



Report of Independent Auditors
and Consolidated Financial Statements for
**Public Hospital District No. 2,
Snohomish County, Washington
(dba Stevens Hospital)**

December 31, 2010 and 2009

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

To the Board of Commissioners
Public Hospital District No. 2,
Snohomish County, Washington

We have audited the consolidated balance sheet of Public Hospital District No. 2, Snohomish County, Washington (dba Stevens Hospital) (the District), as of December 31, 2010 and 2009, and the related consolidated statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the District'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 consolidated 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 consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Hospital District No. 2, Snohomish County, Washington, 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.

The accompanying management's discussion and analysis on pages 2 through 8 is not a required part of the consolidated financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Everett, Washington
August 9, 2011

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following discussion and analysis for Public Hospital District No. 2, Snohomish County, Washington (dba Stevens Hospital) (the District), provides an overview of the District's financial activities for the years ended December 31, 2010 and 2009. Please read it in conjunction with the District's consolidated financial statements, which follow this analysis.

Using These Basic Consolidated Financial Statements

The District's consolidated financial statements consist of three consolidated statements: a balance sheet; a statement of revenues, expenses, and changes in net assets; and a statement of cash flows. The activities of the Stevens Foundation are consolidated with the District's financial statements. These consolidated financial statements and related notes provide information about the financial activities of the District.

The Balance Sheet and Statement of Revenues, Expenses, and Changes in Net Assets

These two statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account when the underlying transactions occur, regardless of when cash is received or paid. These statements report the District's net assets and the changes therein. When assessing the overall health of the District, other nonfinancial factors also need to be considered, such as changes in the District's patient base, changes in services offered, measures of the quality of service offered, and local economic factors.

The Statement of Cash Flows

This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and capital and noncapital financing activities. It provides information about sources and uses of cash and the change in cash balances during the reporting periods.

The Transition of Operations, Effective September 1, 2010

Until September 1, 2010, Public Hospital District No. 2 Snohomish County, Washington, owned and operated Stevens Hospital. Through a lease and operating agreement, on September 1, 2010, Swedish Health Services, a nonprofit corporation, took over operation of the hospital and renamed it Swedish/Edmonds. This transition significantly changed the role of the District. The District retained ownership of the hospital but will no longer manage its operations and will instead be a landlord to Swedish Health Services. As of December 31, 2010, Swedish paid \$2.4 million in lease payments to the District for the use of real property and personal assets owned by the District.

The negotiated agreement terms for use of the hospital by Swedish Health Services are for 30 years, with options to renew, wherein the District will receive monthly lease payments that increase 3.0% per year for the first 15 years, after which time the monthly payments will be steady for the remainder of the agreement. Additionally, Swedish Health Services agrees to invest a minimum of \$90.0 million into District capital improvements over the course of the first 10 years, with no less than \$6.0 million per year in each of those 10 years.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

The Transition of Operations, Effective September 1, 2010 (continued)

The District will maintain investments sufficient to take back the operation of the hospital in the event of default by Swedish Health Services or some other extraordinary event. This transition significantly impacts many of the balance sheet accounts for year ending December 31, 2010, and along with the long-term agreement with Swedish Health Systems, significantly improves the short- and long-term financial viability of the District.

As of September 1, 2010, the District will continue doing business as South Snohomish County Commission for Health (SSCCFH). SSCCFH will be governed by the board of five elected commissioners. The mission of SSCCFH is to improve the health and well-being of our community. This mission will be completed by contracting for services with local partners, businesses, and government agencies. Long-term financial stability will be established by investing available revenues received from Swedish Health Systems, as well as tax levy revenues, into allowable government funds, thus building adequate reserves over the next 10 years.

Balance Sheet

The District's net assets are the difference between its assets and liabilities as reported in the consolidated balance sheet (in thousands).

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Assets			
Current assets	\$ 31,009	\$ 44,034	\$ 41,552
Capital assets, net	37,012	40,266	36,588
Other noncurrent assets	<u>2,716</u>	<u>8,448</u>	<u>13,156</u>
Total assets	<u>\$ 70,737</u>	<u>\$ 92,748</u>	<u>\$ 91,296</u>
Liabilities			
Current liabilities	\$ 5,639	\$ 24,451	\$ 33,091
Long-term debt outstanding, net	9,030	18,401	23,716
Other long-term liabilities	<u>4,042</u>	<u>7,768</u>	<u>8,051</u>
Total liabilities	<u>18,711</u>	<u>50,620</u>	<u>64,858</u>
Net assets			
Invested in capital assets, net of related debt	24,553	17,235	99
Restricted			
For debt service	323	1,655	9,010
Expendable for specific activities		55	122
Unrestricted	<u>27,150</u>	<u>23,183</u>	<u>17,207</u>
Total net assets	<u>52,026</u>	<u>42,128</u>	<u>26,438</u>
Total liabilities and net assets	<u>\$ 70,737</u>	<u>\$ 92,748</u>	<u>\$ 91,296</u>

Balance Sheet (continued)

Current Assets

Total current assets of \$31.0 million at year-end 2010 reflect a decrease of \$13.0 million (29.6%), compared to the balance of \$44.0 million at the end of 2009. This change relates to \$7.5 million of the 1995 Revenue Bonds Sinking Fund that was used June 1, 2009, toward the redemption of the 1995 Revenue Bonds, as well as a decrease of \$20.1 million due to net patient accounts receivable being transferred to Swedish Health Services, and an increase related to the \$17.0 million receivable from Swedish Health Services for the transaction. Cash and short-term investments decreased by \$2.8 million (17.1%) in 2010, compared to an increase of \$6.7 million (70.7%) in 2009.

Capital Assets

The District's net capital assets decreased \$3.3 million (8.1%) in 2010, compared to a net increase of \$3.7 million (10.1%) in 2009. Major moveable assets totaling \$1.2 million were assigned to Swedish Health Services when transfer of the hospital operations occurred on September 1, 2010. During 2010, the District purchased equipment and completed minor capital projects. Major additions are listed below:

- Soarian HIM Software Upgrade
- PET CT Scanner Installation
- Stryker Surgical Towers
- Rapid Medical Evaluation Project in the Emergency Room
- 3rd Floor Lobby Upgrades
- Dietary Room Service Conversion

The District's net capital assets increased \$3.7 million (10.1%) in 2009, compared to a net decrease of \$1.7 million (4.5%) in 2008. During 2009, the District purchased equipment and completed minor capital projects, which combined to increase the capital asset balance by \$10.2 million. Major additions are listed below:

- Pharmacy Medication Dispensing System (McKesson Accudose System)
- Allscripts Electronic Health Records for the Emergency Department
- Patient Beds for PCU, 5W & 8W
- Urology Table for Surgery
- Vital Sign Monitors for the Emergency Department
- Vitamin D Testing for Laboratory
- Numerous Software and Hardware Upgrades throughout the Hospital

Other Noncurrent Assets

Other noncurrent assets decreased by \$5.7 million (67.9%). This decrease was due to the reduction of long-term investments, as funds were transferred to cash to pay the redemption of \$5.0 million of the 1995 Revenue Bonds.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Balance Sheet (continued)

Current Liabilities

Current liabilities decreased \$18.8 million (76.9%) from \$24.4 million in 2009 to \$5.6 million in 2010. Accrued salaries and benefits decreased by \$7.7 million, while accounts payable decreased by \$7.6 million. Part of this decrease also relates to the District's decision to redeem \$5.0 million of the 1995 Revenue Bonds in December 2010. On September 1, 2010, \$5.8 million of hospital-related accounts payable and \$3.9 million of accrued salaries and benefits were transferred to Swedish Health Services.

