



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

Basic Consolidated Financial Statements

December 31, 2008 and 2007

(With Independent Auditors' Report Thereon)

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

Management's Discussion and Analysis

December 31, 2008 and 2007

The following discussion and analysis for Public Hospital District No. 2 of Snohomish County, Washington, dba Stevens Hospital (the District), provides an overview of the District's financial activities for the years ended December 31, 2008 and 2007. 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 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 as to sources and uses of cash and the change in cash balances during the reporting periods.

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Balance Sheets

The District's net assets are the difference between its assets and liabilities as reported in the balance sheets.

Table 1: Assets, Liabilities, and Net Assets

(In thousands)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Assets:			
Current assets	\$ 41,852	35,339	37,293
Capital assets, net	36,588	38,305	34,936
Other noncurrent assets	13,156	18,513	13,563
Total assets	<u>\$ 91,596</u>	<u>92,157</u>	<u>85,792</u>
Liabilities:			
Current liabilities	\$ 34,115	26,304	25,565
Long-term debt outstanding, net	23,716	36,621	34,979
Other long-term liabilities	7,327	7,829	6,435
Total liabilities	<u>\$ 65,158</u>	<u>70,754</u>	<u>66,979</u>
Net assets:			
Invested in capital assets, net of related debt	\$ 99	(3,731)	(3,173)
Restricted:			
For debt service	9,010	8,109	7,203
Expendable for specific activities	122	450	242
Unrestricted	17,207	16,575	14,541
Total net assets	<u>\$ 26,438</u>	<u>21,403</u>	<u>18,813</u>

Current Assets

Total current assets of \$41.8 million at year end 2008 reflect a increase of \$6.5 million (18.4%) compared to the balance of \$35.3 million at the end of 2007. This change relates to \$7.5 million of the 1995 Revenue Bonds Sinking Fund that will be used June 1, 2009, towards the redemption of \$7.8 million of the 1995 Revenue Bonds, and a \$1.0 million reduction in net accounts receivable. Net days of revenue in accounts receivable decreased to 44 days by the end of 2008 compared to 52 days at the end of 2007. Other receivables also decreased \$1.0 million (34%) as a result of payments received during 2008 for other receivables. Cash and short-term investments increased by \$0.8 million (9.3%) in 2008 compared to a decrease of \$1.8 million (16.8%) in 2007.

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Capital Assets

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 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
- Digit 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

During 2007, the District purchased equipment and completed minor capital projects, which combined to increase the capital asset balance by \$9.5 million. Major additions are listed below:

- ICU and PCU Patient Monitoring System
- Pharmacy IV room Upgrade
- ICU/PCU Bed replacements
- Radiology Special Procedures Room upgrade
- Laboratory Analyzer
- Breast MRI
- CO2 Surgical Laser
- Bone Density Scanner
- Significant facility refurbishment projects
- Software and Hardware for the McKesson clinical, patient management, and financial system project

After considering depreciation expense of \$5.8 million, the District showed a net capital asset increase of \$3.4 million for 2007.

Other Noncurrent Assets

Other noncurrent assets decreased by \$5.4 million. This decrease is related to the change in current portion of restricted assets of \$7.5 million as a result of the District's decision to redeem a portion of the 1995 Revenue Bonds June 1, 2009 prior to the stated maturity date of December 1, 2015 and a decrease of \$1.9 million relates 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.

Offsetting this decrease, was an increase in long-term investments of \$3.6 million related to improved operating results in 2008 and an increase of \$0.9 million related to funding of bond sinking fund reserves.

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Current Liabilities

Current liabilities increased \$7.8 million. This increase relates to the District's decision for early redemption 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 \$1.6 million related to the sale of an option to purchase the Stevens Pavilion.

Long-Term Debt

At year-end 2008, the District had \$23.7 million in long-term debt and obligations under capital leases, net of current portion, which is a \$12.9 million or (35.2%) decrease over 2007. This decrease relates to the District's decision to redeem early \$7.8 million of the 1995 Revenue Bonds from funds set aside in the 1995 Revenue Bond Sinking Fund. Total principal payments in 2008 were \$5.9 million, including \$1.8 million of capital lease principal payments. At year-end 2007, the District had \$36.6 million in long-term debt and obligations under capital leases, net of current portion, which was a \$1.6 million (4.7%) increase over 2006. 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.

