

**PUBLIC HOSPITAL DISTRICT NO. 2,  
SNOHOMISH COUNTY, WASHINGTON  
(dba STEVENS HOSPITAL)**

**INDEPENDENT AUDITOR'S REPORT  
AND CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2009 AND 2008**

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## INDEPENDENT AUDITOR'S REPORT

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, 2009, and the related consolidated statements of revenues, expenses, and changes in net assets, and cash flows for the year 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 audit. The consolidated financial statements for the year ended December 31, 2008, were audited by other auditor's whose report dated May 13, 2009, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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, 2009, and the results of its operations and its cash flows for the year 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 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  
April 21, 2010

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

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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, 2009 and 2008. 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 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.

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

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**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>2009</u>	<u>2008</u>	<u>2007</u>
Assets			
Current assets	\$ 44,034	\$ 41,552	\$ 35,339
Capital assets, net	40,266	36,588	38,305
Other noncurrent assets	<u>8,448</u>	<u>13,156</u>	<u>18,513</u>
Total assets	<u>\$ 92,748</u>	<u>\$ 91,296</u>	<u>\$ 92,157</u>
Liabilities			
Current liabilities	\$ 24,451	\$ 33,091	\$ 26,304
Long-term debt outstanding, net	18,401	23,716	36,621
Other long-term liabilities	<u>7,768</u>	<u>8,051</u>	<u>7,829</u>
Total liabilities	<u>50,620</u>	<u>64,858</u>	<u>70,754</u>
Net assets			
Invested in capital assets, net of related debt	17,235	99	(3,731)
Restricted			
For debt service	1,655	9,010	8,109
Expendable for specific activities	55	122	450
Unrestricted	<u>23,183</u>	<u>17,207</u>	<u>16,575</u>
Total net assets	<u>42,128</u>	<u>26,438</u>	<u>21,403</u>
Total liabilities and net assets	<u>\$ 92,748</u>	<u>\$ 91,296</u>	<u>\$ 92,157</u>

**Current Assets**

Total current assets of \$44.0 million at year-end 2009 reflect an increase of \$2.5 million (6.0%), compared to the balance of \$41.6 million at the end of 2008. 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 and a \$2.7 million increase in net accounts receivable. Net days of revenue in accounts receivable decreased to 43 days by the end of 2009, compared to 44 days at the end of 2008. Cash and short-term investments increased by \$6.7 million (70.7%) in 2009, compared to a decrease of \$0.8 million (9.3%) in 2008. Days of operating cash on hand increased from 41 at year-end 2008 to 49 by the end of 2009.

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

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**Balance Sheet (continued)**

**Capital Assets**

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

The District's net capital assets decreased \$1.7 million (4.5%) in 2008, compared to a net increase of \$3.4 million (9.6%) in 2007. The decrease in 2008 was due to a write-off to expense of \$1.5 million for abandonment of the McKesson computer system project that had begun in 2007, accumulated depreciation increase of \$5.7 million, and an increase in capital additions of \$5.5 million, which included the major additions listed below:

- Telemetry Monitoring System and Upgrade
- Refurbishment of 16 bed unit on 2nd Floor east as a extension of the PCU
- Leasehold improvements for relocation of the Wound Healing Institute
- Hyperbaric oxygen chambers as a new wound healing service
- Digital Mammography System and Biopsy System for the Women's Breast Imaging Center
- Software and Hardware for Emergency Department Electronic Medical Record
- New Birthing beds for Mother Baby Unit
- GE Centricity Electronic Medical Record Software for SCIM and SWC

**Other Noncurrent Assets**

Other noncurrent assets decreased by \$4.7 million (35.8%). \$2.3 million of this decrease was related to the use of funds from the escrowed capital project fund established as part of the Bank of America conditional sales agreement established in 2007. Long-term investments were also reduced by \$2.3 million, as funds were withdrawn to pay the redemption of \$7.5 million of the 1995 Revenue Bonds.

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

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**Balance Sheet (continued)**

**Current Liabilities**

Current liabilities decreased \$8.6 million (26.1%). This decrease relates to the District's decision for early redemption in June 2010 of \$7.8 million of the 1995 Revenue Bonds to be funded by the 1995 Revenue Bond Sinking Fund.

**Other Long-Term Liabilities**

Other noncurrent liabilities includes the long-term portion of the reserve for professional liability of \$1.7 million, the long-term portion of the reserve for workers' compensation of \$1.0 million, and deferred revenue of \$1.4 million related to the sale of an option to purchase the Stevens Pavilion.

**Long-Term Debt**

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. This decrease relates to the District's decision to redeem early \$8.4 million of the 1995 Revenue Bonds from funds set aside in the 1995 Revenue Bond Sinking Fund. Total principal payments in 2009 were \$13.9 million, including \$1.1 million of capital lease principal payments. At year-end 2008, the District had \$23.7 million in long-term debt and obligations under capital leases, net of current portion, which was a \$12.9 million (35.2%) decrease over 2007. During 2007, the District issued a \$6.0 million conditional sales agreement to acquire software and implementation services related to the new clinical, patient management, and financial information system project. In September 2008, the District canceled the IT project that was to be funded by the conditional sales agreement and the Commission authorized the District to use the funds for purchase of other necessary District equipment.

