



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

Basic Consolidated Financial Statements

December 31, 2007 and 2006

(With Independent Auditors' Report Thereon)

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

Management's Discussion and Analysis

December 31, 2007 and 2006

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, 2007 and 2006. 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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December 31, 2007 and 2006

**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>2007</u>	<u>2006</u>	<u>2005</u>
<b>Assets:</b>			
Current assets	\$ 35,339	37,293	31,652
Capital assets, net	38,305	34,936	37,823
Other noncurrent assets	18,513	13,563	12,113
Total assets	<u>\$ 92,157</u>	<u>85,792</u>	<u>81,588</u>
<b>Liabilities:</b>			
Current liabilities	\$ 27,637	25,565	19,721
Long-term debt outstanding, net	36,621	34,979	37,814
Other long-term liabilities	6,496	6,435	6,932
Total liabilities	<u>\$ 70,754</u>	<u>66,979</u>	<u>64,467</u>
<b>Net assets:</b>			
Invested in capital assets, net of related debt	\$ (3,731)	(3,173)	(3,559)
Restricted:			
For debt service	8,109	7,203	6,258
Expendable for specific activities	450	242	—
Unrestricted	16,575	14,541	14,422
Total net assets	<u>\$ 21,403</u>	<u>18,813</u>	<u>17,121</u>

***Current Assets***

Total current assets of \$35.3 million at year end 2007 reflect a decrease of \$2.0 million (5.2%) compared to the balance of \$37.3 million at the end of 2006. This change was primarily due to a \$1.9 million reduction in net accounts receivable. Net days of revenue in accounts receivable decreased to 48 days by the end of 2007 compared to 56 days at the end of 2006.

Cash and short-term investments decreased by \$1.8 million (16.8%) in 2007 compared to an increase of \$2.7 million (35.4%) in 2006. The District used cash to update equipment and facilities in 2007, consequently, days of cash on hand decreased to 31 days by the end of 2007 compared to 40 days at the end of 2006.

***Other Noncurrent Assets***

Other noncurrent assets increased \$5.0 million reflecting the balance of funds borrowed for the clinical, patient management, and financial information system project started in 2007.

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***Capital Assets***

The Districts net capital assets increased \$3.4 million (9.6%) in 2007, compared to a net decrease of \$2.9 million (7.6%) in 2006. The District devoted greater resources to capital projects and improvements during 2007, in order to upgrade the facility.

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 Project
- Replacement of ICU Beds
- Upgrade Radiology Equipment
- Emergency Laboratory Analyzer
- Breast MRI Equipment
- CO2 Surgical Laser
- Bone Density Scanner

In addition, the District started and incurred expenses for a new clinical, patient management, and financial information system to be completed in 2009.

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

During 2006, the District continued certain construction projects and added equipment, which combined to increase the capital asset balance by \$3.1 million. The major items added were:

- Electronic Medical Record (EMR), ORSOS Surgery System, Hardware, and Training
- Exchange Server/Microsoft Outlook Upgrade
- Birth and Family Clinic Tenant and Building Improvements
- Various System Upgrades (PACS Radiology Archiving System, Decision Support, Lawson, and Kronos)

Depreciation expense of \$6.0 million resulted in a net capital asset decrease of \$2.9 million for 2006.

***Current Liabilities***

Current liabilities increased \$2.1 million in 2007 compared to 2006. Current portion of long term debt increased \$2.3 million and accrued salaries and benefits increased \$653,000 compared to 2006. Payables to third parties decreased \$1.8 million reflecting the pay back of hold harmless grants related to the Certified Public Expenditure program (CPE) for Medicaid patients.

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***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 \$1.1 million, and deferred revenue of \$1.8 million related to the sale of an option to purchase the Stevens Pavilion.

***Long-Term Debt***

At year-end 2007, the District had \$36.6 million in long-term debt and obligations under capital leases, net of current portion, which is 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 cited previously. New capital lease obligations include an ICU and PCU patient monitoring system, a birth and family bone density scanner, and the restructure of catheter lab equipment leases. Total principal payments in 2007 were \$4.4 million, including \$1.5 million of capital lease principal payments. At year-end 2006, the District had \$35.0 million in long-term debt and obligations under capital leases, net of current portion. Except for capital leases added during 2006 totaling \$454,000, the District added no new debt in 2006. Principal payments during 2006 totaled \$3.7 million, including \$1.2 million in capital lease principle payments.

