Stanford Hospital and Clinics and Subsidiaries

Consolidated Financial Statements
August 31, 2010 and 2009

Stanford Hospital and Clinics and Subsidiaries
Index
August 31, 2010 and 2009

PRICEWATERHOUSECOOPERS

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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, 2010 and 2009 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 15, 2010

Stanford Hospital and Clinics and Subsidiaries
Consolidated Balance Sheets
August 31, 2010 and 2009
(in thousands of dollars)

	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	$ 334,344	$ 331,502
Assets limited as to use, held by trustee	280	280
Patient accounts receivable, net of allowance for doubtful accounts of $78,000 and $71,000 at August 31, 2010 and 2009, respectively	258,553	253,299
Other receivables	28,562	11,925
Inventories	19,148	18,725
Prepaid expenses and other	9,893	8,553
Total current assets	650,780	624,284
Investments	80,817	76,584
Investments in University managed pools	676,598	533,518
Assets limited as to use, held by trustee, net of current portion	712	48,828
Property and equipment, net	860,273	840,955
Other assets	63,521	60,715
Total assets	$ 2,332,701	$ 2,184,884
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	$ 102,723	$ 129,750
Accrued salaries and related benefits	101,378	91,835
Due to related parties	22,885	33,840
Third-party payor settlements	19,907	19,433
Current portion of long-term debt	4,969	8,713
Debt subject to short-term remarketing arrangements	358,000	266,764
Self-insurance reserves and other	21,892	18,303
Total current liabilities	631,754	568,638
Self-insurance reserves and other, net of current portion	104,168	90,811
Other long-term liabilities	174,286	96,244
Pension liability	74,629	65,188
Long-term debt, net of current portion	463,218	556,997
Total liabilities	1,448,055	1,377,878
Net assets:		
Unrestricted	785,092	730,563
Temporarily restricted	93,062	69,951
Permanently restricted	6,492	6,492
Total net assets	884,646	807,006
Total liabilities and net assets	$ 2,332,701	$ 2,184,884

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, 2010 and 2009
(in thousands of dollars)

	2010	2009
Operating revenues:		
Net patient service revenue	$ 1,884,046	$ 1,741,856
Premium revenue	7,296	22,960
Other revenue	71,193	57,666
Net assets released from restrictions used for operations	4,771	5,195
Total operating revenues	1,967,306	1,827,677
Operating expenses:		
Salaries and benefits	839,916	787,035
Professional services	22,118	22,842
Supplies	271,026	265,139
Purchased services	453,532	434,257
Provision for doubtful accounts, net	68,426	53,859
Depreciation and amortization	96,198	73,876
Interest	39,749	37,921
Other	153,058	139,385
Expense recoveries from related parties	(76,787)	(81,317)
Total operating expenses	1,867,236	1,732,997
Income from operations	100,070	94,680
Interest and investment income	4,240	3,814
Increase (decrease) in value of University managed pools	68,138	(146,481)
Interest rate swaps mark to market adjustments	(79,054)	(48,338)
Loss on extinguishment of debt	(12,994)	-
Excess (deficiency) of revenues over expenses	80,400	(96,325)
Other changes in unrestricted net assets:		
Transfer to Stanford University, net	(7,956)	(8,049)
Transfer from Lucile Salter Packard Children's Hospital	-	288
Change in net unrealized gains on investments	680	237
Net assets released from restrictions used for:		
Purchase of property and equipment	11,872	460
Change in pension and postretirement liability	(30,467)	(75,101)
Increase (decrease) in unrestricted net assets	54,529	(178,490)
Changes in temporarily restricted net assets:		
Transfer from Stanford University	2,789	15,167
Transfer to Lucile Salter Packard Children's Hospital	(10)	-
Contributions and other	34,729	5,606
Investment income	140	98
Gains (losses) on University managed pools	2,106	(1,415)
Net assets released from restrictions for:		
Operations	(4,771)	(5,195)
Purchase of property and equipment	(11,872)	(460)
Increase in temporarily restricted net assets	23,111	13,801
Increase (decrease) in net assets	77,640	(164,689)
Net assets, beginning of year	807,006	971,695
Net assets, end of year	$ 884,646	$ 807,006

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, 2010 and 2009
(in thousands of dollars)