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Operating Results and Changes in the District's Net Assets

In 2008, the District's net assets increased \$5.0 million or (23.5%) compared to an increase of \$2.6 million or (13.8%) in 2007.

Table 2: Operating Results and Changes in Net Assets

(In thousands)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Operating revenues:			
Net patient service revenues	\$ 143,473	132,464	125,717
Other operating revenues	8,467	8,887	8,015
Total operating revenues	<u>151,940</u>	<u>141,351</u>	<u>133,732</u>
Operating expenses:			
Salaries and benefits	80,731	74,463	69,320
Supplies and other	64,184	62,506	60,105
Depreciation and amortization	5,695	5,821	5,997
Total operating expenses	<u>150,610</u>	<u>142,790</u>	<u>135,422</u>
Operating gain (loss)	<u>1,330</u>	<u>(1,439)</u>	<u>(1,690)</u>
Nonoperating revenues (expenses):			
Tax levies	3,930	3,914	3,921
Other investment income	1,213	1,157	723
Interest expense and amortization	(1,953)	(1,941)	(2,108)
Noncapital grants and contributions	18	304	335
Other income	464	447	450
Net nonoperating revenues	<u>3,672</u>	<u>3,881</u>	<u>3,321</u>
Excess of revenues over expenses before capital grants and contributions	5,002	2,442	1,631
Capital grants and contributions	<u>33</u>	<u>148</u>	<u>61</u>
Increase in net assets	5,035	2,590	1,692
Net assets at beginning of year	<u>21,403</u>	<u>18,813</u>	<u>17,121</u>
Net assets at end of year	<u>\$ 26,438</u>	<u>21,403</u>	<u>18,813</u>

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The District generated \$143.5 million of net patient service revenue in 2008, an increase of \$11.0 million or 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 or 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. The District generated \$132.5 million of net patient service revenue in 2007, an increase of \$6.7 million or 5.4% over 2006. In 2007, Admissions increased 1% and overall patient days of 33,269 increased 4% due to an overall 4% increase in the average length of stay. The District had 41,760 emergency room visits in 2007 compared to 42,747 in 2006. Surgery volume increased 7% overall in 2007 with an 11% increase in outpatient surgery cases compared to 2006.

Other operating revenues of \$8.5 million decreased by 4.7% between 2007 and 2008. The Cancer Center alliance with Swedish Health Services generated \$0.6 million in revenue in 2008, a decrease of \$1.2 million from 2007. Approximately \$0.3 million of this decrease relates to true up of 2007 cost share and remainder of decrease relates to decrease in volumes of 2.4% and a 2% decrease in reimbursement rate for these revenues. The District has a 6.6% ownership in Pac Lab, LLC, an outreach lab service. In 2008, the District recorded distributions of \$2.0 million from Pac Lab, LLC, an increase of \$0.2 million over 2007. The District generated \$8.9 million of other operating revenues in 2007 compared to \$8.0 million in 2006, an 10.9% increase.

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 purchased 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.

The overall operating costs of \$142.8 million in 2007 reflected an increase of \$7.4 million, a 5.4% increase compared to 2006. The largest increase was in salaries and benefits, which increased \$5.1 million or 7.4% in 2007. The District had added 87 full time equivalent employees during 2007, with 990 full time equivalents on average for the year. In addition, the District implemented wage increases averaging 4% during 2007. The District incurred legal and settlement fees of \$2.9 million in 2007 related to the CytoLab lawsuit filed in 2006. The case was settled in late 2007. Supplies and other expenses increased \$2.4 million, or 4% over 2006. The overall operating costs of \$135.4 million in 2006 reflected a decrease of \$4.6 million or 3.3% compared to 2005. The largest decrease was in salaries and benefits, which decreased \$3.1 million or 4.3% in 2006. This decrease is related to the reduction in force that management implemented in May 2006 of 48 full time equivalent employees.

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.

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Net nonoperating revenues increased \$560,000 in 2007 compared to 2006. Other investment income increased \$434,000 in 2007. 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 2007 and \$1.7 million in 2006, which is restricted for principal payments on these bonds.



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Independent Auditors' Report

The Board of Commissioners
Public Hospital District No. 2
of Snohomish County, Washington:

We have audited the accompanying consolidated balance sheets of Public Hospital District No. 2 of Snohomish County, Washington (dba Stevens Hospital) (the District) as of December 31, 2008 and 2007, and the related consolidated statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the District as of December 31, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 1 through 7 is not a required part of the basic consolidated financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit this information and express no opinion on it.