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

In 2007, the District's net assets increased \$2.6 million or 13.8% compared to an increase of \$1.7 million or 9.9% in 2006.

**Table 2: Operating Results and Changes in Net Assets**

(In thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Operating revenues:			
Net patient service revenues	\$ 132,464	125,717	128,995
Other operating revenues	8,887	8,015	7,166
Total operating revenues	<u>141,351</u>	<u>133,732</u>	<u>136,161</u>
Operating expenses:			
Salaries and benefits	74,463	69,320	72,441
Supplies and other	62,506	60,105	61,533
Depreciation and amortization	5,821	5,997	6,071
Total operating expenses	<u>142,790</u>	<u>135,422</u>	<u>140,045</u>
Operating loss	<u>(1,439)</u>	<u>(1,690)</u>	<u>(3,884)</u>
Nonoperating revenues (expenses):			
Tax levies	3,914	3,921	3,943
Other investment income	1,157	723	406
Interest expense and amortization	(1,941)	(2,108)	(1,961)
Noncapital grants and contributions	304	335	232
Other income	447	450	375
Net nonoperating revenues	<u>3,881</u>	<u>3,321</u>	<u>2,995</u>
Excess of revenues over expenses before capital grants and contributions	2,442	1,631	(889)
Capital grants and contributions	148	61	1
Cumulative effect of change in accounting principle	—	—	(882)
Increase (decrease) in net assets	<u>2,590</u>	<u>1,692</u>	<u>(1,770)</u>
Net assets at beginning of year	<u>18,813</u>	<u>17,121</u>	<u>18,891</u>
Net assets at end of year	<u>\$ 21,403</u>	<u>18,813</u>	<u>17,121</u>

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The District generated \$132.5 million of net patient service revenue in 2007, an increase of \$6.7 million or 5.4% over 2006. 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 implemented price increases during 2007 that averaged 2% to 9%. 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. The District had \$125.7 million in net patient service revenues in 2006, a decrease of \$3.3 million or 2.5% compared to 2005. The reduction was primarily due to a full year of reduced outpatient revenue resulting from moving laboratory outreach from a hospital service to a clinical lab network (PacLab, LLC) in October 2005. The District saw an increase of 4.1% in hospital admissions and a reduction of 6.6% in length of stay during 2006 compared to 2005.

Other operating revenues of \$8.9 million increased by 10.9% between 2006 and 2007. The Cancer Center alliance with Swedish Health Services generated \$1.8 million in revenue in 2007, an increase of \$730,000 over 2006. The District has a 6.6% ownership in Pac Lab, LLC, an outreach lab service. In 2007, the District recorded distributions of \$1.8 million from Pac Lab, LLC, an increase of \$302,000 over 2006. The District generated \$8.0 million of other operating revenues in 2006 compared to \$7.2 million in 2005, an 11.8% increase. The increase in other operating revenues in 2006 compared to 2005 relates to a full year of the District's affiliation with PacLab, LLC.

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 mid 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 management implemented in May 2006 of 48 full time equivalent employees. An additional decrease in supplies and other expense of \$1.4 million in 2006 compared to 2005 relates primarily to the completion of the two-year financial turnaround project that concluded in June 2006.

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, 2007 and 2006, 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 audit 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, 2007 and 2006, 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 6 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**

April 22, 2008

**PUBLIC HOSPITAL DISTRICT NO. 2  
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Consolidated Balance Sheets  
December 31, 2007 and 2006

<b>Assets</b>	<b>2007</b>	<b>2006</b>
Current assets:		
Cash and cash equivalents	\$ 5,743,122	7,399,906
Short-term investments	2,915,617	3,011,036
Accounts receivable, less allowance for collection losses of \$6,983,000 and \$6,302,000 in 2007 and 2006, respectively	18,970,370	20,885,676
Other receivables	3,038,204	1,760,279
Supplies inventory, at cost	2,284,628	2,090,601
Prepaid expenses and other	2,204,404	1,923,829
Current portion of restricted assets	182,501	221,571
Total current assets	35,338,846	37,292,898
Long-term investments	3,173,746	3,699,616
Restricted assets:		
Under bond agreement	7,833,333	6,900,000
Escrow fund for information systems project	4,242,321	—
Temporary investment of tax revenue	109,761	149,108
Taxes and interest receivable	165,904	153,782
Temporarily restricted assets of Foundation	449,692	242,454
Total restricted assets	12,801,011	7,445,344
Less current portion of restricted assets	(182,501)	(221,571)
	12,618,510	7,223,773
Capital assets, net of accumulated depreciation	38,305,398	34,936,195
Other assets	2,435,917	2,302,430
Deferred financing costs, net of accumulated amortization	284,455	337,521
Total assets	\$ 92,156,872	85,792,433

