Stanford Hospital and Clinics and Subsidiaries

Consolidated Financial Statements
August 31, 2009 and 2008

Stanford Hospital and Clinics and Subsidiaries
Index
August 31, 2009 and 2008

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Report of Independent Auditors

To the Board of Directors
Stanford Hospital and Clinics and Subsidiaries

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and changes in net assets and cash flows present fairly, in all material respects, the financial position of Stanford Hospital and Clinics and subsidiaries ("SHC") at August 31, 2009 and 2008 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of SHC's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

December 7, 2009

Stanford Hospital and Clinics and Subsidiaries
Consolidated Balance Sheets
August 31, 2009 and 2008
(in thousands of dollars)

	2009	2008
Assets		
Current assets:		
Cash and cash equivalents	$ 331,502	$ 268,869
Assets limited as to use, held by trustee	280	504
Patient accounts receivable, net of allowance for doubtful accounts of $71,269 at August 31, 2009 and $74,758 at August 31, 2008	253,299	240,989
Other receivables	11,925	9,912
Inventories	18,725	20,420
Prepaid expenses and other	8,553	8,428
Total current assets	624,284	549,122
Investments	76,584	60,068
Investments in University managed pools	533,518	688,644
Assets limited as to use, held by trustee, net of current portion	48,828	163,246
Property and equipment, net	840,955	706,700
Other assets	60,715	63,398
Total assets	$ 2,184,884	$ 2,231,178
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	$ 129,750	$ 143,723
Accrued salaries and related benefits	91,835	82,819
Due to related parties	33,840	23,091
Third-party payor settlements	19,433	14,704
Current portion of long-term debt	8,713	7,877
Debt subject to short-term remarketing arrangements	266,764	249,414
Self-insurance reserves	18,303	20,008
Total current liabilities	568,638	541,636
Self-insurance reserves, net of current portion	90,811	80,222
Other long-term liabilities	96,244	48,338
Pension liability	65,188	6,051
Long-term debt, net of current portion	556,997	583,236
Total liabilities	1,377,878	1,259,483
Net assets:		
Unrestricted	730,563	909,053
Temporarily restricted	69,951	56,150
Permanently restricted	6,492	6,492
Total net assets	807,006	971,695
Total liabilities and net assets	$ 2,184,884	$ 2,231,178

The accompanying notes are an integral part of these consolidated financial statements.

Stanford Hospital and Clinics and Subsidiaries
Consolidated Statements of Operations and Changes in Net Assets
Years Ended August 31, 2009 and 2008
(in thousands of dollars)

	2009	2008
Operating revenues:		
Net patient service revenue	$ 1,741,856	$ 1,578,755
Premium revenue	22,960	20,755
Other revenue	57,666	51,225
Net assets released from restrictions used for operations	5,195	4,816
Total operating revenues	1,827,677	1,655,551
Operating expenses:		
Salaries and benefits	787,035	714,856
Professional services	22,842	24,713
Supplies	265,139	235,542
Purchased services	434,257	385,273
Provision for doubtful accounts, net	53,859	51,578
Depreciation and amortization	73,876	65,812
Interest	37,921	26,334
Other	139,385	120,382
Expense recoveries from related parties	(81,317)	(74,184)
Total operating expenses	1,732,997	1,550,306
Income from operations	94,680	105,245
Interest and investment income	3,814	21,824
(Decrease) increase in value of University managed pools	(146,481)	9,720
Interest rate swaps mark to market adjustments	(48,338)	(42,600)
Loss on extinguishment of debt	-	(17,855)
(Deficiency) excess of revenues over expenses	(96,325)	76,334
Other changes in unrestricted net assets:		
Transfer to Stanford University	(8,049)	(7,670)
Transfer from (to) Lucile Salter Packard Children's Hospital	288	(2,808)
Change in net unrealized gains on investments	237	227
Net assets released from restrictions used for:		
Purchase of property and equipment	460	599
Change in pension liability and postretirement	(75,101)	(2,212)
(Decrease) increase in unrestricted net assets before discontinued operations	(178,490)	64,470
Income from discontinued operations	-	890
(Decrease) increase in unrestricted net assets	(178,490)	65,360
Changes in temporarily restricted net assets:		
Transfer from Stanford University	15,167	-
Contributions	5,606	8,508
Investment income	98	586
(Losses) gains on University managed pools	(1,415)	1,161
Net assets released from restrictions for:		
Operations	(5,195)	(4,816)
Purchase of property and equipment	(460)	(599)
Increase in temporarily restricted net assets	13,801	4,840
Changes in permanently restricted net assets:		
Contributions	-	981
Increase in permanently restricted net assets	-	981
(Decrease) increase in net assets	(164,689)	71,181
Net assets, beginning of year	971,695	900,514
Net assets, end of year	$ 807,006	$ 971,695

The accompanying notes are an integral part of these consolidated financial statements.

Stanford Hospital and Clinics and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended August 31, 2009 and 2008
(in thousands of dollars)

	2009	2008
Cash flows from operating activities:		
(Decrease) increase in net assets	$ (164,689)	$ 71,181
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Gain from sale of discontinued operations	-	(21,273)
Loss on extinguishment of debt	-	17,855
Depreciation and amortization of bond discounts	74,564	67,031
Provision for doubtful accounts	53,859	54,189
Change in fair value of interest rate swaps	48,338	42,600
Decrease (increase) in value of University managed pools	146,481	(9,720)
Unrealized losses (gains) on investments	2,357	(135)
Realized losses (gains) on investments	185	(125)
Contributions received for long lived assets or endowment	(3,720)	(1,800)
Transfer (from) to Lucile Salter Packard Children's Hospital	(288)	2,808
Changes in operating assets and liabilities:		
Patient accounts receivable	(66,169)	(80,032)
Due to related parties	10,749	839
Other receivables, inventory, other assets, prepaid expenses and other	877	3,207
Accounts payable, accrued liabilities and pension liabilities	58,187	36,058
Accrued salaries and related benefits	9,016	9,945
Third-party payor settlements	4,729	178
Self-insurance reserves	8,884	(8,215)
Other long-term liabilities	597	(6,830)
Cash provided by operating activities	183,957	177,761
Cash flows from investing activities:		
Purchases of investments	(24,857)	(82,524)
Sales of investments	8,652	67,786
Purchases of investments in University managed pools	(4,179)	(10,768)
Sales of investments in University managed pools	9,775	147,747
Decrease in assets limited as to use and other	114,642	170,190
Purchases of property and equipment	(220,791)	(252,421)
Net proceeds from sale of discontinued operations	-	21,273
Cash (used in) provided by investing activities	(116,758)	61,283
Cash flows from financing activities:		
Proceeds from issuance of debt	70,500	514,200
Costs of issuance of debt	-	(2,950)
Payment of long-term debt and capital lease obligation	(79,591)	(523,354)
Contributions received for long lived assets or endowment	4,525	2,651
Cash used in financing activities	(4,566)	(9,453)
Net increase in cash and cash equivalents	62,633	229,591
Cash and cash equivalents, beginning of year	268,869	39,278
Cash and cash equivalents, end of year	$ 331,502	$ 268,869
Supplemental disclosures of cash flow information:		
Interest paid	$ 39,975	$ 39,680
Payables for property and equipment	(12,660)	8,857
(Decrease) increase in value of interest in University managed pools	(146,481)	9,720
Assets acquired under capital leases	597	-

The accompanying notes are an integral part of these consolidated financial statements.

1. Organization

Stanford Hospital and Clinics ("Stanford Hospital") operates a licensed acute care hospital and a cancer center in Palo Alto, California, along with numerous outpatient physician clinics in the San Francisco Bay Area, in community settings, and in association with regional hospitals. Stanford Hospital is a principal teaching affiliate of the Stanford University School of Medicine ("SoM") and provides primary and specialty health services to adults, including cardiac care, cancer treatment, solid organ transplantation services, neurosciences, and orthopedics services designated by management as Stanford Hospital's "Strategic Clinical Services". Stanford Hospital, together with Lucile Salter Packard Children's Hospital at Stanford ("LPCH"), operates the clinical settings through which the SoM educates medical and graduate students, trains residents and clinical fellows, supports faculty and community clinicians and conducts medical and biological sciences research.

The Board of Trustees of Leland Stanford Junior University (the "University") is the sole corporate member of Stanford Hospital and LPCH. As part of their ongoing operations, Stanford Hospital and LPCH engage in certain related party transactions as described further in Note 12.

