Valley Medical Center

INDEPENDENT AUDITOR'S REPORT

AND FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007

CONTENTS

INDEPENDENT AUDITOR'S REPORT

To the Board of Commissioners
Public Hospital District No. 1
of King County, Washington
dba Valley Medical Center

We have audited the accompanying balance sheet of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center, as of December 31, 2008 and 2007, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center, as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis on pages 2 through 20 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Moss Adams LLP

Everett, Washington
April 15, 2009

Introduction

This report consists of three parts: Management's Discussion and Analysis (MD&A), Financial Statements, and Notes to the Financial Statements.

The following discussion and analysis provides an overview of the financial position and activities of Public Hospital District No. 1 of King County, dba Valley Medical Center (the Medical Center) for the year ended December 31, 2008. This discussion has been prepared by management and is designed to focus on current activities, resulting changes, and current known facts and should be read in conjunction with the financial statements and accompanying notes that follow this section.

Volume and Statistics

Following are key operating statistics for the years ended December 31, 2008, 2007, and 2006:

	2008	2007	2006
Inpatient and Operating Room Activity			
Available beds	245	234	169
Discharges	16,377	16,281	15,583
Patient days	54,436	53,746	50,570
Length of stay	3.56	3.40	3.25
Occupancy	61%	63%	82%
Surgery patients	11,569	10,937	10,980
Births	4,070	3,844	3,489
Ambulatory and Emergency Services			
Outpatient visits	500,139	489,973	452,493
Emergency department visits	69,703	72,137	73,332
Medical Center Staffing			
Full-time equivalent employees	2,037	1,903	1,824

Overall, the Medical Center experienced increased volumes in 2008 compared with the prior two years.

In January 2008, available beds, which were 169 in 2006 and 234 in 2007, increased to 245. More beds became available in both 2007 and 2008 due to two factors: (1) additional beds added to accommodate expanding service lines, including a step-down progressive care unit and a comprehensive neurosciences unit, and (2) to the completion of construction activity that had resulted in beds previously being taken out of service.

Volume and Statistics (continued)

Discharges and total patient days increased 1% in 2008 over 2007's volumes. Discharges increased 5% and total patient days increased 6% in 2007 over 2006. Average length of stay, excluding newborns, increased slightly from 3.40 days to 3.56 days. The increase in average length of stay is primarily attributed to a slightly increased care mix in 2008 over prior years.

The increase in total patient days, which was primarily within acute care days, can be attributed to the increased volumes throughout the entire medical-surgical array of services and population growth within the District.

The occupancy percentage decreased from 82% in 2006 to 63% in 2007 and 61% in 2008. That is not unexpected given that statistic is calculated using total available beds, and the Medical Center's beds increased somewhat substantially in 2007 and 2008, as noted above.

The surgery department's volumes between 2006 and 2007 and between 2007 and 2008 were constant. Throughout nearly all three years, the surgery department was undergoing major construction and renovation in two phases. Consequently, at given times throughout nearly all three years, there were surgical suites unavailable. Phase I of the surgical remodel was completed in third quarter 2007 and is now operational. Phase II continued throughout the remainder of 2007 and became operational in late 2008.

Births increased 6%, 10%, and 26% between 2007-2008, 2006-2007, and 2005-2006, respectively. The substantial increases in both periods are due to several factors. In late 2005, the Medical Center's remodeled and expanded birthing center opened with a different model: an LDRPN (labor, delivery, recovery, postpartum, and nursery) and neonatal intensive care unit. With the change in model, the Medical Center added a midwifery program with six midwives in September 2006, which has also increased volumes by attracting new patients to the Medical Center.

Outpatient visits increased 2% and 8% between 2007-2008 and 2006-2007, respectively. In 2008, as in 2007, the Medical Center saw increased volumes in the hospital-based outpatient visits in the specialized Breast Health Center, the various therapy-based departments, and the clinical lab on a year-over-year comparative basis. The Medical Center also opened three urgent care clinics in 2008. The majority of primary care clinics had comparative volumes between 2007 and 2008.

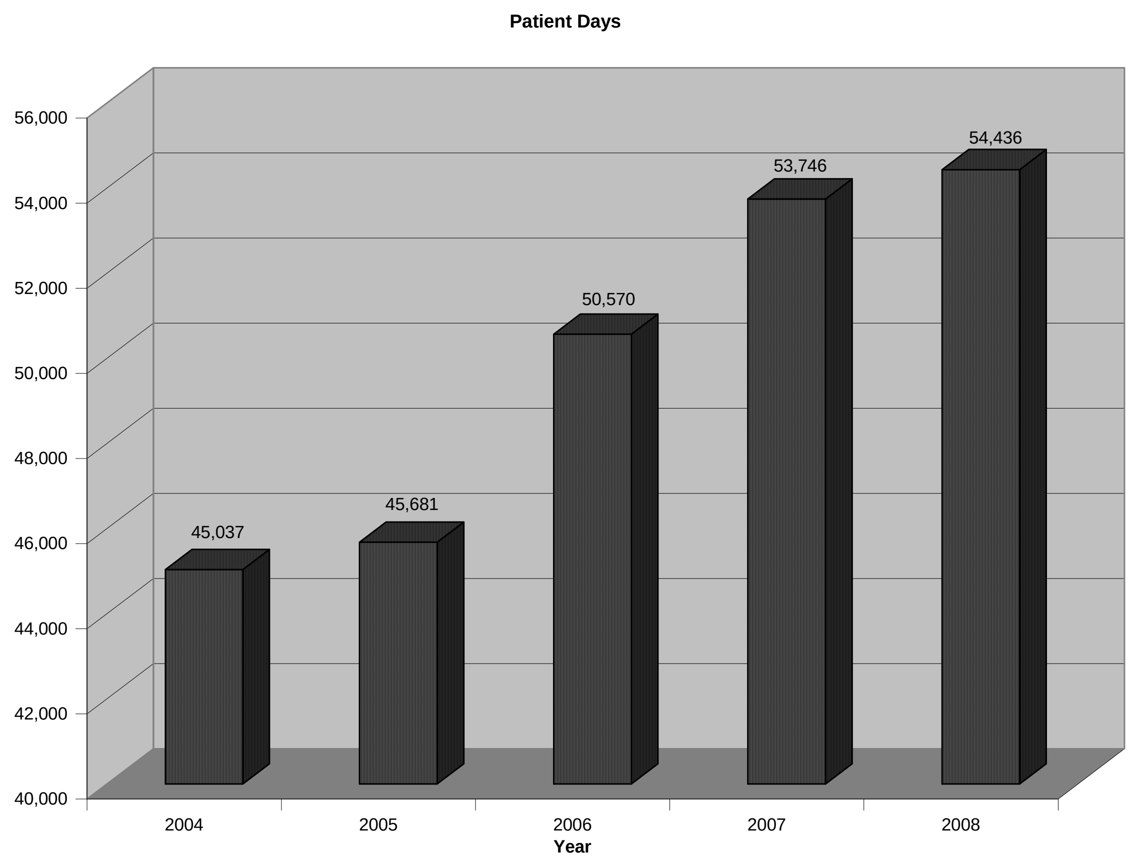
The emergency department visits in 2008 decreased 3% from 2007's volumes. Some of that decrease is attributable to the opening of the urgent care clinics, one of which is in close proximity to the main campus. Also, in early 2007, the Medical Center commenced construction on a new emergency services tower which, at various times during the year, has altered access into the emergency department.

Volume and Statistics (continued)

As volumes have increased and the Medical Center has expanded its service lines into new specialties and subspecialties, additional staff, including many specialists, have been employed, which is demonstrated by the 7% and 4% increase in total FTEs between 2007-2008 and 2006-2007, respectively.

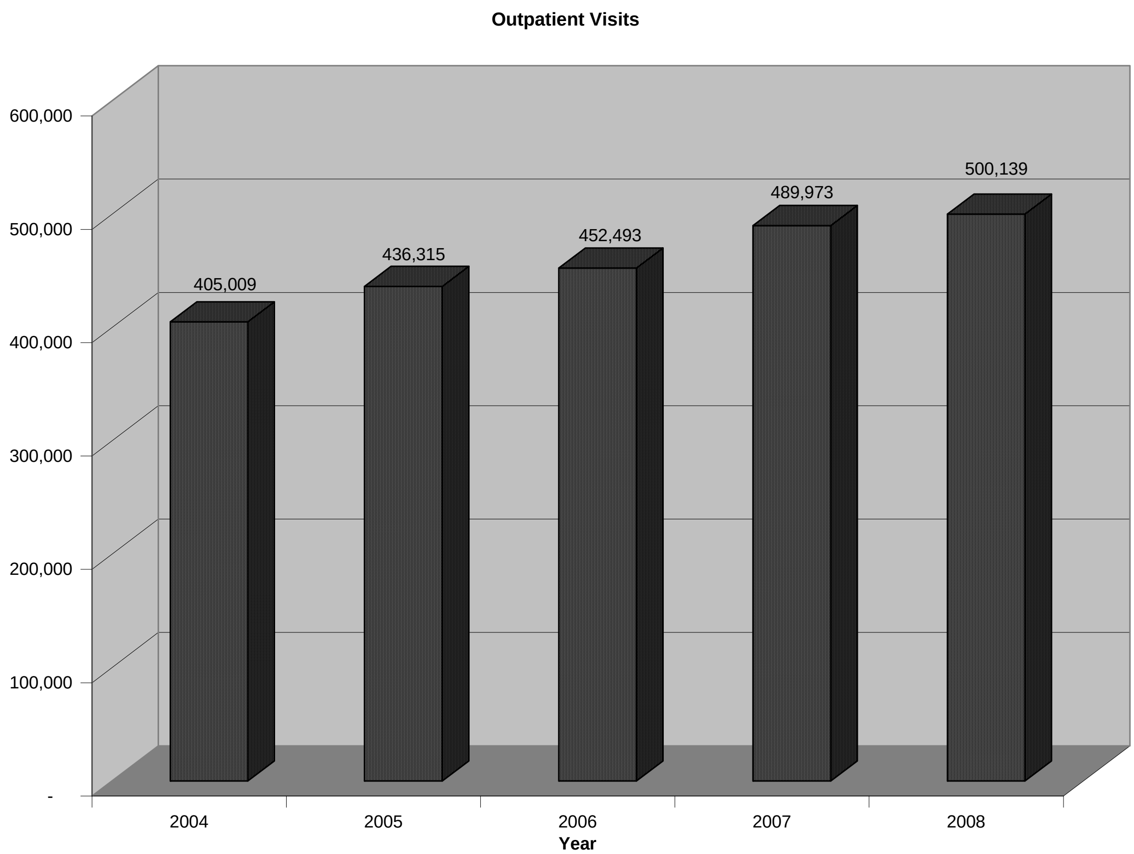
While the Medical Center's overall volumes for the year increased by 2%, as mentioned above, it is worth noting that during the month of December 2008, the greater Puget Sound area experienced a severe snow storm that impacted the region for over a week. The Medical Center's operations were impacted by this storm. Many patients, and some health care providers, were unable to reach the hospital and clinics, which negatively impacted volumes in the month of December (and for the year as a whole).

As the following graphs illustrate, over the past five years, the Medical Center has experienced significant growth in volumes.



Volume and Statistics (continued)

Patient days have increased by 21% between 2004 and 2008 and reflect overall volume growth across the Medical Center's inpatient departments, coupled with a general increase in case mix. Patient days have increased in both acute care and critical care areas, as well as in same-day stays.



