KPMG

SHRINERS HOSPITALS FOR CHILDREN

Combined Financial Statements

December 31, 2013 and 2012

(With Independent Auditors' Report Thereon)

SHRINERS HOSPITALS FOR CHILDREN

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KPMG LLP
Suite 1700
100 North Tampa Street
Tampa, FL 33602

Independent Auditors' Report

The Board of Directors
Shriners Hospitals for Children:

We have audited the accompanying combined financial statements of Shriners Hospitals for Children, which comprise the combined statements of financial position 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 combined financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the combined financial statements referred to above present fairly in all material respects, the financial position of Shriners Hospitals for Children as of December 31, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

April 7, 2014
Certified Public Accountants

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Financial Position

December 31, 2013 and 2012

(In thousands)

Assets		2013	2012
Cash and cash equivalents	$	18,571	17,448
Cash and cash equivalents held as collateral under securities lending transactions		608,878	551,682
Patient accounts receivable, net of allowance for doubtful accounts of approximately $215,258 in 2013		23,841	—
Receivables, net		14,265	10,411
Accrued interest and dividends		23,079	26,751
Patient transportation funds held by Shrine temples		54,867	51,934
Inventories and deferred charges		30,970	28,582
Long-term investments:			
Marketable securities		7,433,670	6,823,988
Charitable gift annuities		31,932	29,907
Beneficial interest in trusts		535,121	490,528
Real estate and mineral interests		239,566	219,170
Miscellaneous investments		18,158	22,222
Estates in process		280,862	290,765
Land, buildings, and equipment, net of accumulated depreciation		771,251	759,128
Total assets	$	10,085,031	9,322,516
Liabilities and Net Assets			
Liabilities:			
Accounts payable and accrued expenses	$	119,493	114,906
Line of credit payable		—	63,000
Pension benefits		98,187	221,059
Liabilities under securities lending transactions		608,878	551,682
Other liabilities		36,982	37,484
Total liabilities		863,540	988,131
Net assets (net of cumulative foreign currency translation adjustment of $8,827 in 2013 and $8,626 in 2012):			
Unrestricted		7,831,449	6,983,238
Temporarily restricted		309,909	320,178
Permanently restricted		1,080,133	1,030,969
Total net assets		9,221,491	8,334,385
Total liabilities and net assets	$	10,085,031	9,322,516

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Operations

Years ended December 31, 2013 and 2012

(In thousands)

		2013	2012
Operating revenues and other support:			
Patient service revenue (net of contractual allowance)	$	360,239	96,161
Provision for Shriners assist		(215,258)	—
Net patient service revenue less provision for Shriners assist		144,981	96,161
Investment return:			
Interest		85,771	92,787
Dividends		99,152	105,039
Other investment income		35,538	34,137
Investment management fees		(14,286)	(14,954)
Amounts released from restrictions used for operations		170,389	166,810
Donations		45,797	38,454
Fund raising and special events		27,052	19,649
Hospital assessments		1,290	1,341
Reimbursements from Canadian Provinces		6,499	6,888
Other governmental revenue		3,421	—
Other		9,637	5,114
Total revenues and other support		615,241	551,426
Operating expenses:			
Hospitals		598,463	588,539
Research		29,500	29,524
Revenue cycle		11,042	7,912
Information systems		28,883	25,440
Headquarters, administrative, and board related		42,767	44,039
Fund raising and special events		24,964	22,457
Total operating expenses		735,619	717,911
Decrease in net assets from operating activities		(120,378)	(166,485)
Nonoperating gains:			
Gain on investments:			
Net realized gain from investments		406,155	148,517
Net unrealized gains on investments		446,061	537,776
Total gains on investments		852,216	686,293
Life memberships		97	136
Change in patient transportation funds held by Shrine temples		2,933	2,992
Pension-related changes other than net periodic pension costs		122,026	(87,501)
Other, net		(8,884)	(1,040)
Foreign currency translation adjustments		201	(718)
Total nonoperating gains		968,589	600,162
Increase in unrestricted net assets	$	848,211	433,677

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Changes in Net Assets

Years ended December 31, 2013 and 2012

(In thousands)

		2013	2012
Unrestricted net assets:			
Decrease in net assets from operating activities	$	(120,378)	(166,485)
Nonoperating gains:			
Gains on investments:			
Net realized gains from investments		406,155	148,517
Net unrealized gains on investments		446,061	537,776
Total gains on investments		852,216	686,293
Life memberships		97	136
Change in patient transportation funds held by Shrine temples		2,933	2,992
Pension related changes other than net periodic pension costs		122,026	(87,501)
Other, net		(8,884)	(1,040)
Foreign currency translation adjustments		201	(718)
Total nonoperating gains		968,589	600,162
Increase in unrestricted net assets		848,211	433,677
Temporarily restricted net assets:			
Bequests		145,975	164,326
Donations		5,410	5,047
Other, net		(1,078)	(430)
Net realized gains (losses) from investment		834	(201)
Net unrealized gains from investments		2,178	9,858
Reclassification of donor intent		6,801	—
Net assets released from restrictions used for operations		(170,389)	(166,810)
(Decrease) increase in temporarily restricted net assets		(10,269)	11,790
Permanently restricted net assets:			
Bequests		10,807	1,773
Donations		6,656	159
Other investment income		114	1
Other, net		—	59
Net realized gain from investment		273	149
Net unrealized gains from investments		38,115	21,285
Reclassification of donor intent		(6,801)	—
Increase in permanently restricted net assets		49,164	23,426
Increase in net assets		887,106	468,893
Net assets, beginning of year		8,334,385	7,865,492
Net assets, end of year	$	9,221,491	8,334,385

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Cash Flows

Years ended December 31, 2013 and 2012

(In thousands)