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

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**Operating Results and Changes in the District's Net Assets**

In 2009, the District's net assets increased \$15.7 million (59.3%), compared to an increase of \$5.0 million (23.5%) in 2008.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating revenues			
Net patient service revenues	\$ 162,374	\$ 143,473	\$ 132,464
Other operating revenues	<u>8,623</u>	<u>8,467</u>	<u>8,887</u>
Total operating revenues	<u>170,997</u>	<u>151,940</u>	<u>141,351</u>
Operating expenses			
Salaries and benefits	89,962	80,731	74,463
Supplies and other	63,169	64,184	62,506
Depreciation and amortization	<u>6,325</u>	<u>5,695</u>	<u>5,821</u>
Total operating expenses	<u>159,456</u>	<u>150,610</u>	<u>142,790</u>
Operating gain (loss)	<u>11,541</u>	<u>1,330</u>	<u>(1,439)</u>
Nonoperating revenues (expenses)			
Tax levies	4,127	3,930	3,914
Other investment income	697	1,213	1,157
Interest expense and amortization	(1,437)	(1,953)	(1,941)
Noncapital grants and contributions	43	18	304
Other income	<u>465</u>	<u>464</u>	<u>447</u>
Net nonoperating revenues	<u>3,895</u>	<u>3,672</u>	<u>3,881</u>
Excess of revenues over expenses before capital grants and contributions	15,436	5,002	2,442
Capital grants and contributions	<u>254</u>	<u>33</u>	<u>148</u>
Increase in net assets	15,690	5,035	2,590
Net assets, beginning of year	<u>26,438</u>	<u>21,403</u>	<u>18,813</u>
Net assets, end of year	<u>\$ 42,128</u>	<u>\$ 26,438</u>	<u>\$ 21,403</u>

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

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

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. The District generated \$143.5 million of net patient service revenue in 2008, an increase of \$11.0 million (8.3%) over 2007 due to rate increases from governmental and managed care payers, general price increases and increased acuity of patients. Admissions decreased slightly, by 26 (0.3%), and overall patient days of 32,983 decreased by 286 days compared to 2007 patient days of 33,269. The District had 41,853 emergency room visits in 2008 compared to 41,760 in 2007. Surgery volume decreased 8.3% overall in 2008 with an 8.1% increase in inpatient surgery cases and a 16.9% decrease in outpatient surgery cases compared to 2007.

Other operating revenues of \$8.6 million increased by 1.8% between 2008 and 2009. The Cancer Center alliance with Swedish Health Services generated \$0.4 million in revenue in 2009, a decrease of \$0.2 million from 2008. This decrease relates primarily to the true up of 2008 cost share. Gross revenue and volumes rose slightly, but were offset by a decrease of 2% reimbursement rate for these revenues. The District has a 6.3% ownership in Pac Lab, LLC, an outreach laboratory service. In both 2009 and 2008, the District recorded distributions of \$2.9 million from Pac Lab, LLC. The District owns 50% interest in Stevens Radia Imaging Center, LLC. Distributions from this investment were \$0.9 million and \$0.7 million in 2009 and 2008 respectively. The District generated \$8.4 million of other operating revenues in 2008 compared to \$8.9 million in 2007, a 6% decrease.

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.

The overall operating costs of \$150.6 million in 2008 show an increase of \$7.8 million, a 5.5% increase compared to 2007. Salaries and benefits made up most of this increase at \$6.3 million, an 8.4% increase compared to 2007. Wage increases averaged 4.1% and 43 full-time equivalents were added during 2008, with 1,033 full-time equivalents on average for the year. During 2008, \$2.0 million was expensed to purchase services relating to the cancellation of the McKesson IT project that was started in 2007. In addition, a reduction and restructuring of management occurred in the first quarter of 2008 that resulted in the elimination of approximately 15 positions, and one-time severance charges of approximately \$765,000.

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

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

Net nonoperating revenues increased \$223,000 in 2009 compared to 2008. This increase relates to a decrease in other interest expense and amortization of \$462,000. Other investment income also decreased by \$516,000, while tax levy revenues increased by \$197,000 in 2009.

Net nonoperating revenues decreased \$209,000 in 2008 compared to 2007. This decrease relates to decrease in noncapital grants and contributions of \$286,000 in 2008. Included in tax levies under nonoperating revenues are receipts restricted to fund the principal and interest payments on the 2003 General Obligation Bonds. The net activity totaled \$1.8 million in 2008 and \$1.8 million in 2007, which is restricted for principal payments on these bonds.

**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 Stevens Hospital, 21727 76th Ave W. Ste H, Edmonds, Washington 98026.

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

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**ASSETS**

	DECEMBER 31,	
	2009	2008
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 13,223,572	\$ 7,735,894
Short-term investments	2,935,296	1,732,025
Accounts receivable, net of estimated uncollectibles of \$13,948,000 in 2009 and \$8,820,000 in 2008	20,657,747	17,921,592
Other receivables	2,067,207	2,010,593
Supplies inventory	2,274,511	2,342,114
Prepaid expenses and other	2,116,077	1,900,883
Estimated third-party payor settlements	350,000	320,640
Current portion of assets whose use is limited	409,631	7,587,844
Total current assets	<u>44,034,041</u>	<u>41,551,585</u>
<b>LONG-TERM INVESTMENTS</b>	<u>4,457,983</u>	<u>6,786,742</u>
<b>ASSETS WHOSE USE IS LIMITED</b>		
Bond agreement reserve	1,300,000	1,300,000
Bond agreement sinking fund		7,466,666
Escrow capital project fund		2,304,872
Temporary investment of tax revenue	212,160	49,193
Taxes and interest receivable	142,514	194,465
Temporarily restricted assets of the Stevens Foundation	54,957	122,123
Less current portion	1,709,631 (409,631)	11,437,319 (7,587,844)
	<u>1,300,000</u>	<u>3,849,475</u>
<b>CAPITAL ASSETS</b>		
Nondepreciable capital assets	4,989,590	4,475,143
Depreciable capital assets, net of accumulated depreciation	35,276,869	32,112,759
<b>CAPITAL ASSETS, net of accumulated depreciation</b>	<u>40,266,459</u>	<u>36,587,902</u>
<b>OTHER ASSETS</b>	<u>2,478,659</u>	<u>2,263,876</u>
<b>DEFERRED FINANCING COSTS, net of accumulated     amortization</b>	<u>210,489</u>	<u>256,494</u>
Total assets	<u>\$ 92,747,631</u>	<u>\$ 91,296,074</u>