	2010	2009
Cash flows from operating activities:		
Increase (decrease) in net assets	$ 77,640	$ (164,689)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Loss on extinguishment of debt	12,994	-
Depreciation and amortization of bond premiums/discounts	96,535	74,564
Provision for doubtful accounts	68,426	53,859
Change in fair value of interest rate swaps	79,054	48,338
(Increase) decrease in value of University managed pools	(68,138)	146,481
Unrealized (gains) losses on investments	(1,755)	2,357
Realized (gains) losses on investments	(110)	185
Contributions received for long lived assets or endowment and net equity transfers to/from related parties	(25,779)	(3,720)
Transfer from Lucile Salter Packard Children's Hospital	-	(288)
Premiums received from bond issuance	14,236	-
Changes in operating assets and liabilities:		
Patient accounts receivable	(73,680)	(66,169)
Due to related parties	(4,933)	10,749
Other receivables, inventory, other assets, prepaid expenses and other	(10,036)	877
Accounts payable, accrued liabilities and pension liabilities	(9,285)	58,187
Accrued salaries and related benefits	9,543	9,016
Third-party payor settlements	474	4,729
Self-insurance reserves	16,946	8,884
Other long-term liabilities	-	597
Cash provided by operating activities	182,132	183,957
Cash flows from investing activities:		
Purchases of investments	(20,095)	(24,857)
Sales of investments	16,660	8,652
Purchases of investments in University managed pools	(78,099)	(4,179)
Sales of investments in University managed pools	4,530	9,775
Decrease in assets limited as to use and other	48,116	114,642
Purchases of property and equipment	(124,300)	(220,791)
Cash used in investing activities	(153,188)	(116,758)
Cash flows from financing activities:		
Proceeds from issuance of debt	366,415	70,500
Costs of issuance of debt	(3,665)	-
Payment of long-term debt and capital lease obligation	(390,661)	(79,591)
Contributions received for long lived assets or endowment and net equity transfers to/from related parties	1,809	4,525
Cash used in financing activities	(26,102)	(4,566)
Net increase in cash and cash equivalents	2,842	62,633
Cash and cash equivalents, beginning of year	331,502	268,869
Cash and cash equivalents, end of year	$ 334,344	$ 331,502
Supplemental disclosures of cash flow information:		
Interest paid	$ 40,042	$ 39,975
Supplemental disclosures of non cash information:		
Payables for property and equipment	$ (8,784)	$ (12,660)
Increase (decrease) in value of interest in University managed pools	68,138	(146,481)
Equity transfers from related parties, net	6,022	-
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, 2010 and 2009. MHA is a wholly owned California limited liability company that operates two outpatient clinics.

Stanford Hospital's share of net assets in SUMIT, a captive insurance carrier, was 97.1% and 83.6% for the years ended August 31, 2010 and 2009, respectively. LPCH's share of net assets in SUMIT was 2.9% and 16.4% for the years ended August 31, 2010 and 2009, 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, 2010 and 2009. The remaining interest of 40% is recorded as a 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. Amounts required to fund current liabilities of SHC have been classified as current assets in the consolidated balance sheets at August 31, 2010 and 2009.

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 and mutual funds and are stated at fair value. Fair value is determined in accordance with current accounting guidance 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 Pool ("MP"), Expendable Funds Pool ("EFP"), and Active Cash Fund ("ACF") (collectively the "Pools"). Under the terms of SHC's agreement with the University, the University has discretion to invest the funds in the Pools. SHC may deposit funds in the Pools at its discretion. Withdrawals from the MP and EFP require advance notice to the University. SHC accounts for its share of the Pools in accordance with current accounting guidance. 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. In fiscal year 2010, the ACF pool was closed.

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 current accounting guidance, 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 $324 and $328 in the consolidated statements of operations and changes in net assets for the years ended August 31, 2010 and 2009, respectively. ARO liability of $6,782 and $6,458 is included in other long-term liabilities on the consolidated balance sheets as of August 31, 2010 and 2009, 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.

In November 2009, SHC sold its interest in Waverley. SHC's interest in Waverley was 33.70% for the year ended August 31, 2009. SHC's interest in PET-CT was 50% for the years ended August 31, 2010 and 2009. 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. In accordance with current accounting guidance, the discount rates 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, 2010 and 2009 were $46,663 and $28,636, respectively. Current portion of contributions receivable of $11,551 and $1,247 is included in other receivables in the consolidated balance sheets as of August 31, 2010 and 2009, respectively. Long term portion of contributions receivable of $35,112 and $27,389 is included in other assets in the consolidated balance sheets as of August 31, 2010 and 2009, 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 either the effective interest method or the 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 current accounting guidance. All swaps are recognized on the consolidated balance sheets at their fair value in accordance with current accounting guidance. 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) and changes in pension and postretirement liability.