		2013	2012
Cash flows from operating activities:			
Change in net assets	$	887,106	468,893
Adjustments to reconcile change in net assets to net cash used in operating activities:			
Depreciation		53,900	46,119
Loss on disposal of property and equipment		294	872
Realized and unrealized gains on investments		(852,795)	(717,384)
Gifts and bequests designated by the board or restricted by donor for long-term investment		(163,535)	(166,235)
Change in value of patient transportation funds held by Shrine temples		(2,933)	(2,992)
Provision for Shriners assist		215,258	—
Pension related changes other than net periodic pension costs		(122,026)	87,501
Changes in operating assets and liabilities:			
Patient accounts receivable		(239,099)	—
Receivables		(3,854)	(4,120)
Accrued interest and dividends		3,672	(3,674)
Inventories and deferred charges		(2,388)	(3,226)
Beneficial interest in trusts		(44,593)	(29,454)
Estates in process		9,903	(7,658)
Accounts payable and accrued expenses		4,587	15,206
Pension benefits		(846)	(13,764)
Net cash used in operating activities		(257,349)	(329,916)
Cash flows from investing activities:			
Additions to property and equipment		(66,317)	(33,553)
Proceeds from sale of investments		3,546,769	2,623,583
Investment purchases		(3,322,013)	(2,351,596)
Net cash provided by investing activities		158,439	238,434
Cash flows from financing activities:			
Gifts and bequests designated for board endowment		145,975	164,326
Gifts and bequests permanently restricted by donors		17,463	1,773
Life memberships		97	136
Borrowings from line of credit		65,000	133,000
Payments on the line of credit		(128,000)	(200,000)
Change in other liabilities		(502)	777
Net cash provided by financing activities		100,033	100,012
Net increase in cash and cash equivalents		1,123	8,530
Cash and cash equivalents at beginning of year		17,448	8,918
Cash and cash equivalents at end of year	$	18,571	17,448

See accompanying notes to combined financial statements.

(1) Summary of Significant Accounting Policies

(a) Combined Organizations

Shriners Hospitals for Children (herein SHC) provides quality, specialized medical care, in the areas of orthopaedics, severe burns, and spinal cord injuries, through a network of 22 hospitals located throughout the United States, Canada, and Mexico. Medical care is provided regardless of the patient or family's ability to pay. SHC also funds intensive programs in pediatric orthopedic and burns research. SHC relies principally on gifts and investment earnings to support their operations and research programs.

The combined financial statements of SHC include the following organizations:

- Shriners Hospitals for Children, a Colorado Corporation
- Shriners Hospitals for Children, a Canadian Corporation
- Shriners Hospitals for Children (Quebec) Inc.
- The Shriners' Hospital for Children, a Massachusetts Corporation
- Shriners Hospitals for Children, a Mexican Association

Additionally, the combined financial statements include the activities of Promotora Mexicana de Servicios Medicos S.A. de C.V., a Mexican Corporation, which was organized to facilitate the construction of the Mexico City hospital. All significant accounts and transactions between SHC have been eliminated in combination.

Shriners Hospitals for Children, a Colorado Corporation and The Shriners' Hospital for Children, a Massachusetts Corporation, have been recognized as exempt from U.S. federal income tax on related income under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3) of the Internal Revenue Code. The Canadian and Quebec Corporations and the Mexican Association and Corporation are also exempt from income tax on related income in accordance with the laws of their respective countries.

(b) Use of Estimates

The preparation of the combined financial statements in accordance with generally accepted accounting principles requires management of SHC to make a number of estimates and assumptions that affect the reported amounts in the combined financial statements and accompanying notes to the combined financial statements. Actual results could differ from those estimates.

Significant estimates have been made by management with regard to estates in process and beneficial interests in trusts. These estimates are subject to significant fluctuation due to changes that occur in the valuation of assets associated with these estates and trusts and the timing of information received from trustees and executors of these estates and trusts. Actual results could differ materially from these estimates, making it reasonably possible that a material change in these estimates could occur in the near term.

(Continued)

(c) Basis of Presentation

The combined financial statements are presented on the accrual basis of accounting. Contributions received and unconditional promises to give are measured at their fair values and are reported as increases in net assets. SHC reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets, or if they are designated as support for future periods. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the combined statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support.

- Unrestricted net assets consist of investments and otherwise unrestricted amounts that are available for use in carrying out the activities of SHC. The majority of unrestricted net assets as of December 31, 2013 and 2012 represent board-designated endowment.
- Temporarily restricted net assets represent those amounts, which are not available until future periods or are donor restricted for specific purposes. SHC reports estates in process, charitable lead trusts, and charitable remainder trusts, as increases in temporarily restricted net assets as these assets are not available for expenditure until future periods.
- Permanently restricted net assets result from gifts and bequests from donors who place restrictions on the use of the funds, which mandate that the original principal be invested in perpetuity. Permanently restricted net assets also include perpetual lead trusts.

(d) Operating Measure

Changes in unrestricted net assets from operating activities represent the revenues, gains, and other support designated to operate SHC, less expenses and other costs associated with SHC operating and research activities and costs to generate operating revenues.

(e) Liquidity

Assets are presented in the accompanying combined statements of financial position according to their nearness of conversion to cash, and liabilities according to the nearness of their maturity and resulting use of cash.

(f) Cash and Cash Equivalents

SHC considers all highly liquid investments made from operating cash accounts and with a maturity of three months or less when purchased to be cash equivalents.

(g) Securities Loaned

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 860, *Transfers and Servicing*, requires SHC to recognize cash received as collateral for assets transferred to brokers in security lending transactions along with the obligation to return the cash. SHC generally receives collateral in the form of cash in an amount in excess of the fair value of securities loaned. SHC monitors the fair value of securities loaned on a monthly basis with additional collateral obtained as necessary. At December 31, 2013 and 2012, SHC held $608,878 and $551,682, respectively, of cash and marketable securities as collateral deposits. The collateral is included as both an asset and a liability in SHC's combined statements of financial position. The securities on loan had a fair value of $594,788 and $541,874 at December 31, 2013 and 2012, respectively, and are included in marketable securities in the accompanying combined statements of financial position.

(h) Inventories

Inventories of supplies are stated at the lower of cost (first-in, first-out method) or market.

(i) Long-Term Investments

The following long-term investments comprise SHC endowment: marketable securities, charitable gift annuities, beneficial interest in trusts, real estate and mineral interests and miscellaneous investments. It is SHC's Board of Directors (Board) policy to maintain a long-term investment portfolio to support the operating and research activities of SHC.

Marketable securities are measured at fair value based on quoted market prices at the reporting date for these or similar investments. Investments in real estate and mineral interests, and miscellaneous investments are reported at fair value at the date of contribution and subsequently measured at fair value based on various sources of information depending on the asset type. Investment income (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the combined statements of operations as increases or decreases in unrestricted net assets unless the income is restricted by donor or law.