Outpatient visits have increased 23% between 2004 and 2008. Growth in outpatient volumes occurred in hospital-based departments, as well as in an expanding primary and specialty care clinic network. The Medical Center also added three urgent care clinics in 2008. Hospital-based departments that experienced significant growth over the past five years include all the therapy-based departments, the clinical lab, the Breast Health Center, and the sleep lab.

The Medical Center emphasized and expanded its primary and specialty care clinic network during this five-year period as well by adding additional primary care clinics and developing a network of specialized clinics and providers in such areas as neurology, neurosurgery, nephrology, midwifery, vascular surgery, and ophthalmology.

Financial Highlights

The health care industry continued to face operational and financial challenges in 2008. At the local, regional, and national levels, health care institutions continued to experience serious cost and payment pressures dictated by federal and state health care reforms, and from both governmental payors (Medicare and Medicaid) and private (instituted health maintenance organizations).

The current economic crisis and recession have also added challenges. As the economy further weakened in 2008, there were inflationary pressures on medical supplies, devices, and pharmaceuticals. The cost of labor and benefits continued to increase at a pace higher than inflation. Employers reduced healthcare coverage for employees and increased deductibles. Unemployment increased, and with an increase in unemployment, there is a corresponding increase in uncompensated care and bad debt.

As in prior years, locally as well as nationally, there remained continuous struggles to employ and retain a specialized health care workforce, creating an increased cost of labor. Due to significant enhancements in some departments, as well as the addition of new services and specialties, the need for specialized labor was even more magnified in 2008 for the Medical Center.

In 2005, the Medical Center recognized that there was significant need within its community for additional access to state-of-the-art medical care, including advances in medical procedures, medical technology, and information technology. To that end, the Medical Center commenced a major initiative in 2006 in remodeling, rebuilding, and constructing new key pieces of the Medical Center's infrastructure, including two floors of surgical suites, a central utility plant, and a new emergency services tower, composed of two floors of underground parking, a new and significantly expanded 56-room emergency department, a new and expanded critical care unit, additional patient floors, and enhanced information technology.

All of those initiatives required substantial commitment to future years of capital infrastructure spending, including a $105 million LTGO bond offering in October 2006. The 2006 LTGO bonds were refunded in early 2008, and another $48 million in LTGO bonds were issued. The Medical Center has pledged its tax revenues to fund this initiative. Construction commenced on the South Tower in third quarter 2007. By the end of 2008, the surgical suites were operational. The central utility plant is scheduled to come online in 2009. The emergency services tower is scheduled to open in early 2010.

While the Medical Center experienced a decrease in net income from operations compared to 2007, the Medical Center's operations overall have remained financially strong. The Medical Center's financial performance as of December 31, 2008, was a net income from operations of $7.2 million, compared to $21.4 million in 2007 (66% decrease between 2007 and 2008) and $18.9 million in 2006 (an increase of 13% between 2006 and 2007).

Financial Highlights (continued)

The Medical Center's overall continued financial stability was due to many factors:

- The Medical Center actively used a daily labor productivity system, which monitored staffing levels on a shift-by-shift acuity basis.
- Significant emphasis was made in 2008 to fill open positions in specialty and nursing care areas, thus reducing the need to use overtime and/or agency replacement staff.
- Increased tax revenues.
- Attention was placed on monitoring actual to budget expenses, with variances requiring immediate attention.
- Continued emphasis on revenue cycle management, ensuring the Medical Center is appropriately billing for and timely collecting for the services it provides.
- Continued emphasis on supply chain management, including renegotiation with key suppliers and focused use of a group purchasing organization, when appropriate.
- Continued diversification and growth of both inpatient and outpatient service lines, with the completion of the Surgery remodel, the building of a neurosciences institute with multiple subspecialties, and the continued expansion of the primary and specialty care clinic network, including the midwifery practice and three urgent care clinics.

Highlights include:

- The Medical Center's current assets increased 11% between 2007 and 2008 and 10% between 2006 and 2007, from $118.1 million in 2006 to $129.7 and $143.4 million in 2007 and 2008, respectively. The increase between years is due to increased tax revenues, as well as increased cash collections.
- The Medical Center's net assets increased in each of the past three years with a $7.0 million, or 4%, increase in 2008; a $25.6 million, or 15%, increase in 2007; and a $19.7 million, or 14%, increase in 2006.
- The Medical Center's total net operating revenue has increased each of the past three years. Net operating revenue increased by 6% over prior year to $348.1 million in 2008. Net operating revenue in 2007 was $328.0 million, which was an increase of 11% over 2006's $295.9 net operating revenue.
- The Medical Center has had positive net operating income for the past three years. In 2008, net income from operations was $7.2 million. In 2007, net income from operations was $21.4 million, and in 2006, net income from operations was $18.9 million.

Overview of the Financial Statements

The Medical Center's financial statements consist of three statements: balance sheet; statement of revenues, expenses, and changes in net assets; and statement of cash flows. These financial statements and related notes provide information about the activities of the Medical Center, including resources held by the Medical Center but restricted for specific purposes by contributors, grantors, or enabling legislation.

The balance sheet includes all of the Medical Center's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be used for general purposes and which are designated for a specific purpose.

The statement of revenues, expenses, and changes in net assets reports all of the revenues and expenses during the time period indicated. Net assets—the difference between assets and liabilities—is one way to measure the financial health of the Medical Center.

The statement of cash flows reports the cash provided by the Medical Center's operating activities, as well as other cash sources such as investment income and cash payments for capital additions and improvements. This statement provides meaningful information on where the Medical Center's cash was generated and what it was used for.

Balance Sheet

The following is a presentation of certain condensed financial information derived from the Medical Center's Balance Sheet (amounts in thousands):

	2008	2007	2006
ASSETS			
Current assets	$ 143,433	$ 129,726	$ 118,119
Assets limited as to use, net of current amount	95,870	143,739	160,222
Capital assets, net	305,698	226,515	193,474
Other noncurrent assets	18,440	15,039	12,629
Total assets	$ 563,441	$ 515,019	$ 484,444
LIABILITIES			
Current liabilities	$ 66,120	$ 63,762	$ 53,898
Noncurrent liabilities	301,960	262,925	267,658
Total liabilities	368,080	326,687	321,556
NET ASSETS			
Invested in capital assets, net of related debt	53,271	66,623	57,036
Restricted			
For debt service	5,286	9,823	9,769
Expendable for specific operating activities	349	284	487
Unrestricted	136,455	111,602	95,596
Total net assets	195,361	188,332	162,888
Total liabilities and net assets	$ 563,441	$ 515,019	$ 484,444

Financial Analysis

Balance Sheet - Assets

At December 31, 2008, the Medical Center had total assets of approximately $563.4 million, which was an increase of $48.4 million, or 9%. Of this amount, approximately 25% is related to current assets, 2% is related to long term investments, 17% is related to restricted cash and investments (assets limited as to use), 54% is investment in capital assets (buildings and equipment), and 2% is in other noncurrent assets.

Financial Analysis (continued)

Balance Sheet - Assets (continued)

The Medical Center had total assets of approximately $515.0 million at December 31, 2007, which was an increase of $30.6 million, or 6%, from 2006's balance sheet figures. Of this amount, approximately 25.2% is related to current assets, 28% is related to restricted cash and investments (assets limited as to use), 44% is investment in capital assets (buildings and equipment), and 3% is in other noncurrent assets.

Current assets increased 11% between 2007 and 2008, from $129.7 million to $143.4 million, for an increase of $13.7 million at December 31, 2008. Cash and cash equivalents decreased 40%, or approximately $23 million, while short-term investments increased 540%, or approximately $30.0 million. In total, however, highly liquid investments increased by a net of approximately $11.0 million, which also explains one-third of the overall increase in total assets at year-end. The overall increase in short-term highly liquid investments and the decrease in cash is reflective of overall portfolio and cash management strategies designed to enhance returns in then-current (year-end 2008) market conditions.

Days in overall net patient accounts receivable remained comparative between years at 38 days in 2008 and 39 days in both 2006 and 2007.

Assets limited as to use decreased $47.9 million, or 33%, between 2007 and 2008 year-ends. This was anticipated, as significant construction activity was underway in 2008 and board-designated assets, including debt proceeds, were being spent for construction-related activity on both the surgery remodel and the emergency services tower projects.

Capital assets, net, increased by $79.2 million, or approximately 35%, between 2007 and 2008. This increase was also anticipated. Between 2007 and 2008, the construction in progress account increased by $50.9 million, or 109%. Likewise, depreciable capital assets, net of depreciation, increased by $28.3 million, or 17%. Both accounts are indicative of the capital spending the Medical Center embarked upon in construction of the South Tower and the subsequent capitalization of the surgery remodel, as well as other construction projects.

Other amounts within the assets limited to use section of the balance sheet include self-insurance reserve funds, deferred compensation arrangements, revenue bond indenture agreements, and limited general obligation bond agreements.

Financial Analysis (continued)

Balance Sheet - Liabilities

The Medical Center had approximately $368.1 and $326.7 million in total liabilities as of December 31, 2008 and 2007, respectively, of which 18% and 20% were current in 2008 and 2007, respectively, and 82% and 80% were long-term liabilities, primarily debt.

Current liabilities include accounts payable (33% of total current liabilities); accrued salaries, wages, and benefits (38%); and other liabilities (29%). These figures, as a percentage of total current liabilities, closely mirror 2007 and 2006's year-end balances.

At December 31, 2008, total current liabilities were $66.1 million, compared with 2007's $63.8 million, for an increase of approximately $2.3 million, or 4%. This increase is a combination of several factors. Year-end accounts payable increased, both as a function of timing and a reflection of the significant capital spending currently underway with the construction of the emergency services tower. The increase in salaries, wages, and benefits represents timing issues, as well as the higher cost of a specialized health care workforce.

Long-term portion of debt, net of current portion, for the years ended December 31, 2008 and 2007, consisted of various bond series and capital leases primarily used to finance construction of medical facilities and for medical and other related equipment. Long-term debt between December 31, 2008 and 2007 increased by $40.1 million (16%), from $258.1 million to $298.2 million. This increase is directly attributable to the 2008 LTGO bonds that were issued in March 2008 as part of the larger 2008 LTGO refunding and new debt issuance.

There was no outstanding balance on the Medical Center's line of credit.

Financial Analysis (continued)

Balance Sheet - Net Assets

The Medical Center reports its net assets in three categories (the Medical Center does not have any assets meeting the criteria of the fourth category, donor-restricted nonexpendable net assets):

Invested in capital assets net of related debt - Total investment in Medical Center property, plant, and equipment net of accumulated depreciation and outstanding debt obligations related to those capital assets.

Restricted for debt service and expendable net assets - Resources the Medical Center is legally or contractually obligated to spend in accordance with restrictions placed by donors and/or external parties that have placed time or purpose restrictions on the use of the asset.

Unrestricted net assets - All other funds available to the Medical Center for the general obligations to meet current expenses for any purpose.

As of December 31, 2008, total net assets increased by $7 million, or 4%, to $195.4 million, from $188.3 million at December 31, 2007. As of December 31, 2007, total net assets increased by $25.4 million to $188.3 million, from $162.9 million at December 31, 2006.