The consolidated financial statements include Stanford Hospital's interest in Menlo Health Alliance, LLC ("MHA"), SUMIT Insurance Company Ltd ("SUMIT"), and Stanford Emanuel Radiation Oncology Center, LLC ("SEROC") (collectively "SHC").

Stanford Hospital's interest in MHA was 100% for the years ended August 31, 2009 and 2008. MHA is a wholly owned California limited liability company that operates an outpatient clinic.

Stanford Hospital's share of net assets in SUMIT, a captive insurance carrier, was 83.6% and 82.0% for the years ended August 31, 2009 and 2008, respectively. LPCH's share of net assets in SUMIT was 16.4% and 18.0% for the years ended August 31, 2009 and 2008, respectively. This is recorded as a minority interest in accounts payable and accrued liabilities on the consolidated balance sheets.

SEROC is a joint venture between Stanford Hospital and Emanuel Medical Center ("EMC"). SEROC operates an outpatient clinic that provides radiation oncology services to patients in Turlock, California and surrounding communities. Stanford Hospital's interest in SEROC was 60% during the years ended August 31, 2009 and 2008. The remaining interest of 40% is recorded as minority interest in accounts payable and accrued liabilities on the consolidated balance sheets.

2. Summary of Significant Accounting Policies

Principles of Consolidation
The consolidated financial statements of SHC include the accounts of Stanford Hospital and its subsidiaries, MHA, SUMIT and SEROC, which are controlled and owned more than 50% by Stanford Hospital. All significant inter-company accounts and transactions are eliminated in the consolidation.

Basis of Presentation
The accompanying consolidated financial statements are prepared on the accrual basis of accounting. Net assets of SHC and changes therein have been classified and are reported as follows:

2. Summary of Significant Accounting Policies (Continued)

Basis of Presentation (continued)

- ***Unrestricted net assets*** — Unrestricted net assets represent those resources of SHC that are not subject to donor-imposed stipulations. The only limits on unrestricted net assets are broad limits resulting from the nature of SHC and the purposes specified in its articles of incorporation or bylaws and, limits resulting from contractual agreements, if any.

- ***Temporarily restricted net assets*** — Temporarily restricted net assets represent contributions, which are subject to donor-imposed restrictions that can be fulfilled by actions of SHC pursuant to those stipulations or by the passage of time.

- ***Permanently restricted net assets*** — Permanently restricted net assets represent contributions that are subject to donor-imposed restrictions that they be maintained permanently by SHC. Generally, the donors of these assets permit SHC to use all or part of the investment return on these assets.

Expenses are generally reported as decreases in unrestricted net assets. A restriction expires when the stipulated time period has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both. Temporarily restricted contributions are recorded as restricted revenue when received and when the restriction expires, the net assets are shown as released from restriction on the consolidated statements of operations and changes in net assets. Investment income on temporarily or permanently restricted assets that is restricted by donor or law is recorded within the respective net asset category, and when the restriction expires, the net assets are shown as released from restriction.

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less. Cash equivalents consist primarily of demand deposits and money market mutual funds.

Assets Limited as to Use, Held by Trustee

Assets limited as to use include various accounts held with a trustee in accordance with indenture requirements. The indenture terms require that the trustee control the expenditure of bond proceeds for capital projects. Assets limited as to use consist of cash and cash equivalents and short-term investments and are recorded at fair value. Amounts required to fund current liabilities of SHC have been classified as current assets in the consolidated balance sheets at August 31, 2009 and 2008.

Inventories

Inventories, which consist primarily of hospital operating supplies and pharmaceuticals, are stated at the lower of cost or market value determined using the first-in, first-out method.

Investments

Investments held directly by SHC consist of cash and cash equivalents, mutual funds and fixed-income securities (government bonds), and are stated at fair value. Fair value is determined in accordance with the provisions of Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* ("SFAS 157"), as further described in Note 7. Investment earnings (including realized gains and losses on investments, interest, dividends and impairment loss on investment securities) are included in investment income unless the income or loss is restricted by donor or law. Income on investments of donor restricted funds is added to or deducted from the appropriate net asset category based on the donor's restriction. Unrestricted unrealized gains and losses on other than trading securities are separately reported below the excess of revenues over expenses.

2. Summary of Significant Accounting Policies (Continued)

Investments in University managed pools

Investments in University managed pools consist of funds invested in the University's Merged Pools ("MP"), Expendable Funds Pool ("EFP"), and Active Cash Fund ("ACF") (collectively the "Pools"). Under the terms of the SHC's agreement with the University, the University has discretion to invest funds invested in the Pools. SHC may deposit funds in the Pools at its discretion. SHC can withdraw funds from ACF at any time; however, withdrawals from the MP and EFP require advance notice to the University. SHC accounts for its share of the Pools in accordance with Statement of Financial Accounting Standard No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others* ("SFAS 136"). The value of its share of the Pools is determined by the University and is based on the fair value of the underlying assets in the Pools.

The University allocates investment earnings to SHC from the University managed pools based on SHC's share of the Pools. Earnings include interest, dividends, distributions, investment gains and losses, and the increases or decreases in the value of SHC's share of the pools. In accordance with SFAS 136, all investment gains and losses and increases and decreases in share value are treated as realized and included in the excess of revenues over expenses.

The increases or decreases in the value of SHC's share of the Pools are recorded as income and gains on University managed pools unless the income is restricted by donor or law. Income on investments of donor restricted funds invested in the University managed pools is added to or deducted from the appropriate net asset category based on the donor's restriction.

Property and Equipment

Property and equipment are stated at cost except for donated assets, which are recorded at fair market value at the date of donation. Depreciation and amortization of property and equipment is provided using the straight-line method over the estimated useful lives of the assets, which are as follows:

Land improvements	10 to 25 years
Buildings and improvements	7 to 40 years
Equipment	3 to 20 years

Significant replacements and improvements are capitalized, while maintenance and repairs, which do not improve or extend the life of the respective assets, are charged to expense as incurred. Upon sale or disposal of property and equipment, the cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in the consolidated statements of operations and changes in net assets.

Equipment includes medical equipment, furniture and fixtures and computer software and hardware.

Equipment under capital leases is recorded at present value at the inception of the leases and is amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. The amortization of the assets recorded under capital leases is included in depreciation and amortization expense in the accompanying consolidated statements of operations and changes in net assets.

Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized, net of any interest earned, as a component of the cost of acquiring those assets.

2. Summary of Significant Accounting Policies (Continued)

Asset Retirement Obligations

Asset retirement obligations ("ARO") are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value as other long-term liabilities and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently accreted over the useful lives of the related assets. SHC recorded current period accretion expense of $328 and $311 in the consolidated statements of operations and changes in net assets for the years ended August 31, 2009 and 2008, respectively. ARO liability of $6,458 and $6,130 is included in other long-term liabilities on the consolidated balance sheets as of August 31, 2009 and 2008, respectively.

Other Assets

Other assets include deferred financing costs, long-term portion of contributions receivable, investments in Waverley Surgery Center, L.P. ("Waverley"), investments in Stanford PET-CT ("PET-CT") and other long-term assets.

Deferred financing costs represent costs incurred in conjunction with the issuance of SHC's long-term debt. These costs are amortized on a straight-line basis, which approximates the effective interest method, over the life of the debt.

Waverley is a California limited partnership which operates an ambulatory surgical center in Palo Alto, providing outpatient surgical and related health care services. PET-CT is a California limited liability company which provides radiological services to patients of the community, including patients served by SHC and physicians affiliated with the SoM. SHC and the University each appoint one-half of the members of the governing board of PET-CT and are its only members.

SHC's interest in Waverley was 33.70% for the years ended August 31, 2009 and 2008. SHC's interest in PET-CT was 50% for the years ended August 31, 2009 and 2008. As SHC has 50% or less ownership and does not have control, these investments are recorded using the equity method.

Contributions Receivable

Unconditional promises to give ("contributions") are recorded at fair value at the date the promise is received. Donations for specific purposes are reported as either temporary or permanently restricted net assets and are included as restricted contributions. Contributions to be received after one year are discounted at an appropriate discount rate commensurate with the risks involved and applicable to the years in which the promises are received, and recorded in their respective net asset category. Prior to fiscal year 2009, the discount rates were determined using the US Treasury Note rate. In accordance with SFAS 157, the discount rates used during fiscal year 2009 were determined using the risk free rate adjusted for the risk of donor default. Amortization of the discount is included in contributions in the consolidated statements of operations and changes in net assets. Conditional promises to give are recognized when the condition is substantially met.