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

**LIABILITIES AND NET ASSETS**

	DECEMBER 31,	
	2009	2008
<b>CURRENT LIABILITIES</b>		
Current portion of long-term debt and obligations under capital leases	\$ 4,630,596	\$ 13,209,488
Notes payable	953,360	1,084,999
Warrants payable	1,699,720	915,408
Accounts payable	8,421,470	9,145,389
Accrued salaries and benefits	8,695,861	8,633,364
Interest payable	49,772	102,283
Total current liabilities	24,450,779	33,090,931
 <b>LONG-TERM DEBT AND OBLIGATIONS UNDER CAPITAL LEASES, net of current portion</b>		
	18,400,846	23,715,583
 <b>OTHER LONG-TERM LIABILITIES</b>		
	7,767,873	8,051,211
Total liabilities	50,619,498	64,857,725
 <b>NET ASSETS</b>		
Invested in capital assets, net of related debt	17,235,017	98,831
Restricted		
For debt service	1,654,674	9,010,324
Expendable for specific activities	54,957	122,123
Unrestricted	23,183,485	17,207,071
Total net assets	42,128,133	26,438,349
Total liabilities and net assets	\$ 92,747,631	\$ 91,296,074

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

	YEAR ENDED DECEMBER 31,	
	2009	2008
<b>OPERATING REVENUE</b>		
Net patient service revenues (net of provision for bad debts of \$20,445,000 in 2009 and \$13,467,000 in 2008)	\$ 162,374,480	\$ 143,472,957
Other operating revenues	8,623,126	8,466,863
Total operating revenues	<u>170,997,606</u>	<u>151,939,820</u>
<b>OPERATING EXPENSES</b>		
Salaries and wages	71,812,479	65,360,304
Employee benefits	18,149,438	15,370,290
Supplies and other	63,168,781	64,184,249
Depreciation	6,325,249	5,695,093
Total operating expenses	<u>159,455,947</u>	<u>150,609,936</u>
Operating income	<u>11,541,659</u>	<u>1,329,884</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
General obligation tax levy	2,162,849	2,016,729
Maintenance and operations tax levy	1,964,113	1,912,989
Other investment income	696,789	1,213,019
General obligation interest expense and amortization	(144,884)	(198,602)
Other interest expense and amortization	(1,292,116)	(1,753,807)
Noncapital grants and contributions	42,730	17,911
Other income	464,953	463,495
Net nonoperating revenues	<u>3,894,434</u>	<u>3,671,734</u>
Excess of revenues over expenses before capital grants and contributions	15,436,093	5,001,618
<b>CAPITAL GRANTS AND CONTRIBUTIONS</b>	<u>253,691</u>	<u>33,478</u>
Increase in net assets	15,689,784	5,035,096
NET ASSETS, beginning of year	<u>26,438,349</u>	<u>21,403,253</u>
NET ASSETS, end of year	<u><u>\$ 42,128,133</u></u>	<u><u>\$ 26,438,349</u></u>