Net Patient Service Revenue
Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers including Medicare and Medi-Cal, and others for services rendered, including estimated retroactive audit adjustments under reimbursement agreements with third-party payers. 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 is a not-for-profit corporation 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 $549 and $653 at August 31, 2010 and 2009, 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 $6,608. For the policy period September 1, 2009 to September 1, 2010, 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, 2009, SHC maintained the same coverage limits as fiscal year 2010. Prior to September 1, 2005, SHC maintained various coverage limits.

- ***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.

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 payers, retirement plan obligations, and self insurance reserves. Actual results could differ from those estimates.

Recent Pronouncements

The Financial Accounting Standards Board (FASB) is the authoritative source of Generally Accepted Accounting Principles (GAAP) in the United States. The consolidated financial statements as of and for the year ended August 31, 2010 reflect several new pronouncements that became effective during the year. These include the effect of the FASB Accounting Standards Codification (ASC), additional disclosures on pensions and other post retirement benefits, and derivatives and hedging activities. The FASB ASC is now the sole source of authoritative non-governmental GAAP in the United States. The ASC did not change any accounting principles, but effective fiscal year 2010, impacts the way in which GAAP is referenced in the financial statements.

Recent accounting guidance now requires entities with defined benefit or other postretirement plans to provide disclosure of assets by level and by major asset category, and describe the valuation techniques and inputs for each major asset category, including a description of how investment allocation decisions are made, the target allocation ranges or percentages employed, the investment goals and risk management practices, and significant risk concentrations within asset categories. SHC adopted this policy during the year ended August 31, 2010. These disclosures are discussed in Note 10.

New GAAP also requires entities that utilize derivative instruments or hedges to include enhanced disclosures about these activities in their financial statements, including their objectives for using derivative instruments in terms of underlying risk and accounting designation, the fair values of derivative instruments and related gains and losses, and information about credit-risk-related contingent features. These disclosures are discussed in Note 9.

The following pronouncements are effective for the fiscal year ending August 31, 2011. SHC is assessing the impact of these pronouncements.

The FASB has issued new guidance surrounding noncontrolling interests in consolidated financial statements. The objective is to improve relevance, comparability and transparency of financial information in consolidated financial statements. This new guidance requires that ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled and presented in the net asset section of the balance sheet, separate from the parent's net assets. It also requires that the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the statement of operations.

2. Summary of Significant Accounting Policies (Continued)

Recent Pronouncements (continued)
There is also new guidance surrounding fair value measurements and disclosures. This guidance requires disclosure of, and reasons for, significant transfers between levels 1 and 2. It also clarifies some existing requirements. It now requires an increased level of disaggregation when providing fair value measurement disclosures and additional disclosures about input and valuation techniques for level 2 and 3 assets and liabilities.

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 payers 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, 2003.

  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 payers 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 20% and 17% of net patient accounts receivable at August 31, 2010 and 2009, respectively. Amounts due from Medicare represent 15% and 16% of net patient accounts receivable at August 31, 2010 and 2009, 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 $5,271 and $5,759 as a result of prior years favorable developments related to reimbursement for the years ended August 31, 2010 and 2009, respectively. SHC also recognized revenues of $2,662 and $12,734 as a result of prior years appeals settled during the years ended August 31, 2010 and 2009, respectively.

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

	2010	2009
Medicare	$ 380,837	$ 356,042
Medi-Cal	32,175	30,097
Managed Care - Capitation	7,296	22,960
Managed Care - Discounted Fee for Services	1,252,327	1,141,866
Self pay and other	173,204	160,844
Related party	45,503	53,007
Total	$ 1,891,342	$ 1,764,816

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:

	2010	2009
Charity care at established rates	$ 72,665	$ 60,303
Estimated cost of charity care	$ 18,839	$ 16,469

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

	2010	2009
Charity care	$ 18,839	$ 16,469
Medi-Cal	85,406	76,112
Medicare	94,804	65,753
Total	$ 199,049	$ 158,334

(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:

	2010		2009	
	Cost	Fair Value	Cost	Fair Value
Cash and cash equivalents	$ 992	$ 992	$ 49,108	$ 49,108
Less: Current portion of assets limited as to use, held by trustee		(280)		(280)
Assets limited as to use, held by trustee, net of current portion		$ 712		$ 48,828

In prior years, SHC was required to maintain a debt service reserve fund with the trustee in connection with the 2003 bonds. However, as of August 31, 2010, this reserve fund is no longer required as a result of SHC meeting certain thresholds set forth in the trust indenture pursuant to which the 2003 bonds were issued.