Other Long-Term Liabilities

Other noncurrent liabilities decreased by \$3.7 million (48.0%) in 2010, as compared to \$0.2 million in 2009 (2.5%). Deferred revenue of \$1.4 million related to the sale of an option to purchase the Stevens Pavilion, and the deferred long-term tenant improvement allowance of \$0.4 million was adjusted to zero due to the transfer to Swedish Health Services effective August 31, 2010.

Long-Term Debt

As of December 31, 2010, the District had \$9.0 million in long-term debt and obligations under capital leases, net of current portion, which is a \$9.3 million (50.9%) decrease from 2009. This decrease relates to the District's decision to redeem \$5.0 million of the 1995 Revenue Bonds in December 2010. Total principal payments during 2010 were \$9.7 million. At year-end 2009, the District had \$18.4 million in long-term debt and obligations under capital leases, net of current portion, which is a \$5.3 million (22.4%) decrease from 2008.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Operating Results and Changes in the District's Net Assets

In 2010, the District's net assets increased \$9.9 million (23.5%), compared to an increase of \$15.7 million (59.3%) in 2009.

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Operating revenues			
Net patient service revenues	\$ 109,644	\$ 162,374	\$ 143,473
Lease revenue	3,462		
Other operating revenues	<u>6,903</u>	<u>8,623</u>	<u>8,467</u>
Total operating revenues	<u>120,009</u>	<u>170,997</u>	<u>151,940</u>
Operating expenses			
Salaries and benefits	66,716	89,962	80,731
Supplies and other	44,185	63,169	64,184
Depreciation and amortization	<u>6,408</u>	<u>6,325</u>	<u>5,695</u>
Total operating expenses	<u>117,309</u>	<u>159,456</u>	<u>150,610</u>
Operating income	<u>2,700</u>	<u>11,541</u>	<u>1,330</u>
Nonoperating revenues (expenses)			
Tax levies	4,193	4,127	3,930
Other investment income	674	697	1,213
Interest expense and amortization	(1,001)	(1,437)	(1,953)
Noncapital grants and contributions	63	43	18
Other income	<u>3,212</u>	<u>465</u>	<u>464</u>
Net nonoperating revenues	<u>7,141</u>	<u>3,895</u>	<u>3,672</u>
Excess of revenues over expenses before capital grants and contributions	9,841	15,436	5,002
Capital grants and contributions	<u>57</u>	<u>254</u>	<u>33</u>
Increase in net assets	9,898	15,690	5,035
Net assets, beginning of year	<u>42,128</u>	<u>26,438</u>	<u>21,403</u>
Net assets, end of year	<u>\$ 52,026</u>	<u>\$ 42,128</u>	<u>\$ 26,438</u>

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Operating Results and Changes in the District's Net Assets (continued)

The District generated \$109.6 million of net patient service revenue in 2010. Admissions totaled 5,368 and overall patient days were 22,868. The District had 30,020 emergency room visits as of August 31, 2010. Surgery volumes for 2010 were 3,283 through August. The District generated \$162.4 million of net patient service revenue in 2009, an increase of \$18.9 million (13.2%) over 2008 due to rate increases from governmental and managed care payers, general price increases, increased acuity of patients, and increased outpatient volumes. Admissions decreased by 267 (3.4%) and overall patient days of 33,265 decreased by 741 days, compared to 2008 patient days of 34,006. The District had 43,661 emergency room visits in 2009, compared to 41,853 in 2008. Surgery volume decreased 4.4% overall in 2009, with a 9.7% decrease in inpatient surgery cases and a 0.8% decrease in outpatient surgery cases compared to 2008.

Operating revenues totaling \$3.4 million were attributed to lease payments from the transition to Swedish Health Services as of September 1, 2010. No lease revenue was reported in 2009 or 2008.

Other operating revenues for 2010 totaled \$6.9 million. The Cancer Center alliance with Swedish Health Services generated \$1.6 million in revenue. The District has a 6.3% ownership in PACLAB, LLC, an outreach laboratory service. For the eight months ended August 31, 2010, the District recorded distributions of \$1.9 million from PACLAB, LLC. The District owns 50% interest in Stevens Radia Imaging Center, LLC. Distributions from this investment were \$0.4 for the eight months ended August 31, 2010. The District generated \$8.6 million of other operating revenues in 2009 compared to \$8.4 million in 2008, a 1.8% increase.

Overall operating costs for 2010 were \$117.3 million. Salaries and benefits totaled \$66.7 million. Wage increases averaged 4.3% and 48 full-time equivalents were added during the eight months ended August 31, 2010, with 1,133 full-time equivalents, on average, through August 31, 2010. Total supplies expense for the eight months ended August 31, 2010, was \$20.5 million. Purchased services for the eight months ended August 31, 2010, totaled \$8.2 million.

The overall operating costs of \$159.5 million in 2009 show an increase of \$8.8 million, a 5.9% increase compared to 2008. Salaries and benefits made up most of this increase at \$9.2 million, an 11.4% increase compared to 2008. Wage increases averaged 4.2% and 51 full-time equivalents were added during 2009, with 1,085 full-time equivalents on average for the year. Total supplies expense also increased by \$1.1 million, up 3.9% when compared to 2008. Purchased services in 2009 decreased by \$2.1 million (14.7%) when compared to 2008. This was due to the expense related to the cancellation of the McKesson IT project in 2008.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Operating Results and Changes in the District's Net Assets (continued)

Net nonoperating revenues for 2010 were \$7.1 million, compared to \$3.9 million in 2009. The \$3.2 million increase relates to an increase in other income of \$2.7 million. It also includes \$1.4 million related to recording of the District's share of membership interest in First Choice Health Network, Inc.

Contacting the District's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the District's finance office at PO Box 2606, Lynnwood, Washington 98036.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
CONSOLIDATED BALANCE SHEET**

ASSETS

	DECEMBER 31,	
	<u>2010</u>	<u>2009</u>
CURRENT ASSETS		
Cash and cash equivalents	\$13,391,689	\$13,223,572
Short-term investments		2,935,296
Accounts receivable, net of estimated uncollectibles of \$0 in 2010 and \$13,948,000 in 2009		20,657,747
Transaction receivable	17,024,702	
Other receivables	71,751	2,067,207
Supplies inventory		2,274,511
Prepaid expenses and other	197,519	2,116,077
Estimated third-party payor settlements		350,000
Current portion of assets whose use is limited	<u>322,998</u>	<u>409,631</u>
Total current assets	<u>31,008,659</u>	<u>44,034,041</u>
LONG-TERM INVESTMENTS		<u>4,457,983</u>
ASSETS WHOSE USE IS LIMITED		
Bond agreement reserve		1,300,000
Temporary investment of tax revenue	83,333	212,160
Taxes and interest receivable	239,665	142,514
Temporarily restricted assets of the Stevens Foundation		<u>54,957</u>
	322,998	1,709,631
Less current portion	<u>(322,998)</u>	<u>(409,631)</u>
		<u>1,300,000</u>
CAPITAL ASSETS		
Nondepreciable capital assets	3,996,406	4,989,590
Depreciable capital assets, net of accumulated depreciation	<u>33,015,195</u>	<u>35,276,869</u>
CAPITAL ASSETS, net of accumulated depreciation	<u>37,011,601</u>	<u>40,266,459</u>
DEFERRED FINANCING COSTS, net of accumulated amortization	<u>99,254</u>	<u>210,489</u>
DEFERRED RENT	<u>1,252,933</u>	
OTHER ASSETS	<u>1,364,738</u>	<u>2,478,659</u>
Total assets	<u><u>\$70,737,185</u></u>	<u><u>\$92,747,631</u></u>