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

Increase (Decrease) in Cash and Cash Equivalents

	YEAR ENDED	
	DECEMBER 31,	
	<u>2009</u>	<u>2008</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received for patient services and other operations	\$167,482,908	\$152,799,846
Cash paid to employees	(89,899,420)	(79,562,904)
Cash paid to suppliers for goods and services	<u>(63,445,415)</u>	<u>(63,065,319)</u>
Net cash from operating activities	<u>14,138,073</u>	<u>10,171,623</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Cash received from maintenance and operations tax levy for noncapital purposes	454,226	308,929
Noncapital grants and contributions	42,730	17,911
Principal payments on noncapital long-term debt	(36,000)	(36,000)
Interest paid on noncapital long-term debt	(1,840)	(10,037)
Proceeds from notes payable	1,304,551	1,483,752
Payments on notes payable	(1,436,190)	(1,592,094)
Cash received from other noncapital financing activities	<u>275,080</u>	<u>273,622</u>
Net cash from noncapital financing activities	<u>602,557</u>	<u>446,083</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Capital grants and contributions	253,691	33,478
Principal payments on long-term debt and capital lease obligations	(13,769,757)	(5,895,696)
Interest paid on long-term debt and capital lease obligations	(1,529,538)	(2,017,184)
Cash received from maintenance and operations tax levy for capital	1,492,195	1,601,473
Cash received from general obligation tax levy for capital	2,110,557	1,993,310
Proceeds from sale of capital assets	29,315	45,035
Acquisition and construction of capital assets	<u>(10,184,528)</u>	<u>(5,279,450)</u>
Net cash from capital and related financing activities	<u>(21,598,065)</u>	<u>(9,519,034)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of investments, net	(1,719,369)	(1,168,305)
(Purchase) sale of investments under bond agreement, net	7,466,666	(933,333)
Distributions from joint ventures	870,000	708,477
Contributions to joint ventures	(150,238)	
Investment income	<u>1,037,249</u>	<u>805,087</u>
Net cash from investing activities	<u>7,504,308</u>	<u>(588,074)</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	646,873	510,598
CASH AND CASH EQUIVALENTS, beginning of year	<u>13,538,421</u>	<u>13,027,823</u>
CASH AND CASH EQUIVALENTS, end of year	<u><u>\$ 14,185,294</u></u>	<u><u>\$ 13,538,421</u></u>
<b>RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENT OF NET ASSETS</b>		
Cash and cash equivalents	13,223,572	7,735,894
Cash and cash equivalents in assets whose use is limited	<u>961,722</u>	<u>5,802,527</u>
	<u><u>\$ 14,185,294</u></u>	<u><u>\$ 13,538,421</u></u>
<b>NONCASH FINANCING AND INVESTING ACTIVITIES</b>		
Capital lease acquisitions		<u><u>\$ 468,789</u></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,	
	2009	2008
RECONCILIATION OF OPERATING LOSS TO NET CASH FROM OPERATING ACTIVITIES		
Operating income	\$ 11,541,659	\$ 1,329,884
Adjustments to reconcile operating income to net cash from operating activities		
Depreciation	6,325,249	5,695,093
Provision for bad debts	20,444,949	13,467,309
Equity in earnings of unconsolidated joint ventures	(838,574)	(658,334)
Loss on disposal of capital assets	151,407	1,469,568
Changes in assets and liabilities		
Accounts receivable, net	(23,181,104)	(12,418,531)
Other receivables	(62,016)	1,015,301
Supplies inventory	67,603	(57,486)
Prepaid expenses and other	(215,194)	(317,119)
Estimated third-party payor settlements, net	(29,360)	(172,767)
Warrants payable	784,312	(353,447)
Accounts payable	(723,919)	113,243
Accrued salaries and benefits	62,497	1,276,398
Other long-term liabilities	(189,436)	(217,489)
Net cash from operating activities	<u>\$ 14,138,073</u>	<u>\$ 10,171,623</u>

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

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**Note 1 - Organization and Summary of Accounting Policies**

**Organization** - Public Hospital District No. 2 of Snohomish County, Washington (dba Stevens Hospital) (the District) is a Washington municipal corporation operating Stevens Hospital (the Hospital) located in Edmonds, Washington. The Hospital is an acute care community hospital with 156 set up beds. The District includes 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 are nominated and elected, subject to confirmation by the Board of Commissioners (the Board) of the District. Management and staff of the Foundation are employees of the Hospital. As a controlled foundation, the financial statements are included with the District's. As of December 31, 2009 and 2008, the Foundation had net assets of \$215,328 and \$384,369, respectively.

The percentages of the District's total labor force covered under collective bargaining agreements were 77% at December 31, 2009 and 2008. A new collective bargaining agreement was reached during 2008, which extends the agreement to June 30, 2011.

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 \$1,964,000 of funding in 2009 and \$1,913,000 of funding in 2008. 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.

The District provides management services on a cost basis for a physician group that practices adjacent to the Hospital.

**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.

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

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

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 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 \$11,075,356 and \$5,470,164 as of December 31, 2009 and 2008, 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 5, 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.

As also described further in Note 5, 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.

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

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

A special trust fund known as the Public Hospital District No. 2, Snohomish County, Washington /Banc of America Public Capital Corporation Acquisition Fund was established in October 2007 for the purpose of paying the cost of acquiring certain software and related services for District purposes in a principal amount not to exceed \$6,000,000. These funds are temporarily invested in obligations of the U.S. government until disbursed. As of December 31, 2008, the balance in this fund was \$2,304,872. These funds were fully spent as of December 31, 2009.

**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
Fixed equipment	2 - 50 years
Land improvements	2 - 25 years
Major and minor movable equipment	2 - 20 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.

**Self-insurance liabilities** - The District accrues an estimate of losses and related expenses for its self-insured workers' compensation claims, employee health and dental claims, and unemployment claims. The District maintains stop-loss insurance for workers' compensation and employee health claims in excess of specified amounts. These estimated liabilities are recorded in the accompanying consolidated balance sheet within accrued salaries and benefits. The sum of these estimates totals approximately \$2,601,000 and \$2,327,000 as of December 31, 2009 and 2008, respectively.

**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.

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

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

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, 2006. The estimated settlements amounts for the 2008 and 2009 cost reports are included in the accompanying consolidated financial statements.

**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 Hospital 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 Hospital is provided to patients under contractual arrangements with the following payors:

	<u>2009</u>	<u>2008</u>
Medicare	42%	43%
Medicaid	15%	14%
Regence	10%	10%
Other contractual payors	<u>27%</u>	<u>27%</u>
Total contractual payors	94%	94%
Self pay/uninsured	<u>6%</u>	<u>6%</u>
Total payors	<u><u>100%</u></u>	<u><u>100%</u></u>

**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.

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

**PUBLIC HOSPITAL DISTRICT NO. 2,  
SNOHOMISH COUNTY, WASHINGTON**

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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

In the spring of 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.

**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.

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

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

**Subsequent events** - Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are available to be issued. The District recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The District's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before the financial statements are available to be issued. Note 14 provides disclosure of certain subsequent events that did not result in recognition in the financial statements.

The Company has evaluated subsequent events through April 21, 2010, 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 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.