KPMG LLP

May 13, 2009

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Consolidated Balance Sheets
December 31, 2008 and 2007

Assets	2008	2007
Current assets:		
Cash and cash equivalents	\$ 7,735,894	5,743,122
Short-term investments	1,732,025	2,915,617
Accounts receivable, less allowance for collection losses of \$8,820,000 and \$6,983,000 in 2008 and 2007, respectively	17,921,592	18,970,370
Other receivables	2,010,593	3,038,204
Supplies inventory, at cost	2,342,114	2,284,628
Prepaid expenses and other	2,521,523	2,204,404
Current portion of restricted assets	7,587,844	182,501
Total current assets	41,851,585	35,338,846
Long-term investments	6,786,742	3,173,746
Restricted assets:		
Bond agreement reserve	1,300,000	1,300,000
Bond agreement sinking fund	7,466,666	6,533,333
Escrow capital project fund	2,304,872	4,242,321
Temporary investment of tax revenue	49,193	109,761
Taxes and interest receivable	194,465	165,904
Temporarily restricted assets of Foundation	122,123	449,692
Total restricted assets	11,437,319	12,801,011
Less current portion of restricted assets	(7,587,844)	(182,501)
	3,849,475	12,618,510
Capital assets, net of accumulated depreciation	36,587,902	38,305,398
Other assets	2,263,876	2,435,917
Deferred financing costs, net of accumulated amortization	256,494	284,455
Total assets	\$ 91,596,074	92,156,872

See accompanying notes to consolidated financial statements.

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Consolidated Balance Sheets

December 31, 2008 and 2007

Liabilities and Net Assets	2008	2007
	<u> </u>	<u> </u>
Current liabilities:		
Current portion of long-term debt and obligations under capital leases	\$ 13,209,488	5,887,586
Notes payable	1,084,999	1,193,341
Warrants payable	915,408	1,268,855
Accounts payable	10,054,094	10,171,891
Accrued salaries and benefits	8,449,109	7,172,711
Interest payable	102,283	136,527
Estimated third-party payor settlements, net	300,000	472,767
Total current liabilities	<u>34,115,381</u>	<u>26,303,678</u>
Long-term debt and obligations under capital leases, net of current portion:		
To be repaid from taxation	3,266,040	5,241,493
To be repaid from operations	20,449,543	31,379,352
	<u>23,715,583</u>	<u>36,620,845</u>
Other long-term liabilities	7,326,761	7,829,096
Total liabilities	<u>65,157,725</u>	<u>70,753,619</u>
Commitments and contingencies (note 12)		
Net assets:		
Invested in capital assets, net of related debt	98,831	(3,731,033)
Restricted:		
For debt service	9,010,324	8,108,998
Expendable for specific activities	122,123	449,692
Unrestricted	17,207,071	16,575,596
Total net assets	<u>26,438,349</u>	<u>21,403,253</u>
Total liabilities and net assets	<u>\$ 91,596,074</u>	<u>92,156,872</u>

See accompanying notes to consolidated financial statements.

**PUBLIC HOSPITAL DISTRICT NO. 2
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Consolidated Statements of Revenues, Expenses, and Changes in Net Assets
Years ended December 31, 2008 and 2007

	2008	2007
Operating revenues:		
Net patient service revenues (net of provision for bad debts of \$13,467,309 and \$11,932,274 in 2008 and 2007, respectively)	\$ 143,472,957	132,463,784
Other operating revenues	8,466,863	8,887,475
Total operating revenues	151,939,820	141,351,259
Operating expenses:		
Salaries and wages	65,360,304	60,174,386
Employee benefits	15,370,290	14,288,192
Supplies and other	64,184,249	62,506,597
Depreciation	5,695,093	5,821,341
Total operating expenses	150,609,936	142,790,516
Operating gain (loss)	1,329,884	(1,439,257)
Nonoperating revenues (expenses):		
General obligation (GO) tax levy	2,016,729	2,045,730
Maintenance and operations (M&O) tax levy	1,912,989	1,868,718
Other investment income	1,213,019	1,156,551
General obligation (GO) interest expense and amortization	(198,602)	(250,184)
Other interest expense and amortization	(1,753,807)	(1,691,079)
Noncapital grants and contributions	17,911	303,771
Other income	463,495	447,661
Net nonoperating revenues	3,671,734	3,881,168
Excess of revenues over expenses before capital grants and contributions	5,001,618	2,441,911
Capital grants and contributions	33,478	147,998
Increase in net assets	5,035,096	2,589,909
Net assets, beginning of the year	21,403,253	18,813,344
Net assets, end of the year	\$ 26,438,349	21,403,253

See accompanying notes to consolidated financial statements.