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
CONSOLIDATED BALANCE SHEET**

LIABILITIES AND NET ASSETS

	DECEMBER 31,	
	2010	2009
CURRENT LIABILITIES		
Current portion of long-term debt and obligations under capital leases	\$ 3,428,377	\$ 4,630,596
Notes payable		953,360
Accounts and warrants payable	847,580	10,121,190
Accrued salaries and benefits	1,031,237	8,695,861
Estimated third-party payor settlements	327,719	
Interest payable	4,331	49,772
Total current liabilities	5,639,244	24,450,779
LONG-TERM DEBT AND OBLIGATIONS UNDER CAPITAL LEASES, net of current portion	9,030,067	18,400,846
OTHER LONG-TERM LIABILITIES	4,041,974	7,767,873
Total liabilities	18,711,285	50,619,498
NET ASSETS		
Invested in capital assets, net of related debt	24,553,157	17,235,017
Restricted		
For debt service	322,998	1,654,674
Expendable for specific activities		54,957
Unrestricted	27,149,745	23,183,485
Total net assets	52,025,900	42,128,133
Total liabilities and net assets	\$70,737,185	\$92,747,631

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
CONSOLIDATED STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN NET ASSETS**

	YEAR ENDED DECEMBER 31,			
	2010			2009
	Hospital	Leasing Company	Total	Hospital / Total
OPERATING REVENUE				
Net patient service revenues (net of provision for bad debts of \$15,092,000 in 2010 and \$20,445,000 in 2009)	\$ 109,643,983		\$ 109,643,983	\$ 162,374,480
Lease revenue		\$ 3,461,994	3,461,994	
Other operating revenues	6,903,167		6,903,167	8,623,126
Total operating revenues	116,547,150	3,461,994	120,009,144	170,997,606
OPERATING EXPENSES				
Salaries and wages	52,796,883	5,283	52,802,166	71,812,479
Employee benefits	13,839,246	74,579	13,913,825	18,149,438
Supplies and other	43,672,724	512,461	44,185,185	63,168,781
Depreciation	4,311,496	2,096,551	6,408,047	6,325,249
Total operating expenses	114,620,349	2,688,874	117,309,223	159,455,947
Operating income	1,926,801	773,120	2,699,921	11,541,659
NONOPERATING REVENUES (EXPENSES)				
General obligation tax levy	1,450,001	749,846	2,199,847	2,162,849
Maintenance and operations tax levy	1,325,930	667,165	1,993,095	1,964,113
Investment income (loss)	712,928	(38,978)	673,950	696,789
General obligation interest expense and amortization	(62,411)	(26,306)	(88,717)	(144,884)
Other interest expense and amortization	(589,552)	(323,153)	(912,705)	(1,292,116)
Noncapital grants and contributions	62,554		62,554	42,730
Other income (expense)	3,220,388	(8,101)	3,212,287	464,953
Net nonoperating revenues	6,119,838	1,020,473	7,140,311	3,894,434
Excess of revenues over expenses before capital grants and contributions	8,046,639	1,793,593	9,840,232	15,436,093
CAPITAL GRANTS AND CONTRIBUTIONS	57,535		57,535	253,691
Increase in net assets	\$ 8,104,174	\$ 1,793,593	9,897,767	15,689,784
NET ASSETS, beginning of year			42,128,133	26,438,349
NET ASSETS, end of year			\$ 52,025,900	\$ 42,128,133

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
CONSOLIDATED STATEMENT OF CASH FLOWS**

Increase (Decrease) in Cash and Cash Equivalents

	YEAR ENDED	
	DECEMBER 31,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received for patient services and other operations	\$ 117,951,952	\$ 167,482,908
Cash paid to employees	(69,692,242)	(89,899,420)
Cash paid to suppliers for goods and services	(47,292,261)	(63,445,415)
Net cash from operating activities	<u>967,449</u>	<u>14,138,073</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash received from maintenance and operations tax levy for noncapital purposes	500,419	454,226
Noncapital grants and contributions	62,554	42,730
Principal payments on noncapital long-term debt	(40,000)	(36,000)
Interest paid on noncapital long-term debt	(1,469)	(1,840)
Proceeds from notes payable		1,304,551
Payments on notes payable	(953,360)	(1,436,190)
Cash transfer to Swedish Health Services	(206,876)	
Cash received from other noncapital financing activities	<u>1,614,186</u>	<u>275,080</u>
Net cash from noncapital financing activities	<u>975,454</u>	<u>602,557</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital grants and contributions	57,535	253,691
Principal payments on long-term debt and capital lease obligations	(9,708,738)	(13,769,757)
Interest paid on long-term debt and capital lease obligations	(987,967)	(1,529,538)
Cash received from maintenance and operations tax levy for capital	1,470,411	1,492,195
Cash received from general obligation tax levy for capital	2,136,679	2,110,557
Proceeds from sale of capital assets	39,497	29,315
Acquisition and construction of capital assets	(4,654,018)	(10,184,528)
Net cash from capital and related financing activities	<u>(11,646,601)</u>	<u>(21,598,065)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Sales (purchases) of investments, net	7,632,403	(1,719,369)
Sale of investments under bond agreement, net		7,466,666
Distributions from joint ventures	512,208	870,000
Contributions to joint ventures	(57,534)	(150,238)
Investment income	<u>906,349</u>	<u>1,037,249</u>
Net cash from investing activities	<u>8,993,426</u>	<u>7,504,308</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	(710,272)	646,873
CASH AND CASH EQUIVALENTS, beginning of year	<u>14,185,294</u>	<u>13,538,421</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 13,475,022</u>	<u>\$ 14,185,294</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENT OF NET ASSETS		
Cash and cash equivalents	\$ 13,391,689	\$ 13,223,572
Cash and cash equivalents in assets whose use is limited	<u>83,333</u>	<u>961,722</u>
	<u>\$ 13,475,022</u>	<u>\$ 14,185,294</u>

See accompanying notes.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
CONSOLIDATED STATEMENT OF CASH FLOWS (continued)**