The components of net patient service revenues for the years ended December 31, 2009 and 2008, are as follows:

	<u>2009</u>	<u>2008</u>
Patient service charges		
Inpatient	\$ 223,805,064	\$ 186,033,784
Outpatient	219,899,824	168,806,040
Total patient service charges	<u>443,704,888</u>	<u>354,839,824</u>
Adjustments to patient service charges		
Contractual adjustments	(251,917,107)	(191,264,490)
Charity	(8,968,352)	(6,635,068)
Bad debts	<u>(20,444,949)</u>	<u>(13,467,309)</u>
Total adjustments to patient service charges	<u>(281,330,408)</u>	<u>(211,366,867)</u>
Net patient service revenues	<u>\$ 162,374,480</u>	<u>\$ 143,472,957</u>

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

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

**General** - The composition of cash, cash equivalents, investments, and deposits at December 31, 2009 and 2008, is as follows:

	<u>2009</u>	<u>2008</u>
Assets whose use is not restricted		
Cash in banks - interest-bearing	\$ 2,148,271	\$ 2,265,730
Short-term Treasury Investment Fund	384,005	1,268,549
Governmental Mutual Fund	8,234,025	2,478,967
Washington State Investment Pool	2,457,326	1,722,648
Certificates of deposit		913,552
U.S. Treasury obligations	1,200,942	2,117,930
U.S. agency obligations	6,192,282	5,487,285
	<u>20,616,851</u>	<u>16,254,661</u>
Restricted investments		
Money Market Fund	54,951	2,304,872
Short-term Treasury Investment Fund	31,411	811,040
Governmental Mutual Fund	674,161	1,585,250
Washington State Investment Pool	201,199	1,101,365
Certificates of deposit		577,976
U.S. Treasury obligations	98,357	1,354,086
U.S. agency obligations	507,038	3,508,265
	<u>1,567,117</u>	<u>11,242,854</u>
Total cash, cash equivalents, investments, and deposits	<u>\$ 22,183,968</u>	<u>\$ 27,497,515</u>

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

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

All deposits and investments of the District are made in accordance with Washington State law. Limitations as they relate to interest risk, credit risk, and custodial credit risk are indicated in the schedules below:

Maturity	Authorized Investment Types		
	Maximum Percentage of Portfolio	Maximum Length of Maturity	Maximum Investment in One Issuer
U.S. Treasury bonds, certificates, and bills (and obligations secured by the U.S. Treasury)	100%	10 years	None
Other obligations of the United States of America or its agencies, for example: FNMAs, FHLMCs, GNMAs, FHLMC, or FNMA discount notes	50%	10 years	None
Bank notes, bonds, or debentures of savings and loan associations, banks, mutual savings banks, and savings and loan service corporation operating with the approval of the Federal Home Loan Bank	25%	5 years	10%
Time certificates of deposit (with Public Deposit Protection Commission approved institutions)	25%	2 years	10%
Eligible bankers' acceptances	25%	180 days	10%
Commercial paper	25%	180 days	10%
Repurchase agreements	50%	90 days	None
Reverse repurchase agreements	25%	90 days	None
Washington State Investment Pool	50%	1 day	None

**Interest rate risk** - Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The District manages its exposure to interest rate risk by purchasing a combination of shorter-term and longer-term investments. The District policy regarding portfolio balance maturities is as follows:

Portfolio balance percentage	
Maturing in under 180 days	20
Maturing in 181 days to 5 years	75
Maturing in under 10 years	100

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

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

**Segmented time distribution** - Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations is provided by the following schedule that shows the distribution of the District's investments by maturity as of December 31, 2009:

	<u>Fair Value</u>	<u>Twelve Months or Less</u>	<u>One to Three Years</u>	<u>Three to Five Years</u>	<u>Five to Ten Years</u>	<u>Greater than Ten Years</u>
Assets whose use is not restricted						
Cash in banks - interest bearing	\$ 2,148,271	\$ 2,148,271	\$ -		\$ -	
Short-term Treasury Investment Fund	384,005	384,005				
Governmental Mutual Fund Washington State	8,234,025	8,234,025				
Investment Pool	2,457,326	2,457,326				
U.S. Treasury obligations	1,200,942	1,200,942				
U.S. agency obligations	<u>6,192,282</u>	<u>1,734,299</u>		<u>\$ 41,637</u>		<u>\$4,416,346</u>
	<u>20,616,851</u>	<u>16,158,868</u>		<u>41,637</u>		<u>4,416,346</u>
Restricted investments						
Money Market Fund	54,951	54,951				
Short-term Treasury Investment Fund	31,411	31,411				
Governmental Mutual Fund Washington State	674,161	674,161				
Investment Pool	201,199	201,199				
U.S. Treasury obligations	98,357	98,357				
U.S. agency obligations	<u>507,038</u>	<u>142,031</u>		<u>3,410</u>		<u>361,597</u>
	<u>1,567,117</u>	<u>1,202,110</u>		<u>3,410</u>		<u>361,597</u>
Total cash, cash equivalents, investments, and deposits	<u>\$ 22,183,968</u>	<u>\$ 17,360,978</u>	<u>\$ -</u>	<u>\$ 45,047</u>	<u>\$ -</u>	<u>\$4,777,943</u>

**Credit risk** - Credit risk is the risk that an issuer or counterparty to an investment will not fulfill its obligation to the holder of the investment. The District's investment policy limits the types of securities available for investment to obligations secured by the U.S. Treasury, other obligations of the United States of America or its agencies, certificates of deposit with approved institutions, eligible bankers' acceptances and notes, repurchase agreements, commercial paper rated A-1/P-1, and the Washington State Investment Pool (operated in a manner consistent with the Securities and Exchange Commission's Rule 2a-7 of the Investment Company Act of 1940). The District currently does not have any bankers' acceptances, commercial paper, or repurchase agreements.