**PUBLIC HOSPITAL DISTRICT NO. 2
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Consolidated Statements of Cash Flows

Years ended December 31, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Cash received for patient services and other operations	\$ 152,799,846	140,357,207
Cash paid to employees	(79,562,904)	(74,268,811)
Cash paid to suppliers for goods and services	(63,065,319)	(62,546,452)
Net cash provided by operating activities	10,171,623	3,541,944
Cash flows from noncapital financing activities:		
Cash received from M&O tax levy for noncapital purposes	308,929	671,919
Noncapital grants and contributions	17,911	303,771
Principal payments on noncapital long-term debt	(36,000)	(12,000)
Interest paid on noncapital long-term debt	(10,037)	(17,630)
Proceeds from notes payable	1,483,752	1,631,506
Payments on notes payable	(1,592,094)	(1,477,487)
Cash received from other noncapital financing activities	273,622	257,788
Net cash provided by noncapital financing activities	446,083	1,357,867
Cash flows from capital and related financing activities:		
Capital grants and contributions	33,478	147,998
Principal payments on long-term debt and capital lease obligations	(5,895,696)	(3,925,179)
Proceeds from issuance of long-term debt	—	6,000,000
Interest paid on capital debt	(2,017,184)	(2,008,198)
Cash received from M&O tax levy for capital	1,601,473	1,193,915
Cash received from GO tax levy for capital	1,993,310	2,009,728
Proceeds from sale of capital assets	45,035	10,277
Acquisition and construction of capital assets	(5,279,450)	(6,881,584)
Net cash used in capital and related financing activities	(9,519,034)	(3,453,043)
Cash flows from investing activities:		
Purchases of investments, net	313,869	(3,579,212)
Purchase of investments under bond agreement	(933,333)	(933,333)
Distributions from joint ventures	708,477	375,000
Interest received	805,087	969,271
Cash received from other investing activities	—	64,722
Net cash provided by (used in) investing activities	894,100	(3,103,552)
Net increase (decrease) in cash and cash equivalents	1,992,772	(1,656,784)
Cash and cash equivalents, beginning of year	5,743,122	7,399,906
Cash and cash equivalents, end of year	\$ 7,735,894	5,743,122
Noncash financing and investing activities:		
Capital lease acquisitions	\$ 468,789	2,324,005
Capital lease restructure	—	(320,330)
Unrealized gain on investments	(417,687)	(209,711)

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Consolidated Statements of Cash Flows

Years ended December 31, 2008 and 2007

	2008	2007
Reconciliation of operating loss to net cash provided by operating activities:		
Operating gain (loss)	\$ 1,329,884	(1,439,257)
Adjustments to reconcile operating (loss) to net cash provided by operating activities:		
Depreciation and amortization	5,695,093	5,821,341
Provision for bad debts	13,467,309	11,932,274
Equity in earnings of unconsolidated joint ventures	(658,334)	(427,930)
Loss on disposal of capital assets	1,469,568	21,089
Net (increase) decrease in:		
Accounts receivable, net	(12,418,531)	(10,016,968)
Other receivables	1,015,301	(1,338,314)
Supplies inventory	(57,486)	(194,027)
Prepaid expenses and other	(317,119)	(280,575)
Net increase (decrease) in:		
Warrants payable	(353,447)	135,174
Accounts payable	113,243	328,875
Accrued salaries and benefits	1,276,398	572,082
Estimated third-party payor settlements, net	(172,767)	(1,794,827)
Other long-term liabilities	(217,489)	223,007
Net cash provided by operating activities	\$ 10,171,623	3,541,944

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(1) Organization and Summary of Accounting Policies

(a) 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 three 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. As of December 31, 2008 and 2007, the Foundation had net assets of \$384,369 and \$580,700, respectively.

The percentages of the District's total labor force covered under collective bargaining agreements were 77% at December 31, 2008 and 2007. 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 \$1,913,000 of funding in 2008 and \$1,869,000 of funding in 2007. The levy is ongoing in future years. The M&O tax levy funds are reported in the accompanying consolidated statements 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.