Increase (Decrease) in Cash and Cash Equivalents

	YEAR ENDED	
	DECEMBER 31,	
	2010	2009
RECONCILIATION OF OPERATING LOSS TO NET CASH FROM		
OPERATING ACTIVITIES		
Operating income	\$ 2,699,921	\$ 11,541,659
Adjustments to reconcile operating income to net cash from operating activities		
Depreciation	6,408,047	6,325,249
Provision for bad debts	15,091,885	20,444,949
Equity in earnings of unconsolidated joint ventures	(1,918,027)	(838,574)
Loss on disposal of capital assets	12,181	151,407
Changes in assets and liabilities		
Accounts receivable, net	(14,577,319)	(23,181,104)
Other receivables	(90,698)	(62,016)
Supplies inventory	(37,761)	67,603
Prepaid expenses and other	1,038,218	(215,194)
Deferred rent	(1,252,933)	
Estimated third-party payor settlements, net	677,719	(29,360)
Accounts and warrants payable	(9,273,610)	60,393
Accounts payable	5,781,533	
Accrued salaries and benefits	(2,976,251)	62,497
Other long-term liabilities	(615,456)	(189,436)
Net cash from operating activities	<u>\$ 967,449</u>	<u>\$ 14,138,073</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH NONCAPITAL FINANCING ACTIVITIES		
Net noncash net assets transferred and assigned in exchange for transaction receivable from Swedish Health Services	<u>\$ 16,817,826</u>	

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 1 - Organization and Summary of Accounting Policies

Organization - Until September 1, 2010, Public Hospital District No. 2 of Snohomish County, Washington (the District), a Washington municipal corporation, owned and operated Stevens Hospital (the Hospital) located in Edmonds, Washington. The Hospital is an acute care community hospital with 156 set-up beds. The District also operated a retail pharmacy and two primary care clinics, which have 13 primary care physicians.

The Stevens Foundation (the Foundation) was organized and formally incorporated as a 501(c)(3) tax-exempt organization in September 2006. The mission of the Foundation is to provide philanthropic support for the Hospital on a continuing basis. The members of the Board of Trustees for the Foundation were nominated and elected, subject to confirmation by the Board of Commissioners (the Board) of the District. Management and staff of the Foundation were employees of the Hospital through August 31, 2010. As a controlled foundation, the financial statements are included with the District's through August 31, 2010. As of December 31, 2010 and 2009, the Foundation had net assets of \$0 and \$215,328, respectively.

On March 4, 2010, the District entered into an Agreement to Lease and Operate the Hospital (the Agreement) with Swedish Health Services (SHS), a nonprofit corporation that calls for a long-term lease of all the facilities and operations of the Hospital that were operated by the District. SHS renamed the Hospital Swedish/Edmonds. As part of this agreement, the District transferred and assigned certain assets and liabilities to Swedish/Edmonds on September 1, 2010, in exchange for cash considerations of \$17,024,702, which were paid on March 28, 2011. This includes transfer of control of the Foundation. The transferred and assigned assets and liabilities for both the Hospital and the Foundation were as follows at August 31, 2010:

ASSETS	
Cash	\$ 206,876
Accounts receivable, net of estimated uncollectibles	20,143,181
Other receivables	2,108,419
Supplies inventory	2,312,272
Prepaid expenses and other	880,340
Temporarily restricted assets of Stevens Foundation	99,889
Nondepreciable capital assets	14,671
Depreciable capital assets, net of accumulated depreciation	1,434,480
Other assets	<u>2,634,375</u>
Total assets	<u>29,834,503</u>
LIABILITIES	
Accounts payable	5,781,533
Accrued salaries and benefits	3,911,269
Other accrued expenses	777,104
Long-term debt and obligations under capital leases	770,452
Other long-term liabilities	<u>1,569,443</u>
Total liabilities	<u>12,809,801</u>
Net assets transferred and assigned	<u>\$ 17,024,702</u>

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 1 - Organization and Summary of Accounting Policies (continued)

In conjunction with the Agreement between the district and SHS, a Lease and Operating Agreement (the Lease) was executed between the District and Swedish/Edmonds, which was dated and effective September 1, 2010. This agreement represents a lease of the District's hospital facility, equipment, and health care delivery system. The leased assets are included in the consolidated balance sheet under the following headings and in the following amounts at December 31, 2010:

CAPITAL ASSETS	
Nondepreciable capital assets	\$ 1,574,076
Depreciable capital assets, net of accumulated depreciation	<u>33,015,195</u>
Total	<u><u>\$34,589,271</u></u>

The terms of the Lease specify an initial 30-year term, with two 10-year renewal options. Rental payments to be made by Swedish will be \$600,000 per month, with annual escalation of 3% per year on each anniversary date for the first 15 years. The rent is on an absolute net basis, with SHS being responsible for all operating costs associated with the facilities. The Lease calls for certain approvals by the District that affect the operation of the facility for the following: change in license, major service line changes, union contract representation, and maintenance of an independent medical staff. SHS has committed to an initial capital investment of \$90 million over the first 10 years of the lease, including the installation of the Epic electronic medical record system at the facility. An additional capital investment by SHS is committed each year based on 25% of the defined profitability of the facility. In addition, a potential commitment of a major expansion project of up to \$60 million will be undertaken, provided there is adequate return on investment and demand criteria are met, and the SHS Board of Trustees approves such a project. The District and SHS will form a strategic collaboration committee to provide oversight for the Lease and strategic planning activities for the facility (Note 5).

The County Treasurer acts as an agent to collect property taxes levied in the county for all taxing authorities. Taxes are levied annually on assessed values as established by the County Assessor. Tax collections are distributed monthly to the District by the County Treasurer. Property taxes are recorded as receivables and revenue when levied. Since state law allows for the sale of property for failure to pay taxes, no estimate of uncollectible taxes is made.

In September 1997, the voters of the District approved a maintenance and operations (M&O) tax levy upon the taxable property within the district; the M&O tax provided approximately \$1,993,000 of funding in 2010 and \$1,964,000 of funding in 2009. The levy is ongoing in future years. The M&O tax levy funds are reported in the accompanying consolidated statement of revenues, expenses, and changes in net assets as nonoperating revenues.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 1 - Organization and Summary of Accounting Policies (continued)

Basis of presentation - The consolidated financial statements reflect the operations of the District using enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

The District reports its financial information in a form that complies with the pronouncements of the Governmental Accounting Standards Board (GASB) and the Audit and Accounting Guide for Health Care Organizations of the American Institute of Certified Public Accountants.

Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the District has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Use of 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Key estimates include uncollectible and contractual allowances on patients accounts receivable, third-party cost report settlements, and self-insured liabilities.

Cash and cash equivalents - For purposes of the statements of cash flows, the District considers all highly liquid investments (excluding cash and short-term investments included in restricted assets) with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents totaled \$11,647,481 and \$11,075,356 as of December 31, 2010 and 2009, respectively.

Accounts receivable - Receivables arising from revenue for services to patients are reduced by an allowance for estimated uncollectible accounts based on past experience and other circumstances, which may affect the ability of patients to meet their obligations. Accounts deemed uncollectible are charged against this allowance.

Supplies inventory - Supplies inventory consists of pharmaceutical, medical-surgical, and other supplies used in the operation of the District. Inventory is stated at the lower of cost, determined on a first-in, first-out basis, or net realizable value.

Restricted assets - As described further in Note 6, certain funds are restricted by bond indentures related to the 1995 Revenue Bonds to be used solely for debt service. These funds are invested primarily in obligations of the U.S. government and certificates of deposit with financial institutions.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 1 - Organization and Summary of Accounting Policies (continued)

As also described further in Note 6, the District receives tax levy funds that are used solely for debt service associated with the general obligation bonds. Taxes and interest receivable and scheduled debt service payments temporarily invested prior to becoming due are recorded as restricted assets. All receipts and earnings generated on such investments are reported as nonoperating revenues and expenses.