SHC has a beneficial interest in a variety of trust agreements. Many of these trusts are charitable lead trusts where SHC receives distributions from the trust, which in most cases are administered by a third party. Perpetual lead trusts are recorded at the fair value of the trust's underlying assets and are classified as permanently restricted net assets. All other charitable lead trusts are recorded at the present value of the estimated future distributions expected to be received by SHC, and are classified as temporarily restricted net assets.

Charitable remainder trusts and pooled income funds represent trust agreements where SHC maintains custody of the related assets and makes specified distributions to a designated beneficiary or beneficiaries over the term of the trust. Assets under both types of trusts are recorded at fair value. Annuity liabilities associated with charitable remainder trusts are determined based on the present value of the estimated future payments to be paid to the designated beneficiaries. Deferred income is recognized on gifts to pooled income funds representing the discounted value of the assets for the estimated time period until the donor's death. The difference between the recorded assets and the annuity liabilities or deferred income associated with pooled income funds is classified as temporarily restricted net assets.

Subsequent adjustments to the carrying value of the respective assets and related liabilities or deferred income are recognized in the combined statements of operations and combined statements of changes in net assets and are included in unrealized gains and losses in their respective net asset category.

Included in other liabilities in the accompanying combined statements of financial position are annuity liabilities of $20,930 and $21,741 and deferred income of $15,225 and $14,583 at December 31, 2013 and 2012, respectively.

(j) Estates in Process

SHC recognizes a receivable and revenue for its interest in estates in process based on the inventories of estate assets and conditions contained in the respective wills. Amounts expected to be received in future years are discounted to provide estimates in current year dollars. SHC records estates in process (when the court declares the related will valid) as either temporarily restricted net assets, as these assets will not be available for expenditures until future periods (typically one to five years), or as permanently restricted net assets. As funds from an estate (other than permanently restricted) are collected, temporarily restricted net assets are reclassified to unrestricted net assets, and reported in the combined statements of operations and combined statements of changes in net assets as net assets released from restrictions.

(k) Land, Buildings, and Equipment

Land, land improvements, buildings, and equipment are stated at cost, if purchased, or at estimated fair value at date of receipt if acquired by gift. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

(l) Impairment or Disposal of Long-Lived Assets

SHC accounts for long-lived assets in accordance with the provisions of FASB ASC Topic 360-10-35, *Property, Plant, and Equipment – Subsequent Measurement*, which requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

SHC reviews whether events and circumstances have occurred to indicate if the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of an asset may not be recoverable. If such an event occurs, an assessment of possible impairment is based on whether the carrying amount of the asset exceeds the expected total undiscounted cash flows expected to result from the use of the assets and their eventual disposition. No impairments were recorded in 2013 or 2012.

(m) Foreign Currency Translation

Revenues and expenses of the Canadian and Quebec corporations and the Mexican Association and Corporation are translated using average exchange rates during the year, while monetary assets and liabilities are translated into U.S. dollars using current exchange rates at the end of the year.

Nonmonetary asset and liability items (land, buildings, and equipment) and related revenues, expenses, gains, and losses are remeasured using historical exchange rates. Resulting translation adjustments are accumulated in the combined statements of financial position caption "Cumulative foreign currency translation adjustment," as a component of unrestricted net assets.

(n) Contributed Services

No amounts have been reflected in the combined financial statements for contributed services. SHC's programs pay for most services requiring specific expertise. However, many individuals (Shriners and non-Shriners) volunteer their time at SHC and perform a variety of tasks that assist SHC with specific programs and various committee assignments.

(o) Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services. SHC has agreements with third-party payors that provide for payments to SHC at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, and discounted charges.

Revenue from the Medicaid and Medicare program accounted for approximately 35% and less than one percent of SHC's net patient service revenue for the year ended December 31, 2013. The composition of patient service revenue (net of contractual adjustments) but before the provision for Shriners assist recognized from these major payor sources is as follows (in thousands):

		2013
Medicaid	$	147,048
Commercial payors		213,191
Total all payors	$	360,239

SHC analyzes its past collection history and identifies trends by each of its major payor sources of patient service revenue to estimate the appropriate allowance for doubtful accounts and provision for Shriners assist. Management regularly reviews data about the major payor sources of patient service revenue in evaluating the adequacy of the allowance for doubtful accounts.

SHC analyzes contractual amounts due from third-party payors and provides an allowance for doubtful accounts and a provision for Shriners assist. For uninsured and Shriners assist patients, which includes those patients without insurance coverage and patients with deductibles and copayment balances for which third-party coverage exists for a portion of the bill, SHC records a significant provision for Shriner assist for patients that are unable to pay for any portion of the bill. Account balances are charged off against the allowance for Shriners assist.

(In thousands)

SHC's allowance for doubtful accounts for Shriners assist patients was 36% of patient accounts receivable as of December 31, 2013. SHC has not experienced significant changes in write-off trends and has not changed its uninsured or charity care policies for the year ended December 31, 2013.

Laws and regulations governing the Medicaid and Medicare programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates associated with these programs will change by a material amount in the near term. As a result, provisions for third-party payor settlements and adjustments are estimated in the period the related services are provided and adjusted in future periods as additional information becomes available and as final settlements are determined or as years are no longer subject to audits, reviews and investigations.

Net patient accounts receivable included approximately $11,196 or 47% and $4 or less than one percent due from the Medicaid and Medicare programs as of December 31, 2013. The credit risk for other concentrations of receivables is limited due to the large number of insurance companies and other payors that provide payments for services.

(p) Charity Care

SHC, through its overall charitable policies, provides funding for cash requirements of the Hospitals not met through normal operations. In addition, SHC provides care to patients who meet certain criteria under the charity care policies established by SHC without charge to its patients or families. Partial payments to which SHC is entitled from patients, third-party payors, Medicaid and others that meet SHC's charity care criteria are reported as net patient service revenue.

SHC provides necessary medical care regardless of the patient's ability to pay for services under its Charity Care policy. In addition, regulatory changes that may have the potential to alter charity classifications are monitored and incorporated into the policy, as necessary. SHC maintains records to identify and monitor the level of charity care. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The following measures the level of charity care and other community benefits, as defined, at estimated costs for the years ended December 31, 2013 and 2012:

		2013	**2012**
Traditional charity care	$	598,463	588,539
Direct offsetting revenue		(131,060)	(103,049)
Net traditional charity care	$	467,403	485,490
As a percentage of total expense		64%	67%

(q) Electronic Health Records Incentive Payments

The American Recovery and Reinvestment Act of 2009 provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and professionals that adopt and use electronic health records (EHR) in a meaningful way. Meaningful use is demonstrated by meeting established criteria that focus on capturing and using electronic health information to improve health care quality, efficiency, and patient safety.