Contributions receivable as of August 31, 2009 and 2008 were $28,636 and $29,877, respectively. Current portion of contributions receivable of $1,247 and $1,933 is included in other receivables in the consolidated balance sheets as of August 31, 2009 and 2008, respectively. Long term portion of contributions receivable of $27,389 and $27,944 is included in other assets in the consolidated balance sheets as of August 31, 2009 and 2008, respectively.

2. Summary of Significant Accounting Policies (Continued)

Premiums and Discounts on Long-Term Debt

Premiums and discounts arising from the original issuance of long-term debt are amortized on a straight-line basis, which approximates the effective interest method, over the life of the debt. The unamortized portion of these premiums and discounts are included in long-term debt on the consolidated balance sheets.

Interest Rate Swap Agreements

SHC has entered into several interest rate swap agreements, also known as risk management or derivative instruments, to reduce the effect of interest rate fluctuation on its variable rate bonds. SHC designates at inception whether the swap agreement is considered hedging or non-hedging for accounting purposes in accordance with Statement of Financial Accounting Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities* (“SFAS 133”). All swaps are recognized on the consolidated balance sheets at their fair value in accordance with SFAS 157. The net cash payments or receipts under the interest rate swap agreements have been recorded as an increase (decrease) to interest expense.

Changes in the fair value of the interest rate swaps that are effective and qualify as a cash flow hedge are recorded as change in unrestricted net assets. Changes in the fair value of interest rate swaps not designated as hedges are included in excess of revenues over expenses.

Any hedge ineffectiveness (which represents the amount by which the changes in the fair value of the derivative exceed the variability in the cash flows of the forecasted transaction) is included in excess of revenues over expenses.

Excess of Revenues over Expenses

The consolidated statements of operations include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, include transfers of assets to and from affiliates for other than goods and services, change in unrealized gains and losses on marketable investments, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), changes in pension liability, changes in fair value of interest rate swaps considered effective, income or loss from discontinued operations and cumulative effect of changes in accounting principles.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors including Medicare and Medi-Cal, and others for services rendered, including estimated retroactive audit adjustments under reimbursement agreements with 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. Contracts, laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates may change by a material amount in the near term.

2. Summary of Significant Accounting Policies (Continued)

Premium Revenue
SHC has capitated agreements with various health maintenance organizations ("HMOs") to provide medical services to enrollees. Under these agreements, monthly payments are received based on the number of health plan enrollees. These receipts are recorded as premium revenue in the consolidated statements of operations and changes in net assets. Costs are accrued when services are rendered under these contracts, including cost estimates of incurred but not reported ("IBNR") claims. The IBNR accrual (which is included in accounts payable and accrued liabilities in the consolidated balance sheets) includes an estimate of the costs of services for which SHC is responsible, including referrals to outside healthcare providers.

Charity Care
SHC provides either full or partial charity care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as net patient service revenue. SHC also provides services to other indigent patients under Medi-Cal and other publicly sponsored programs, which reimburse at amounts less than the cost of the services provided to the recipients. The difference between the cost of services provided to these indigent persons and the expected reimbursement is included in the estimated cost of charity care.

Income Taxes
SHC and SUMIT are not-for-profit corporations and tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code. The estimated tax liability pertaining to unrelated business taxable income associated with Waverley has been recorded as $653 and $513 at August 31, 2009 and 2008, respectively, and is included in accounts payable and accrued liabilities in the consolidated balance sheets.

Self-Insurance Plans
SHC self-insures for professional liability risks, postretirement medical benefits, workers' compensation, health and dental. These liabilities are reflected as self-insurance reserves in the consolidated balance sheets.

- ***Professional Liability*** — SHC is self-insured through SUMIT for medical malpractice and general liability losses under claims-made coverage. SHC also maintains professional liability reserves for claims not covered by SUMIT which totals $6,501. For the policy period September 1, 2008 to September 1, 2009, SUMIT retains 100% of the risk related to the first $15,000 per occurrence. The next $115,000 is transferred to various reinsurance companies. For the period from September 1, 2005 to September 1, 2008, SHC maintained the same coverage limits as fiscal year 2009.

- ***Postretirement Medical Benefits*** – Liabilities for post-retirement medical claims for current and retired employees are actuarially determined.

- ***Workers' Compensation*** — SHC purchases insurance for workers' compensation claims with a $750 deductible per occurrence. Workers' compensation insurance provides statutory limits for the State of California. An actuarial estimate of retained losses (or losses retained within the deductible) has been used to record a liability.

- ***Health and Dental*** — Liabilities for health and dental claims for current employees are based on estimated costs.

(in thousands of dollars)

2. Summary of Significant Accounting Policies (Continued)

Fair Value of Financial Instruments
Due to the short-term nature of cash and cash equivalents, accounts payable and accrued liabilities, and accrued salaries and related benefits, their carrying value approximates their fair value. The fair value of the amounts payable under third-party reimbursement contracts is not readily determinable. The fair value of long-term debt is estimated based on quoted market prices for the bonds or similar financial instruments.

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. The most significant estimates relate to patient accounts receivable allowances, amounts due to third party payors, retirement plan obligations, and self insurance reserves. Actual results could differ from those estimates.

Reclassification
Certain reclassifications have been made to the 2008 consolidated financial statements to conform to the 2009 presentation. Such reclassifications had no effect on excess of revenues over expenses as previously reported.

Discontinued Operations
In August 2008, SHC sold certain assets and liabilities of its clinical laboratory testing outreach business to an unrelated party for $30,000 plus the assumption of certain property leases valued at approximately $2,000 less sales expense and other exit costs of $8,727.

This transaction was accounted for in accordance with Statement of Financial Accounting Standard No. 144, *Accounting for the Impairment of Disposal of Long-Lived Assets* ("SFAS 144"). As a result, the gains or losses from the operations of the clinical testing laboratory outreach business were reported as discontinued operations for the year ended August 31, 2008.

The net operating loss included in the results of discontinued operations for the year ended August 31, 2008 was $20,383.

The following table sets forth the components of discontinued operations for the year ended August 31, 2008:

		2008
Total operating revenue	$	29,520
Total operating expenses		49,903
Loss from operations		(20,383)
Net proceeds from sale		21,273
Income from discontinued operations	$	890

2. Summary of Significant Accounting Policies (Continued)

Recent Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ("SFAS 158"). SFAS 158 requires sponsors of defined benefit pension plans and other postretirement benefit plans to recognize the funded status of the plans in the balance sheet, measure the fair value of plan assets and benefit obligations as of the fiscal year-end balance sheet date and provide additional disclosures. In fiscal year 2007, SHC adopted the recognition and disclosure provisions of SFAS 158. The provision that requires measurement of plan assets and benefit obligations as of the end of the fiscal year was adopted for the fiscal year ending August 31, 2009. The effect of this adoption for fiscal year 2009 is discussed in Note 10.

In fiscal year 2009, SHC also adopted the following pronouncements.

In September 2006, the FASB issued SFAS 157. SFAS 157 establishes a common definition for fair value to be applied to generally accepted accounting principles requiring use of fair value, establishes a framework for measuring fair value and expands the related disclosure requirements about fair value measurements. The effect of this adoption is discussed in Note 7.

In August 2008, the FASB issued FASB Staff Position No. 117-1, *Endowments for Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act and Enhanced Disclosures for All Endowment Funds* ("FSP 117-1"). FSP 117-1 provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). California adopted a version of UPMIFA which became effective January 1, 2009. FSP 117-1 also requires additional disclosures about an organization's endowment funds, whether or not the organization is subject to UPMIFA. The effect of this adoption is discussed in Note 11.

In December 2008, the FASB issued FASB Staff Position No. 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises* ("FSP 48-3"), clarifying the effective date of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). Under FSP 48-3, the effective date for SHC is for the fiscal year ended August 31, 2009. The standard requires SHC to accrue for liabilities relating to uncertain tax positions only when such liabilities are probable and reasonably estimable. The effect of the adoption did not have a material effect on SHC's financial statements.

3. Net Patient Service Revenue

SHC has agreements with third-party payers that provide for payments at amounts different from SHC's established rates. A summary of payment arrangements with major third-party payor's follows:

- ***Medicare*** — Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Medicare reimburses hospitals for covered outpatient services rendered to its beneficiaries by way of an outpatient prospective payment system based on ambulatory payment classifications. SHC's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review.