Capital assets - Capital assets are stated at cost. Improvements and replacement of capital assets are capitalized. The District's capitalization threshold is \$1,000 per item and a useful life of at least two years. Maintenance and repairs are expensed. The cost of capital assets sold or retired and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recorded.

Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Assets under capital leases are amortized over the shorter of the lease term or useful life. Amortization attributable to assets acquired under capital leases is included with depreciation as shown on the consolidated statement of revenues, expenses, and changes in net assets. The following is a summary of asset lives used:

Buildings and building improvements	2 - 50 years
Equipment	2 - 50 years
Land improvements	2 - 25 years

Financing costs - The cost of obtaining debt is deferred and amortized on the straight-line method over the term of the related debt, which approximates the result of using the effective interest method.

Deferred rent - Deferred rent represents lease revenue on a straight-line basis in excess of lease payments received. Lease revenue is recorded evenly throughout the lease term. Differences between the actual lease payments owed during the year and the amount of lease payments recorded evenly throughout the lease term represent deferred rent income.

Self-insurance liabilities - The District accrues an estimate of losses and related expenses for its self-insured workers' compensation claims. The District maintains stop-loss insurance for workers' compensation claims in excess of specified amounts. This estimated liability is recorded in the accompanying consolidated balance sheet within accrued salaries and benefits. The amount is approximately \$1,780,000 as of December 31, 2010. As of December 31, 2009, the amount of \$2,601,000 included estimates for employee health and dental claims, as well as unemployment claims.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 1 - Organization and Summary of Accounting Policies (continued)

Estimated third-party payor settlements - Under a contractual agreement with Medicare, the Hospital is paid at an interim rate during the year for certain services and programs. The difference between interim payments and estimated final reimbursement for the cost report year results in a settlement receivable or payable, which may be adjusted in future periods as final settlements are determined.

The Medicare program's administrative procedures preclude final determination of settlement amounts until after the annual cost reports have been audited or otherwise reviewed and settled by Medicare. The District's cost reports have been audited by the Medicare fiscal intermediary through December 31, 2007. The estimated settlements amounts for the 2008, 2009, and 2010 cost reports are included in the accompanying consolidated financial statements.

Consolidated Statement of revenues, expenses, and changes in net assets - For purposes of presentation, transactions deemed by management to be ongoing, major, or central to the provision of District services, including income from its equity investments, are reported as operating revenues and expenses. All levy income, interest expense, investment income, and other peripheral or incidental transactions are reported as nonoperating revenues and expenses.

Contractual arrangements - A significant portion of the services of the District's Hospital operations was provided to patients under contractual arrangements with the following payors:

	2010	2009
Medicare	43%	42%
Medicaid	17%	15%
Regence	9%	10%
Other contractual payors	25%	27%
Total contractual payors	94%	94%
Self pay/uninsured	6%	6%
Total payors	100%	100%

Medicare - The Hospital is paid for services to Medicare inpatients under a prospective payment system, which provides for payments based on diagnosis-related groupings (DRGs). Such DRG payments are prospectively established and may be greater or less than the Hospital's actual charges for its services. The Hospital is also paid for outpatient services under a prospective payment system known as ambulatory payment classifications (APCs). As with DRGs, APC payments are prospectively established and may be greater or less than the Hospital's actual charges for its services.

The Hospital is paid under certain other Medicare programs based upon formulas (disproportionate share) or cost reports.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 1 - Organization and Summary of Accounting Policies (continued)

Medicaid - Prior to July 1, 2005, inpatient acute care services rendered to Medicaid program beneficiaries were paid on a prospective payment system.

In spring 2005, the Washington State Legislature and the Center for Medicare and Medicaid Services (CMS) approved a Medicaid Certified Public Expenditures (CPE) program for inpatient reimbursement. The CPE program uses public expenditures by certain public hospitals to earn federal matching funds. The program was designed to preserve a significant amount of federal match funding for the state of Washington and thereby retain current funding levels for hospitals. It replaced various intergovernmental transfer programs that were used to earn federal matching funds in prior years. This new CPE program was effective July 1, 2005.

The CPE program uses three payment mechanisms to reimburse hospitals for inpatient care: inpatient hospital claims payments, disproportionate share (DSH) payments, and state grants. Under the program, hospitals are paid at an estimate of the cost to provide services to Medicaid recipients or for uncompensated care. For each payment to a hospital in the program, only the federal matching portion of the payment is initially remitted to the hospital; the state portion is funded through certified public expenditures. Certified public expenditures are qualifying expenditures made by the hospital to serve Medicaid-eligible or uninsured patients.

The intent of the legislature is that hospitals in the program receive no less in combined federal and state payments than the hospital would have received under the methodology that was in place in the state's fiscal year 2005. In the event of a shortfall between CPE program component payments and this baseline amount, the difference would be paid to the hospitals with state grant funds. To the extent that state grant funds allocated at the start of the year are insufficient to meet the hold harmless provision of the program, additional legislative appropriations may be required.

Outpatient services are paid on a fee schedule or a percentage of allowed charges based on a ratio of the District's allowable operating expenses to total allowable revenue.

Commercial - The Hospital also has entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Charity care - The District provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. These amounts are not reported as revenue as the District does not pursue collection of amounts determined to qualify as charity care.

Income taxes - As a political subdivision of the state of Washington, the District is not subject to federal income tax, as its income is excluded from gross income for federal income tax purposes under Section 115 of the Internal Revenue Code.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 1 - Organization and Summary of Accounting Policies (continued)

Reclassifications - Certain reclassifications have been made to prior-year amounts to conform to the current-year presentation to more consistently present financial information between years.

Subsequent events - Subsequent events are events or transactions that occur after the consolidated balance sheet date but before consolidated financial statements are available to be issued. The District recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the consolidated balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The District's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the consolidated balance sheet but arose after the consolidated balance sheet date and before the consolidated financial statements are available to be issued.

The District has evaluated subsequent events through August 9, 2011, which is the date the financial statements are available to be issued.

Note 2 - Net Patient Service Revenues

The District has agreements with third-party payors that provide for payments to the District for its Hospital operations at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. The difference between payments based on contractual arrangements and the District's standard billing rates is recorded as a contractual adjustment to patient service charges. Net patient service revenue is reported at the net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Third-party settlements are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 2 - Net Patient Service Revenues (continued)

The components of net patient service revenues for the years ended December 31, 2010 and 2009, are as follows:

	<u>2010</u>	<u>2009</u>
Patient service charges		
Inpatient	\$167,709,192	\$223,805,064
Outpatient	<u>162,714,042</u>	<u>219,899,824</u>
Total patient service charges	<u>330,423,234</u>	<u>443,704,888</u>
Adjustments to patient service charges		
Contractual adjustments	(198,267,134)	(251,917,107)
Charity	(7,420,232)	(8,968,352)
Bad debts	<u>(15,091,885)</u>	<u>(20,444,949)</u>
Total adjustments to patient service charges	<u>(220,779,251)</u>	<u>(281,330,408)</u>
Net patient service revenues	<u>\$109,643,983</u>	<u>\$162,374,480</u>

Note 3 - Cash, Cash Equivalents, Investments, and Deposits

General - The composition of cash, cash equivalents, investments, and deposits at December 31, 2010 and 2009, is as follows:

Assets whose use is not restricted		
Cash in banks - interest-bearing	\$ 1,744,208	\$ 2,148,271
Short-term Treasury Investment Fund	65,418	384,005
Governmental Mutual Fund	11,382,226	8,234,025
Washington State Investment Pool	199,837	2,457,326
U.S. Treasury obligations		1,200,942
U.S. agency obligations		<u>6,192,282</u>
	<u>13,391,689</u>	<u>20,616,851</u>
Restricted investments		
Money market fund		54,951
Short-term Treasury Investment Fund	468	31,411
Governmental Mutual Fund	81,435	674,161
Washington State Investment Pool	1,430	201,199
U.S. Treasury obligations		98,357
U.S. agency obligations		<u>507,038</u>
	<u>83,333</u>	<u>1,567,117</u>
Total cash, cash equivalents, investments, and deposits	<u>\$13,475,022</u>	<u>\$22,183,968</u>

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 3 - Cash, Cash Equivalents, Investments, and Deposits (continued)

The District makes investments in accordance with Washington State law. Eligible investments include obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, certificates of deposit with approved institutions, eligible bankers' acceptances, and repurchase agreements (up to 30 days).