(In thousands)

SHC records incentive payments when it is reasonably assured that it has met the meaningful use requirements. SHC recognized approximately $2,649 of incentive payments in other revenues for the year ended December 31, 2013. Incentive payment revenue is subject to change as the result of audits of compliance with meaningful use criteria and Medicare cost reports, with changes recorded in the period they occur.

(2) Long-Term Investments

Marketable securities at December 31, 2013 and 2012 consist of the following:

		2013		2012	
		Cost	**Fair value**	**Cost**	**Fair value**
Short-term investments	$	122,883	122,883	89,873	89,873
Common and preferred stocks		3,839,272	4,781,476	4,126,382	4,545,293
U.S. government securities		693,663	687,960	698,290	735,806
Corporate bonds		741,776	757,846	727,167	777,001
Other fixed income securities		954,195	949,329	590,484	597,414
Commodities fund		80,000	72,007	80,000	78,601
Fund of funds		60,000	62,169	—	—
	$	6,491,789	7,433,670	6,312,196	6,823,988

Investment income and total return on all long-term investments comprise the following components for the years ended December 31, 2013 and 2012:

		2013	2012
Interest	$	85,771	92,787
Dividends		99,152	105,039
Trust income		15,983	17,827
Rents and royalties		13,225	11,919
Other income		6,330	4,391
Less investment management fees		(14,286)	(14,954)
Total income from investments		206,175	217,009
Net realized gains from investments		406,155	148,517
Net unrealized gains (losses) from investments		446,061	537,776
Total return on investments	$	1,058,391	903,302

(In thousands)

(3) Land, Buildings, and Equipment

Land, buildings, and equipment at December 31, 2013 and 2012 consist of the following:

		2013	2012	Estimated useful lives
Land	$	40,243	29,743	—
Land improvements		11,916	11,664	5 – 20 years
Buildings		975,223	968,020	40 – 50 years
Equipment		368,318	354,784	4 – 25 years
		1,395,700	1,364,211	
Less accumulated depreciation		(698,349)	(652,743)	
		697,351	711,468	
Projects in process		22,853	17,418	
Construction in progress		51,047	30,242	
Land, buildings, and equipment, net	$	771,251	759,128	

Included in hospitals expense is $53,900 and $46,119 of depreciation expense for the years ended December 31, 2013 and 2012, respectively.

(4) Construction and Other Major Capital Projects

Construction and other major capital projects committed to by the Board are as follows:

Project		Total appropriation	Unexpended at December 31, 2013
Canada	$	122,000	101,435
Cincinnati		8,000	5,047
Tampa		2,200	623
Los Angeles		8,910	4,560
Lexington		6,377	1,891
St. Louis		48,000	35,510
Approved equipment expenditures:			
PACS imaging		5,500	3,138
Information systems projects		23,458	15,549
Other equipment		17,452	4,083
	$	241,897	171,836

(Continued)

(5) Line of Credit

During 2011, SHC entered into an unsecured line-of-credit agreement, for up to $150,000, with a financial institution for the purpose of aiding in operations and cash management. During 2013, this limit was increased to $250,000. On the date of a principal draw, SHC may elect to incur interest at one of two interest rate options. At December 31, 2013 and 2012, $0 and $63,000, respectively, was outstanding.

(6) Transactions with the Shriners International

SHC was founded by Shriners International (formerly known as the Imperial Council of the Ancient Arabic Order of the Nobles of the Mystic Shrine for North America).

The International Headquarters building and equipment is owned by SHC. A portion of the building is occupied by Shriners International, which is allocated a share of the operating costs and depreciation of the building and equipment. The allocation of the costs is based upon the portion of the building occupied by Shriners International in relation to the total occupied space in the building.

SHC and Shriners International also share other costs based on the estimated fair value received by each organization. Additionally, hospital assessments, donations, and other charitable receipts from Shrine temples are collected and remitted to SHC by Shriners International.

At December 31, 2013 and 2012, amounts of $2,005 and $1,515, respectively, were due from Shriners International, and are included in receivables, net in the accompanying combined statements of financial position.

(7) Fund-Raising Activities and Special Events

SHC is financially supported through each Shriner's annual hospital assessment, income from investments, gifts, and bequests from the general public and from Shriners, and certain fund-raising activities conducted by Shriners. Shrine temples and Shriners raise funds for both fraternal and charitable purposes. Shrine fund-raising activities consist of paper sale donations, football games, golf tournaments, and other miscellaneous activities. The name "Shriners Hospitals for Children" may be used in connection with a fund-raising activity by a Shrine temple or Shriner only with the written consent of Shriners International and SHC when the proceeds are to benefit SHC. Some of these funds are retained by individual Shrine temples for the support of their respective hospital patient transportation fund.

Through the efforts of the donor relations committee, which oversees the development activities of SHC, gifts, and bequests are solicited and received to support the operations of SHC or are designated by the Board for endowment purposes. Although the costs of these activities are included in fund-raising expenses, the associated revenues are reported as bequests and donations in the accompanying combined statements of operations and combined statements of changes of net assets.

SHC also engages in other fund-raising activities to generate donations and to develop their donor base. These activities are conducted through an agreement with an unrelated third party.

(In thousands)

Fund-raising and special events revenues and costs for the years ended December 31, 2013 and 2012 consist of the following:

		2013	2012
Revenues from Shrine temple sponsored events	$	7,567	8,021
Direct mail revenue		11,316	4,950
Other revenue		8,169	6,678
	$	27,052	19,649
Fund-raising costs paid directly by Shrine temples in connection with fund-raising events	$	531	651
Donor relations expense		6,713	12,027
Direct mail expense		5,519	451
Other costs		12,201	9,328
	$	24,964	22,457

Revenues from Shrine temple sponsored events are reported net of direct costs of $2,924 and $3,483 for 2013 and 2012, respectively.