  Inpatient non-acute services, certain outpatient services and medical education costs related to Medicare beneficiaries are paid based, in part, on a cost reimbursement methodology. SHC is reimbursed for cost reimbursable items at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The estimated amounts due to or from the program are reviewed and adjusted annually based on the status of such audits and any subsequent appeals. Differences between final settlements and amounts accrued in previous years are reported as adjustments to net patient service revenue in the year examination is substantially completed. SHC's Medicare cost reports have been audited by the Medicare fiscal intermediary through August 31, 2002.

  Professional services are reimbursed based on a fee schedule.

- ***Medi-Cal*** — Inpatient services rendered to Medi-Cal program beneficiaries are reimbursed under a contract at a prospectively determined negotiated per diem rate. Outpatient services are reimbursed based upon prospectively determined fee schedules. Professional services are reimbursed based on a fee schedule.

- ***Other*** – SHC has entered into agreements with numerous non-government third-party payors to provide patient care to beneficiaries under a variety of payment arrangements. These include arrangements with:

  - Commercial insurance companies, including workers' compensation plans, which reimburse SHC at negotiated charges.

  - Managed care contracts such as those with HMOs and PPOs, which reimburse SHC at contracted or per diem rates, which are usually less than full charges.

  - Counties in the State of California, which reimburse SHC for certain indigent patients covered under county contracts.

(in thousands of dollars)

3. Net Patient Service Revenue (Continued)

Amounts due from Blue Cross represent 17% of net patient accounts receivable at August 31, 2009 and 2008. Amounts due from Medicare represent 16% and 14% of net patient accounts receivable at August 31, 2009 and 2008, respectively. SHC does not believe there are significant credit risks associated with this health care payor or this government agency.

SHC recognized net patient service revenue of $5,759 and $8,561 as a result of prior years favorable developments related to reimbursement for the years ended August 31, 2009 and 2008, respectively. SHC also recognized revenues of $12,734 and $6,581 as a result of prior years appeals settled during the years ended August 31, 2009 and 2008, respectively.

Net patient service revenue, including premium revenue, by major payor for the years ended August 31 is as follows:

	2009	2008
Medicare	$ 356,042	$ 313,281
Medi-Cal	30,097	27,614
Managed Care - Capitation	22,960	20,755
Managed Care - Discounted Fee for Services	1,141,866	1,020,096
Self pay and other	160,844	167,651
Related party	53,007	50,113
Total	$ 1,764,816	$ 1,599,510

4. Charity Care and Uncompensated Costs

SHC engages in numerous community benefit programs and services. These services include health research, education and training and other benefits for the larger community that are excluded from the information below.

Uncompensated charity care is provided to vulnerable populations. Additionally, Medi-Cal and Medicare program reimbursements do not cover the estimated costs of services provided.

Information related to SHC's charity care for the years ended August 31 is as follows:

	2009	2008
Charity care at established rates	$ 60,303	$ 50,536
Estimated cost of charity care	$ 16,469	$ 14,525

Estimated cost of services in excess of reimbursement for the years ended August 31 is as follows:

	2009	2008
Charity care	$ 16,469	$ 14,525
Medi-Cal	76,112	66,043
Medicare	65,753	55,395
Total	$ 158,334	$ 135,963

(in thousands of dollars)

5. Assets Limited As to Use, Held by Trustee

The composition of assets limited as to use at August 31 is as follows:

	2009		2008	
	Cost	**Fair Value**	**Cost**	**Fair Value**
Cash and cash equivalents	$ 49,108	$ 49,108	$ 163,750	$ 163,750
Less: Current portion of assets limited as to use, held by trustee		(280)		(504)
Assets limited as to use, held by trustee, net of current portion		$ 48,828		$ 163,246

SHC is required to maintain a debt service reserve fund with the trustee in connection with the 2003 bonds (see Note 9). The fair value of the deposits with the trustee was $14,269 at August 31, 2009 and 2008.

6. Investments and Investments in University Managed Pools

The composition of investments held directly by SHC at August 31 is as follows:

	2009		2008	
	Cost	**Fair Value**	**Cost**	**Fair Value**
Investments:				
Cash and cash equivalents	$ 33,955	$ 33,955	$ 13,447	$ 13,447
Mutual funds	41,168	42,629	45,537	46,621
Total	$ 75,123	$ 76,584	$ 58,984	$ 60,068

The composition of investments in University managed pools at August 31 is as follows:

	Fair Value	
	2009	**2008**
Investments in University Managed Pools:		
Merged Pool	$ 525,986	$ 672,904
Active Cash Fund	3,632	12,030
Expendable Funds Pool	3,900	3,710
Total	$ 533,518	$ 688,644

The Merged Pool (“MP”) is the primary investment pool in which funds are invested. The MP is invested with the objective of maximizing long-term total return. It is a unitized pool in which the fund holders purchase investments and withdraw funds based on a monthly share value. The MP's investments at August 31, 2009 and 2008 consist of approximately 1% and 1% cash and cash equivalents, 1% and 2% fixed income securities, 2% and 2% in real estate, 25% and 31% public equity securities and mutual funds, and 71% and 64% in limited partnerships, respectively.

(in thousands of dollars)

7. Fair Value Measurements

SFAS 157 defines fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability.

The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity. In addition, the fair value of liabilities should include consideration of non-performance risk.

In addition to defining fair value, SFAS 157 expands the disclosure requirements around fair value and establishes a fair value hierarchy for valuation inputs. The hierarchy prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels which is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the measurement date. Financial assets and liabilities in Level 1 include U.S. Treasury securities and listed equities.

Level 2: Pricing inputs are based on quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in inactive markets, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in this category generally include asset-backed securities, corporate bonds and loans, municipal bonds and interest rate swap instruments.

Level 3: Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of the fair value require management’s judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparables, third party appraisals, discounted cash flow models, and fund manager estimates. SHC has no investments that are categorized as level 3.

The following table summarizes SHC’s assets and liabilities measured at fair value on a recurring basis as of August 31, 2009, based on the inputs used to value them:

	Level 1	Level 2	Total
Assets			
Cash and cash equivalents	$ 331,502	$ -	$ 331,502
Assets limited as to use, held by trustee	49,108	-	49,108
Investments	33,955	42,629	76,584
Investments in University managed pools	-	533,518	533,518
Total assets	$ 414,565	$ 576,147	$ 990,712
Liabilities			
Interest rate swap instruments	$ -	$ 87,311	$ 87,311

(in thousands of dollars)

8. Property and Equipment

Property and equipment consist of the following as of August 31:

	2009	2008
Land and improvements	$ 27,364	$ 25,761
Buildings and improvements	773,532	559,621
Equipment	479,815	411,841
	1,280,711	997,223
Less: Accumulated depreciation	(647,514)	(580,796)
Construction-in-progress	207,758	290,273
Property and equipment, net	$ 840,955	$ 706,700

Depreciation and amortization expense totaled $73,876 and $65,812 for the years ending August 31, 2009 and 2008, respectively, and is included in the consolidated statements of operations and changes in net assets.

As of August 31, 2009, medical equipment acquired under capital leases totaled $6,472 and is included in property and equipment in the consolidated balance sheet. Amortization expense under capital leases is included in depreciation expense in the consolidated statements of operations and changes in net assets. Accumulated amortization was $2,605 and $1,371 as of August 31, 2009 and 2008.

Interest expense on debt issued for construction projects and income earned on the funds held pending use are capitalized until the projects are placed in service and depreciated over the estimated useful life of the asset. Capitalized interest expense net of capitalized investment income was $2,049 and $4,465 for the years ended August 31, 2009 and 2008, respectively.