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

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

**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 deposits or investments that are in the possession of an outside party. All Foundation deposits up to \$250,000 are covered by Federal Deposit Insurance Corporation (FDIC) and all District deposits are fully covered by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission, and all investments are insured, registered, or held by the District's agent in the District's name. The District's investment policy does not contain policy requirements that would limit the exposure to custodial risk for investments.

**Note 4 - Capital Assets**

Capital asset additions, retirements, and balances for the years ended December 31, 2009 and 2008, were as follows:

	Beginning Balance January 1, 2009	Additions	Retirements	Account Transfers	Ending Balance December 31, 2009
<b>ASSETS AT COST</b>					
<b>NONDEPRECIABLE CAPITAL ASSETS</b>					
Land	\$ 3,996,406				\$ 3,996,406
Construction in progress	478,737	\$ 6,260,363		\$ (5,745,916)	993,184
Total nondepreciable capital assets	4,475,143	6,260,363		(5,745,916)	4,989,590
<b>DEPRECIABLE CAPITAL ASSETS</b>					
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
Fixed equipment	27,688,947	271,725	(2,507,776)	383,951	25,836,847
Major and minor moveable equipment	45,608,115	3,489,999	(6,106,023)	4,671,734	47,663,825
<b>LESS ACCUMULATED DEPRECIATION</b>					
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
Fixed equipment	22,831,300	596,477	(2,500,014)		20,927,763
Major and minor moveable equipment	34,860,178	4,210,177	(5,951,629)		33,118,726
<b>DEPRECIABLE CAPITAL ASSETS, net</b>	<u>32,112,759</u>	<u>(2,401,084)</u>	<u>(180,722)</u>	<u>5,745,916</u>	<u>35,276,869</u>
<b>CAPITAL ASSETS, net</b>	<u>\$ 36,587,902</u>	<u>\$ 3,859,279</u>	<u>\$ (180,722)</u>	<u>\$ -</u>	<u>\$ 40,266,459</u>

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

**Note 4 - Capital Assets (continued)**

	Beginning Balance January 1, 2008	Additions	Retirements	Account Transfers	Ending Balance December 31, 2008
<b>ASSETS AT COST</b>					
<b>NONDEPRECIABLE</b>					
<b>CAPITAL ASSETS</b>					
Land	\$ 3,996,406				\$ 3,996,406
Construction in progress	4,436,315	\$ 3,142,715	\$ (1,491,986)	\$ (5,608,307)	478,737
Total nondepreciable capital assets	<u>8,432,721</u>	<u>3,142,715</u>	<u>(1,491,986)</u>	<u>(5,608,307)</u>	<u>4,475,143</u>
<b>DEPRECIABLE</b>					
<b>CAPITAL ASSETS</b>					
Land improvements	2,227,812				2,227,812
Buildings and building improvements	36,169,914	97,981		1,423,858	37,691,753
Fixed equipment	27,280,636	149,611	(292,668)	551,368	27,688,947
Major and minor moveable equipment	41,924,811	2,101,878	(2,051,655)	3,633,081	45,608,115
<b>LESS ACCUMULATED DEPRECIATION</b>					
Land improvements	1,477,389	87,580			1,564,969
Buildings and building improvements	20,208,349	1,639,072			21,847,421
Fixed equipment	22,508,399	615,569	(292,668)		22,831,300
Major and minor moveable equipment	<u>33,536,359</u>	<u>3,352,872</u>	<u>(2,029,053)</u>		<u>34,860,178</u>
<b>DEPRECIABLE CAPITAL ASSETS, net</b>	<u>29,872,677</u>	<u>(3,345,623)</u>	<u>(22,602)</u>	<u>5,608,307</u>	<u>32,112,759</u>
<b>CAPITAL ASSETS, net</b>	<u>\$ 38,305,398</u>	<u>\$ (202,908)</u>	<u>\$ (1,514,588)</u>	<u>\$ -</u>	<u>\$ 36,587,902</u>

Included in major and minor movable equipment are assets under capital lease obligations as of December 31, 2009 and 2008, with a cost of \$886,752 and \$4,419,509, respectively, and accumulated depreciation thereon of \$408,642 and \$2,770,852, respectively.

As of December 31, 2007, construction in progress included \$1,492,000 in software expenditures for a new patient care financial billing system under an agreement with McKesson Corporation. Due to a change in strategy and plans, the District elected to abandon this project and negotiated a settlement with the vendor effective September 25, 2008, to cancel the remaining commitments under the agreement. The above amounts of \$1,492,000 incurred in 2007 and additional amounts of \$570,000 incurred in 2008, for a total of \$2,062,000, were written off and recognized as other expense in 2008.

