,445	(2,139)	(694)
464	-	464
(96)	-	(96)
471	-	471
839	-	839
5,766	-	66,080
41,419	-	497,248
\$ 47,185	\$ -	\$ 563,328