(in thousands of dollars)

9. Long-Term Debt

SHC's outstanding debt at August 31 is summarized below:

	2009	2008
1998 Series B Fixed Rate Bonds, payable in varying annual amounts through 2031, with an interest rate of 5%	$ 163,435	$ 167,195
2003 Series A Fixed Rate Bonds, payable in varying annual amounts from November 2007 through 2023, with interest rates ranging from 2% to 5%	88,015	91,990
2003 Series B, C and D Variable Rate Demand Bonds, maturing in November, 2036, with an interest rate of 0.67% at August 31, 2009 and 1.77% at August 31, 2008	150,000	150,000
2008 Series A Variable Rate Demand Bonds, maturing in November 2040, with an interest rate of 1.38% at August 31, 2009 and 2.24% at August 31, 2008	260,300	260,300
2008 Series B Variable Rate Demand Bonds, maturing in November 2045, with an interest rate of 0.16% at August, 2009 and 1.53% at August 31, 2008	168,200	168,200
Promissory note, maturing in July 2014, with an interest rate of 7.03% at August 31, 2009 and 2008	857	999
Total principal amounts	830,807	838,684
Unamortized original issue premium/(discount), net	1,667	1,843
Current portion of long-term debt	(8,713)	(7,877)
Debt subject to short-term remarketing arrangements	(266,764)	(249,414)
Long-term portion, net of current portion	$ 556,997	$ 583,236

In June 2008, The California Health Facilities Financing Authority ("CHFFA") on behalf of SHC, refunded the 2006 Variable Rate Demand Bonds ("VRDB") in the aggregate principal amount of $428,500 and issued 2008 VRDB's in the aggregate principal amount of $428,500. The 2008 bonds were comprised of $260,300 of 2008 Series A VRDB's that were issued as Series A-1, Series A-2, and Series A-3; and $168,200 of 2008 Series B VRDB's that were issued as Series B-1 and Series B-2. As a result of the bond refinancing, the 2006 bond issuance costs of $17,855 were included in loss on extinguishment of debt for the year ended August 31, 2008. In June 2009, SHC remarketed the $70,500 2008 Series A-1 bonds and achieved a lower interest rate effective for one year.

The $70,500 2008 Series A-1 and $85,700 Series A-3 VRDB's are subject to mandatory repurchase tenders on June 15, 2010 and June 15, 2011, respectively. The $104,100 2008 Series A-2 bonds are 7 day VRDB's and are secured by a direct pay letter of credit which expires June 2011. The 2008 Series B bonds are 7 day VRDB's with self-liquidity. In 2008, SHC entered into an agreement with Stanford University to access on a same-day basis up to $200,000 of SHC's investments which are managed for SHC by Stanford University to enhance its liquidity.

(in thousands of dollars)

9. Long-Term Debt (Continued)

In June 2008, SHC converted its $150,000 2003 Series B, C and D VRDB's from 35 day auction rate notes to 7 day VRDB's. In order to provide liquidity for the 2003 VRDB's, SHC entered into three Standby Bond Purchase Agreements related to each series in the aggregate amount of $150,000, each of which expires in June 2011.

The 2008 bonds, together with the 2003 bonds and 1998 bonds are collectively referred to as the "Revenue Bonds". The Revenue Bonds are a limited obligation of CHFFA and are payable solely from payments made by SHC. Payments of principal and interest on the Revenue Bonds are collateralized by a pledge against the revenues of SHC. The 1998 and 2003 Series B, C and D bonds are insured by municipal bond guaranty policies. The Master Trust Indenture of SHC includes, among other things, limitations on additional indebtedness, liens on property, restrictions on the disposition or transfer of assets, and maintenance of certain financial ratios. SHC may redeem the Revenue Bonds, in whole or in part, prior to the stated maturities. Total debt outstanding under the Master Trust Indenture is in the aggregate principal amounts of $829,950 and $837,685 as of August 31, 2009 and 2008, respectively.

Scheduled principal payments on long-term debt including unsecured promissory notes are summarized below, assuming remarketing of the 2003 and 2008 VRDB's:

2010	$	8,713
2011		9,114
2012		11,261
2013		11,010
2014		12,489
Thereafter		778,220
	$	830,807

The scheduled principal payments above represent the annual payments required under debt repayment schedules. The current portion of long-term obligations, including debt subject to short term remarketing arrangements, includes payments scheduled to be made in 2010, the VRDB's supported by SHC's liquidity and that portion of credit facilities that would be due in the event the bondholders tendered the bonds to those facilities. Generally accepted accounting principles require that bonds backed by credit facilities expiring within one year of the balance sheet date and bonds supported by SHC's liquidity be classified as current liabilities.

The estimated fair value of the Revenue Bonds as of August 31, 2009 and 2008 was $823,864 and $828,443, respectively.

In 1998, SHC advance refunded its 1993 and 1995 bonds in the amount of $111,014 by issuing the 1998 bonds. As of August 31, 2009 and 2008, $27,295 and $32,415, respectively, of advance refunded bonds, which are considered extinguished, remain outstanding.

Interest Rate Swap Agreements

SHC has entered into various interest rate swap agreements (swap agreements) with varying maturities through November 2045. The purpose of the swap agreements, also known as risk management or derivative instruments, is to reduce the effect of interest rate fluctuation on its variable rate bonds.

The swap agreements require SHC to pay fixed interest rates varying from 3.365% to 3.942% on a notional amount and to receive a variable interest payment computed based on a percentage of the 30-day London Interbank Offered Rate ("LIBOR") based on the same notional amount.

9. Long-Term Debt (Continued)

Interest Rate Swap Agreements (continued)

Certain swap agreements require mutual posting of collateral between SHC and the counterparties should the fair market value of the swap agreements exceed a predetermined threshold dollar amount.

The notional amounts under the swap agreements were $749,400 at August 31, 2009 and 2008. The swap agreements can be canceled at anytime by SHC by settling the contracts at the current fair market value.

The swap agreements are recognized on the consolidated balance sheets at their fair value. The fair market value of the swap agreements as of August 31, 2009 and 2008 was a liability of $87,311 and $38,973, respectively, included in other long-term liabilities.

In June 2008, the underlying bonds that were being hedged were refinanced and as a result, the swap agreements are no longer treated as a hedge for accounting purposes. As a result, the change in the fair market value of the swap agreements of $48,338 and $42,600 for the years ended August 31, 2009 and 2008, respectively, has been included in the (deficiency) excess of revenues over expenses in the consolidated statements of operations and changes in net assets.

Interest expense includes the net of cash receipts and cash payments under the interest swap agreements. Interest expense includes net cash payments of $15,550 and $3,198 for the years ended August 31, 2009 and 2008, respectively.

10. Retirement Plans

SHC provides retirement benefits through defined benefit and defined contribution retirement plans covering substantially all benefit eligible employees.

For fiscal year 2009, SHC adopted the provision of SFAS 158 which requires measurement of the plan assets and benefit obligations of SHC’s defined benefit and postretirement medical benefit plans as of SHC’s fiscal year end, therefore the measurement date for 2009 was changed from June 30 to August 31.

Defined Contribution Retirement Plan

Employer contributions to the defined contribution retirement plan are based on a percentage of participant annual compensation. Employer contributions to this plan for SHC employees excluding LPCH leased employees (see Note 12) totaling $38,593 and $34,864 for the years ended August 31, 2009 and 2008, respectively, are included in salaries and benefits expense in the consolidated statements of operations and changes in net assets.

Defined Benefit Pension Plan

Certain employees of the Hospitals are covered by a noncontributory defined benefit pension plan (the “Staff Pension Plan”). Benefits are based on years of service and the employee’s compensation. Contributions to the plans are based on actuarially determined amounts sufficient to meet the benefits to be paid to plan participants.

10. Retirement Plans (Continued)

Defined Benefit Pension Plan (continued)

As of August 31, 2004, SHC assumed the pension liability of the employees leased to LPCH. SHC received $2,527 in cash during the year ended August 31, 2005, which represented the pension liability as of August 31, 2004. In addition, SHC received $433 and $454 in cash for the years ending August 31, 2009 and 2008, respectively, which represented the current year pension expense related to LPCH leased employees, and another $72 for the year ending August 31, 2009 which represented the gap period from July 1, 2008 to August 31, 2008, as a result of the change in measurement date.

Postretirement Medical Benefit Plan

SHC currently provides health insurance coverage for SHC employees upon retirement as early as age 55, with years of service as defined by specific criteria. The health insurance coverage for retirees who are under age 65 is the same as that provided to active employees. A Medicare supplement option is provided for retirees over age 65.

SHC implemented a postretirement medical benefit plan change effective January 2009. This change added a Retiree Health Reimbursement Account for certain participants. As a result of this plan amendment, the benefit obligation increased by $3,632 for the year ended August 31, 2009.

The following tables present information on plan assets and obligations, costs, and actuarial assumptions for the Staff Pension Plan and the Postretirement Medical Benefit Plan for the years ended August 31, 2009 and 2008, respectively.