Financial Analysis (continued)

Revenues, Expenses, and Changes in Net Assets

The statement of revenues, expenses, and changes in net assets presents the operating results of the Medical Center, as well as the nonoperating revenues and expenses. Activities are reported as either operating or nonoperating. The use of long-lived assets, referred to as capital assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

Medical Center Summary of Revenues, Expenses, and Changes in Net Assets
Years Ended December 31, 2008, 2007, and 2006
(dollars in thousands)

	2008	2007	2006
Net operating revenue	$ 348,116	$ 327,699	$ 295,861
Net operating expenses	340,899	306,262	276,915
Operating income	7,217	21,437	18,946
Nonoperating income (expense)	(188)	4,007	737
Increase in net assets	7,029	25,444	19,683
Net assets, beginning of year	188,332	162,888	143,205
Net assets, end of year	$ 195,361	$ 188,332	$ 162,888

Total Operating Revenues

For the year ended December 31, 2008, the Medical Center's net operating revenue was $348.1 million. Net operating revenues consist of net patient revenues, tax revenues, and other operating revenues. The net operating revenues for 2008 increased 6% over 2007's net operating revenues of $327.7 million. The increase in net operating revenues between 2006 and 2007 was 11%.

For the third consecutive year, the Medical Center experienced increases, on a year-to-year comparative, in net operating revenue. For all three years, revenues increased due to both inpatient and outpatient volume and rate increases, as the overall aggregate number of patients increased by 2% between 2007 and 2008, and 3% between 2006 and 2007.

Financial Analysis (continued)

Total Operating Revenues (continued)

In 2008, the Medical Center continued to build two service line initiatives that have both inpatient and outpatient components: a neurosciences institute and a comprehensive oncology program, including the Breast Health Center and Radiation Oncology. Both the Breast Health Center and the Radiology-based departments experienced significant growth in 2008.

The Birth Center and Neonatal Intensive Care Unit (NICU) continued to experience high volumes. The Birth Center had over 4,000 births in 2008, and the NICU continued to have higher than anticipated level three days.

In 2008, the Medical Center added three urgent care clinics to its primary and specialty care clinic network. The clinic network also expanded access by adding extended hours and Saturday coverage at some of the primary care clinics.

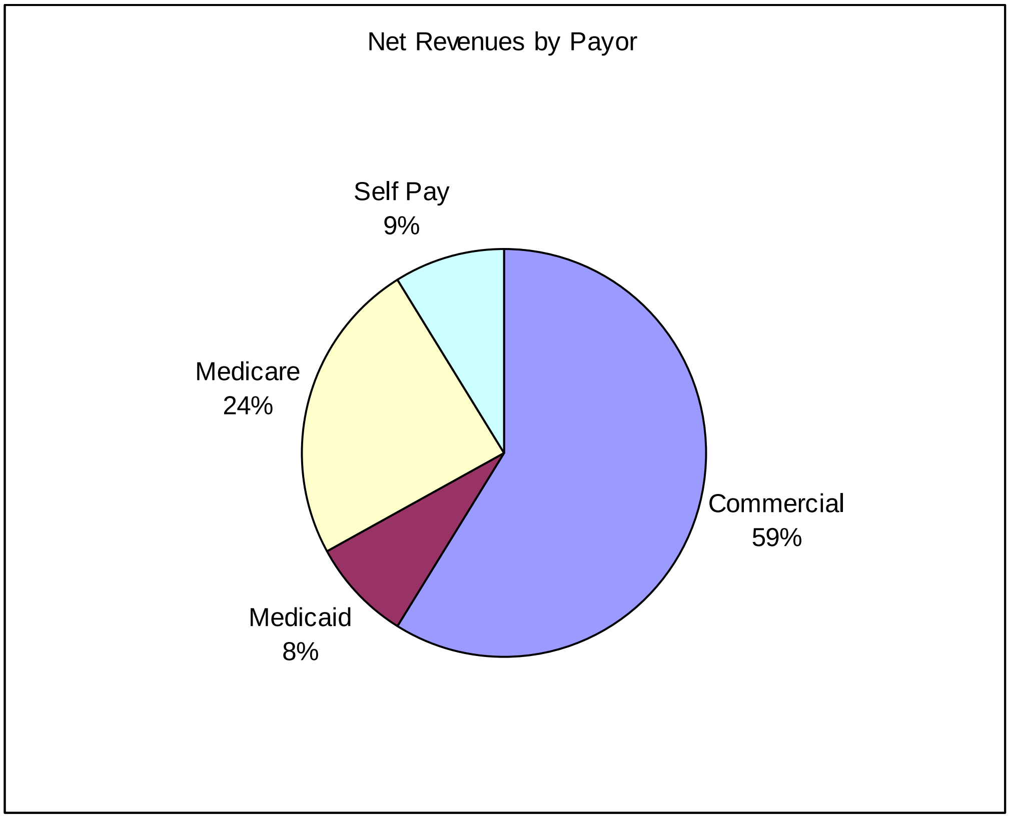
Revenues also increased due to selected rate increases, which were implemented mid-year and from contract renegotiation with third-party payors.

The Medical Center has agreements with governmental and third-party payors that provide for payments at amounts different from gross charges. Contractual adjustments represent the difference between published rates for services and amounts paid by these third-party payors. Additionally, charity care and bad debts are also netted in determining net patient revenues. The resulting net patient revenues are shown on the statement of revenues, expenses, and changes in net assets.

Financial Analysis (continued)

Total Operating Revenues (continued)

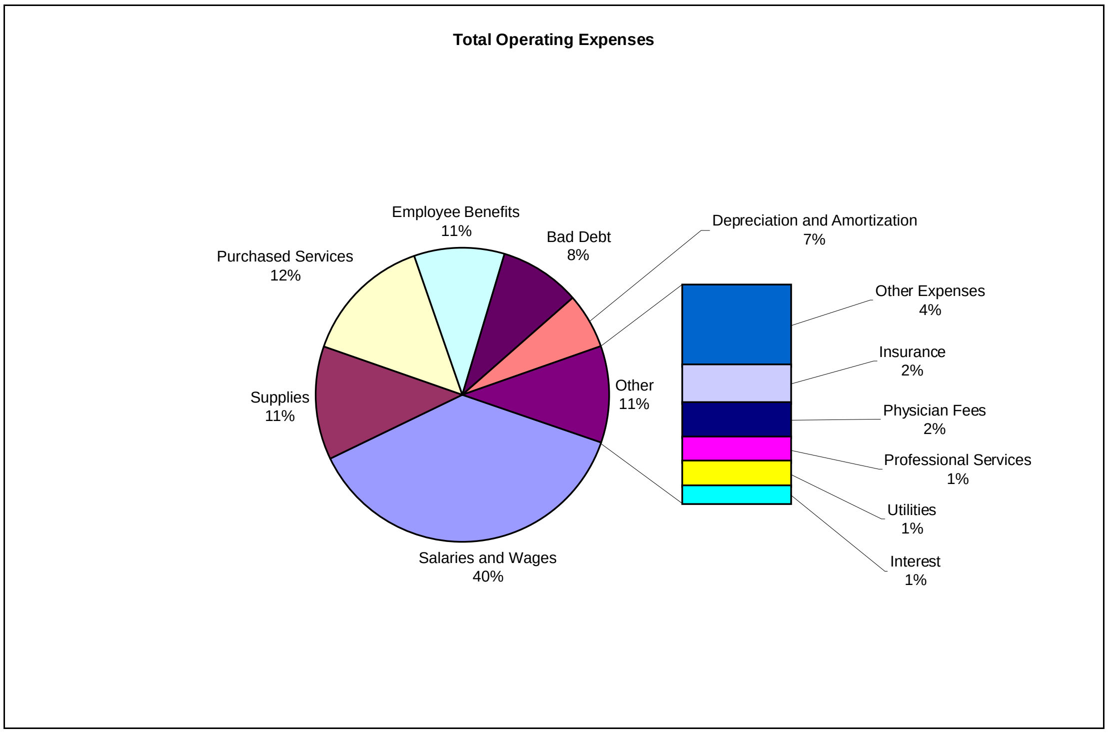
The Medical Center's largest singular payor, based upon gross revenues, is Medicare, though commercial payors, collectively, comprise the largest segment. The graph below illustrates the Medical Center's payor mix based on net revenues for the year ended December 31, 2008.



Financial Analysis (continued)

Total Operating Expenses

The graph below illustrates the various components of operating expenses expressed as percentages of total operating expense, including bad debt expense, which, for financial statement purposes, is netted against net patient revenue on the statement of revenues, expenses, and changes in net assets.



Salaries, wages, and benefits comprised 51% of total operating expenses in 2008 and 50% of total operating expenses in 2007, compared with 52% of total operating expenses in 2006.

Supplies, purchased services, and other related expenses collectively accounted for 34% of operating expenses in 2008 (33% in 2007 and 35% in 2006), and 5% of operating expense was related to depreciation (6% in 2007 and 7% in 2006). Bad debt comprised 8% of operating expense in 2008, compared with 9% in 2007 and 5% in 2006, and 2% of total operating expense was interest and amortization in 2008, 2007, and 2006.

Financial Analysis (continued)

Operating Expense Detail

Operating expenses totaled approximately $340.9 million, $306.3 million, and $276.9 million for the years ended December 31, 2008, 2007, and 2006, respectively. This was an increase of 11% in both 2008 and 2007, and 14% in 2006.

Operating expenses increased 11% between 2007 and 2008 for several reasons. Salaries and wages increased approximately $16.3 million, or 12%, between years. Mid-year, the hospital switched from an acuity-based staffing model to a matrix schedule. The Medical Center's model also strengthened the nursing core by employing more registered nurses and fewer patient care assistants. Also, during 2008, a concerted effort was deployed to fill highly specialized positions, thus reducing the need for contract personnel. As part of the initiative of increasing the breadth and depth of comprehensive services the Medical Center provides to its community, new hospital-based departments and clinics were opened throughout the year, which required employing specialized physicians and ancillary and support staff. These factors are also directly applicable to the change in salaries and wages between 2006 and 2007.

Increases in salaries and wages were also attributed to contractually agreed-upon salary increases under various labor agreements.

Employee benefits increased 9% from $36.4 million in 2007 to $39.7 million in 2008. Increases in employee benefits included high utilization of benefits, as well as higher pension costs. Both of these increases are due to an increase in the number of employees, as well as employee dependents, covered under the Medical Center's health and dental insurance plans.

Supplies and other expenses increased 11% from $112.2 million in 2007 to $124.4 million in 2008. This line item includes supplies, physician fees, professional services, purchased services, utilities, and other expenses.

As previously mentioned, the Medical Center experienced higher overall volumes in 2008, which resulted in higher overall supply expense on a pure dollar basis (though supply expense was down, year to year, on a volume/case mix adjusted basis). The Medical Center participates in a group purchasing organization for the benefit of volume discounts on supply purchases.

Physician fees represent the Medical Center's investment in certain physician coverage programs and medical directorships. Examples of coverage programs include contract physician hospitalists and intensivists, as well as emergency department call coverage, to provide needed patient care. All of these programs were expanded in 2008 to provide appropriate care to the Medical Center's community.

Financial Analysis (continued)

Operating Expense Detail (continued)

Purchased services include such items as medical services, including lab services; repair and maintenance; and software-related maintenance fees. Purchased services increased primarily because the patient accounting functionality was transitioned to a third party mid-way through 2007, so 2008 had a full year's of that purchased service expense. In addition, new software systems came online in 2008 that increased software-related maintenance expense.