(b) 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.

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Notes to Consolidated Financial Statements

December 31, 2008 and 2007

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.

(c) 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.

(d) 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 \$5,470,164 and \$2,932,969 as of December 31, 2008 and 2007, respectively.

(e) 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.

(f) 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.

(g) 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.

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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.

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 is \$2,304,872. These funds will be fully spent by December 31, 2009.

(h) Capital Assets

Capital assets are stated at cost. Improvements and replacement of capital assets are capitalized. 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 statements 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

(i) 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.

(j) 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 sheets within accrued salaries and benefits. The sum of these estimates totals approximately \$2,327,000 and \$1,983,000 as of December 31, 2008 and 2007, respectively.

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(k) 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, 2006. The estimated settlements amounts for the 2007 and 2008 cost report are included in the accompanying consolidated financial statements.

(l) Statements 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.

(m) Contractual Arrangements

A significant portion of the services of the Hospital is provided to patients under contractual arrangements with the following payors:

	2008	2007
Medicare	43%	43%
Medicaid	14	13
Regence	10	11
Other contractual payors	27	28
Total contractual payors	94	95
Self pay/uninsured	6	5
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.

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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.

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 new 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. The District has estimated that it received overpayments of \$0 in 2008 and \$190,000 in 2007 through state grants. A liability for the 2007 overpayment was recorded and included in estimated third-party payor settlements, net in the accompanying consolidated balance sheets as of December 31, 2007.

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.

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(n) *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.

(o) *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.

(p) *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.

(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. Adjustments from finalization of prior year's cost reports resulted in an increase in net patient service revenues of approximately \$347,000 in 2008 and \$175,000 in 2007.

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The components of net patient service revenues for the years ended December 31, 2008 and 2007 are as follows:

	2008	2007
Patient service charges:		
Inpatient	\$ 186,033,784	161,257,685
Outpatient	168,806,040	146,926,790
Total patient service charges	354,839,824	308,184,475
Adjustments to patient service charges:		
Contractual adjustments	(191,264,490)	(158,453,443)
Charity	(6,635,068)	(5,334,974)
Bad debts	(13,467,309)	(11,932,274)
Total adjustments to patient service charges	(211,366,867)	(175,720,691)
Net patient service revenues	\$ 143,472,957	132,463,784

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(3) Cash, Cash Equivalents, Investments, and Deposits

(a) General

The composition of cash, cash equivalents, investments, and deposits at December 31, 2008 and 2007 is as follows:

	2008	2007
Assets whose use is not restricted:		
Cash in banks – interest bearing	\$ 2,265,730	2,846,888
Short-term Treasury Investment Fund	1,268,549	36,736
Governmental Mutual Fund	2,478,967	—
Washington State Investment Pool	1,722,648	2,896,233
Certificates of deposit	913,552	888,045
U.S. Treasury obligations	2,117,930	1,916,475
U.S. agency obligations	5,487,285	3,248,108
	16,254,661	11,832,485
Restricted investments:		
Cash in banks – interest bearing	—	449,692
Money Market Fund	2,304,872	—
Short-term Treasury Investment Fund	811,040	4,274,795
Governmental Mutual Fund	1,585,250	—
Washington State Investment Pool	1,101,365	2,560,214
Certificates of deposit	577,976	785,015
U.S. Treasury obligations	1,354,086	1,694,126
U.S. agency obligations	3,508,265	2,871,265
	11,242,854	12,635,107
Total cash, cash equivalents, investments, and deposits	\$ 27,497,515	24,467,592

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

<u>Maturity</u>	<u>Authorized investment types</u>		
	<u>Maximum percentage of portfolio</u>	<u>Maximum length of maturity</u>	<u>Maximum investment in one issuer</u>
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

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(b) 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:	
Maturing in under 180 days	20%
Maturing in 181 days – 5 years	75
Maturing in under 10 years	100

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(c) *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, 2008:

	<u>Fair value</u>	<u>12 months or less</u>	<u>1 – 3 years</u>	<u>3 – 5 years</u>	<u>5 – 10 years</u>
Assets whose use is not restricted:					
Cash in banks – interest bearing	\$ 2,265,730	2,265,730	—	—	—
Short-term Treasury Investment Fund	1,268,549	1,268,549	—	—	—
Governmental Mutual Fund	2,478,967	2,478,967	—	—	—
Washington State Investment Pool	1,722,648	1,722,648	—	—	—
Certificates of deposit	913,552	913,552	—	—	—
U.S. Treasury obligations	2,117,930	—	435,760	1,682,170	—
U.S. agency obligations	5,487,285	818,473	2,738,594	1,930,218	—
	<u>16,254,661</u>	<u>9,467,919</u>	<u>3,174,354</u>	<u>3,612,388</u>	<u>—</u>
Restricted investments:					
Cash in banks – interest bearing	—	—	—	—	—
Money Market Fund	2,304,872	2,304,872	—	—	—
Short-term Treasury Investment Fund	811,040	811,040	—	—	—
Governmental Mutual Fund	1,585,250	1,585,250	—	—	—
Washington State Investment Pool	1,101,365	1,101,365	—	—	—
Certificates of deposit	577,976	577,976	—	—	—
U.S. Treasury obligations	1,354,086	—	278,600	1,075,486	—
U.S. agency obligations	3,508,265	523,286	1,750,905	1,234,074	—
	<u>11,242,854</u>	<u>6,903,789</u>	<u>2,029,505</u>	<u>2,309,560</u>	<u>—</u>
Total cash, cash equivalents, investments, and deposits	<u>\$ 27,497,515</u>	<u>16,371,708</u>	<u>5,203,859</u>	<u>5,921,948</u>	<u>—</u>

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(d) 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.

(e) 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. As of December 31, 2008, 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.

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(4) Capital Assets

Capital asset additions, retirements, and balances for the years ended December 31, 2008 and 2007 were as follows:

	Assets, at cost				
	December 31, 2007	Additions	Transfers	Sales and retirements	December 31, 2008
Construction in progress	\$ 4,436,315	3,142,715	(5,608,307)	(1,491,986)	478,737
Land	3,996,406	—	—	—	3,996,406
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	551,368	(292,668)	27,688,947
Major and minor moveable equipment	41,924,811	2,101,878	3,633,081	(2,051,655)	45,608,115
Total capital assets	\$ 116,035,894	5,492,185	—	(3,836,309)	117,691,770
	Accumulated depreciation				
	December 31, 2007	Additions	Transfers	Sales and retirements	December 31, 2008
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	33,536,359	3,352,872	—	(2,029,053)	34,860,178
Total accumulated depreciation	77,730,496	5,695,093	—	(2,321,721)	81,103,868
Capital assets, net	\$ 38,305,398				36,587,902

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	Assets, at cost				
	December 31, 2006	Additions	Transfers	Sales and retirements	December 31, 2007
Construction in progress	\$ 897,955	6,268,772	(2,730,412)	—	4,436,315
Land	3,996,406	—	—	—	3,996,406
Land improvements	2,227,812	—	—	—	2,227,812
Buildings and building improvements	38,045,896	24,871	1,999,662	(3,900,515)	36,169,914
Fixed equipment	27,143,025	60,488	199,082	(121,959)	27,280,636
Major and minor moveable equipment	42,842,855	3,188,109	531,668	(4,637,821)	41,924,811
Total capital assets	\$ 115,153,949	9,542,240	—	(8,660,295)	116,035,894
	Accumulated depreciation				
	December 31, 2006	Additions	Transfers	Sales and retirements	December 31, 2007
Land improvements	\$ 1,389,038	88,351	—	—	1,477,389
Buildings and building improvements	19,269,061	1,296,943	—	(357,655)	20,208,349
Fixed equipment	22,018,078	606,860	—	(116,539)	22,508,399
Major and minor moveable equipment	37,541,577	3,829,187	—	(7,834,405)	33,536,359
Total accumulated depreciation	80,217,754	5,821,341	—	(8,308,599)	77,730,496
Capital assets, net	\$ 34,936,195				38,305,398

Included in major and minor movable equipments are assets under capital lease obligations as of December 31, 2008 and 2007, with a cost of \$4,419,509 and \$3,854,982, respectively, and accumulated depreciation thereon of \$2,770,852 and \$1,676,589, 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 incurred in 2008 of \$570,000 for a total of \$2,062,000 were written off and recognized as other expense in 2008.