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Consolidated Balance Sheets

December 31, 2007 and 2006

<b>Liabilities and Net Assets</b>	<b>2007</b>	<b>2006</b>
Current liabilities:		
Current portion of long-term debt and obligations under capital leases	\$ 5,887,586	3,614,813
Notes payable	1,193,341	1,039,322
Warrants payable	1,268,855	1,133,681
Accounts payable	10,171,891	9,506,365
Accrued salaries and benefits	8,506,275	7,853,636
Interest payable	136,527	149,346
Estimated third-party payor settlements, net	472,767	2,267,594
Total current liabilities	27,637,242	25,564,757
Long-term debt and obligations under capital leases, net of current portion:		
To be repaid from taxation	5,241,493	7,168,230
To be repaid from operations	31,379,352	27,810,629
	36,620,845	34,978,859
Other long-term liabilities	6,495,532	6,435,473
Total liabilities	70,753,619	66,979,089
Commitments and contingencies (note 12)		
Net assets:		
Invested in capital assets, net of related debt	(3,731,033)	(3,173,477)
Restricted:		
For debt service	8,108,998	7,202,890
Expendable for specific activities	449,692	242,454
Unrestricted	16,575,596	14,541,477
Total net assets	21,403,253	18,813,344
Total liabilities and net assets	\$ 92,156,872	85,792,433

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, 2007 and 2006

	<b>2007</b>	<b>2006</b>
Operating revenues:		
Net patient service revenues (net of provision for bad debts of \$11,932,274 and \$10,578,443 in 2007 and 2006, respectively)	\$ 132,463,784	125,716,819
Other operating revenues	8,887,475	8,014,909
Total operating revenues	141,351,259	133,731,728
Operating expenses:		
Salaries and wages	60,174,386	55,639,919
Employee benefits	14,288,192	13,679,924
Supplies and other	62,506,597	60,104,521
Depreciation and amortization	5,821,341	5,997,124
Total operating expenses	142,790,516	135,421,488
Operating loss	(1,439,257)	(1,689,760)
Nonoperating revenues (expenses):		
General obligation (GO) tax levy	2,045,730	2,106,345
Maintenance and operations (M&O) tax levy	1,868,718	1,814,486
Other investment income	1,156,551	723,347
General obligation (GO) interest expense and amortization	(250,184)	(367,748)
Other interest expense and amortization	(1,691,079)	(1,740,444)
Noncapital grants and contributions	303,771	335,174
Other income	447,661	450,111
Net nonoperating revenues	3,881,168	3,321,271
Excess of revenues over expenses before capital grants and contributions	2,441,911	1,631,511
Capital grants and contributions	147,998	61,009
Increase in net assets	2,589,909	1,692,520
Net assets, beginning of the year	18,813,344	17,120,824
Net assets, end of the year	\$ 21,403,253	18,813,344