As a political subdivision of the state, deposits and investments are categorized to give an indication of the risk assumed at year-end. Category 1 includes deposits and investments that are insured, registered, or held in the District's name. Category 2 includes uninsured and unregistered investments that are held by a broker's or dealer's trust department or agent in the District's name. Category 3 includes uninsured and unregistered deposits and investments for which the securities are held by the broker or dealer, or its trust department or agent, but not in the District's name. At December 31, 2010 and 2009, all deposits and investments of the District are categorized as Category 1.

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The District's investment policy limits the types of securities to those authorized by statute; therefore, credit risk is very limited.

Deposits - All of the District's deposits are either insured or collateralized. The District's insured deposits are covered by the Federal Deposit Insurance Corporation. Collateral protection is provided by the Washington Public Deposit Protection Commission.

Custodial credit risk - Custodial credit risk is the risk that, in the event of a failure of the counterparty, the District will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The District is not exposed to custodial credit risk.

Concentration of credit risk - Concentration of credit risk is the risk of loss attributed to the magnitude of the District's investment in a single issuer. The District is not exposed to concentration of credit risk because all deposits and investments are insured or collateralized.

Interest rate risk - Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the fair value of an investment. The District is not exposed to interest rate risk because all deposits and investments are extremely liquid.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 4 - Capital Assets

Capital asset additions, retirements, and balances for the years ended December 31, 2010 and 2009, were as follows:

	Beginning Balance January 1, 2010	Additions	Retirements	Account Transfers	Ending Balance December 31, 2010
ASSETS AT COST					
NONDEPRECIABLE CAPITAL ASSETS					
Land	\$ 3,996,406				\$ 3,996,406
Construction in progress	993,184	\$ 1,751,749	\$ (14,671)	\$ (2,730,262)	
Total nondepreciable capital assets	<u>4,989,590</u>	<u>1,751,749</u>	<u>(14,671)</u>	<u>(2,730,262)</u>	<u>3,996,406</u>
DEPRECIABLE CAPITAL ASSETS					
Land improvements	2,285,382				2,285,382
Buildings and building improvements	37,965,187			1,522,734	39,487,921
Equipment	73,500,672	2,902,269	(28,532,339)	1,207,528	49,078,130
LESS ACCUMULATED DEPRECIATION					
Land improvements	1,639,146	91,841			1,730,987
Buildings and building improvements	22,788,737	1,517,628			24,306,365
Equipment	54,046,489	4,798,578	(27,046,181)		31,798,886
DEPRECIABLE CAPITAL ASSETS, net	<u>35,276,869</u>	<u>(3,505,778)</u>	<u>(1,486,158)</u>	<u>2,730,262</u>	<u>33,015,195</u>
CAPITAL ASSETS, net	<u>\$ 40,266,459</u>	<u>\$ (1,754,029)</u>	<u>\$ (1,500,829)</u>	<u>\$ -</u>	<u>\$ 37,011,601</u>
ASSETS AT COST					
NONDEPRECIABLE CAPITAL ASSETS					
Land	\$ 3,996,406				\$ 3,996,406
Construction in progress	478,737	\$ 6,260,363		\$ (5,745,916)	993,184
Total nondepreciable capital assets	<u>4,475,143</u>	<u>6,260,363</u>		<u>(5,745,916)</u>	<u>4,989,590</u>
DEPRECIABLE CAPITAL ASSETS					
Land improvements	2,227,812	72,928	\$ (15,358)		2,285,382
Buildings and building improvements	37,691,753	89,513	(506,310)	690,231	37,965,187
Equipment	73,297,162	3,761,624	(8,613,799)	5,055,685	73,500,672
LESS ACCUMULATED DEPRECIATION					
Land improvements	1,564,969	89,535	(15,358)		1,639,146
Buildings and building improvements	21,847,421	1,429,060	(487,744)		22,788,737
Equipment	57,691,478	4,806,654	(8,451,643)		54,046,489
DEPRECIABLE CAPITAL ASSETS, net	<u>32,112,859</u>	<u>(2,401,184)</u>	<u>(180,722)</u>	<u>5,745,916</u>	<u>35,276,869</u>
CAPITAL ASSETS, net	<u>\$ 36,588,002</u>	<u>\$ 3,859,179</u>	<u>\$ (180,722)</u>	<u>\$ -</u>	<u>\$ 40,266,459</u>

Included in equipment are assets under capital lease obligations as of December 31, 2010 and 2009, with a cost of \$0 and \$886,752, respectively, and accumulated depreciation thereon of \$0 and \$408,642, respectively, as these assets were transferred to SHS as part of the Lease.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 5 - Deferred Rent

As referenced in Note 1, the District entered into a Lease and Operating Agreement (the Lease) with SHS which was dated and effective September 1, 2010. The terms of the Lease specify an initial 30-year term, with two 10-year renewal options. Rental payments to be made by Swedish will be \$600,000 per month, with annual escalation of 3% per year on each anniversary date for the first 15 years. The rental payments will freeze at the rate set during year 15 for the duration of the lease. Rental payments to be received under this agreement are as follows:

	Rental Payments
2011	\$ 7,272,000
2012	7,490,160
2013	7,714,865
2014	7,946,311
2015	8,184,700
2016 - 2020	44,757,295
2021 - 2025	51,885,971
2026 - 2030	56,086,827
2031 - 2035	56,086,827
2035 - 2040	2,347,705
	\$249,772,661

Note 6 - Long-Term Debt and Obligations Under Capital Leases

The balances of the District's long-term debt and obligations under capital leases at December 31, 2010 and 2009, are set forth below:

	2010	2009
Unlimited tax general obligation bonds 2003 Refunding Series, 4.50%, due serially until 2011, net of unamortized premium of \$19,361 and \$73,168 in 2010 and 2009, respectively.	\$ 1,174,361	\$ 3,178,168
LTGO Bonds, 2005, paid in full during 2010.		209,196
LTGO Bonds, 1999, variable interest rate determined weekly by Bank of America, due serially until 2018 (interest rate of 0.54% at December 31, 2010).	9,000,000	10,000,000
Revenue bonds, 1995 Series, paid in full during 2010.		5,600,000
Master equipment sales agreement, with interest at 5.48% due monthly through 2013.	2,284,083	3,594,900
Capital lease obligations, assumed by SHS during 2010.		449,178
Total long-term debt and obligations under capital leases	12,458,444	23,031,442
Less current portion	(3,428,377)	(4,630,596)
Long-term debt and obligations under capital leases, net of current portion	\$ 9,030,067	\$18,400,846