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(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, 2008 and 2007 are set forth below:

	2008	2007
Long-term debt to be repaid from taxation:		
Unlimited tax general obligation bonds:		
2003 Refunding Series, 4.50%, due serially until 2011 (net of unamortized premium of \$161,040 and \$281,493 in 2008 and 2007, respectively)	\$ 5,121,040	7,016,493
Total long-term debt to be repaid from taxation	5,121,040	7,016,493
Long-term debt to be repaid from operations:		
Master equipment sales agreement, with interest at 5.48%, due monthly through 2012	4,739,505	5,824,693
LTGO Bonds, 2005, interest is based on a LIBOR fixed rate that is reset monthly, due monthly through July 1, 2010 (average rate for 2008 of 2.84%)	602,506	976,140
LTGO Bonds, 1999, variable interest rate determined weekly by Bank of America, due serially until 2018 (average rate for 2008 of 2.08%)	10,900,000	11,800,000
Revenue bonds, 1995 Series, 6.75%, due in 2015	14,000,000	14,000,000
Capital lease obligations with interest at 5.30% to 8.25%, due monthly through 2012	1,562,020	2,891,105
Total long-term debt to be repaid from operations	31,804,031	35,491,938
Total long-term debt and obligations under capital leases	36,925,071	42,508,431
Less current maturities	(13,209,488)	(5,887,586)
Long-term debt and obligations under capital leases, net of current portion	\$ 23,715,583	36,620,845

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Long-term debt and capital lease obligations' activity summary for 2008 and 2007 is as follows:

	<u>December 31, 2007</u>	<u>Additions</u>	<u>Reductions</u>	<u>December 31, 2008</u>	<u>Amounts due within one year</u>
Long-term debt to be repaid from taxation:					
UTGO Bonds:					
2003 Refunding	\$ 7,016,493	—	(1,895,453)	5,121,040	1,855,000
Total to be repaid from taxation	<u>7,016,493</u>	<u>—</u>	<u>(1,895,453)</u>	<u>5,121,040</u>	<u>1,855,000</u>
Long-term debt to be repaid from operations:					
Master equipment sales agreement	5,824,693	—	(1,085,188)	4,739,505	1,144,605
LTGO Bonds, 2005	976,140	—	(373,634)	602,506	390,385
LTGO Bonds, 1999	11,800,000	—	(900,000)	10,900,000	900,000
Revenue Bonds, 1995	14,000,000	—	—	14,000,000	7,800,000
Notes payable	—	—	—	—	—
Capital lease obligations	2,891,105	468,789	(1,797,874)	1,562,020	1,119,498
Total to be repaid from operations	<u>35,491,938</u>	<u>468,789</u>	<u>(4,156,696)</u>	<u>31,804,031</u>	<u>11,354,488</u>
	<u>\$ 42,508,431</u>	<u>468,789</u>	<u>(6,052,149)</u>	<u>36,925,071</u>	<u>13,209,488</u>

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	<u>December 31, 2006</u>	<u>Additions</u>	<u>Reductions</u>	<u>December 31, 2007</u>	<u>Amounts due within one year</u>
Long-term debt to be repaid from taxation:					
UTGO Bonds:					
2003 Refunding	\$ 8,873,230	—	(1,856,737)	7,016,493	1,775,000
Total to be repaid from taxation	<u>8,873,230</u>	<u>—</u>	<u>(1,856,737)</u>	<u>7,016,493</u>	<u>1,775,000</u>
Long-term debt to be repaid from operations:					
Master equipment sales agreement	—	6,000,000	(175,307)	5,824,693	1,085,188
LTGO Bonds, 2005	1,323,173	—	(347,033)	976,140	357,778
LTGO Bonds, 1999	12,100,000	—	(300,000)	11,800,000	900,000
Revenue Bonds, 1995	14,000,000	—	—	14,000,000	—
Notes payable	229,688	—	(229,688)	—	—
Capital lease obligations	<u>2,067,581</u>	<u>2,324,005</u>	<u>(1,500,481)</u>	<u>2,891,105</u>	<u>1,769,620</u>
Total to be repaid from operations	<u>29,720,442</u>	<u>8,324,005</u>	<u>(2,552,509)</u>	<u>35,491,938</u>	<u>4,112,586</u>
	<u>\$ 38,593,672</u>	<u>8,324,005</u>	<u>(4,409,246)</u>	<u>42,508,431</u>	<u>5,887,586</u>

Scheduled principal and interest repayments on long-term debt and payments on capital lease obligations are as follows as of December 31, 2008:

	<u>Long-term debt</u>		<u>Capital lease obligations</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2009	\$ 12,089,990	2,051,525	1,119,498	43,439
2010	4,369,397	1,844,040	243,661	9,863
2011	3,428,377	1,628,654	174,691	4,827
2012	2,114,247	1,447,466	24,170	515
2013	1,100,000	1,359,500	—	—
2014 – 2018	<u>12,100,000</u>	<u>2,934,500</u>	<u>—</u>	<u>—</u>
	<u>35,202,011</u>	<u>11,265,685</u>	<u>1,562,020</u>	<u>58,644</u>
Plus unamortized bond premium	<u>161,040</u>			
	<u>\$ 36,925,071</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 as to rate or amount.