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, 2007 and 2006

	<b>2007</b>	<b>2006</b>
Cash flows from operating activities:		
Cash received for patient services and other operations	\$ 140,357,207	131,281,683
Cash paid to employees	(74,268,811)	(69,174,630)
Cash paid to suppliers for goods and services	(62,546,452)	(55,152,062)
Net cash provided by operating activities	3,541,944	6,954,991
Cash flows from noncapital financing activities:		
Cash received from M&O tax levy for noncapital purposes	671,919	738,036
Noncapital grants and contributions	303,771	239,174
Principal payments on noncapital long-term debt	(12,000)	(8,000)
Interest paid on noncapital long-term debt	(17,630)	(17,042)
Proceeds from notes payable	1,631,506	1,420,923
Payments on notes payable	(1,477,487)	(1,972,584)
Cash received from other noncapital financing activities	257,788	260,237
Net cash provided by noncapital financing activities	1,357,867	660,744
Cash flows from capital and related financing activities:		
Capital grants and contributions	147,998	61,009
Principal payments on long-term debt and capital lease obligations	(3,925,179)	(3,612,572)
Proceeds from issuance of long-term debt	6,000,000	—
Interest paid on capital debt	(2,008,198)	(2,122,248)
Cash received from M&O tax levy for capital	1,193,915	1,080,057
Cash received from GO tax levy for capital	2,009,728	2,079,365
Proceeds from sale of capital assets	10,277	27,241
Acquisition and construction of capital assets	(6,881,584)	(2,459,898)
Net cash used in capital and related financing activities	(3,453,043)	(4,947,046)
Cash flows from investing activities:		
Purchases of investments, net	(3,579,212)	(1,050,970)
Purchase of investments under bond agreement	(933,333)	(933,332)
Distributions from joint ventures	375,000	150,000
Investment in joint ventures	—	(250,000)
Interest received	969,271	743,319
Cash received from other investing activities	64,722	277,933
Net cash used in investing activities	(3,103,552)	(1,063,050)
Net (decrease) increase in cash and cash equivalents	(1,656,784)	1,605,639
Cash and cash equivalents, beginning of year	7,399,906	5,794,267
Cash and cash equivalents, end of year	\$ 5,743,122	7,399,906
Noncash financing and investing activities:		
Capital lease acquisitions	\$ 2,324,005	454,056
Capital lease restructure	(320,330)	—
Unrealized (gain) loss on investments	(209,711)	10,949

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Consolidated Statements of Cash Flows

Years ended December 31, 2007 and 2006

	<b>2007</b>	<b>2006</b>
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (1,439,257)	(1,689,760)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization	5,821,341	5,997,124
Provision for bad debts	11,932,274	10,578,443
Equity in earnings of unconsolidated joint ventures	(427,930)	(531,292)
Loss (gain) on disposal of capital assets	21,089	(25,158)
Net (increase) decrease in:		
Accounts receivable, net	(10,016,968)	(15,446,247)
Other receivables	(1,338,314)	323,822
Supplies inventory	(194,027)	8,798
Prepaid expenses and other	(280,575)	664,839
Net increase (decrease) in:		
Warrants payable	135,174	493,875
Accounts payable	328,875	3,717,133
Accrued salaries and benefits	572,082	159,584
Estimated third-party payor settlements, net	(1,794,827)	3,037,198
Other long-term liabilities	223,007	(333,368)
Net cash provided by operating activities	\$ 3,541,944	6,954,991

See accompanying notes to consolidated financial statements.

**PUBLIC HOSPITAL DISTRICT NO. 2  
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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

**(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 15 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, 2007 and 2006, the Foundation held assets of \$617,908 and \$255,322, respectively.

The percentages of the District's total labor force covered under collective bargaining agreements were 84% and 77% at December 31, 2007 and 2006, respectively. The collective bargaining agreements are set to expire June 30, 2008.

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 \$1,869,000 of funding in 2007 and \$1,814,000 of funding in 2006. 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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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, excluding long-term investments, totaled \$2,932,969 and \$5,451,238 as of December 31, 2007 and 2006, respectively.

**(e) Restricted Assets**

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

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

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 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.

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(dba STEVENS HOSPITAL)**

Notes to Consolidated Financial Statements

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**(f) 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

**(g) 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 using the effective interest method.

**(h) 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 \$1,983,000 and \$2,280,000 as of December 31, 2007 and 2006, respectively.

**(i) 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 settlement amounts for the 2007 cost report is included in the accompanying consolidated financial statements.

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**(j) *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.

**(k) *Contractual Arrangements***

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

	<b>2007</b>	<b>2006</b>
Medicare	43%	41%
Medicaid	13	13
Regence	11	11
Other	26	27

***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.

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.

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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 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 approximately \$190,000 and \$1,841,000 through state grants. Liabilities in these amounts have been recorded and are included in estimated third-party payor settlements, net in the accompanying consolidated balance sheets as of December 31, 2007 and 2006, respectively.

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.

**(l) *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.

**(m) *Income Taxes***

As a political subdivision of the state of Washington, the District is not subject to federal income tax.