During the year ended December 31, 2008, SHC became the Host Organization and Title Sponsor of a PGA Tour golf tournament. Beginning in 2013, this tournament became part of the Fed-Ex tour. The term of this agreement commenced with the 2008 event and will conclude after the 2017 tournament. The 2013 event yielded $5,925 in revenues. Expenses incurred on this event in 2013 were $10,263, creating a net loss on the event of $4,338. The 2012 event yielded $5,208 in revenues. Expenses incurred on this event in 2012 were $8,172, creating a net loss on the event of $2,964. These revenues and expenses are included above in other revenue and other costs.

(8) Patient Transportation Funds Held by Shrine Temples

Shrine temples pay for substantially all of the costs of transporting patients to individual Shriners Hospitals from their temple hospital transportation funds. These costs are supported by funds authorized to be retained from fund-raising events held for the benefit of SHC (note 7), as well as local donations from Shriners and the general public. The activities of the Shrine temple patient transportation funds are reflected as a nonoperating change in patient transportation funds held by Shrine temples in the accompanying combined statements of operations.

(In thousands)

The activities of the patient transportation funds reflected for the years ended December 31, 2013 and 2012 are as follows:

		2013	2012
Temple revenues restricted for patient transportation	$	17,416	18,225
Patient transportation costs		(14,483)	(15,233)
Change in patient transportation funds	$	2,933	2,992

(9) Fair Value Measurements

FASB ASC Topic 820, *Fair Value Measurement*, defines fair value as the exit price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 requires investments to be grouped into three categories based on certain criteria as noted below:

Level 1: Fair value is determined by using quoted prices for identical assets or liabilities in active markets.

Level 2: Fair value is determined by using other than quoted prices that are observable for the asset or liability (e.g., quoted prices for identical assets or liabilities in inactive markets, quoted prices for similar assets or liabilities in active markets, observable inputs other than quoted prices, and inputs derived principally from or corroborated by observable market data by correlation or other means).

Level 3: Fair value is determined by using inputs based on management assumptions that are not directly observable.

(Continued)

(In thousands)

The tables below summarizes SHC's significant financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2013 and 2012:

	December 31, 2013	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Recurring:				
Assets:				
Long-term investments:				
Short-term investments	$ 122,883	122,883	—	—
Common and preferred stocks	4,781,476	2,878,780	1,902,045	651
U.S. government securities	687,960	687,960	—	—
Corporate bonds	757,846	—	756,832	1,014
Other fixed income securities	949,329	—	949,329	—
Commodities fund	72,007	—	72,007	—
Fund of funds	62,169	—	62,169	—
Charitable gift annuities	31,932	—	31,932	—
Beneficial interests in trusts	535,121	—	535,121	—
Real estate and mineral interests	239,566	—	—	239,566
Miscellaneous investments	18,158	—	18,158	—
Total	$ 8,258,447	3,689,623	4,327,593	241,231
Collateral under securities lending transactions	$ 608,878	608,878	—	—
Liabilities:				
Annuity liabilities	$ 20,930	—	20,930	—
Liabilities under securities lending transactions	608,878	608,878	—	—
Non recurring:				
Patient transportation funds held by Shrine Temples	$ 54,867	—	54,867	—
Estates in process	280,862	—	—	280,862
	$ 335,729	—	54,867	280,862

(Continued)

(In thousands)

	December 31, 2012	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Recurring:				
Assets:				
Long-term investments:				
Short-term investments	$ 89,873	89,873	—	—
Common and preferred stocks	4,545,293	1,711,779	2,833,511	3
U.S. government securities	735,806	735,806	—	—
Corporate bonds	777,001	—	775,203	1,798
Other fixed income securities	597,414	—	597,414	—
Commodities fund	78,601	—	78,601	—
Charitable gift annuities	29,907	—	29,907	—
Beneficial interests in trusts	490,528	—	490,528	—
Real estate and mineral interests	219,170	—	—	219,170
Miscellaneous investments	22,222	—	22,222	—
Total	$ 7,585,815	2,537,458	4,827,386	220,971
Collateral under securities lending transactions	$ 551,682	551,682	—	—
Liabilities:				
Annuity liabilities	$ 21,741	—	21,741	—
Liabilities under securities lending transactions	551,682	551,682	—	—
Non recurring:				
Patient transportation funds held by Shrine Temples	$ 51,934	—	51,934	—
Estate in process	290,765	—	—	290,765
	$ 342,699	—	51,934	290,765

SHC’s Level 1 assets and liabilities include investments in cash, cash equivalents, common and preferred stocks, and U.S. government securities and are valued at quoted market prices.

SHC’s Level 2 assets include investments in foreign common and preferred stock, corporate debt securities, other fixed income securities, charitable gift annuities, beneficial interest in trusts, and miscellaneous investments with fair values modeled by external pricing vendors. Liabilities include annuity liabilities.

SHC’s Level 3 assets include certain foreign and domestic common and preferred stocks, real estate and mineral interests, and investments in foreign and domestic corporate bonds.

(In thousands)

SHC's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstance that caused the transfer. There were no transfers into or out of level 1 or Level 2 for the years ended December 31, 2013 or 2012.

The tables below summarize the changes in Level 3 assets for the years ended December 31, 2013 and 2012:

		Fair value measurements using significant unobservable inputs (Level 3)		
		Common and preferred stock and corporate bonds	**Real estate and mineral interests**	**Total**
2013:				
Beginning balance	$	1,801	219,170	220,971
Total gains (realized/unrealized) included in increase (decrease) in unrestricted net assets		—	20,199	20,199
Purchases		—	3,724	3,724
Settlements		—	—	—
Sales		(136)	(3,527)	(3,663)
Transfers in/out of Level 3		—	—	—
Ending balance	$	1,665	239,566	241,231

		Fair value measurements using significant unobservable inputs (Level 3)		
		Common and preferred stock and corporate bonds	**Real estate and mineral interests**	**Total**
2012:				
Beginning balance	$	—	192,331	192,331
Total gains (realized/unrealized) included in increase (decrease) in unrestricted net assets		392	26,143	26,535
Purchases		1,017	3,136	4,153
Settlements		—	—	—
Sales		—	(2,440)	(2,440)
Transfers in/out of Level 3		392	—	392
Ending balance	$	1,801	219,170	220,971

(In thousands)

Realized and unrealized gains included in changes in net assets for the years ended December 31, 2013 and 2012 are reported in investment income as follows:

		December 31	
		2013	**2012**
Total gains included in increase in unrestricted net assets	$	20,199	26,535
Change in unrealized gains relating to assets still held at reporting date		20,199	26,143

The fair values of the following investments have been estimated using the net asset value per share of the investments as of December 31, 2013. There are no unfunded commitments on any of these funds.