Depreciation continued to be relatively consistent between years, increasing 5% between 2007 and 2008, from $19.0 million to nearly $20.0 million. The increase between 2006 and 2007 was nearly 2%, from $18.7 million in 2006 to $19.0 million in 2007. The increase in depreciation was fully anticipated as the renovated surgery suites were capitalized. While a significant amount of construction was capitalized in both 2008 and 2007, the Medical Center also had a facility life analysis performed by an external consultant on the Medical Center's buildings that resulted in extending the composite remaining economic life of those buildings.

Interest and amortization increased 28% between 2007 and 2008, from $6.8 million to $8.6 million. There are several reasons for the increase in interest expense. Prior to March 2008, the Medical Center had $170 million in auction rate securities—$65 million in the 2005 revenue series A and B bonds and $105 million in the 2006 limited tax general obligation series A and B bonds. Those bonds had been trading on a seven-day auction period with an average 3.75% variable interest rate. The dislocation in the market resulted in default interest rates as high as 15%.

In March 2008, the Medical Center successfully refunded both the 2005 and 2006 bond series with the 2008 LTGO bond series (see note 8) and a fixed interest rate of 5.25%. However, the Medical Center did pay higher than anticipated variable interest for the time period between when the auction rate market dislocated and when the refunding was finalized.

In addition, the Medical Center issued $50 million in new LTGO debt as part of the 2008 LTGO bond series to fund certain District capital projects, including completion of the emergency services tower project.

The provision for bad debt expense is shown netted against net operating revenue for purposes of financial reporting. In 2008, the Medical Center had $29.9 million in bad debt, compared to $30.0 million in 2007.

Financial Analysis (continued)

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses primarily include rental income and expense from medical office buildings the Medical Center owns, as well as any gain/loss of the sale of assets.

Overall, nonoperating revenue and expense decreased by 105% from approximately $4.0 million in 2007 to a loss of nearly ($200,000) in 2008. Given that the Medical Center is statutorily limited in what it may invest in (see Note 4), the significant decrease is due to market conditions in the overall economy and the associated unrealized losses associated with those market fluctuations.

The large gain in 2007 is also not a truly appropriate comparative. In November 2007, the $65.0 million interest rate swaps associated with the 2005 revenue bonds were unwound, resulting in a nonoperating gain of $4.1 million.

Statement of Cash Flows

The statement of cash flows presents the information related to cash inflows and outflows summarized by operating, capital, and noncapital financing and investing activities, and information about cash receipts and cash payments during the year. This statement also helps users assess the Medical Center's ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

**Medical Center Summary of Cash Flows - Direct Method
Years Ended December 31, 2008, 2007, and 2006
(dollars in thousands)**

	2008	2007	2006
Cash flows from			
Operating activities	$ 7,304	$ 31,156	$ 15,437
Noncapital financing activities	18,550	17,802	17,488
Capital and related financing activities	(65,152)	(68,187)	52,758
Investing activities	9,920	24,614	(25,001)
Net change in cash and cash equivalents	(29,378)	5,385	60,682
Cash and cash equivalents, beginning of year	93,963	88,578	27,896
Cash and cash equivalents, end of year	$ 64,585	$ 93,963	$ 88,578

Financial Analysis (continued)

Statement of Cash Flows (continued)

Operating activities - This section reflects operating cash flows and the net cash provided by the operating activities of the Medical Center.

Noncapital financing activities - This section shows the cash received and spent for nonoperating, noninvesting, and noncapital financing purposes.

Capital and related financing activities - This section reflects the sources and uses of cash for the acquisition and construction of capital and related items.

Investing activities - This section reflects the cash flows from investing activities and shows the purchases, proceeds, and interest received from investing activities.

Contacting the Medical Center's Financial Management

This financial report provides the reader with a general overview of the Medical Center's finances and operations. If you have questions about this report or need additional financial information, please contact the Chief Financial Officer, Larry Smith, at Valley Medical Center, PO Box 50010, Renton, WA 98058, by email at larry.smith@valleymed.org, or by phone at 425.228.3450.

PUBLIC HOSPITAL DISTRICT NO. 1
OF KING COUNTY, WASHINGTON
BALANCE SHEET

ASSETS

	DECEMBER 31, 2008	DECEMBER 31, 2007
CURRENT ASSETS		
Cash and cash equivalents	$ 35,212,714	$ 58,244,680
Short-term investments	35,658,322	5,569,435
Accounts receivable, less allowance for uncollectible accounts of $21,307,699 in 2008 and $24,290,074 in 2007	32,339,273	30,862,997
Assets whose use is limited, required for current obligations	29,909,137	23,683,522
Supplies inventory	4,642,731	3,941,976
Prepaid expenses and other assets	5,670,839	7,423,178
Total current assets	143,433,016	129,725,788
LONG-TERM INVESTMENTS	11,762,302	7,589,262
ASSETS LIMITED AS TO USE		
By board for general capital improvements	114,030,561	150,027,526
By board for self-insurance reserve funds	1,744,837	1,615,332
Under deferred compensation arrangements	4,717,310	5,956,325
Under revenue bond indenture agreements	4,766,309	9,427,958
Under general and limited general obligation bond agreements	519,689	395,488
	125,778,706	167,422,629
Less amounts required for current obligations	(29,909,137)	(23,683,522)
	95,869,569	143,739,107
CAPITAL ASSETS		
Land	8,286,029	8,286,029
Construction in progress	97,399,006	46,548,547
Depreciable capital assets, net of accumulated depreciation	200,013,190	171,680,451
	305,698,225	226,515,027
DEFERRED FINANCING COSTS	4,725,475	4,539,654
INVESTMENT IN AFFILIATE	1,952,532	2,910,372
Total assets	$ 563,441,119	$ 515,019,210

LIABILITIES AND NET ASSETS

	DECEMBER 31, 2008	DECEMBER 31, 2007
CURRENT LIABILITIES		
Warrants payable	$ 4,219,676	$ 4,377,732
Accounts payable	17,689,734	15,512,612
Accrued salaries, wages, and benefits	25,176,835	23,458,946
Estimated third-party payor settlements	400,000	270,807
Interest, patient refunds, and other payables	11,796,953	13,833,534
Current portion of long-term debt and capital lease obligations	6,837,255	6,308,939
Total current liabilities	66,120,453	63,762,570
DEFERRED COMPENSATION	3,754,443	4,832,728
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS, net of current portion	298,204,713	258,091,870
Total liabilities	368,079,609	326,687,168
NET ASSETS		
Invested in capital assets, net of related debt	53,271,061	66,622,936
Restricted		
For debt service	5,285,998	9,823,446
Expendable for specific operating activities	348,995	283,595
Unrestricted	136,455,456	111,602,065
Total net assets	195,361,510	188,332,042
Total liabilities and net assets	$ 563,441,119	$ 515,019,210

See accompanying notes.

PUBLIC HOSPITAL DISTRICT NO. 1
OF KING COUNTY, WASHINGTON
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

	YEAR ENDED DECEMBER 31, 2008	YEAR ENDED DECEMBER 31, 2007
OPERATING REVENUES		
Net patient service revenue (net of provision for bad debts of $29,867,693 in 2008 and $29,977,769 in 2007)	$ 309,323,803	$ 286,373,372
Revenue from taxation	18,531,186	18,004,812
Other operating revenue	20,261,406	23,320,234
Total operating revenues	348,116,395	327,698,418
OPERATING EXPENSES		
Salaries and wages	148,148,994	131,883,195
Employee benefits	39,711,384	36,398,416
Supplies and other expenses	124,438,743	112,223,474
Depreciation	19,981,900	19,004,893
Interest and amortization	8,617,573	6,751,826
Total operating expenses	340,898,594	306,261,804
OPERATING INCOME	7,217,801	21,436,614
NONOPERATING INCOME (EXPENSE)		
Investment income (loss)	(883,472)	5,507,678
Other, net	695,139	(1,500,835)
Net nonoperating income (expense)	(188,333)	4,006,843
INCREASE IN NET ASSETS	7,029,468	25,443,457
NET ASSETS, beginning of year	188,332,042	162,888,585
NET ASSETS, end of year	$ 195,361,510	$ 188,332,042

See accompanying notes.

STATEMENT OF CASH FLOWS

Increase (Decrease) in Cash and Cash Equivalents

	YEAR ENDED DECEMBER 31, 2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from and on behalf of patients	$ 307,976,720	$ 286,270,152
Payments to suppliers and contractors	(124,950,234)	(103,861,855)
Payments to employees	(187,220,774)	(164,469,106)
Other cash receipts	11,498,659	13,217,027
Net cash from operating activities	7,304,371	31,156,218
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash received from tax levy	18,484,065	18,004,812
Other	65,400	(203,309)
Net cash from noncapital financing activities	18,549,465	17,801,503
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from issuance of refunding bonds	218,220,000	
Proceeds from premium on refunding bonds	1,772,154	
Payment to refunding bond escrow agent	(170,753,540)	
Principal payments on long-term debt and capital lease obligations	(6,309,341)	(5,706,704)
Cash paid for bond issuance	(3,750,119)	
Interest paid, net of amounts capitalized	(6,497,248)	(6,364,838)
Purchases of capital assets	(98,463,679)	(56,477,019)
Other	629,739	361,747
Net cash from capital and related financing activities	(65,152,034)	(68,186,814)
CASH FLOWS FROM INVESTING ACTIVITIES		
Distributions from joint venture	5,392,397	6,160,437
Cash provided by investments and assets whose use is limited	150,471,447	72,236,811
Deposits into investments and assets whose use is limited	(150,271,556)	(58,998,148)
Investment and interest income, net of amounts capitalized	4,328,190	5,215,056
Net cash from investing activities	9,920,478	24,614,156
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(29,377,720)	5,385,063
CASH AND CASH EQUIVALENTS, beginning of year	93,963,086	88,578,023
CASH AND CASH EQUIVALENTS, end of year	$ 64,585,366	$ 93,963,086
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENT OF NET ASSETS		
Cash and cash equivalents	$ 35,212,714	$ 58,244,680
Cash and cash equivalents in assets whose use is limited	29,372,652	35,718,406
	$ 64,585,366	$ 93,963,086

See accompanying notes.

PUBLIC HOSPITAL DISTRICT NO. 1
OF KING COUNTY, WASHINGTON
STATEMENT OF CASH FLOWS (continued)

Increase (Decrease) in Cash and Cash Equivalents

	YEAR ENDED DECEMBER 31, 2008	2007
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income	$ 7,217,801	$ 21,436,614
Adjustments to reconcile operating income to net cash from operating activities		
Interest expense considered a capital financing activity	6,497,248	6,364,838
Revenue from tax levies considered a noncapital financing activity	(18,531,186)	(18,004,812)
Interest income considered an investing activity	(4,328,190)	(5,215,056)
Depreciation	20,433,070	19,656,176
Amortization	1,273,412	415,298
Provision for bad debts	29,867,693	29,977,769
Income recognized from equity investment	(4,434,557)	(4,888,151)
Changes in current assets and liabilities		
Accounts receivable	(31,343,969)	(29,910,128)
Supplies inventory	(700,755)	(355,153)
Prepaid expenses and other assets	1,752,339	(1,107,213)
Warrants payable	(158,056)	67,922
Accounts payable	1,027,305	3,287,876
Accrued salaries, wages, and benefits	1,717,889	2,809,263
Other accrued liabilities, including estimated third-party payor settlements	129,193	(170,861)
Other liabilities	(2,036,581)	5,788,594
Deferred compensation	(1,078,285)	1,003,242
NET CASH FROM OPERATING ACTIVITIES	$ 7,304,371	$ 31,156,218
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Increase (decrease) in capital assets included in accounts payable	$ 1,149,817	$ (2,553,946)
Equipment financed with capital lease obligations	$ 2,772	$ 433,867

Note 1 - Organization

Public Hospital District No. 1 of King County, Washington (the District), a Washington municipal corporation established under Chapter 70.44 Revised Code of the State of Washington (RCW), operates Valley Medical Center (the Medical Center). The District is considered a political subdivision of the state of Washington and is allowed, by law, to be its own treasurer. The District has also been granted 501(c)(3) status by the Internal Revenue Service.