The tables for the Postretirement Medical Benefit Plan include SHC and LPCH leased employees. The total postretirement medical benefit liability was $78,828 and $62,818 as of August 31, 2009 and 2008, respectively. SHC recorded a liability within self-insurance reserves in the consolidated balance sheets of $63,227 and $50,477 as of August 31, 2009 and 2008, respectively, which represents the liability for SHC employees excluding LPCH leased employees.

(in thousands of dollars)

10. Retirement Plans (Continued)

The change in pension and other post-retirement plan assets and the related change in benefit obligations, using a measurement date of August 31, as of and for the years ended August 31 are as follows:

	Staff Pension Plan Obligations		Postretirement Medical Benefits Net of Medicare Part D Subsidy	
	2009	**2008**	**2009**	**2008**
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 140,777	$ 152,074	$ -	$ -
Adjustment due to change in measurement date pursuant to SFAS 158				
Changes due to gap period benefit payments	(1,134)	-	(575)	-
Actual return on plan assets	(23,171)	(11,576)	-	-
Employer contributions	3,075	6,898	4,490	3,657
Participants contributions	-	-	665	682
Benefits paid	(7,344)	(6,619)	(4,580)	(4,339)
Fair value of plan assets at end of year	$ 112,203	$ 140,777	$ -	$ -
Change in benefit obligation:				
Benefit obligation at beginning of year	$ 146,828	$ 157,568	$ 63,543	$ 66,339
Adjustments due to change in measurement date pursuant to SFAS 158				
Service and interest costs during gap period	2,008	-	962	-
Changes due to gap period benefit payments	(1,134)	-	(575)	-
Service cost	1,497	1,720	1,427	1,583
Interest cost	10,548	9,952	4,343	4,071
Participants contributions	-	-	665	682
Benefits paid	(7,344)	(6,619)	(4,580)	(4,339)
Plan amendment	-	-	3,632	-
Actuarial loss (gain)	24,988	(15,793)	9,411	(4,793)
Benefit obligation at end of year	$ 177,391	$ 146,828	$ 78,828	$ 63,543

(in thousands of dollars)

10. Retirement Plans (Continued)

	Staff Pension Plan Obligations		Postretirement Medical Benefits Net of Medicare Part D Subsidy	
	2009	**2008**	**2009**	**2008**
Amounts recognized in consolidated balance sheets:				
Plan assets minus benefit obligation	$ (65,188)	$ (6,051)	$ (78,828)	$ (63,543)
Contributions made from July 1 to August 31	-	-	-	725
Net benefit liability recognized	$ (65,188)	$ (6,051)	$ (78,828)	$ (62,818)
Amounts recognized in consolidated balance sheets (after SFAS 158) consist of:				
Current liabilities	$ -	$ -	$ (4,739)	$ (4,262)
Noncurrent liabilities	(65,188)	(6,051)	(74,089)	(58,556)
Net benefit liability recognized	$ (65,188)	$ (6,051)	$ (78,828)	$ (62,818)
Amounts recognized in accumulated other comprehensive income:				
Prior service cost (credit)	$ -	$ -	$ 2,020	$ (2,585)
Net loss (gain)	65,583	3,524	1,495	(8,972)
Accumulated other comprehensive income	$ 65,583	$ 3,524	$ 3,515	$ (11,557)

The estimated net loss for the staff pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is $1,282. The estimated net loss and prior service cost for the postretirement medical plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are $105 and $574, respectively.

Total benefit obligation at the end of the year for Postretirement Medical Benefits excluding Medicare Part D subsidiary increased to $86,497.

The accumulated benefit obligation for the defined benefit pension plan was $173,319 and $142,876 as of August 31, 2009 and June 30, 2008, respectively.

(in thousands of dollars)

10. Retirement Plans (Continued)

Net benefit expense related to the plans for the years ended August 31 includes the following components:

	Staff Pension Plan Obligations		
	2009	Gap Period	2008
Service cost	$ 1,497	$ 250	$ 1,720
Interest cost	10,548	1,758	9,952
Expected return on plan assets	(11,914)	(1,986)	(11,057)
Total net periodic benefit cost	$ 131	$ 22	$ 615

	Postretirement Medical Benefits					
	Net of Medicare Part D Subsidy			Excluding Medicare Part D Subsidy		
	2009	Gap Period	2008	2009	Gap Period	2008
Service cost	$ 1,427	$ 238	$ 1,583	$ 1,541	$ 257	$ 1,673
Interest cost	4,343	724	4,071	4,869	812	4,747
Amortization of prior service cost	(834)	(139)	(834)	(834)	(139)	(834)
Recognized net actuarial (gain) loss	(905)	(151)	(448)	(593)	(99)	184
Total net periodic benefit cost	$ 4,031	$ 672	$ 4,372	$ 4,983	$ 831	$ 5,770

Changes recognized in other comprehensive income for the years ended August 31 include the following components:

	Staff Pension Plan Obligations		Postretirement Medical Benefits Net of Medicare Part D Subsidy	
	2009	2008	2009	2008
Prior service cost arising during period	$ -	$ -	$ 3,632	$ -
Net loss (gain) arising during period	62,059	6,839	9,411	(4,793)
Amortizations				
Prior service credit	-	-	973	834
Gain	-	-	1,056	448
Total recognized in other comprehensive income	$ 62,059	$ 6,839	$ 15,072	$ (3,511)
Total recognized in net periodic benefit cost and other comprehensive income	$ 62,190	$ 7,454	$ 19,103	$ 861

(in thousands of dollars)

10. Retirement Plans (Continued)

Actuarial Assumptions

The weighted-average assumptions used to determine benefit obligations are as follows for the years ended August 31:

	Staff Pension Plan Obligations		Postretirement Medical Benefits	
	2009	**2008**	**2009**	**2008**
Weighted-average assumptions				
Discount rate	6.10%	7.38%	5.83%	7.12%
Rate of compensation increase	5.50%	5.50%	N/A	N/A

The discount rate, expected rate of return on plan assets, and the projected covered payroll growth rates used in determining the above net benefit expense are as follows for the years ended August 31:

	Staff Pension Plan Obligations		Postretirement Medical Benefits	
	2009	**2008**	**2009**	**2008**
Weighted-average assumptions				
Discount rate	7.38%	6.47%	7.12%	6.35%
Expected return on plan assets	8.00%	8.00%	N/A	N/A
Rate of compensation increase	5.50%	5.50%	N/A	N/A

To develop the assumption for the expected rate of return on plan assets, SHC considered the historical and future expected returns. The historical return of the plan assets for the past ten years ending June 30, 2009 averaged 2.6%. An independent investment consulting firm provided SHC with an estimate of the future expected returns for each asset class based on SHC's asset allocation targets. The evaluation of the historical returns and the future expected returns resulted in the use of 8.0% as the assumption for the expected return on plan assets.

To determine the accumulated post-retirement benefit obligation as of August 31, 2009, a 9.5% annual rate of increase in the pre-65 per capita costs and 10.0% annual rate of increase in the post-65 prescription drug per capita costs, and 7.0% rate of increase in the post-65 per capita cost of all other medical benefits was assumed for 2009, declining gradually to 5.0% by 2014 for pre-65 per capita costs, 2014 for post-65 prescription drug per capita cost, and 2011 for post-65 per capita costs of all other medical benefits, and remaining at this rate thereafter.

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the post-retirement medical benefit plan. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post-retirement benefit obligation by $2,764 and the aggregate service and interest cost by $251. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post-retirement benefit obligation by $2,509 and the aggregate service and interest cost by $227.

(in thousands of dollars)

10. Retirement Plans (Continued)

Plan Assets
SHC's staff pension plan weighted-average asset allocations as of the measurement date August 31, 2009 and June 30, 2008, respectively by asset category are as follows:

Asset Category	August 31, 2009	June 30, 2008
Equity securities	42%	66%
Debt securities	42%	21%
Real estate	7%	12%
Other	9%	1%
Total	100%	100%

Plan Investments
The investment objective of the staff pension plan funds is to maximize the total rate of return (income and appreciation) within the limits of prudent risk taking and Section 404 of the Employee Retirement Income Security Act. The funds are diversified across asset classes to achieve an optimal balance between risk and return and between income and capital appreciation. Many of the pension liabilities are long term. The investment horizon is also long-term; however, the investment plan also ensures adequate near-term liquidity to meet benefit payments.