		Fair value			
		December 31, 2013	**December 31, 2012**	**Redemption frequency**	**Redemption notice period**
Northern Trust Global Investments Collective Daily S&P 500 Equity Index Fund – Lending (a)	$	1,148,403	998,289	Daily	None
Common Daily EAFE Index – Lending (b)		590,373	537,866	Daily	None
WTC CTF Opportunistic Fixed Income (c)		391,210	408,924	Monthly	30 days
Capital Guardian Absolute Income (d)		69,615	59,736	Monthly	5 days
Gresham TAP Fund (e)		72,007	78,601	Monthly	5 days
AQR Delta Fund (f)		31,163	—	Monthly	30 days
Aetos Capital Multi-Strategy (f)		31,005	—	Monthly	30 days
Russell 2000 Growth Equity-Lending (g)		165,248	—	Daily	None
Total	$	2,499,024	2,083,416		

(a) The primary investment objective of the equity index fund is to match the risk and return characteristics of the S&P 500 Index. Funds that participate in the securities lending program have a twice-per-month redemption restriction, and a total redemption would require the Hospitals to fund its portion of any collateral shortfall.

(b) The primary objective of the fund is to approximate the risk and return characteristics of the Morgan Stanley Europe, Australasia, and Far East (MSCI EAFE) Index. This Index is commonly used to represent the non U.S. equity markets. This Fund may participate in securities lending.

(c) The fund’s investment objective is an unconstrained, nonbenchmark oriented investment approach. Barclays Capital U.S. Aggregate Bond Index will be used as the primary reference benchmark.

(In thousands)

(d) The investment objective of the fund is to seek a level of income that exceeds the average yield on U.S. stocks generally, to grow such income annually, and to distribute an increasing amount of income per unit of the fund.

(e) The investment objective of this fund is to provide a return that exceeds the Dow Jones/UBS Commodities Index.

(f) The investment objective of this fund is to provide a return that exceeds the HFRI fund of funds composite.

(g) The primary objective of this fund is to approximate the nsk and return characteristics of the Russell 2000 Growth Index.

(10) Retirement Plans and Other Postretirement Benefits

The employees of U.S. hospitals are included in the Shriners Hospitals for Children Employees' Retirement Plan and the Shriners Hospitals for Children Supplemental Retirement Plan (collectively, the Pension Plans). Benefits are based on years of service and the employees' compensation during the highest five consecutive years of employment. Contributions are made to the Pension Plans in accordance with ERISA requirements. In addition, SHC sponsors a postretirement life insurance plan (the Postretirement Plan). In March 2009, the Board voted to freeze entry of new participants into the Pension Plans effective May 1, 2009.

The actuarially computed net periodic pension cost for the Shriner's Hospital Pension Plans and the Postretirement Plan for the years ended December 31, 2013 and 2012 included the following components:

	Pension Plans		Postretirement Plan	
	2013	2012	2013	2012
Service cost – benefits earned during the period	$ 22,737	19,377	417	383
Interest cost on projected benefit obligation	23,777	21,937	552	558
Expected return on plan assets	(27,615)	(24,732)	—	—
Net amortized and deferral of unrecognized gains and losses	19,075	7,822	26	39
Net periodic pension cost	$ 37,974	24,404	995	980

(In thousands)

The following table sets forth the Pension Plans' and the Postretirement Plan's funded status and amounts recognized in the combined statements of financial position as of December 31, 2013 and 2012, respectively (using a measurement date of December 31):

		Pension Plans		Postretirement Plan	
		2013	2012	2013	2012
Change in benefit obligation:					
Benefit obligation at beginning of year	$	580,606	445,401	13,535	10,929
Service cost		22,737	19,377	417	383
Interest cost		23,777	21,937	552	558
Actuarial (gain) loss		(91,552)	108,514	(2,731)	1,825
Benefits paid		(18,599)	(14,623)	(230)	(160)
Benefit obligation at end of year	$	516,969	580,606	11,543	13,535

		Pension Plans		Postretirement Plan	
		2013	2012	2013	2012
Change in plan assets:					
Fair value of plan assets at beginning of year	$	373,082	309,008	—	—
Actual return on plan assets		38,404	39,709	—	—
Employer contributions		37,438	38,988	230	160
Benefits paid		(18,599)	(14,623)	(230)	(160)
Fair value of plan assets at end of year		430,325	373,082	—	—
Funded status at end of year	$	(86,644)	(207,524)	(11,543)	(13,535)

The accumulated benefit obligation for the Pension Plans was $458,199 and $502,200 at December 31, 2013 and 2012, respectively. The accumulated benefit obligation differs from the benefit obligation above in that it includes no assumption about future compensation levels. It represents the actuarial present value of future payments to plan participants using current and past compensation levels.

Weighted average assumptions used to determine projected benefit obligations at December 31, 2013 and 2012 were as follows:

	Pension Plans		Postretirement Plan	
	2013	2012	2013	2012
Discount rate	5.00%	4.00%	5.00%	4.00%
Rate of compensation increase	3.50	3.50	N/A	N/A

(In thousands)

Weighted average assumptions used to determine the net periodic benefit costs of the Pension Plans and the Postretirement Plan are:

	Pension Plans		Postretirement Plan	
	2013	**2012**	**2013**	**2012**
Discount rate	4.00%	5.00%	4.00%	5.00%
Expected long-term rate of return on plan assets	7.50	7.50	N/A	N/A
Rate of compensation increase	3.50	3.50	N/A	N/A

The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

The following are deferred pension costs, which have not yet been recognized in periodic pension expense but instead are accrued in unrestricted net assets as of December 31, 2013. Unrecognized actuarial losses represent unexpected changes in the projected benefit obligation and plan assets over time, primarily due to changes in assumed discount rates and investment experience. Unrecognized prior service cost is the impact of changes in plan benefits applied retrospectively to employee service previously rendered. Deferred pension costs are amortized into annual pension expense over the average remaining assumed service period for active employees.