The District includes the cities of Kent, Renton, Covington, and portions of Newcastle and Tukwila. It is the first and largest of the 56 public hospital districts in the state of Washington.

The District was established in 1948 by resolution of the Board of County Commissioners and is governed by a five-member Board of Commissioners, each elected by district residents to serve a six-year term. In accordance with the laws of the state of Washington, the commissioners have delegated day-to-day operations of the District and the Medical Center to the superintendent/CEO.

The Medical Center comprises a hospital, licensed for 303 beds; primary care clinics in the South King County area, including a residency program affiliated with the University of Washington Medical School; three urgent care clinics; specialty clinics in neurosurgery, general surgery, vascular surgery, neurology, nephrology, and internal medicine; and two occupational health clinics and a behavioral health clinic.

The Medical Center does not have any component units (separate governmental entities) within its activities.

Note 2 - Summary of Significant Accounting Policies

Accounting standards - The Medical Center 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 healthcare 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 Medical Center 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.

GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. In June 1999, GASB approved Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* This and other applicable GASB statements are reflected in the accompanying financial statements (including notes to the financial statements).

Note 2 - Summary of Significant Accounting Policies (continued)

The Medical Center has implemented GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. There was no impact on the Medical Center's financial position and results of operations for the years ended December 31, 2008 and 2007, respectively.

The Medical Center has implemented GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation—an amendment of GASB No. 34*, and GASB Statement No. 47, *Accounting for Termination Benefits*. There was no impact on the Medical Center's financial position and results of operations for the year ended December 31, 2008 and 2007, respectively.

The Medical Center has implemented GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. This statement establishes accounting and financial reporting standards for transactions in which a government receives, or is entitled to, resources in exchange for future cash flows generated by collecting specific receivables or specific future revenues. There was no impact on the Medical Center's financial position and results of operations for the years ended December 31, 2008 and 2007, respectively.

The Medical Center has implemented GASB Statement No. 50, *Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27*. This statement requires defined benefit pension plans and defined contribution plans to disclose in the notes to financial statements additional information to improve the transparency and decision usefulness of financial reporting. Required disclosures are found within Note 10.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Guidance is provided relating to the accounting and financial reporting for intangible assets to reduce inconsistencies in reporting and improve comparability among the state and local governments. This statement is effective for periods beginning after June 15, 2009. The Medical Center has not implemented this statement.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments. This statement is effective for periods beginning after June 15, 2009. The Medical Center has not implemented this statement.

The Medical Center has also implemented Statement of Financial Accounting Standards (SFAS) No. 154, *Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3,* which replaces APB Opinion No. 20, *Accounting Changes,* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements*. The statement applies to voluntary changes in existing accounting principles and to new accounting standards that do not specify the transition requirement upon adoption of those standards.

Note 2 - Summary of Significant Accounting Policies (continued)

Except for changes in depreciation methods, this standard requires retrospective application of the new accounting principle to previous periods reported rather than presenting the cumulative effect on the change as of the beginning of the period of the change.

The following is a summary of the most significant accounting policies.

Accrual basis - The accompanying financial statements have been prepared on the accrual basis of accounting using the economic resources measurement focus. Under this method of accounting, revenues are recognized when earned and expenses are recorded when liabilities are incurred without regard to receipt or disbursement of cash.

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.

Capital assets - Land, buildings, and equipment acquisitions are recorded at cost. Improvements and replacements of land, buildings, and equipment are capitalized. The Medical Center's capitalization threshold is $2,500 per item and a useful life of at least three years. Maintenance and repairs are expensed. The cost of land, buildings, and equipment sold or retired and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recorded.

Land, buildings, and equipment donated for Medical Center operations are recorded as additions at fair market value at the date of receipt.

Depreciation is recorded over the estimated useful life of each class of depreciable asset using the American Hospital Association guidelines or based upon facility life analysis performed by an external consultant on the Medical Center's buildings and is computed using the straight-line method over the shorter period of the lease term or the estimated useful life of the asset. The estimated useful lives used by the Medical Center are as follows:

Buildings, renovations, and furnishings	5-60 years
Fixed equipment	5-25 years
Movable equipment	3-20 years
Leasehold improvements	Shorter of lease term or useful life

Interest is capitalized on construction projects as a cost of the related project beginning with commencement of construction and ceases when the construction period ends and the related asset is placed in service. Capitalized interest is depreciated over the estimated useful life of the related asset.

Note 2 - Summary of Significant Accounting Policies (continued)

Federal income taxes - The Medical Center, as a political subdivision of the state of Washington, is not subject to federal income taxes under Section 115 of the Internal Revenue Code unless unrelated business income is generated during the year.

Assets limited as to use/investments - Periodically, the Board of Commissioners sets aside cash resources for the funding of future capital improvements, self-insurance reserves (Note 9), and employee deferred compensation agreements (Note 10). In addition, certain funds are restricted by bond indentures to be used solely for debt service (Note 8). These funds are invested in bankers' acceptances, repurchase agreements, obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, and certificates of deposit or money market funds with financial institutions in accordance with state guidelines.

All Medical Center investments are carried at market value except for debt securities purchased within one year of maturity, which are carried at amortized cost. Investment income earned on the revenue and limited tax general obligation bond indenture agreements is reported as other operating revenue. Realized and unrealized investment income or losses on other investments is reported as nonoperating income or expense.

Deferred financing costs - Deferred financing costs are amortized over the period the obligation is outstanding using the straight-line method that approximates the effective-interest method.

Cash and cash equivalents - Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less, excluding amounts whose use is limited by board designation or by other arrangements under trust agreements.

Patient accounts receivable - The Medical Center's primary credit risk is patient accounts receivable, which consist of amounts owed by various governmental agencies, insurance companies, and private patients. The Medical Center manages the receivables by regularly reviewing its accounts and contracts and by providing appropriate allowance accounts for uncollectible amounts.

Supplies inventory - Supplies inventory, consisting of pharmaceutical, medical-surgical, and other medical supplies, is valued at the lower of cost (computed on the first-in, first-out basis), or net realizable value. Obsolete and uninsurable items are written off.

Insurance - The Medical Center pays certain medical, dental, prescription, and vision claims for its employees, as well as worker's compensation and professional liability claims, on a self-insured basis. The Medical Center has purchased stop-loss insurance to cover claims that exceed stated limits and has recorded estimated reserves for the ultimate costs for both reported claims and claims incurred but not reported.

Note 2 - Summary of Significant Accounting Policies (continued)

General funds - The Medical Center is required to maintain its financial records on a fund accounting basis that segregates assets, liabilities, revenues, and expenses in conformity with state of Washington municipal corporation laws prescribed by the State Auditor under the authority of Chapter 43.09 RCW and the Department of Health in *Accounting and Reporting Manual for Hospitals,* as well as the Board of Commissioners' resolutions. Certain funds maintained separately on the books of the Medical Center have been combined for financial statement presentation.

Operating fund - This fund accounts for current operating assets, liabilities, revenues, and expenses.

Plant and construction funds - These funds account for land, buildings, equipment, funded depreciation, the proceeds of the 2001, 2004, and 2008 limited tax general obligation bonds, and 1992, 1997, and 1998 series revenue bond principal payments. The District transfers sufficient taxation revenues from the bond redemption fund to make principal payments on the series 2001, 2004, and 2008 bonds. Interest payments are also made from the bond redemption fund.

Bond redemption fund - This fund records tax levies and receipts. Principal and interest payments on the series 2001, 2004, and 2008 bonds are made from this fund.

Restricted funds - These funds are maintained to account for restricted donations, gifts, and bequests received from outside sources for specific purposes.

Operating revenues and expenses - The Medical Center's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues, such as patient service revenue, result from exchange transactions associated with providing health care services—the Medical Center's primary business. Exchange transactions are those in which each party to the transaction receives and gives up essentially equal values. Tax levy income and debt service related to limited general obligation bonds and other peripheral or coincidental transactions are also reported within operations. Operating expenses are all expenses incurred to provide health care services.

Net patient service revenue - Patient service revenue is recorded at established rates. Net patient service revenue is reported at the estimated net realizable amounts from governmental agencies, third-party payors, patients, and others for services rendered. Preliminary settlements under reimbursement agreements with Medicare and Medicaid are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Note 2 - Summary of Significant Accounting Policies (continued)

Reimbursements received from governmental agencies and certain third-party payors are subject to audit and retroactive adjustment. Provision for possible adjustment as a result of audits is recorded in the financial statements. When reimbursement settlements are received, or when information becomes available with respect to reimbursement changes, any variations from amounts previously accrued are accounted for in the period in which the settlements are received or the change in information becomes available.

Charity care - The Medical Center provides care to indigent patients who meet certain criteria under its charity care policies. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. Forgone revenue for charity care provided during 2008 and 2007, measured by the Medical Center's standard charges, was $8,874,603 and $12,691,187, respectively.

Net assets - Net assets of the Medical Center are classified in three components. *Net assets invested in capital assets, net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted net assets* (expendable and nonexpendable) are noncapital assets that must be used for a specific purpose, as specified by grantors or contributors external to the Medical Center. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital, net of related debt* or *restricted.*

Reclassifications - Certain amounts on the December 31, 2007, financial statements have been reclassified to conform to the December 31, 2008, financial statement presentation.

Note 3 - Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from governmental agencies, third-party payors, patients, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with governmental agencies and third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

The Medical Center has agreements with governmental agencies and third-party payors that provide for payments to the Medical Center at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Note 3 - Net Patient Service Revenue (continued)

Medicare - Medical Center services rendered to Medicare program beneficiaries are paid at prospectively determined rates, which provide for reimbursement based on Medicare severity adjusted diagnostic related groupings (MS-DRGs). These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The majority of Medicare outpatient services are reimbursed under a prospective payment methodology, the Ambulatory Payment Classification system (APC), or fee schedule. The Medical Center is reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicare fiscal intermediary. Net revenue under the Medicare program totaled approximately $74.2 million and $74.0 million for 2008 and 2007, respectively.

Medicaid - On July 1, 2005, a new inpatient Medicaid reimbursement methodology for all noncritical access Washington State governmental hospitals was implemented called "Certified Public Expenditures" (CPE). Under this program, the Medical Center is paid for inpatient Medicaid services based on allowable costs as determined by Medicaid. The estimated costs for inpatient care are calculated as a ratio of cost to charges from a base year (two years before the service year). Under the program, the Medical Center will be reimbursed the higher of the cost of service or "baseline" reimbursement that would have been received based on the inpatient prospective payment system (IPPS) effective prior to when the CPE program was implemented. The Medical Center has recognized revenue equal to the baseline amount. Outpatient services are paid on a fee schedule or a percentage of allowed charges based on a ratio of the Medical Center's allowable operating expenses to total allowable revenue. The CPE program has been funded by the state Legislature only through the current state biennium (through June 30, 2009).