The allowable asset mix range and target asset allocations are:

Asset Category	Acceptable Range	Target Allocation
Equity securities	28% to 60%	46%
Debt securities	36% to 60%	44%
Real Estate	0% to 12%	10%
Cash equivalents	0% to 4%	< 1%

Appropriate investments include common, preferred and convertible equities of domestic and foreign companies, mutual and commingled trust funds, top tier commercial paper, certificates of deposit, and fixed income securities whose assets are rated investment grade or better. Financial futures and options on futures traded on exchanges are also permitted for hedging purposes. Prohibited investments include commodities, unregistered securities and short sales. Derivative products may not be used to leverage a portfolio or to speculate. All assets must have readily ascertainable market value and be easily marketable.

Portfolios are expected to be well diversified with respect to industry and economic sectors. Equity investments in any one company shall be limited to the greater of 5% of the market value of the portfolio at time of purchase or twice the applicable benchmark weighting of the security. The investment manager shall not hold more than 15% of any company's outstanding equity.

Fixed income investments may consist of U.S. government, U.S. government guaranteed, and U.S. government agency securities. Corporate bond holdings must have an investment grade credit rating at the time of purchase and during the holding period. No single issuer of fixed income or cash equivalent securities (with the exception of the U.S. Government and its Agencies) will account for more than 10% of the market value of the fixed income securities in a manager's portfolio.

(in thousands of dollars)

10. Retirement Plans (Continued)

Plan Investments (continued)
Investments in any one real estate investment trust company shall be limited to the greater of 5% of the market value of the portfolio at time of purchase or twice the applicable benchmark weighting of that security. The investment manager shall not hold more than 15% of any company's outstanding shares.

Expected Contributions
SHC expects to contribute $14,300 to its Staff Pension Plan for both SHC and LPCH leased employees during the fiscal year ending August 31, 2010. SHC expects to contribute $4,739 to its Postretirement Medical Plan for both SHC and LPCH leased employees during the fiscal year ending August 31, 2010.

Expected Benefit Payments
The following benefit payments, which reflect expected future service, are expected to be paid for the fiscal years ending August 31:

		Postretirement Medical Benefits	
	Pension Benefits	Net of Medicare Part D Subsidy	Excluding Medicare Part D Subsidy
2010	$ 8,592	$ 4,739	$ 5,202
2011	9,294	5,232	5,763
2012	9,929	5,682	6,284
2013	10,567	6,143	6,816
2014	11,285	6,485	7,227
2015 - 2019	65,576	33,310	38,040

11. Temporarily and Permanently Restricted Net Assets

Temporarily Restricted Net Assets
Temporarily restricted net assets consist of the following at August 31:

	2009	2008
Plant replacement and expansion	$ 48,767	$ 31,138
Other patient services	8,457	12,060
Indigent care	6,318	6,506
Clinical services	3,382	3,414
Education	3,027	3,032
Total	$ 69,951	$ 56,150

(in thousands of dollars)

11. Temporarily and Permanently Restricted Net Assets (Continued)

Permanently Restricted Net Assets
SHC adopted FSP 117-1 effective for the beginning of fiscal year 2009. SHC has interpreted UPMIFA as requiring the preservation of the original gift as of the gift date of donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, SHC classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a manner consistent with standard of prudence prescribed by UPMIFA.

In accordance with UPMIFA, SHC considers the following factors in making a determination to appropriate or accumulate endowment funds:

1. The duration and preservation of the fund.
2. The purposes of SHC and the donor restricted endowment fund.
3. General economic conditions.
4. The possible effect of inflation and deflation.
5. The expected total return from income and the appreciation of investments.
6. Other resources of the organization.
7. The investment policies of the organization.

Endowment funds by net asset classification as of August 31, 2009 and 2008 are as follows:

	2009			2008
Donor restricted endowment	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**Total**
Donor restricted endowment	$ 4,373	$ 5,611	$ 9,984	$ 13,007
Pledge receivable	-	881	881	492
Total endowment	$ 4,373	$ 6,492	$ 10,865	$ 13,499

(in thousands of dollars)

11. Temporarily and Permanently Restricted Net Assets (Continued)

Changes in SHC's endowment for the years ended August 31, 2009 and 2008 are as follows:

	2009			2008
Change in endowment net assets	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**Total**
Endowment net assets, beginning of year	$ 7,007	$ 6,492	$ 13,499	$ 12,476
Investment return:				
Investment income	22	-	22	353
Mark to market adjustments	(2,594)	-	(2,594)	(28)
Total investment return	(2,572)	-	(2,572)	325
Contributions	-	-	-	981
Expenditures	(62)	-	(62)	(283)
Endowment net assets, end of year	$ 4,373	$ 6,492	$ 10,865	$ 13,499

The following provides descriptions of amounts classified as permanently restricted net assets and temporarily restricted net assets (endowment only). The portion of endowment funds that is required to be retained permanently or temporarily, either by explicit donor stipulation or by California UPMIFA, as of August 31, 2009 and 2008 is as follows:

	2009			2008
Endowment classified as net assets	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**Total**
Restricted for:				
Clinical services	$ (97)	$ 4,000	$ 3,903	$ 4,929
Education	1,749	1,235	2,984	3,847
Plant replacement and expansion	(1)	901	900	940
Indigent care and other	2,722	356	3,078	3,783
Total endowment classified as net assets	$ 4,373	$ 6,492	$ 10,865	$ 13,499

Most of SHC's endowment, $10,865 and $13,499 are invested in the MP at August 31, 2009 and 2008, respectively. The funds are held in perpetuity, invested to generate income to support.

Return Objectives and Risk Parameters
The return objective for the endowment assets is to generate optimal total return while maintaining an appropriate level of risk established by the University.

Strategies Employed for Achieving Investment Objectives
SHC relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gain) and current yield (interest and dividend) managed by the MP.

12. Related-Party Transactions

Transactions with the University and SoM

SHC has various transactions with the University and the SoM. SHC records expense transactions where direct and incremental economic benefits are received by SHC.

Expenses paid to the University and the SoM are reported as operating expenses in the statements of operations and changes in net assets and are management's best estimates of SHC's arms-length payments of such amounts for its market specific circumstances. To the extent that payments to the University and the SoM exceed an arms-length estimated amount relative to the benefits received by SHC, they are recorded as transfers to the University and the SoM in other changes in net assets.

SHC purchases certain services from the University and the SoM. Payment for these services is based on management's best estimate of its market specific circumstances.

Services provided by the SoM include physician services that benefit SHC, such as emergency room coverage, physicians providing medical direction to SHC, and physicians providing service to the clinical practice, which are covered by the Professional Services Agreement ("PSA"). Such expenses are reflected as purchased services in the consolidated statements of operations and changes in net assets, and total $249,237 and $215,403 for the years ended August 31, 2009 and 2008, respectively.

Services provided by the University include telecommunications, transportation, utilities, blood products, and certain administrative services, which consist of legal, internal audit, and risk management. Total costs incurred by SHC were $85,833 and $72,953 for the years ended August 31, 2009 and 2008, respectively, and are reflected in various categories in the consolidated statements of operations and changes in net assets.

SHC paid service fees to the University in the amount of $4,155 and $4,406 for the years ended August 31, 2009 and 2008, respectively. The service fees represent costs for the utilization of infrastructure owned by the University such as road improvements, parking garages and generators and are reflected in the consolidated statements of operations and changes in net assets as other expense. Expected payments over the next 24 years total $48,738. Annual service fees range from approximately $4,026 for the year ending August 31, 2010 to $453 for the year ending August 31, 2033.

SHC also received payment for services provided to the University including primarily building maintenance, housekeeping, and security. Costs incurred by SHC in providing these services are reflected in the respective categories in the consolidated statements of operations and changes in net assets. Reimbursement from the University totaled $33,910 and $24,064 for the years ended August 31, 2009 and 2008, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

In addition, SHC received certain grant monies for clinical trials from the University. Grant revenue totaled $4,912 and $5,443 for the years ended August 31, 2009 and 2008, respectively, and is reflected in the statements of operations and changes in net assets as net patient service revenue and recoveries.

During the year ended August 31, 2004, SHC paid $5,500 to the University. The amount represented a prepayment of a 51 year lease for property owned by the University. The short term portion of $108 is included in prepaid expenses and other in the consolidated balance sheets as of August 31, 2009 and 2008. The remaining amount included in other assets in the consolidated balance sheets is $4,565 and $4,673 as of August 31, 2009 and 2008, respectively.