	Pension Plans		Postretirement Plan	
	Amounts recognized in unrestricted net assets at December 31, 2013	**Amounts in unrestricted net assets to be recognized during the next fiscal year**	**Amounts recognized in unrestricted net assets at December 31, 2013**	**Amounts in unrestricted net assets to be recognized during the next fiscal year**
Actuarial loss	$ 96,593	6,838	1,533	—
Prior service cost	(36)	3	—	—
Transition obligation	—	—	—	(33)
Total	$ 96,557	6,841	1,533	(33)

(Continued)

(In thousands)

(a) Plan Assets

The weighted average allocation of the Pension Plans' assets at December 31, 2013 and 2012 was as follows:

Asset category	2013	2012
Short-term investments	1%	—%
Common and preferred stock	52	51
Corporate and miscellaneous bonds	19	19
Mutual funds	28	30
Total assets	100%	100%

SHC's investment policies and strategies for pension benefits do not use target allocations for the individual asset categories. The Hospitals' investment goals are to maximize returns subject to specific risk management policies.

(In thousands)

The table below summarizes the Pension Plan’s significant financial assets measured at fair value on a recurring basis using the net asset value per share of the investments as of December 31, 2013:

		December 31, 2013	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Assets:					
Northern Trust Global Investments Collective Funds Trust (a)	$	4,017	4,017	—	—
Dimensional Fund Advisors (DFA) Emerging Markets Value (b)		20,433	—	20,433	—
Blackrock Global Allocation Fund (c)		21,715	—	21,715	—
Blackrock World Ex-U.S. Alpha Tilts L Fund (d)		45,276	—	45,276	—
Northern Trust Global Investments Collective Russell 2000 Index Fund – Nonlending (e)		44,827	—	44,827	—
Northern Trust Global U.S. Treasury Interest Strips (f)		80,081	—	80,081	—
Northern Trust Global Investments Collective Daily S&P 500 Equity Index Fund – Nonlending (g)		133,855	—	133,855	—
Pacific Investment Management:					
Long Duration Total Return Funds (h)		60,642	—	60,642	—
Series All AST funds (i)		19,479	—	19,479	—
Total	$	430,325	4,017	426,308	—

(a) This fund is composed of high-grade money market instruments with short maturities. The fund seeks to provide an investment vehicle for cash reserves while offering a competitive rate of return.

(b) The fund seeks to provide long-term growth of capital by investing primarily in a wide variety of international equity securities issued throughout the world, normally excluding the U.S.

(c) This fund seeks to provide a high total investment return through investing in equity, debt and money market securities. The fund may invest up to 35% of its total assets in junk bonds, corporate loans, distressed securities and real estate investment trusts.

(d) This fund seeks to exceed the Morgan Stanley Capital International Europe Australasia Far East Free Index.

(e) The primary objective of this fund is to approximate the risk and return characterized by the Russell 2000 Index. This index is commonly used to represent the small cap segment of the U.S. equity market. The fund does not participate in securities lending.

(f) This fund seeks to provide a growth of capital by investing in U.S. Treasury Separate Trading of Registered Interest and Principal Securities or STRIPS.

(g) The primary objective of this fund is to approximate the risk and return characteristics of the S&P 500 Index. The Index is commonly used to represent the large-cap segment of the U.S. equity market. This fund does not participate in securities lending.

(h) This fund seeks to maximize current income and capital appreciation while maintaining exposure consistent with its benchmark. The fund maintains duration within two years of the Barclays Capital Long Term Government/Credit Index.

(i) This fund seeks maximum real return, consistent with preservation of real capital and prudent investment management. While the fund is nondiversified, it invests in diversified underlying holdings.

(In thousands)

The table below summarizes the Pension Plan's significant financial assets measured at fair value on a recurring basis using the net asset value per share of the investments as of December 31, 2012:

	December 31, 2012	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Assets:				
Northern Trust Global Investments Collective Funds Trust (a)	$ 1,567	1,567	—	—
Dimensional Fund Advisors (DFA) Emerging Markets Value (b)	20,245	—	20,245	—
Blackrock Global Allocation Fund (c)	17,746	—	17,746	—
Blackrock World Ex-U.S. Alpha Tilts L Fund (d)	40,394	—	40,394	—
Northern Trust Global Investments Collective Russell 2000 Index Fund – Nonlending (e)	38,350	—	38,350	—
Northern Trust Global U.S. Treasury Interest Strips (f)	69,795	—	69,795	—
Northern Trust Global Investments Collective Daily S&P 500 Equity Index Fund – Nonlending (g)	112,469	—	112,469	—
Pacific Investment Management:				
Long Duration Total Return Funds (h)	54,695	—	54,695	—
Series All AST funds (i)	17,821	—	17,821	—
Total	$ 373,082	1,567	371,515	—

(a) This fund is composed of high-grade money market instruments with short maturities. The fund seeks to provide an investment vehicle for cash reserves while offering a competitive rate of return.

(b) The fund seeks to provide long-term growth of capital by investing primarily in a wide variety of international equity securities issued throughout the world, normally excluding the U.S.

(c) This fund seeks to provide a high total investment return through investing in equity, debt and money market securities. The fund may invest up to 35% of its total assets in junk bonds, corporate loans, distressed securities and real estate investment trusts.

(In thousands)

(d) This fund seeks to exceed the Morgan Stanley Capital International Europe Australasia Far East Free Index.

(e) The primary objective of this fund is to approximate the risk and return characterized by the Russell 2000 Index. This index is commonly used to represent the small cap segment of the U.S. equity market. The fund does not participate in securities lending.

(f) This fund seeks to provide a growth of capital by investing in U.S. Treasury Separate Trading of Registered Interest and Principal Securities or STRIPS.

(g) The primary objective of this fund is to approximate the risk and return characteristics of the S&P 500 Index. The Index is commonly used to represent the large-cap segment of the U.S. equity market. This fund does not participate in securities lending.

(h) This fund seeks to maximize current income and capital appreciation while maintaining exposure consistent with its benchmark. The fund maintains duration within two years of the Barclays Capital Long Term Government/Credit Index.

(i) This fund seeks maximum real return, consistent with preservation of real capital and prudent investment management. While the fund is nondiversified, it invests in diversified underlying holdings.

(b) Contributions

Annual contributions are determined based upon calculations prepared by the plans' actuary. Expected contributions to the Pension Plans and the Postretirement Plan are $32,043 and $335, respectively, in 2014.