**(n) *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.

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**(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 \$175,000 in 2007, and a decrease in net patient service revenues of approximately \$221,000 in 2006.

The components of net patient service revenues for the years ended December 31, 2007 and 2006 are as follows:

	<b>2007</b>	<b>2006</b>
Patient service charges:		
Inpatient	\$ 161,257,685	139,127,176
Outpatient	146,926,790	138,932,751
Total patient service charges	308,184,475	278,059,927
Adjustments to patient service charges:		
Contractual adjustments	(158,453,443)	(138,314,495)
Charity	(5,334,974)	(3,450,170)
Bad debts	(11,932,274)	(10,578,443)
Total adjustments to patient service charges	(175,720,691)	(152,343,108)
Net patient service revenues	\$ 132,463,784	125,716,819

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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, 2007 and 2006 is as follows:

	<b>2007</b>	<b>2006</b>
Assets whose use is not restricted:		
Cash in banks – interest bearing	\$ 2,846,888	1,948,669
Short-term Treasury Investment Fund	36,736	101,411
Washington State Investment Pool	2,896,233	5,349,827
Certificates of deposit	888,045	1,004,174
U.S. Treasury obligations	1,916,475	1,610,542
U.S. agency obligations	3,248,108	4,095,935
	11,832,485	14,110,558
Restricted investments:		
Cash in banks – interest bearing	449,692	242,454
Short-term Treasury Investment Fund	4,274,795	58,778
Washington State Investment Pool	2,560,214	3,100,794
Certificates of deposit	785,015	582,026
U.S. Treasury obligations	1,694,126	933,480
U.S. agency obligations	2,871,265	2,374,030
	12,635,107	7,291,562
Total cash, cash equivalents, investments, and deposits	\$ 24,467,592	21,402,120

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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, 2007:

	<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	\$ 2,846,888	2,846,888	—	—	—
Short-term Treasury Investment Fund	36,736	36,736	—	—	—
Washington State Investment Pool	2,896,233	2,896,233	—	—	—
Certificates of deposit	888,045	888,045	—	—	—
U.S. Treasury obligations	1,916,475	—	525,666	1,390,809	—
U.S. agency obligations	3,248,108	1,990,836	943,847	313,425	—
	<u>11,832,485</u>	<u>8,658,738</u>	<u>1,469,513</u>	<u>1,704,234</u>	<u>—</u>
Restricted investments:					
Cash in banks – interest bearing	449,692	449,692	—	—	—
Short-term Treasury Investment Fund	4,274,795	4,274,795	—	—	—
Washington State Investment Pool	2,560,214	2,560,214	—	—	—
Certificates of deposit	785,015	785,015	—	—	—
U.S. Treasury obligations	1,694,126	—	464,678	1,229,448	—
U.S. agency obligations	2,871,265	1,759,861	834,343	277,061	—
	<u>12,635,107</u>	<u>9,829,577</u>	<u>1,299,021</u>	<u>1,506,509</u>	<u>—</u>
Total cash, cash equivalents, investments, and deposits	<u>\$ 24,467,592</u>	<u>18,488,315</u>	<u>2,768,534</u>	<u>3,210,743</u>	<u>—</u>

**(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

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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, 2007, all Foundation deposits up to \$100,000 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.

**(4) Capital Assets**

Capital asset additions, retirements, and balances for the years ended December 31, 2007 and 2006 were as follows:

	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	<u>115,153,949</u>	<u>9,542,240</u>	<u>—</u>	<u>(8,660,295)</u>	<u>116,035,894</u>
	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	<u>80,217,754</u>	<u>5,821,341</u>	<u>—</u>	<u>(8,308,599)</u>	<u>77,730,496</u>
Capital assets, net	<u>\$ 34,936,195</u>				<u>38,305,398</u>