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

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**Note 5 - 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, 2009 and 2008, are set forth below:

	<u>2009</u>	<u>2008</u>
Unlimited tax general obligation bonds 2003 Refunding Series, 4.50%, due serially until 2011 (net of unamortized premium of \$73,168 and \$161,040 in 2009 and 2008, respectively).	\$ 3,178,168	\$ 5,121,040
LTGO Bonds, 2005, interest is based on a LIBOR fixed rate that is reset monthly, due monthly through July 1, 2010 (interest rate of 1.09% at December 31, 2009).	209,196	602,506
LTGO Bonds, 1999, variable interest rate determined weekly by Bank of America, due serially until 2018 (interest rate of 0.28% at December 31, 2009).	10,000,000	10,900,000
Revenue bonds, 1995 Series, 6.75%, due in 2015.	5,600,000	14,000,000
Master equipment sales agreement, with interest at 5.48%, due monthly through 2013.	3,594,900	4,739,505
Capital lease obligations with interest at 5.30% to 8.25%, due monthly through 2012.	<u>449,178</u>	<u>1,562,020</u>
Total long-term debt and obligations under capital leases	23,031,442	36,925,071
Less current portion	<u>(4,630,596)</u>	<u>(13,209,488)</u>
Long-term debt and obligations under capital leases, net of current portion	<u>\$ 18,400,846</u>	<u>\$ 23,715,583</u>

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

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**Note 5 - Long-Term Debt and Obligations Under Capital Leases (continued)**

Long-term debt and capital lease obligations' activity summary for 2009 and 2008 is as follows:

	January 1, 2009	Additions	Reductions	December 2009	Amounts Due Within One Year
<b>LONG-TERM DEBT</b>					
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	<u>1,562,020</u>		<u>(1,112,842)</u>	<u>449,178</u>	<u>264,125</u>
Total long-term debt	<u>36,925,071</u>		<u>(13,893,629)</u>	<u>23,031,442</u>	<u>4,630,596</u>
<b>OTHER LONG-TERM LIABILITIES</b>	<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>
	January 1, 2008	Additions	Reductions	December 2008	Amounts Due Within One Year
<b>LONG-TERM DEBT</b>					
2003 UTGO Bond	\$ 7,016,493		\$ (1,895,453)	\$ 5,121,040	\$ 1,855,000
2005 LTGO Bond	976,140		(373,634)	602,506	390,385
1999 LTGO Bond	11,800,000		(900,000)	10,900,000	900,000
1995 Revenue Bond	14,000,000			14,000,000	7,800,000
Master equipment sales agreement	5,824,693		(1,085,188)	4,739,505	1,144,605
Capital lease obligations	<u>2,891,105</u>	<u>\$ 468,789</u>	<u>(1,797,874)</u>	<u>1,562,020</u>	<u>1,119,498</u>
Total long-term debt	<u>42,508,431</u>	<u>468,789</u>	<u>(6,052,149)</u>	<u>36,925,071</u>	<u>13,209,488</u>
<b>OTHER LONG-TERM LIABILITIES</b>	<u>7,829,096</u>		<u>(502,335)</u>	<u>7,326,761</u>	
	<u>\$ 50,337,527</u>	<u>\$ 468,789</u>	<u>\$ (6,554,484)</u>	<u>\$ 44,251,832</u>	<u>\$ 13,209,488</u>

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**Note 5 - Long-Term Debt and Obligations Under Capital Leases (continued)**

Scheduled principal and interest repayments on long-term debt and payments on capital lease obligations are as follows as of December 31, 2009:

	Long-Term Debt		Capital Lease Obligations	
	Principal	Interest	Principal	Interest
2010	\$ 4,366,471	\$ 708,972	\$ 264,125	\$ 14,177
2011	3,428,377	551,620	174,692	5,858
2012	2,114,248	427,633	10,361	515
2013	1,100,000	397,343		
2014	1,100,000	394,263		
2015 - 2018	10,400,000	378,980		
	22,509,096	\$ 2,858,811	\$ 449,178	\$ 20,550
Plus unamortized bond premium	73,168			
	<u>\$ 22,582,264</u>			

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, 2009, the remaining balance for this obligation was \$3,594,900.

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.

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**Note 5 - Long-Term Debt and Obligations Under Capital Leases (continued)**

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 of 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.

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.

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.

A loan covenant associated with the 1995 Series Revenue Bonds requires that net income available for debt service (as defined in the loan agreements) must be equal to or greater than 125% of annual debt service. In management's opinion, as of December 31, 2009, the District is in compliance with this and other covenant provisions.

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**Note 6 - Professional Liability Insurance**

The District maintains 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 is currently \$100,000 per claim. Coverage for employed physician professional liability insurance is carried on a claims-made basis. The District accrues 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 and 2008, is included in accounts payable and other long-term liabilities in the accompanying consolidated balance sheets, and is approximately \$2,002,000 and \$1,827,000, respectively.

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.

**Note 7 - 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 percent 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 2009 and 2008, the District's regular tax levy was \$0.08 per \$1,000 on a total assessed valuation of \$25,086,183,847 and \$24,666,507,978, for a total regular levy of \$1,964,113 and \$1,912,989, respectively. There is a voter-approved tax levy for service of the UTGO bonds. For 2009 and 2008, the tax levy for bond service was \$0.09 and \$0.08 per \$1,000 on the total assessed valuation, for a total additional levy of \$2,162,849 and \$2,016,729, 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.

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

**Note 8 - Retirement Plan**

The District sponsors a 401(k) plan that is available to all employees. Employees are eligible to contribute at their hire date. For benefit-eligible hospital employees meeting certain requirements, the District provides a match of 150% to the first 4.5% contributed by the employee. The District's policy is to fund the matching contribution currently. The retirement matching contribution was approximately \$2,589,000 and \$2,456,000 in 2009 and 2008, respectively. Employee contributions were approximately \$4,210,000 and \$4,053,000 in 2009 and 2008, respectively.