(c) Benefit Payments

The following benefit payments, that reflect expected future service, as appropriate, are expected to be paid out of the plans:

	Pension plans	Postretirement plan
Fiscal year:		
2014	19,719	335
2015	21,705	359
2016	23,073	384
2017	25,619	412
2018–2023	198,771	3,136

SHC also has a retirement savings plan for all eligible employees. Under this plan, SHC matches 50% of the first 6% of voluntary contributions made from eligible compensation by employees.

Matching contributions by SHC to the retirement savings plan were $6,029 and $6,576 in 2013 and 2012, respectively.

Canadian and Mexican hospital employees are included in government retirement programs.

(11) Estimated Malpractice Costs and Other Contingencies

SHC is self-insured for claims attributed to malpractice and workers' compensation from providing professional and patient care services. Claims alleging malpractice have been asserted against SHC and are currently in various stages of litigation. Additional claims may be asserted against SHC arising from services provided to patients through December 31, 2013. Liabilities for malpractice and workers' compensation claims are established based on specific identification and historical experience using actuarial methodologies. It is the opinion of management that estimated malpractice and workers' compensation claims accrued should be adequate to provide for potential losses resulting from both reported claims and claims incurred but not reported. Such amounts are not material and are recorded in accounts payable and accrued expenses on the accompanying combined statements of financial position.

SHC is also a party to various other claims and legal actions arising in the ordinary course of business. Management does not believe that the ultimate outcome of such claims and legal actions will have a material adverse effect on the financial position or activities of SHC.

(12) Endowment Funds

FASB ASC Subtopic 958-205, *Not-for-Profit Entities – Presentation of Financial Statements*, provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). FASB ASC Subtopic 958-205 also requires enhanced disclosures about an organization's endowment funds, whether or not the organization is subject to an enacted version of UPMIFA. These disclosures shall enable users of financial statements to understand the net asset classification, net asset composition, changes in net asset composition, spending policy, and related investment policy of its endowment funds (both donor restricted and board designated). On July 1, 2012, the State of Florida enacted UPMIFA. As a result, SHC implemented all requirements of FASB ASC Subtopic 958-205, most notably the requirement that all donor-restricted endowment funds that are not classified as permanently restricted net assets be classified as temporarily restricted net assets until those amounts are appropriated for expenditure by SHC in a manner consistent with the standard of prudence prescribed in UPMIFA. SHC performed an analysis of the endowment funds and concluded that no reclassifications were needed between the endowment classes.

SHC's endowment consists of marketable securities, charitable gift annuities, beneficial interest in trusts, real estate and mineral interests, and miscellaneous investments. The endowment consists of both donor-restricted funds, as well as funds designated by the Board of Trustees to function as endowments.

The Board has interpreted the wishes of donors and state law 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, SHC classifies as permanently restricted net assets (a) the original value of gifts donated, (b) the original value of subsequent gifts to the permanent endowment, and (c) 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 endowment. Gifts given with a restriction of time or purpose are added to the endowment as temporarily restricted funds. Upon the passage of time or completion of purpose, these funds are released as unrestricted. Funds designated by the Board as endowment funds are included as unrestricted endowment funds.

(In thousands)

Investment Return Objectives, Risk Parameters, and Strategies. SHC has adopted investment and spending policies, approved by the Investment Committee, for endowment assets that attempt to provide a predictable stream of funding to support the hospital system, while also maintaining the purchasing power of those endowment assets over the long term. Accordingly, the investment process seeks to achieve an after-cost total real rate of return, including investment income, as well as capital appreciation, which exceeds the budgeted annual distribution with acceptable levels of risk. Endowment assets are invested in a well-diversified asset mix, which includes equity and fixed-income securities that is intended to result in a rate of return that has sufficient liquidity to provide a high level of cash distribution, while growing the funds, if possible. Therefore, SHC expects its endowment assets, over time, to produce an average rate of return of approximately 7.25% annually. Actual returns in any given year may vary from this amount. Investment risk is measured in terms of the total endowment fund; investment assets and allocation between asset classes and strategies are managed to not expose the fund to unacceptable levels of risk.

Spending Policy. The Board does not have a formal endowment spending policy. Generally, all investment return (excluding capital appreciation) is utilized in funding SHC's programs. In making this funding decision, the Board considers the long-term expected return on its investment assets, the nature and duration of the individual endowment funds, some of which must be maintained in perpetuity because of donor-restrictions, and the possible effects of inflation. The Board's goal is for its endowment funds to grow annually to maintain the purchasing power of the endowment assets, as well as, to provide additional real growth through new gifts and investment return.

Endowment asset composition by type of fund, as of December 31, 2013 and 2012, is as follows:

	Unrestricted	Temporarily restricted	Permanently restricted	Total endowment assets
2013:				
Board-designated endowment funds	$ 7,723,326	—	—	7,723,326
Donor-restricted endowment funds	—	108,400	426,721	535,121
	$ 7,723,326	108,400	426,721	8,258,447

(In thousands)

		Unrestricted	Temporarily restricted	Permanently restricted	Total endowment assets
2012:					
Board-designated endowment funds	$	7,095,288	—	—	7,095,288
Donor-restricted endowment funds		—	108,611	381,916	490,527
	$	7,095,288	108,611	381,916	7,585,815

Changes in endowment assets for the years ended December 31, 2013 and 2012 are as follows:

		Unrestricted	Temporarily restricted	Permanently restricted	Total endowment net assets
2013:					
Balance, beginning of year	$	7,095,288	108,611	381,916	7,585,815
Donations and bequests		—	1,113	6,656	7,769
Investment income		206,175	—	114	206,289
Net appreciation		852,216	3,012	38,035	893,263
Reclassifications		4,336	(4,336)	—	—
Withdrawals		(434,689)	—	—	(434,689)
Balance, end of year	$	7,723,326	108,400	426,721	8,258,447
2012:					
Balance, beginning of year	$	6,649,720	100,591	360,653	7,110,964
Donations and bequests		—	1,012	159	1,171
Investment income		217,009	—	1	217,010
Net appreciation		686,624	9,657	21,103	717,384
Reclassifications		2,649	(2,649)	—	—
Withdrawals		(460,714)	—	—	(460,714)
Balance, end of year	$	7,095,288	108,611	381,916	7,585,815

(13) Subsequent Events

SHC has evaluated events and transactions occurring subsequent to December 31, 2013 as of April 7, 2014, which is the date the financial statements were available to be issued. Management believes that no material events have occurred since December 31, 2013 that require recognition or disclosure in the financial statements.