12. Related-Party Transactions (Continued)

Transactions with the University and SoM (continued)
For the years ended August 31, 2009 and 2008, SHC transferred $8,049 and $7,675 to the University related to academic grants.

During the year ended August 31, 2009, SHC received an equity transfer of $15,167 which represented gifts originally donated to the University. These gifts were subsequently re-designated mostly for SHC capital projects.

Transactions with LPCH
Shared Services - SHC and LPCH share certain departments, including facilities design and construction, materials management, managed care contracting, payroll, compliance, risk management and general services. Shared service costs are included in the respective categories on the consolidated statements of operations and changes in net assets, and are allocated between SHC and LPCH based on negotiated rates. Reimbursement received from LPCH totaled $20,161 and $25,223 for the years ended August 31, 2009 and 2008, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

Purchased Services - SHC provides various services to LPCH. These services include operating room, cardiac catheterization, interventional radiology, radiation oncology and laboratory. The cost of these services is charged back to LPCH based on a percentage of charges intended to approximate cost or a cost per procedure. Costs of these purchased services are reflected in the appropriate category in the consolidated statements of operations and changes in net assets. Reimbursement of purchased services from LPCH totaled $53,007 and $50,113 for the years ended August 31, 2009 and 2008, respectively, and is reflected in the consolidated statements of operations and changes in net assets as net patient service revenue.

Other Services - Other services provided by SHC include services provided by interns and residents, billings and collections, building maintenance and utilities. Reimbursement of these services totaled $25,559 and $23,444 for the years ended August 31, 2009 and 2008, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries. SHC also leased 2,732 and 2,513 full time and part time employees to LPCH during the years ended August 31, 2009 and 2008, respectively.

Transfers to LPCH
Effective September 1, 2006, LPCH and the University entered into the LPCH PSA pursuant to which the University assigned to LPCH the right to all revenues related to pediatric and obstetric practices of SoM faculty. As part of the LPCH PSA, LPCH assumed the right to all pediatric and obstetric revenues after September 1, 2006. SHC transferred net assets of $807 to LPCH in connection with this transfer agreement during the year ended August 31, 2008.

In 2008, SHC agreed to execute an equity transfer of $2,001 to LPCH which represents a fixed allocation of 18% of the total net assets of SUMIT as of August 31, 2007. Previously net assets were allocated relative to the percentage of the premiums paid to SUMIT in each fiscal year. In 2009, $288 was transferred to SHC which represents 18% of the initial capital contribution made by SHC of which SHC owns 100%.

(in thousands of dollars)

13. Operating and Capital Leases

SHC leases various equipment and facilities under non-cancelable lease agreements expiring at various dates. Total rental expense (included in other expense in the consolidated statements of operations and changes in net assets) under these leases for the years ended August 31, 2009 and 2008 was $35,575 and $32,947, respectively.

Net minimum future lease payments under all non-cancelable operating leases and capital lease obligations for periods subsequent to August 31, 2009 are as follows:

Year Ending August 31,	**Operating**	**Capital**
2010	$ 27,770	$ 1,396
2011	21,644	1,396
2012	20,629	976
2013	19,790	136
2014	16,448	57
Thereafter	110,742	-
	$ 217,023	3,961
Less amount representing interest		(190)
Subtotal		3,771
Current portion		(1,296)
Long-term portion, net of current portion		$ 2,475

Capital lease obligations totaled $3,771 of which $1,296 is included in accounts payable and accrued liabilities on the consolidated balance sheet. The remaining capital lease obligation of $2,475 is included in other long term liabilities on the consolidated balance sheet.

SHC leases space in its medical office building to others under noncancelable operating lease arrangements. Future minimum base rentals to be received under these leases in place as of August 31, 2009 are as follows:

Year Ending August 31,	
2010	$ 637
2011	164
2012	166
2013	135
2014	56
	$ 1,158

14. Commitments and Contingencies

SHC is aware of certain asserted and unasserted legal claims. While the outcome cannot be determined at this time, management is of the opinion that the liability, if any, from these actions will not have a material effect on SHC's financial position.

SHC has irrevocable standby letters of credit in the amount of $14,619, which are required as security for the workers' compensation self-insurance arrangement and a direct pay letter of credit for the 2008 Series A-2 debt in the amount of $105,674. In fiscal year 2009, SHC obtained standby letters of credit in the amount of $85,000 to support collateral requirements under certain interest rate swap agreements. No amounts have been drawn on these letters of credit as of August 31, 2009.

At August 31, 2009, SHC had contractual obligations of approximately $133,666 primarily related to the construction of the new Hospital, the upgrade of the clinical information systems and consulting services.

Effective September 1, 2004, SHC entered into a seven year agreement with Perot Systems Health Care Services LLC ("Perot"), pursuant to which Perot will provide certain information technology services to SHC. Under the terms of the 2008 amended agreement, SHC will be charged a fixed annual service charge including expenses, payable monthly, for core services as defined, and additional fees plus expenses for special projects. The annual fixed service charges are subject to adjustment under certain conditions, but unless so adjusted, amount to approximately $41,919 for the year ending August 31, 2010, decreasing annually thereafter to approximately $39,398 for the year ending August 31, 2011. SHC has certain rights to reduce the scope of services to be purchased and to terminate the agreement early for a termination fee. The amount of the termination fee depends on when the right to terminate is exercised and reduces annually to $6,000 for the year ending August 31, 2010.

Effective April 1, 2008, SHC entered into a five year agreement with Accenture LLC ("Accenture"), pursuant to which Accenture will provide certain information technology services to SHC. Under the terms of the agreement, SHC will be charged a fixed annual service charge including expenses, payable monthly, for core services as defined, and additional fees plus expenses for special projects. The annual fixed service charges are subject to adjustment under certain conditions, but unless so adjusted, amount to approximately $12,157 for the year ending August 31, 2010, decreasing annually thereafter to approximately $250 for the year ending August 31, 2012. SHC has certain rights to reduce the scope of services to be purchased and to terminate the agreement early for a termination fee. The amount of the termination fee depends on when the right to terminate is exercised and reduces periodically from $2,600 for the year ending August 31, 2010 to $450 at September 30, 2011.

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation, as well as to regulatory actions unknown or unasserted at this time. Recently, government activity has increased with respect to investigations and allegations concerning possible violations by healthcare providers of regulations that could result in the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. SHC is subject to similar regulatory reviews, and while such reviews may result in repayments and/or civil remedies that could have a material effect on SHC's financial results of operations in a given period, management believes that such repayments and/or civil remedies would not have a material effect on SHC's financial position.

(in thousands of dollars)

14. Commitments and Contingencies (Continued)

The percentage of SHC employees excluding LPCH leased employees that are covered by collective bargaining arrangements is approximately 38%. There are currently no expired agreements.

California's Hospital Seismic Safety Act requires licensed acute care functions to be conducted only in facilities that meet specified seismic safety standards. Facilities classified by the State of California as non-compliant in the event of an earthquake must be retrofitted, replaced or removed from acute-care service by applicable deadlines in 2013, 2015, or 2030.

The State of California has classified a substantial portion of SHC's facilities as compliant with seismic safety structural standards until 2030 and beyond. However, some acute care activities are located in facilities that current law requires to be made compliant or to be taken out of service by 2013 or, under prescribed circumstances, by 2015. SHC plans to construct a new hospital facility to address seismic safety requirements and other needs. Applications for state and local approvals are pending. SHC also is seeking passage of legislation to extend deadlines and requirements. In light of uncertainties in the timing of approvals and in the duration of construction of the new hospital, and considering economic conditions and other factors that will likely extend completion of replacement facilities beyond currently applicable deadlines, SHC has also developed preliminary contingency plans to retrofit portions of noncompliant facilities in order to reduce the duration of service disruptions and closures of bed units should such action be required. If undertaken, the preliminary estimated construction cost of such retrofitting currently ranges between $200,000 and $300,000.

15. Functional Expenses

Expenses are categorized on a functional basis for the years ended August 31:

	2009	2008
Patient services	$ 1,592,313	$ 1,418,605
Management and general	136,049	128,943
Fundraising	4,635	2,758
Total functional expenses	$ 1,732,997	$ 1,550,306

16. Subsequent Events

Stanford Hospital has evaluated subsequent events occurring between the end of the most recent fiscal year and December 7, 2009, the date the financial statements were available for issuance.