Net revenue under the Medicaid program totaled approximately $27.5 million and $25.2 million for 2008 and 2007, respectively.

The Medical Center's estimates of final settlements to or from Medicare and Medicaid for all years through 2008 have been recorded in the accompanying balance sheet. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Differences between the net amounts accrued and subsequent settlements are recorded in operations at the time of settlement. The Medical Center's Medicare cost reports have been audited by the Medicare fiscal intermediary through December 31, 2006.

Other third-party payors - The Medical Center has also entered into various payment arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations, which provide for payment or reimbursement at amounts different from published rates. Contractual adjustments represent the difference between published rates for services and amounts paid or reimbursed by these third-party payors.

Note 3 - Net Patient Service Revenue (continued)

The following are the components of net patient service revenue for the years ended December 31:

	2008	2007
Gross patient service charges	$ 804,431,607	$ 745,499,770
Adjustments to patient service charges		
Contractual discounts	456,365,508	416,457,442
Provision for bad debts	29,867,693	29,977,769
Charity care	8,874,603	12,691,187
	495,107,804	459,126,398
Net patient service revenue	$ 309,323,803	$ 286,373,372

In addition to the charity amounts reported above (care given without reimbursement or at less than established rates), the Medical Center provided significant services to community residents at little or no cost.

Note 4 - Investments and Deposits

General - Chapter 39.59 RCW authorizes the Medical Center to makes investments in accordance with Washington State law. The Medical Center may, through formal interlocal agreement, invest funds not immediately required for expenditure with the King County Investment Pool (the Pool) and/or the Washington State Treasurer's Local Government Investment Pool (the LGIP), or may separately invest such funds in either actively managed individual portfolio or mutual fund accounts that meet all statutory investment requirements.

Eligible investments include obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, certificates of deposit with approved institutions, eligible bankers' acceptances, eligible commercial paper, and repurchase and reverse repurchase agreements. Investments of debt proceeds are governed by the provisions of the debt agreements, which also must meet statutory requirements.

Note 4 - Investments and Deposits (continued)

The related required assessed risks for each type of investment are disclosed below.

At December 31, 2008 and 2007, deposits and investments of the Medical Center consist of the following:

	2008	2007
Unrestricted cash and cash equivalents	$ 35,212,714	$ 58,244,680
Investments		
U.S. Treasury securities and bonds	45,984,934	13,158,697
Membership interest	1,435,690	
	47,420,624	13,158,697
Assets whose use is limited		
Cash and cash equivalents	29,372,652	35,718,406
U.S. Treasury securities and bonds	66,147,224	102,195,809
U.S. Government mutual funds	25,541,520	23,552,089
Deferred compensation plan assets and other	4,717,310	5,956,325
	125,778,706	167,422,629
	$ 208,412,044	$ 238,826,006

Interest income included in other operating revenue totaled $4,328,190 and $5,215,056 for the years ended December 31, 2008 and 2007, respectively.

Investments related to the deferred compensation plan are self-directed by the participant of the plan and include money market funds and other eligible investments as authorized by state law. While the investments are currently in the Medical Center's name, the payment of deferred compensation to the participant will be for the resulting value of the self-directed investments. Therefore, the risk of loss has been transferred to the participant, and deferred compensation plan assets are exempt from risk disclosures.

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

Membership interest - Similar to other public hospitals, the District is not a shareholder of the First Choice Health Network (FCHN), but has a contractual agreement with the FCHN that provides for certain rights and obligations equivalent, but not identical, to those of Class B shareholders, including liquidation and dividend rights. The capital contributions of the non-shareholders are recorded as paid-in capital from affiliates. These contractual agreements are considered to be common share equivalents.

Note 4 - Investments and Deposits (continued)

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. This is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The Medical Center follows state statute, which provides that commercial paper, negotiable certificates of deposit, and banker's acceptances must be rated at least A-1 by Standard and Poor's (S&P) and P-1 by Moody's Investor's Services, Inc., and fixed income holdings are limited to securities that are issued by or fully guaranteed by the U.S. Treasury, U.S. Government-Sponsored Enterprises, or U.S. Government Agencies, including U.S. Government Agency Mortgage-Backed Securities. Money market funds are limited to those with an average credit quality of AAA by S&P.

According to GASB Statement No. 40, unless there is information to the contrary, obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government are not considered to have credit risk and do not require disclosure of credit quality.

As of December 31, 2008, the Medical Center's investment in the Pool was not rated by a NRSRO. In January 2008, the rating of the King County investment pool was temporarily suspended by Standard and Poor's pending further information being available on the outcome of restructuring proposals associated with each impaired investment. Standard and Poor's took this action because they were not able to receive timely information about the impaired investments due to the confidential nature of the various enforcement events and related restructuring proceedings. In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency and mortgage-backed securities, municipal securities (rated at least A by two NRSROs), commercial paper (rated at least the equivalent of A-1 by two NRSROs), certificates of deposit issued by qualified public depositories, repurchase agreements, and the LGIP.

As of September 1, 2008, impaired commercial paper assets were removed from the main King County Investment Pool and placed into an impaired investment pool. As of December 31, 2008, the King County impaired investment pool held one commercial paper asset that is impaired and part of an enforcement event in which a trustee or receiver is appointed to determine the best options for selling assets and/or restructuring the portfolio; and the residual investments in four commercial paper assets that were part of completed enforcement events. The Medical Center's share of the impaired investment pool is $520,069 and the Medical Center's unrealized loss for these investments is $440,390.

Note 4 - Investments and Deposits (continued)

The composition of investments, valued at fair market by investment type and rating at December 31, 2008, is as follows:

Investment Type	Fair Value	Ratings	% of Totals
Money market mutual fund	$ 45,438,212	AAA	23.72%
U.S. Treasury securities	19,877,227	Exempt from disclosure	10.38%
U.S. Agency bonds	92,254,932	AAA	48.16%
U.S. Agency mortgage		AAA	0.00%
U.S. Government mutual fund	25,541,520	AAA	13.33%
King County Investment Pool	2,259,277	Exempt from disclosure	1.18%
State (LGIP) Investment Pool	23,488	Exempt from disclosure	0.01%
Deferred comp plan assets	4,717,310	Exempt from disclosure	2.46%
Membership interest	1,435,690	Not rated	0.75%
Total	$ 191,547,656		100.00%

Concentration of credit risk - Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing the organization to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments.

There are no investments exceeding 5% of total investments that are with any one issuer other than the U.S. Treasury, U.S. agency, or U.S. Government-sponsored entities. As of December 31, 2008, the Medical Center holds investments in U.S. Government-sponsored entities totaling 24% of its total investments in Federal National Mortgage Association securities, 32% of its total investments in Federal Home Loan Mortgage Corporation securities, 27% of its total investments in Federal Home Loan Bank, and 17% in Federal Farm Bureau securities.

Custodial credit risk - Custodial credit risk is the risk that, in the event of a failure of the counterparty, the Medical Center will not be able to recover the value of the investment or collateral securities that are in possession of the Medical Center.

With respect to investments, custodial credit risk generally applies only to direct investments of marketable securities. Custodial credit risk typically does not apply to the Medical Center's indirect investments in securities through the use of mutual funds or governmental investment pools (such as the Pool and LGIP).

Note 4 - Investments and Deposits (continued)

In the individually managed portfolios (which include bond proceeds), the Medical Center's securities are registered in the Medical Center's name by the custodial bank as an agent for the Medical Center. Securities used in repurchase agreements are subject to additional restrictions, which are designed to significantly limit the Medical Center's exposure to risk and ensure the safety of the investment. The market value of securities used in repurchase agreements are priced daily and held by the Medical Center's custodian in the Medical Center's name. Such securities must be at least 104% of the value of the repurchase agreement. No repurchase agreements were in effect during 2008.

Interest rate risk - Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

One of the ways the Medical Center manages its exposure to interest rate risk is by purchasing a combination of shorter and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturing evenly over time as necessary to provide cash flow and liquidity needed for operations.

The Medical Center further manages interest rate risk by constraining the average maturity of securities to five years or less as required by state statute.

The Medical Center's investments in a U.S. Government mutual fund had a weighted-average duration of 2.8 years at December 31, 2008.

As of December 31, 2008, the Pool's average duration was .48 years. As a means of limiting its exposure to rising interest rates, securities purchased in the Pool must have a final maturity, or weighted-average life, of no longer than five years. Although the Pool's market value is calculated on a monthly basis, unrealized gains or losses are not distributed to participants. The Pool distributes earnings monthly using an amortized cost methodology.

The LGIP is an unrated 2a-7 pool, as defined by GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.* Accordingly, the Medical Center's balances in the LGIP are not subject to interest rate risk, as the weighted-average maturity of the portfolio will not exceed 90 days. At December 31, 2008, the weighted-average maturity was 63 days.

Note 4 - Investments and Deposits (continued)

Information about the sensitivity of the fair values of the Medical Center's investments (including investments held by bond trustee) to market interest rate fluctuations is provided by the following table, which shows the distribution of the Medical Center's investments by maturity:

		Remaining Maturity (in Months)			
Investment Type	Fair Value	12 Months or Less	13 to 24 Months	25 to 48 Months	More Than 48 Months
Money market mutual fund	$ 45,438,212	$ 45,438,212			
U.S. Treasuries	19,877,227	6,134,849	$ 8,837,738	$ 4,904,640	
U.S. Agencies	92,254,932	31,188,524	47,858,524	13,207,884	
U.S. Government mutual Fund	25,541,520			25,541,520	
King County Investment Pool	2,259,277	2,259,277			
State Investment Pool	23,488	23,488			
Deferred compensation plan assets	4,717,310				$ 4,717,310
Membership interest	1,435,690				1,435,690
	$ 191,547,656	$ 85,044,350	$ 56,696,262	$ 43,654,044	$ 6,153,000

Note 5 - Property Tax Revenues

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

Taxes are due in two equal installments on April 30 and October 31. Funds are distributed monthly to the district by the county treasurer as collected.

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

For 2008, the District's authorized regular tax levy was $.59 per $1,000 on a total assessed valuation of $36,700,867,291. The actual levy rate for 2008 was $.51 per $1,000 for a total regular levy of $18,666,255.