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		<b>Assets, at cost</b>				
		<b>December 31, 2005</b>	<b>Additions</b>	<b>Transfers</b>	<b>Sales and retirements</b>	<b>December 31, 2006</b>
Construction-in-progress	\$	518,934	2,128,007	(1,748,986)	—	897,955
Land		3,996,406	—	—	—	3,996,406
Land improvements		2,227,812	—	—	—	2,227,812
Buildings and building improvements		37,701,721	63,328	372,365	(91,518)	38,045,896
Fixed equipment		27,133,533	12,735	30,623	(33,866)	27,143,025
Major and minor moveable equipment		41,275,136	938,293	1,345,998	(716,572)	42,842,855
Total capital assets		<u>112,853,542</u>	<u>3,142,363</u>	<u>—</u>	<u>(841,956)</u>	<u>115,153,949</u>
		<b>Accumulated depreciation</b>				
		<b>December 31, 2005</b>	<b>Additions</b>	<b>Transfers</b>	<b>Sales and retirements</b>	<b>December 31, 2006</b>
Land improvements		1,299,480	89,558	—	—	1,389,038
Buildings and building improvements		18,299,597	1,060,983	—	(91,519)	19,269,061
Fixed equipment		21,393,764	658,180	—	(33,866)	22,018,078
Major and minor moveable equipment		34,038,135	4,188,403	—	(684,961)	37,541,577
Total accumulated depreciation		<u>75,030,976</u>	<u>5,997,124</u>	<u>—</u>	<u>(810,346)</u>	<u>80,217,754</u>
Capital assets, net	\$	<u><u>37,822,566</u></u>				<u><u>34,936,195</u></u>

Included in major and minor movable equipments are assets under capital lease obligations as of December 31, 2007 and 2006, with a cost of \$3,804,982 and \$6,482,704, respectively, and accumulated depreciation thereon of \$1,669,089 and \$4,203,294, respectively.

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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, 2007 and 2006 are set forth below:

	<u>2007</u>	<u>2006</u>
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 \$281,493 and \$433,230 in 2007 and 2006, respectively)	\$ 7,016,493	8,873,230
Total long-term debt to be repaid from taxation	<u>7,016,493</u>	<u>8,873,230</u>
Long-term debt to be repaid from operations:		
Master equipment sales agreement, with interest at 5.48%, due monthly through 2012	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 2007 of 4.33%)	976,140	1,323,173
LTGO Bonds, 1999, variable interest rate determined weekly by Bank of America, due serially until 2018 (average rate for 2007 of 3.65%)	11,800,000	12,100,000
Revenue bonds, 1995 Series, 6.75%, due in 2015	14,000,000	14,000,000
Notes payable	—	229,688
Capital lease obligations with interest at 2.18% to 9.16%, due monthly through 2012	2,891,105	2,067,581
Total long-term debt to be repaid from operations	<u>35,491,938</u>	<u>29,720,442</u>
Total long-term debt and obligations under capital leases	42,508,431	38,593,672
Less current maturities	<u>(5,887,586)</u>	<u>(3,614,813)</u>
Long-term debt and obligations under capital leases, net of current portion	<u>\$ 36,620,845</u>	<u>34,978,859</u>

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Long-term debt and capital lease obligations' activity summary for 2007 and 2006 is as follows:

	<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	2,067,581	2,324,005	(1,500,481)	2,891,105	1,769,620
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>

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	<u>December 31, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>December 31, 2006</u>	<u>Amounts due within one year</u>
Long-term debt to be repaid from taxation:					
UTGO Bonds:					
2003 Refunding	\$ 10,621,878	—	(1,748,648)	8,873,230	1,705,000
Total to be repaid from taxation	<u>10,621,878</u>	<u>—</u>	<u>(1,748,648)</u>	<u>8,873,230</u>	<u>1,705,000</u>
Long-term debt to be repaid from operations:					
LTGO Bonds, 2005	1,658,587	—	(335,414)	1,323,173	344,980
LTGO Bonds, 1999	12,300,000	—	(200,000)	12,100,000	300,000
Revenue Bonds, 1995	14,000,000	—	—	14,000,000	—
Notes payable	469,854	—	(240,166)	229,688	222,009
Capital lease obligations	<u>2,823,518</u>	<u>454,056</u>	<u>(1,209,993)</u>	<u>2,067,581</u>	<u>1,042,824</u>
Total to be repaid from operations	<u>31,251,959</u>	<u>454,056</u>	<u>(1,985,573)</u>	<u>29,720,442</u>	<u>1,909,813</u>
	<u>\$ 41,873,837</u>	<u>454,056</u>	<u>(3,734,221)</u>	<u>38,593,672</u>	<u>3,614,813</u>