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 6 - Long-Term Debt and Obligations Under Capital Leases (continued)

Long-term debt and capital lease obligations' activity summary for 2010 and 2009 is as follows:

	January 1, 2010	Additions	Reductions	December 31, 2010	Amounts Due Within One Year
LONG-TERM DEBT					
2003 UTGO Bond	\$ 3,178,168	\$ -	\$ (2,003,807)	\$ 1,174,361	\$ 1,155,000
2005 LTGO Bond	209,196		(209,196)		
1999 LTGO Bond	10,000,000		(1,000,000)	9,000,000	1,000,000
1995 Revenue Bond	5,600,000		(5,600,000)		
Master equipment sales agreement	3,594,900		(1,310,817)	2,284,083	1,273,377
Capital lease obligations	449,178		(449,178)		
Total long-term debt	<u>23,031,442</u>		<u>(10,572,998)</u>	<u>12,458,444</u>	<u>3,428,377</u>
OTHER LONG-TERM LIABILITIES	<u>7,767,873</u>		<u>(3,725,899)</u>	<u>4,041,974</u>	
	<u>\$30,799,315</u>	<u>\$ -</u>	<u>\$ (14,298,897)</u>	<u>\$ 16,500,418</u>	<u>\$ 3,428,377</u>
	January 1, 2009	Additions	Reductions	December 31, 2009	Amounts Due Within One Year
LONG-TERM DEBT					
2003 UTGO Bond	\$ 5,121,040		\$ (1,942,872)	\$ 3,178,168	\$ 1,950,000
2005 LTGO Bond	602,506		(393,310)	209,196	209,196
1999 LTGO Bond	10,900,000		(900,000)	10,000,000	1,000,000
1995 Revenue Bond	14,000,000		(8,400,000)	5,600,000	
Master equipment sales agreement	4,739,505		(1,144,605)	3,594,900	1,207,275
Capital lease obligations	1,562,020		(1,112,842)	449,178	264,125
Total long-term debt	<u>36,925,071</u>		<u>(13,893,629)</u>	<u>23,031,442</u>	<u>4,630,596</u>
OTHER LONG-TERM LIABILITIES	<u>7,326,761</u>	<u>\$ 441,112</u>		<u>7,767,873</u>	
	<u>\$44,251,832</u>	<u>\$ 441,112</u>	<u>\$ (13,893,629)</u>	<u>\$30,799,315</u>	<u>\$ 4,630,596</u>

Scheduled principal and interest repayments on long-term debt are as follows as of December 31, 2010:

	Long-Term Debt	
	Principal	Interest
2011	\$ 3,428,377	\$ 173,620
2012	2,114,248	49,633
2013	1,100,000	19,343
2014	1,100,000	16,263
2015	1,200,000	13,160
2016 - 2019	3,496,458	19,320
	12,439,083	\$ 291,339
Plus unamortized bond premium	19,361	
	<u>\$ 12,458,444</u>	

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 6 - Long-Term Debt and Obligations Under Capital Leases (continued)

The District levies taxes annually upon the taxable property within the District to service bond principal and interest payments on the unlimited tax general obligation (UTGO) bonds. Taxes to finance debt service on these UTGO bonds may be levied without limit on rate or amount.

On August 22, 2007, the District's Board adopted Resolution No. 2007-07, which authorized an executory conditional sales contract, in the form of a lease, to acquire certain software and related services for District purposes in a principal amount not to exceed \$6,000,000; appointed an escrow agent; and authorized the execution and delivery of an escrow agreement. On September 24, 2008, the District's Board adopted Resolution No. 2008-11, which authorized the use of the project funds of the conditional sales contract (lease) for general capital equipment purposes. As of December 31, 2010, the remaining balance for this obligation was \$2,284,083.

On November 15, 2006, the District's Board adopted Resolution No. 2006-08, which authorized the amendment of the trust indenture relating to the District's outstanding 1999 Limited Tax General Obligation (LTGO) Bonds (1999 LTGO Bonds). The amendment restructured the principal payments, allowing the District to reduce the principal amounts due in certain maturities and reamortize the principal payments throughout the term of the bonds.

On June 22, 2005, the District's Board adopted Resolution No. 2005-07, authorizing the issuance of a single limited tax general obligation bond of the District for a nonrevolving line of credit (2005 LTGO Bond) principal amount not to exceed \$1,800,000 par value, issued for the purpose of repaying, redeeming, and retiring the District's outstanding 2002 LTGO Bond and for carrying out the project plan adopted by the Board. The project plan was for the acquisition, construction, remodeling, renovating, equipping, and furnishing of capital improvements for the District's hospital facilities, including the acquisition of a computed tomography scanner, laser, portable C-Arm x-ray with vascular package, DEXA scanner, and surgical instruments.

On June 18, 2003, the District's Board adopted Resolution No. 2003-04, which authorized the issuance and sale of \$13,145,000 principal amount of unlimited tax general obligation refunding bonds, 2003 (2003 UTGO Bonds). These bonds were issued at a premium of \$1,083,640, with issuance costs of \$203,640. These costs are being amortized over the life of the bonds using the bonds' outstanding method. The proceeds from the 2003 UTGO Bonds were used to refund, on a current basis, the District's unlimited tax general obligation bonds, 1993 (1993 UTGO Bonds), maturing on December 1, 2004 through 2011, inclusive, outstanding in the aggregate principal amount of \$14,025,000. The 2003 UTGO Bonds mature annually beginning on December 1, 2004, and bear interest payable semiannually, commencing on June 1, 2004, and every December 1 and June 1 of each year thereafter, until their stated dates of maturity. This refunding was undertaken to provide debt service savings to the District. The difference between cash flows required to service the 1993 UTGO Bonds and the cash flows required to service the 2003 UTGO Bonds and to complete the refunding was approximately \$1,332,000, and the economic gain resulting from the transaction was approximately \$1,263,000.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 6 - Long-Term Debt and Obligations Under Capital Leases (continued)

In July 1999, the District issued the 1999 Limited Tax General Obligation Improvement and Refunding Variable Rate Demand Bonds (1999 LTGO Bonds) for \$14,100,000. A portion of the proceeds from the bonds was used to refund the remaining balance of the 1994 Series Revenue Bonds, which totaled approximately \$3,300,000, including interest payable. Net proceeds of approximately \$10,600,000 were used to fund the District's projects in 1999 and 2000. The District has designated its M&O tax levy, approved by the voters of the District in September 1997, to the payment of principal and interest on the 1999 LTGO Bonds. In conjunction with its 1999 LTGO Bonds issuance, the District entered into an irrevocable letter of credit with a bank in the amount of the outstanding principal and accrued interest balance of the debt. Scheduled principal and interest payments are drawn by the trustee on the letter of credit facility and automatically reimbursed to the letter of credit facility by the District under the terms of a separate reimbursement obligation agreement with the bank. The letter of credit expires in July 2011, unless otherwise extended or earlier terminated or replaced by the District. The 1999 LTGO Bonds are subject to mandatory redemption following notification of the termination of and failure to replace the letter of credit facility, or in the event of a default, as defined in the agreement. The letter of credit was extended in July 2011 until July 21, 2014.