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On August 22, 2007, the District's Board adopted Resolution No. 2007-07, authorizing 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, appointing an escrow agent, and authorizing the execution and delivery of an escrow agreement. On September 24, 2008 the District's Board adopted Resolution No. 2008-11 authorizing the use of the project funds of the conditional sales contract (lease) to be used for general capital equipment purposes. As of December 31, 2008 the remaining balance for this obligation was \$4,739,505.

On November 15, 2006, the District's Board adopted Resolution No. 2006-08, authorizing 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, authorizing 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, \$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 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.

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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, 2008, the District is in compliance with this and other covenant provisions.

(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 insurance 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, 2008 and 2007 is included in accounts payable and other long-term liabilities in the accompanying consolidated balance sheets, and is approximately \$1,827,000 and \$1,742,000, respectively.

In October 2008, the District financed its professional liability insurance through notes payable to a bank. The notes include monthly payments at a rate of 4.40%, per annum, with final payment in October 2009. The notes payable correspond with the policy period.

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(7) 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 \$2,456,000 and \$2,235,000 in 2008 and 2007, respectively.

(8) 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 \$709,199 and \$650,054 as of December 31, 2008 and 2007, respectively, and is included in other assets in the accompanying consolidated balance sheets.

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 6.6% (excluding certain contributed capital) at December 31, 2008 and 2007. The District's recorded investment in PacLab, LLC was \$343,011 and \$452,299 as of December 31, 2008 and 2007, respectively, and is included in other assets in the accompanying consolidated balance sheets.

The following represents unaudited summary financial information of SRIC, LLC and PacLab, LLC as of and for the year ended December 31, 2008:

	Stevens Radia Imaging Center, LLC	PacLab, LLC
	(Unaudited)	(Unaudited)
Current assets	\$ 1,436,129	1,867,950
Noncurrent assets, net	539,655	4,909,131
	\$ 1,975,784	6,777,081
Current liabilities	\$ 551,262	147,490
Equity	1,424,522	6,629,591
	\$ 1,975,784	6,777,081
Revenue	\$ 4,644,702	185,594
Expenses	3,223,101	1,881,806
Net income (loss)	\$ 1,421,601	(1,696,212)

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(9) 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 \$299,025 and \$384,954 in 2008 and 2007, respectively, for space and equipment that SCIS rents from the District. Net income distributed under the Alliance Agreement to the District was \$620,253 (this includes a \$298,777 net loss true up for 2007) in 2008 and \$1,688,944 in 2007. The alliance income is included in other operating revenues in the accompanying consolidated statements of revenues, expenses, and changes in net assets in 2008 and 2007. At December 31, 2008 and 2007, the District had a net payable to SCIS of \$481,881 and \$77,165, 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 was \$72,706.

(10) Concentrations of Credit Risk

The District grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The composition of patient accounts receivable at December 31, 2008 and 2007 was as follows:

	2008	2007
Medicare	30%	32%
Medicaid	11	10
Other third-party payors and patients	59	58

(11) Disclosure About Fair Value of Financial Instruments

The estimated fair value of financial instruments is reflected in the accompanying consolidated balance sheets. 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 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 \$36,936,318 and \$42,962,494 at December 31, 2008 and 2007, respectively. The carrying value was \$36,925,071 and \$42,508,431 at December 31, 2008 and 2007, respectively.

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(12) Commitments and Contingencies

(a) Operating Leases

The District leases certain facilities and equipment under operating lease arrangements. Rent expense totaled approximately \$3,099,272 and \$3,483,000 in 2008 and 2007, 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, 2008:

2009	\$	3,284,407
2010		3,246,151
2011		3,268,078
2012		2,402,296
2013 – 2017		10,227,891
2018 – 2019		847,907
		847,907
	\$	23,276,730

(b) 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.