Scheduled principal and interest repayments on long-term debt and payments on capital lease obligations are as follows:

	<u>Long-term debt</u>		<u>Capital lease obligations</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2008	\$ 4,117,965	2,046,229	1,769,621	110,643
2009	4,275,398	1,879,899	955,228	43,501
2010	4,399,845	1,676,317	83,129	9,863
2011	3,428,377	1,475,188	58,961	4,827
2012	2,114,248	1,311,178	24,166	515
2013 – 2017	19,800,000	3,827,472	—	—
2018 – 2018	<u>1,200,000</u>	<u>46,750</u>	<u>—</u>	<u>—</u>
	<u>39,335,833</u>	<u>12,263,033</u>	<u>2,891,105</u>	<u>169,349</u>
Plus unamortized bond premium	<u>281,493</u>			
	<u>\$ 42,508,431</u>			

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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.

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 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.

On 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

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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 2009, 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, 2007, 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. On July 1, 2003, this coverage changed from a \$50,000 deductible per claim to a \$100,000 self-insured retention 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 deductible portion and for unreported incidents. The District's estimate for claims incurred but not paid as of December 31, 2007 and 2006 is included in accounts payable and other long-term liabilities in the accompanying consolidated balance sheets, and is approximately \$1,742,000 and \$2,112,000, respectively.

In October 2007, the District financed its professional liability insurance through notes payable to a bank. The notes include monthly payments at a rate of 4.47%, per annum, with final payment in August 2008. The notes payable correspond with the policy period.

**(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 \$2,235,000 and \$2,188,000 in 2007 and 2006, respectively.

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**(8) Joint Ventures**

***Stevens Radia Imaging Center, LLC***

Effective December 31, 2005, the District sold its 56% ownership in Edmonds Center for Diagnostic Imaging, LLC and formed a joint venture with Radia Technical Imaging, LLC, called 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 \$650,054 and \$634,872 as of December 31, 2007 and 2006, respectively, and is included in other assets in the accompanying consolidated balance sheets.

***PacLab, LLC***

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 approximately 7% at December 31, 2007 and 2006. The District's recorded investment in PacLab, LLC was \$452,299 and \$414,551 as of December 31, 2007 and 2006, 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, 2007:

	<b>Stevens Radia Imaging Center, LLC</b>	<b>PacLab, LLC</b>
	(Unaudited)	(Unaudited)
Current assets	\$ 876,658	3,849,963
Noncurrent assets, net	4,408,101	5,516,731
	\$ 5,284,759	9,366,694
Current liabilities	\$ 429,711	125,115
Long-term liabilities	—	43,208
Equity	4,855,048	9,198,371
	\$ 5,284,759	9,366,694
Revenue	\$ 3,818,193	140,910
Expenses	3,311,169	1,802,814
Net income (loss)	\$ 507,024	(1,661,904)

Income recorded related to joint ventures of \$427,930 and \$531,292 is reflected in other operating revenues in the accompanying consolidated statements of revenues, expenses, and changes in net assets in 2007 and 2006, respectively.

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**(9) Transactions with Affiliates and Related Parties**

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 \$384,954 and \$379,441 in 2007 and 2006, respectively, for space and equipment that SCIS rents from the District. Net income distributed under the Alliance Agreement to the District was \$1,688,944 and \$955,213 in 2007 and 2006, respectively. The affiliated income is included in other operating revenues in the accompanying consolidated statements of revenues, expenses, and changes in net assets in 2007 and 2006. At December 31, 2007 and 2006, the District had a net payable to SCIS of \$55,139 and \$361,393, respectively.

**(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, 2007 and 2006 was as follows:

	<b>2007</b>	<b>2006</b>
Medicare	32%	26%
Medicaid	10	10
Other third-party payors and patients	58	64

**(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 \$42,962,494 and \$34,270,159 at December 31, 2007 and 2006, respectively. The carrying value was \$42,508,431 and \$38,593,672 at December 31, 2007 and 2006, 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 \$3,483,000 and \$4,314,000 in 2007 and 2006, 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, 2007:

2008	\$	3,344,858
2009		3,218,363
2010		3,147,021
2011		2,977,889
2012 – 2016		8,471,383
2017 – 2019		3,420,959
		3,420,959
	\$	24,580,473

**(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.