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

Note 6 - Capital Assets

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

	Beginning Balance January 1, 2008	Additions	Retirements	Account Transfers	Ending Balance December 31, 2008
NONDEPRECIABLE CAPITAL ASSETS					
Land	$ 8,286,029				$ 8,286,029
Construction in progress	46,548,547	$ 91,454,860		$ (40,604,401)	97,399,006
Total nondepreciable capital assets	54,834,576	91,454,860		(40,604,401)	105,685,035
DEPRECIABLE CAPITAL ASSETS					
Land improvements	10,797,630			239,277	11,036,907
Buildings and leasehold improvements	201,531,609	6,272,648		24,666,593	232,470,850
Equipment					
Fixed	24,857,227	10,695		1,595,089	26,463,011
Major movable	93,047,497	1,513,961	$ (1,834,114)	13,413,791	106,141,135
Minor	8,522,832	364,104		689,651	9,576,587
LESS ACCUMULATED DEPRECIATION					
Land improvements	(8,692,135)	(266,862)			(8,958,997)
Buildings and leasehold improvements	(75,762,242)	(8,157,854)			(83,920,096)
Equipment					
Fixed	(18,107,076)	(1,025,684)			(19,132,760)
Major movable	(60,379,157)	(10,244,393)	1,834,114		(68,789,436)
Minor	(4,135,734)	(738,277)			(4,874,011)
Depreciable capital assets, net	171,680,451	(12,271,662)	-	40,604,401	200,013,190
Capital assets, net	$ 226,515,027	$ 79,183,198	$ -	$ -	$ 305,698,225

Note 6 - Capital Assets (continued)

	Beginning Balance January 1, 2007	Additions	Retirements	Account Transfers	Ending Balance December 31, 2007
NONDEPRECIABLE CAPITAL ASSETS					
Land	$ 8,286,029				$ 8,286,029
Construction in progress	41,887,880	$ 49,103,257	$ (1,558,885)	$ (42,883,705)	46,548,547
Total nondepreciable capital assets	50,173,909	49,103,257	(1,558,885)	(42,883,705)	54,834,576
DEPRECIABLE CAPITAL ASSETS					
Land improvements	10,719,117			78,513	10,797,630
Buildings and leasehold improvements	166,151,768	2,227,334		33,152,507	201,531,609
Equipment					
Fixed	22,946,274	44,865	(5,005)	1,871,093	24,857,227
Major movable	84,691,328	2,412,741	(1,075,305)	7,018,733	93,047,497
Minor	7,224,956	568,745	(33,728)	762,859	8,522,832
LESS ACCUMULATED DEPRECIATION					
Land improvements	(8,374,170)	(317,965)			(8,692,135)
Buildings and leasehold improvements	(68,300,380)	(7,461,862)			(75,762,242)
Equipment					
Fixed	(16,875,765)	(1,236,316)	5,005		(18,107,076)
Major movable	(51,387,737)	(9,968,573)	977,153		(60,379,157)
Minor	(3,495,764)	(671,462)	31,492		(4,135,734)
Depreciable capital assets, net	143,299,627	(14,402,493)	(100,388)	42,883,705	171,680,451
Capital assets, net	$ 193,473,536	$ 34,700,764	$ (1,659,273)	$ -	$ 226,515,027

The Medical Center capitalized interest costs of $8,042,064 and $8,112,831 during the years ended December 31, 2008 and 2007, respectively. The Medical Center also capitalized interest income of $3,574,196 and $5,843,917 during the years ended December 31, 2008 and 2007, respectively.

Depreciation expense of operating assets for the years ended December 31, 2008 and 2007, was $19,981,900 and $19,004,893, respectively.

Included in major movable equipment at December 31, 2008 and 2007, is $6,250,677 and $6,239,163, respectively, of equipment under capital lease. Accumulated amortization of the equipment under capital lease totaling $4,670,589 and $3,511,416 is included in accumulated depreciation at December 31, 2008 and 2007, respectively.

Note 6 - Capital Assets (continued)

During the years ended December 31, 2008 and 2007, the Medical Center retired approximately $1,834,000 and $1,114,000, respectively, of various land improvements, buildings, and equipment that were no longer in use.

Note 7 - Investment in Affiliate

Imaging Partners at Valley, LLC (IPV) - The Medical Center has an investment with a local radiology group for the purpose of providing inpatient and outpatient magnetic resonance imaging and other such imaging services through a limited liability company to individuals within the community. The Medical Center has an 80% interest in this joint venture at December 31, 2008 and 2007, which is accounted for using the equity method of accounting. For the years ended December 31, 2008 and 2007, the Medical Center recognized $4,434,557 and $4,888,151, respectively, of other operating revenue for its share of net income earned by IPV. Additionally, the Medical Center received cash distributions of $5,392,397 and $6,160,437, respectively, from IPV for the years ended December 31, 2008 and 2007. The Medical Center's recorded investment in IPV was $3,388,222 and $2,910,372, as of December 31, 2008 and 2007, respectively, and is included in investment in affiliate in the Medical Center's financial statements.

The following represents the summary financial information of IPV as of December 31:

	2008	2007
Cash and cash equivalents	$ 1,311,045	$ 1,446,589
Other current assets	1,786,384	2,277,740
Property, plant, and equipment, net	1,702,071	2,809,333
	$ 4,799,500	$ 6,533,662
Current liabilities	$ 2,576,778	$ 2,459,578
Long-term liabilities, net	291,287	1,419,723
Equity	1,931,435	2,654,361
	$ 4,799,500	$ 6,533,662
Revenues	$ 15,987,830	$ 17,302,588
Expenses	(10,195,547)	(10,926,817)
Net income	$ 5,792,283	$ 6,375,771

For more information on IPV, or to obtain financial statement information, please contact the administration of the Medical Center.

Note 7 - Investment in Affiliate (continued)

Alliance agreements - The Medical Center entered into a 10-year joint venture with Swedish Heart Institute in 1999 to collectively operate and manage the delivery of certain cardiovascular health care services to residents of South King County. Through this agreement, the two parties jointly fund, coordinate, and participate in administrative activities, delivery of specific patient services, and the undertaking of other activities to improve the access, efficiency, and quality of cardiovascular disease-related services. Financial risks and rewards are shared between the two parties in proportion to the sharing percentages from the provision of services provided to residents of the region. The Medical Center's share is 48%, which is accounted for using the equity method of accounting. For the years ended December 31, 2008 and 2007, the Medical Center recorded gains of $250,000 and $1,518,954, respectively, related to this joint venture, and is included in other operating revenue.

The Medical Center also has an agreement with Swedish Health Services related to radiation oncology services under the name Valley Medical Center Radiation Oncology. This agreement is renewable annually. Through this agreement, Swedish provides specific management services, including supervision and oversight of the technical staff within the radiation oncology department. Swedish receives, as compensation for its specific management services, a management fee based upon the level of income, not to exceed 24% of the net department margin and a contractually agreed "ceiling" amount. For the years ended December 31, 2008 and 2007, the Medical Center had net income prior to management fees of $2,987,355 and $2,096,556, respectively, related to this program, which is included in operating income.

Note 8 - Long-Term Debt and Capital Lease Obligations

The District refunded, on a current basis, both its 2005 revenue bonds and 2006 limited tax general obligation bonds in March 2008 into fixed rate series 2008A and 2008B limited tax general obligation bonds.

	2008	2007
Limited tax general obligation bonds		
2008 series A and B, 4.0% to 5.25%, due serially in December, in amounts from $1,185,000 in 2011 to $17,365,000 in 2037, plus interest due semi-annually, net of unamortized premiums of $1,722,192 and unamortized loss on refinancing of $3,167,083.	$ 216,775,109	
2006 series A and B, each auction rate securities, refunded during 2008.		$ 105,000,000

Note 8 - Long-Term Debt and Capital Lease Obligations (continued)

	2008	2007
2001 series, 4.125% to 5.5%, due serially in December, in amounts from $1,815,000 in 2009 to $5,995,000 in 2021, plus interest due semi-annually, net of unamortized premiums of $186,986 and $201,463.	41,456,986	42,926,463
2004 series, 3.75% to 4.25%, due serially in December, in amounts from $575,000 in 2010 to $1,260,000 in 2017, plus interest due semi-annually, net of unamortized premiums of $184,685 and $205,395 and unamortized loss on refinance of $417,425 and $465,590.	8,202,260	8,174,805
Revenue bonds		
2005 series A and B, each auction rate securities, refunded during 2008.		65,000,000
1998 series, 4.75% to 5.75%, due serially in September, in amounts from $1,145,000 in 2009 to $3,565,000 in 2012, plus interest due semi-annually, net of unamortized premiums of $631,814 and $685,970 and unamortized loss on refinance of $641,014 and $695,182.	20,915,800	22,015,788
1997 series, 5.25% to 6.0%, due serially in September, in amounts from $1,940,000 in 2009 to $2,660,000 in 2015, plus interest due semi-annually, net of unamortized discount of $60,531 and $69,611 and unamortized loss on refinance of $781,514 and $897,290.	15,187,955	16,908,099
1992 series, 6.25%, due serially in September, in the amount of $810,000 in 2009 plus interest, net of unamortized discount of $57,957 and $92,729.	786,816	1,512,043
Long-term debt	303,324,926	261,537,198
Capital lease obligations, stated at present value of future minimum lease payments	1,717,042	2,863,611
	305,041,968	264,400,809
Less current portion	(6,837,255)	(6,308,939)
Long-term portion of debt and capital lease obligations	$ 298,204,713	$ 258,091,870

Note 8 - Long-Term Debt and Capital Lease Obligations (continued)

Under the terms of its financing agreements, the District has agreed to maintain certain financial ratios and meet certain covenants. Financing covenants associated with the District's revenue bonds require that net income available for debt service (as defined in the financing agreement) be equal to or greater than 125% of maximum annual debt service, set limits of encumbrances, indebtedness, disposition of assets, and transfer services, and maintain certain other financial covenants. Management is not aware of any violations with its debt covenants.

2008 bond issue - On February 13, 2008, the nationwide auction rate securities market experienced a historic dislocation previously unseen in the financial marketplace. The District had $170 million in auction rate securities—$65 million in the 2005 revenue series A and B bonds and $105 million in the 2006 limited tax general obligation series A and B bonds. Those bonds had been trading on a seven-day auction period with an average 3.75% variable interest rate. The dislocation in the market resulted in default interest rates as high as 15%.

Pursuant to resolution 870 adopted by the District's Board of Commissioners in December 2007, as amended by resolution 875, adopted by the board on February 19, 2008, both the 2005 and 2006 bond series were refunded, on a current basis, from variable rate auction securities to 30-year fixed rate debt in the form of limited tax general obligation and refunding bonds, series 2008A and 2008B. In addition, the District issued $50 million in new LTGO debt to fund certain District capital projects, including completion of the South Tower project.

The refunding resulted in the recognition of an accounting loss of $3,265,368 for the year ended December 31, 2008, which will be deferred and amortized over the life of the new bonds. The refunding increased the Medical Center's aggregate debt service payments by $57,765,000 over the next 30 years and resulted in an economic loss (difference between the present values of the old and new debt service payments) of $7,596,000.

As part of the current refunding of the 2006 series, the interest rate swaps associated with the 2006 LTGO series A and B terminated, resulting in the District's payment of termination fees of $5.1 million to the counterparty.

In total, the District issued $218,220,000 in limited tax general obligation and refunding bonds, series 2008A and 2008B, in March 2008.

Series 2008A is for $113,315,000 and comprises $97,745,000 5.0%-5.25% term bonds maturing beginning with $14,730,000 maturing in 2023 to $59,725,000 5.0% bonds maturing in 2037. $15,570,000 of this subseries is in 4.0%-5.0% serial bonds, which mature for eight consecutive years beginning in 2011. Series 2008A is insured.

Series 2008B is for $104,905,000 5.25% term bonds, beginning with $8,920,000 maturing in 2023 to $69,260,000 maturing in 2037. Series 2008B is uninsured.

The District has pledged tax revenues to secure the bonds.

Note 8 - Long-Term Debt and Capital Lease Obligations (continued)

2006 limited tax general obligation interest rate exchange (swap) - With respect to both 2006 subseries, the District entered in an interest rate swap transaction with a certain counterparty who meets statutory requirements as is permitted by RCW Chapter 39.96.

The interest rate swaps related to the 2006 LTGO series were terminated when the 2006 series was refunded in March 2008.

Other interest rate exchanges (swaps) - Three interest rate exchange (swap) agreements were unwound in early January 2008 for a gain of $640,000. The Medical Center no longer has any outstanding interest rate swaps.