In 1995, the District issued \$14,000,000 of revenue bonds (1995 Series Revenue Bonds) at 6.75%, due in 2015. Beginning in 2001, the District is required to deposit \$933,333 into a sinking fund annually until 2015. The bond agreement also requires the District to maintain a \$1,300,000 bond reserve until the bonds are repaid. These bonds were retired and refunded during 2010.

Note 7 - Professional Liability Insurance

Prior to September 1, 2010, The District maintained a claims-made professional liability insurance policy through a commercial carrier with a self-insured retention per claim. For all of 2007 through September 14, 2008, the self-insured retention per claim was \$250,000; as of September 15, 2008, the self-insured retention was \$100,000 per claim. Coverage for employed physician professional liability insurance was carried on a claims-made basis. The District accrued an actuarial estimate for incidents and claims within its self-insured retention portion and for unreported incidents. The District's estimate for claims incurred but not paid as of December 31, 2009, is included in accounts payable and other long-term liabilities in the accompanying consolidated balance sheets and is \$2,002,000. In October 2009, the District financed its professional liability insurance through notes payable to a bank. The notes include monthly payments at a rate of 3.90% per annum, with final payment in August 2010. The notes payable correspond with the policy period.

**PUBLIC HOSPITAL DISTRICT NO. 2,
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 7 - Professional Liability Insurance (continued)

Effective September 1, 2010, the District purchased a tail policy to cover all claims incurred prior to that date. Under this policy, there is a deductible amount of \$100,000 per claim. The policy was purchased to provide maximum coverage for the exposure to the deductible for all claims. At December 31, 2010, the District had estimated a liability for amounts to be paid under the deductible of this policy. This liability is included in the accompanying consolidated balance sheet at \$1,730,000.

Note 8 - Property Taxes

The County Treasurer acts as an agent to collect property taxes levied in the county for all taxing authorities. Taxes are levied annually on January 1 on property values listed as of the prior May 31. Assessed values are established by the County Assessor at 100% of fair market value. A revaluation of all property is required every four years.

Taxes are due in two equal installments on April 30 and October 31. Collections are distributed monthly to the District by the County Treasurer.

The District is permitted by law to levy up to \$0.75 per \$1,000 of assessed valuation for general District purposes. Washington State Constitution and Washington State Law, RCW 84.55.010, limit the rate. The District may also levy taxes at a lower rate. Further amounts of tax need to be authorized by the vote of the people.

For 2010 and 2009, the District's regular tax levy was \$0.09 and \$0.08 per \$1,000 on a total assessed valuation of \$23,127,534,712 and \$25,086,183,847, for a total regular levy of \$1,993,095 and \$1,964,113, respectively. There is a voter-approved tax levy for service of the UTGO bonds. For 2010 and 2009, the tax levy for bond service was \$0.10 and \$0.09 per \$1,000 on the total assessed valuation, for a total additional levy of \$2,199,847 and \$2,162,849, respectively.

Property taxes are recorded as receivables when levied. Because state law allows for sale of property for failure to pay taxes, no estimate of uncollectible taxes is made.

Note 9 - Retirement Plan

Prior to September 1, 2010, The District sponsored a 401(k) plan that was available to all employees. Employees were eligible to contribute at their hire date. For benefit-eligible hospital employees meeting certain requirements, the District provided a match of 150% to the first 4.5% contributed by the employee. The District's policy was to fund the matching contribution. The retirement matching contribution was approximately \$2,083,000 and \$2,589,000 in 2010 and 2009, respectively. Employee contributions were approximately \$3,270,000 and \$4,210,000 in 2010 and 2009, respectively.

**PUBLIC HOSPITAL DISTRICT NO. 2,
SNOHOMISH COUNTY, WASHINGTON
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 9 - Retirement Plan (continued)

Effective July 1, 2010, the District sponsored a 401(a) plan that is available to all benefit-eligible employees working over 20 hours per week. Employees are eligible to contribute at their hire date. The District contributes 3% of employee wages with an additional matching contribution of up to 3% contributed by the employee. The District's policy is to fully fund the contributions.

Note 10 - Joint Ventures and Strategic Alliances

Prior to September 1, 2010, the District was involved in joint ventures and strategic alliances as noted below. As part of the transaction with SHS described in Note 1, ownership interests in these joint ventures were transferred as of September 1, 2010.

Stevens Radia Imaging Center, LLC - Effective December 31, 2005, the District sold its 56% ownership in Edmonds Center for Diagnostic Imaging, LLC and formed a joint venture with Radia Technical Imaging, LLC, doing business as Stevens Radia Imaging Center, LLC (SRIC, LLC), of which the District owned a 50% interest. SRIC, LLC provides outpatient radiology services. The District's recorded investment in SRIC, LLC was \$0 and \$709,199 as of December 31, 2010 and 2009, respectively, and is included in other assets in the accompanying consolidated balance sheet.

PACLAB, LLC - Effective October 1, 2005, the District became a member in PACLAB, LLC, a regional reference laboratory. The District used excess laboratory capacity to perform outreach laboratory testing for which it received marginal test cost reimbursement monthly, and excess cash disbursements quarterly. The District's ownership interest was 0% and 6.3% (excluding certain contributed capital) at December 31, 2010 and 2009, respectively. The District's recorded investment in PACLAB, LLC was \$0 and \$360,823 as of December 31, 2010 and 2009, respectively, and is included in other assets in the accompanying consolidated balance sheet.

First Choice Health Network, Inc. - Similar to other public hospitals, the District was not a shareholder of First Choice Health Network, Inc. (FCHN), but had a contractual agreement with FCHN that provided for certain rights and obligations equivalent, but not identical, to those of Class B shareholders, including liquidation and dividend rights. The capital contributions of the nonshareholders were recorded as paid-in-capital from affiliates. These contractual agreements were considered to be common share equivalents. The District had acquired a membership interest in FCHN during the year, which went to \$0 as of December 31, 2010, as a result of the transaction SHS.

Swedish Cancer Institute at Stevens - The District and SHS, through an Alliance Agreement, formed Swedish Cancer Institute at Stevens (SCIS). Expenses and net revenue were shared equally. The District received \$212,622 and \$317,189 in 2010 and 2009, respectively, for space and equipment that SCIS rented from the District. Net income distributed under the Alliance Agreement to the district was \$1,602,218 in 2010 and \$395,545 in 2009. The alliance income is included in other operating revenues in the accompanying consolidated statements of revenues, expenses, and changes in net assets in 2010 and 2009. At December 31, 2010 and 2009, the District had a net payable to SCIS of \$0 and \$875,490, respectively.

**PUBLIC HOSPITAL DISTRICT NO. 2,
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Note 11 - Concentrations of Credit Risk

The District grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. There were no patient accounts receivable as of December 31, 2010. The composition of patient accounts receivable at December 31, 2009, was as follows:

	<u>2009</u>
Medicare	27%
Medicaid	11%
Other third-party payors and patients	62%

Note 12 - Commitments and Contingencies

Litigation and compliance with laws and regulations - The District is involved in litigation arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the District's future financial position or results from operations.

The hospital industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government hospital program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government agencies are actively conducting investigations concerning possible violations of fraud and abuse statutes and regulations by hospital providers. Violations of these laws and regulations could result in expulsion from government hospital programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the District is in compliance with the fraud and abuse regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.