**Note 9 - Joint Ventures**

**Stevens Radia Imaging Center, LLC and PacLab, 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 owns a 50% interest. SRIC, LLC provides outpatient radiology services. The District's recorded investment in SRIC, LLC was \$1,307,637 and \$709,199 as of December 31, 2009 and 2008, respectively, and is included in other assets in the accompanying consolidated balance sheet.

Effective October 1, 2005, the District became a member in PacLab, LLC, a regional reference laboratory. The District uses excess laboratory capacity to perform outreach laboratory testing for which it receives marginal test cost reimbursement monthly, and excess cash disbursements quarterly. The District's ownership interest was 6.3% (excluding certain contributed capital) at December 31, 2009 and 2008. The District's recorded investment in PacLab, LLC was \$360,823 and \$343,011 as of December 31, 2009 and 2008, respectively, and is included in other assets in the accompanying consolidated balance sheet.

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**Note 9 - Joint Ventures (continued)**

The following represents summary financial information of SRIC, LLC and PacLab, LLC as of and for the year ended December 31, 2009:

	Stevens Radia Imaging Center, LLC (Unaudited)	<u>PacLab, LLC</u>
Current assets	\$ 1,563,412	\$ 2,036,804
Noncurrent assets, net	<u>3,355,705</u>	<u>4,909,376</u>
	<u>\$ 4,919,117</u>	<u>\$ 6,946,180</u>
Current liabilities	\$ 628,443	\$ 468,434
Equity	<u>4,290,674</u>	<u>6,477,746</u>
	<u>\$ 4,919,117</u>	<u>\$ 6,946,180</u>
Revenue	\$ 4,897,744	\$ 88,290
Expenses	<u>3,649,551</u>	<u>1,810,031</u>
Net income (loss)	<u>\$ 1,248,193</u>	<u>\$ (1,721,741)</u>

**Note 10 - Transactions with Swedish Health Services**

The District and Swedish Health Services (SHS), through an Alliance Agreement, formed Swedish Cancer Institute at Stevens (SCIS). Expenses and net revenue are shared equally. The District received \$317,189 and \$299,025 in 2009 and 2008, respectively, for space and equipment that SCIS rents from the District. Net income distributed under the Alliance Agreement to the District was \$395,545 in 2009 and \$620,253 (this includes a \$298,777 net loss true up for 2007) in 2008. The alliance income is included in other operating revenues in the accompanying consolidated statements of revenues, expenses, and changes in net assets in 2009 and 2008. At December 31, 2009 and 2008, the District had a net payable to SCIS of \$875,490 and \$481,881, respectively. The payable amount for 2008 includes \$96,391 true up of prior years' equipment rent.

Starting July 2008, the District entered into a separate agreement with SHS to manage the District's outpatient mammography service. Total amount paid under the agreement for the years ended December 31, 2009 and 2008, was \$145,411 and \$72,706, respectively.

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**Note 11 - Concentrations of Credit Risk**

The District grants credit without collateral to its patients, most of which are local residents and are insured under third-party payor agreements. The composition of patient accounts receivable at December 31, 2009 and 2008, was as follows:

	2009	2008
Medicare	27%	30%
Medicaid	11%	11%
Other third-party payors and patients	62%	59%

**Note 12 - Disclosure About Fair Value of Financial Instruments**

The estimated fair value of financial instruments is reflected in the accompanying consolidated balance sheet. The carrying amount of cash and cash equivalents, accounts receivable, warrants payable, accounts payable, accrued expenses, and estimated third-party payor settlements approximates fair value of these instruments. Fair values of investments and restricted assets are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

The fair value of long-term debt, estimated based on the quoted market prices for similar issues, was \$23,179,096 and \$36,936,318 at December 31, 2009 and 2008, respectively. The carrying value was \$23,031,442 and \$36,925,071 at December 31, 2009 and 2008, respectively.

**Note 13 - Commitments and Contingencies**

**Operating leases** - The District leases certain facilities and equipment under operating lease arrangements. Rent expense totaled approximately \$2,749,105 and \$3,099,272 in 2009 and 2008, respectively. The following is a schedule by year of future minimum lease payments that have remaining noncancelable terms in excess of one year as of December 31, 2009:

2010	\$ 3,046,000
2011	3,269,000
2012	2,848,000
2013	2,593,000
2014	2,624,000
2015 - 2018	6,647,000
	\$ 21,027,000

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**Note 13 - Commitments and Contingencies (continued)**

**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.

**Note 14 - Subsequent Event**

As of March 4, 2010, and as approved by the Board of Commissioners on February 24, 2010, the District entered into an "Agreement to Lease and Operate Hospital" with Swedish Health Services that calls for a long-term lease of all the facilities and operations of the Hospital that are currently operated by the District. This agreement requires the completion of due diligence by Swedish, and the approval by the Washington State Department of Health for Swedish to operate the Hospital. It is anticipated that the transfer date to Swedish could occur in the early fall of 2010, at the start of a month. The actual 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 Swedish 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. Swedish has committed 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. Additional capital investment by Swedish 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 Swedish board approves such a project. The District and Swedish will form a strategic collaboration committee to provide oversight for this lease and strategic planning activities for the facility.

**PUBLIC HOSPITAL DISTRICT NO. 2,  
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**Note 14 - Subsequent Event (continued)**

The District, after the lease begins, will continue to operate and focus its activities and direction on healthcare needs of the District's residents. The District will not operate hospitals but will concentrate on providing health promotion, awareness, and other activities; the specific activities will be determined after the District completes a strategic planning process.