Risks associated with the swap agreements - On December 31, 2008, the District no longer had any outstanding swap agreement. From the District's perspective, however, the following risks are generally associated with swap agreements:

Credit risk - The counterparty becomes insolvent or is otherwise not able to perform its financial obligations. In the event of deterioration in the credit ratings of the counterparty or the Medical Center below statutory prescribed levels, such party will comply with the collateralization requirements specified in Revised Code of Washington Chapter 39.96.

Basis risk - For both the 2006 limited tax general obligation bonds and the 2005 revenue bonds, the variable interest rate paid by the counterparty under the swap and the fixed rate paid by the Medical Center on the associated bonds may not be the same. If the counterparty's rate under the swap is lower than the fixed interest rate, then the counterparty's payment under the swap agreement does not fully reimburse the Medical Center for its interest payment on the associated bonds. Conversely, if the fixed interest rate is lower than the variable rate, there is a net benefit to the Medical Center.

For the three interest rate exchange swaps related to the 1992, 1997, and 1998 bond series, the variable interest rate paid by the Medical Center under the swap and the fixed rate paid by the counterparty may not be the same. As the SIFMA Municipal Swap Index increases, the Medical Center's exposure to variable interest rates increases and, consequently, the synthetic floating rate to fixed swaps decreases in value.

The Medical Center uses an external financial advisor experienced in swap arrangements to assist in monitoring the Medical Center's risk to changing interest rates.

Note 8 - Long-Term Debt and Capital Lease Obligations (continued)

Termination risk - The Medical Center or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. If, at the time of the termination, the swap has a negative fair value, the Medical Center would be liable to the counterparty for that payment.

Fair value - As of December 31, 2007, the swaps had a fair value of $(6,111,836). The fair value of the swaps may be countered by changes in total interest payments required under the variable rates. In accordance with GASB Technical Bulletin 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*, the fair value has not been recorded in the financial statements.

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

	Beginning Balance January 1, 2008	Additions	Reductions	Ending Balance December 31, 2008	Amounts Due Within One Year
Limited tax general obligation bonds					
2008 series		$ 216,726,786	$ (48,323)	$ 216,775,109	
2005 series	$ 105,000,000		105,000,000		
2004 series	8,174,805		(27,455)	8,202,260	
2001 series	42,926,463		1,469,477	41,456,986	$ 1,815,000
Revenue bonds					
2005 series	65,000,000		65,000,000		
1998 series	22,015,788		1,099,988	20,915,800	1,145,000
1997 series	16,908,099		1,720,144	15,187,955	1,940,000
1992 series	1,512,043		725,227	786,816	810,000
Capital lease obligations	2,863,611	2,772	1,149,341	1,717,042	1,127,255
Total long-term debt and capital lease obligations	264,400,809	216,729,558	176,088,399	305,041,968	6,837,255
Deferred compensation	4,832,728		1,078,285	3,754,443	
Total noncurrent liabilities	$ 269,233,537	$ 216,729,558	$ 177,166,684	$ 308,796,411	$ 6,837,255

Note 8 - Long-Term Debt and Capital Lease Obligations (continued)

	Beginning Balance January 1, 2007	Additions	Reductions	Ending Balance December 31, 2007	Amounts Due Within One Year
Limited tax general obligation bonds					
2006 series	$ 105,000,000			$ 105,000,000	
2004 series	8,147,351		$ (27,454)	8,174,805	
2001 series	44,070,939		1,144,476	42,926,463	$ 1,455,000
Revenue bonds					
2005 series	65,000,000			65,000,000	
1998 series	23,065,775		1,049,987	22,015,788	1,100,000
1997 series	18,533,244		1,625,145	16,908,099	1,845,000
1992 series	2,192,271		680,228	1,512,043	760,000
Capital lease obligations	3,491,448	$ 433,867	1,061,704	2,863,611	1,148,939
Total long-term debt and capital lease obligations	269,501,028	433,867	5,534,086	264,400,809	6,308,939
Deferred compensation	3,829,486	1,003,242		4,832,728	
Total noncurrent liabilities	$ 273,330,514	$ 1,437,109	$ 5,534,086	$ 269,233,537	$ 6,308,939

Note 8 - Long-Term Debt and Capital Lease Obligations (continued)

A summary of future maturities on long-term debt for the next five years and thereafter, as of December 31, 2008, using the new fixed interest rate, for both principal and interest, is presented below:

	Principal	Interest
2009	$ 5,710,000	$ 15,696,089
2010	6,035,000	15,399,807
2011	8,235,000	15,118,157
2012	8,615,000	14,742,400
2013	7,660,000	14,312,826
Amounts due 2014 - 2018	44,690,000	65,340,866
Amounts due 2019 - 2023	45,745,000	53,079,265
Amounts due 2024 - 2028	50,015,000	41,257,638
Amounts due 2029 - 2033	64,455,000	26,824,714
Amounts due 2034 - 2037	64,530,000	8,490,889
	305,690,000	$ 270,262,651
Plus amount representing net unamortized bond discounts and premiums	2,641,962	
Less amount representing unamortized losses on refinancings	(5,007,036)	
	$ 303,324,926	

Capital leases - The Medical Center acquired certain equipment under capital lease obligations. The imputed interest rate on the equipment under capital lease is 6.4%. These leases are collateralized by the related equipment. Future minimum lease payments and the present value of net minimum lease payments are as follows:

2009	$ 1,199,277
2010	476,334
2011	117,528
2012	57,699
2012	108
Total minimum lease payments	1,850,946
Less amount representing interest	(133,904)
Present value of capital lease payments	1,717,042
Less current portion	(1,127,255)
	$ 589,787

Line of credit - The Medical Center has a $2.0 million line of credit with its banking institution. The line of credit was unused during 2008 and 2007, and there was no outstanding balance as of December 31, 2008 or 2007.

Note 9 - Professional Liability Claims

The Medical Center purchases insurance from a third-party insurance carrier, who in 2005 assumed the then-existing self-insurance program that insured certain claims on both a retrospective and prospective basis. Insurance limits are $2,000,000 per claim with an $8,500,000 annual aggregate. The Medical Center also maintains excess commercial insurance on a claims-made basis with a limit of liability of $25,000,000 per occurrence and $25,000,000 annual aggregate.

Settlement amounts have not exceeded insurance coverage in the last three years.

Note 10 - Retirement Plans

The Medical Center maintains a defined contribution plan, the Money Purchase Pension Plan, that covers substantially all of its employees. The plan is administered by the Medical Center. The Medical Center's contribution is based on the salaries of active participants in accordance with formulas specified in the plan. Plan provisions and contribution requirements are established by the Medical Center and may be amended by the Medical Center's Board of Commissioners. Actuarial assumptions are not used in the determination of costs because benefits are payable only to the extent of available assets derived from contributions and plan earnings.

Employer contributions to the plan were $8,987,508 and $8,288,844 for the years ended December 31, 2008 and 2007, respectively. Employee contributions are permitted within the plan in an amount up to 10% of pay period earnings, capped at the annual amount allowed by federal law, and totaled $509,293 and $470,813 for the years ended December 31, 2008 and 2007, respectively.

The Medical Center offers its employees two deferred compensation plans created in accordance with Internal Revenue Code (IRC) Sections 403(b) and 457. The plans, available to all employees, permit them to defer a portion of their salary until future years. Employee contributions to the plans totaled $5,209,704 and $4,783,616 for the years ended December 31, 2008 and 2007, respectively. The deferred compensation is payable to employees upon termination, retirement, death, or unforeseen emergency.

It is the opinion of internal legal counsel that the Medical Center has no uninsured liability for losses under the plans. Under both plans, the participants select investments from alternatives offered by the plans, and the funds are held in trust/custodial accounts with the custodians, who are under contract with the Medical Center to manage the plans. Investment selection by a participant may be changed each pay period. The Medical Center manages none of the investment selections. By making the selections, enrollees accept and assume all risks that pertain to the plan and its administration.

Note 10 - Retirement Plans (continued)

In accordance with GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans,* the Medical Center placed the deferred compensation plan assets of the plans into a trust for the exclusive benefit of plan participants and beneficiaries.

The Medical Center has limited administrative involvement and does not perform the investing function for either plan, as each plan has an investment advisor. The Medical Center does not hold the assets of either plan in a trustee capacity and does not perform fiduciary accountability for the plan.

Note 11 - Charity Care and Community Benefits

The Medical Center provides care without charge, or at reduced charges, to patients who meet certain criteria under its charity care policy. Records are maintained to identify and monitor the level of charity care provided. The Medical Center does not pursue collection of the amounts determined to qualify as charity care, and such amounts are not reported as revenue. The costs of the services and supplies furnished under the Medical Center's charity care policy, as measured by the Medical Center's standard charges, totaled $8.9 million in 2008 and $12.7 million in 2007.

The Medical Center provides many other health and educational activities for the benefit of the community. These benefits go beyond uncompensated services and would include classes, educational materials, graduate medical education programs, health fairs and screenings, and other community-based events.

Note 12 - Concentrations of Credit Risk

The Medical Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31 was as follows:

	2008	2007
Medicare	20%	23%
Medicaid	13%	12%
Blue Shield/Regence	13%	15%
PPO/First Choice	7%	8%
Blue Cross/Premera	6%	6%
Patient	18%	19%
Commercial	10%	8%
Other third-party payors	13%	9%
	100%	100%

Note 13 - Commitments and Contingencies

Operating leases - The District leases certain facilities and equipment under operating lease arrangements, some of which contain renewal options. The following is a schedule by year of future minimum lease payments as of December 31, 2008:

2009	$ 6,802,000
2010	6,779,000
2011	6,648,000
2012	6,205,000
2013	3,168,000
Thereafter	1,341,000
Total minimum lease payments	$ 30,943,000

Rent expense on operating leases for 2008 and 2007 was $7,994,000 and $7,219,000, respectively.

Litigation - The Medical Center is involved in litigation and regulatory investigations 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 Medical Center's future financial position or results from operations.

Compliance with laws and regulations - The health care industry is subject to numerous laws and regulations from federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity with respect to investigations and allegations regarding possible violations of these laws and regulations by health care providers, including those related to medical necessity, coding, and billing for services, has increased substantially. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management, to the best of their knowledge, believes that the Medical Center 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.

Risk management - The Medical Center is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters and no claims have exceeded such coverage.

Note 13 - Commitments and Contingencies (continued)

Construction and information technology commitments - The Medical Center has committed to various remodel projects and further information technology implementations and upgrades to be completed during calendar years 2007 and beyond. As of December 31, 2008, the future commitments for these projects total $88.9 million.

Collective bargaining agreements - The Medical Center has a total of approximately 2,500 employees. Of this total, approximately 74% are covered under one of the Medical Center's collective bargaining agreements as of December 1, 2008.

Note 14 - Disclosures About Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and short-term investments - The carrying amount approximates the fair value because of the short maturity of those instruments.

Long-term investments - The carrying amount approximates the fair values of investments. The fair values are estimated based on quoted market prices for those or similar investments.

Long-term debt - The Medical Center is not able to estimate the fair value of its long-term debt because there is little or no trading of its bonds in secondary markets to establish a current fair value.

Note 15 - Pledged Tax Revenues

The District has pledged its future tax revenues, as well as operating revenues, to repay its limited tax general obligation and revenue bonds issued in 1992, 1997, 1998, 2001, 2004, and 2008 to finance construction, other capital improvements, medical equipment and technology, and information technology systems.