6. Investments and Investments in University Managed Pools

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

	2010		2009	
	Cost	Fair Value	Cost	Fair Value
Investments:				
Cash and cash equivalents	$ 34,634	$ 34,634	$ 33,955	$ 33,955
Mutual funds	44,137	46,183	41,168	42,629
Total	$ 78,771	$ 80,817	$ 75,123	$ 76,584

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

	Fair Value	
	2010	2009
Investments in University Managed Pools:		
Merged Pool	$ 672,495	$ 525,986
Active Cash Fund	-	3,632
Expendable Funds Pool	4,103	3,900
Total	$ 676,598	$ 533,518

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, 2010 and 2009 consist of approximately 4% and 1% cash and cash equivalents, 2% and 1% fixed income, 22% and 25% public equity securities, 9% and 10% real estate, 9% and 11% natural resources, 30% and 30% absolute returns, and 24% and 22% private equity securities, respectively.

7. Fair Value Measurements

Current accounting guidance 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, this guidance 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.

(in thousands of dollars)

7. Fair Value Measurements (Continued)

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

	2010		
	Level 1	**Level 2**	**Total**
Assets			
Cash and cash equivalents	$ 334,344	$ -	$ 334,344
Assets limited as to use, held by trustee	992	-	992
Investments	34,634	46,183	80,817
Investments in University managed pools	-	676,598	676,598
Total assets	$ 369,970	$ 722,781	$1,092,751
Liabilities			
Interest rate swap instruments	$ -	$ 166,365	$ 166,365

	2009		
	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

8. Property and Equipment

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

	2010	**2009**
Land and improvements	$ 27,369	$ 27,364
Buildings and improvements	809,558	773,532
Equipment	605,355	479,815
	1,442,282	1,280,711
Less: Accumulated depreciation	(729,273)	(647,514)
Construction-in-progress	147,264	207,758
Property and equipment, net	$ 860,273	$ 840,955

(in thousands of dollars)

8. Property and Equipment (Continued)

Depreciation and amortization expense totaled $96,198 and $73,876 for the years ending August 31, 2010 and 2009, respectively, and is included in the consolidated statements of operations and changes in net assets.

As of August 31, 2010, 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 $3,900 and $2,605 as of August 31, 2010 and 2009, respectively.

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 $1,283 and $2,049 for the years ended August 31, 2010 and 2009, respectively.

9. Long-Term Debt

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

	Year of Maturity	Interest Rates 2010/2009	Outstanding Principal 2010	Outstanding Principal 2009
Fixed Rate Obligations				
1998 Series B Revenue Bonds	-	- /5.00%	$ -	$ 163,435
2003 Series A Revenue Bonds	2023	2.00% to 5.00%	83,400	88,015
2008 Series A1 Refunding Revenue Bonds	2040	2.25% to 5.15%/0.55%	70,360	70,500
2010 Series A Refunding Revenue Bonds	2031	4.00% to 5.75%	149,345	-
2010 Series B Refunding Revenue Bonds	2036	4.50% to 5.75%	146,710	-
Promissory note	2014	7.03%	704	857
Variable Rate Obligations				
2003 Series B, C and D Revenue Bonds	-	- /0.67%	-	150,000
2008 Series A2 Refunding Revenue Bonds	2040	0.26%/0.24%	104,100	104,100
2008 Series A3 Refunding Revenue Bonds	2040	3.45%/3.45%	85,700	85,700
2008 Series B Refunding Revenue Bonds	2045	0.24%/0.16%	168,200	168,200
Total principal amounts			808,519	830,807
Unamortized original issue premiums/discounts, net			17,668	1,667
Current portion of long-term debt			(4,969)	(8,713)
Debt subject to short-term remarketing arrangements			(358,000)	(266,764)
Long-term portion, net of current portion			$ 463,218	$ 556,997

9. Long-Term Debt (Continued)

In June 2008, the California Health Facilities Financing Authority ("CHFFA"), on behalf of SHC, issued Variable Rate Demand Bonds ("VRDB's") in the aggregate principal amount of $428,500 (the "2008 Bonds") to refund its previously issued 2006 Bonds. 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.

In June 2009, SHC remarketed the 2008 Series A-1 bonds in the aggregate principal amount of $70,500. In June 2010, SHC converted the 2008 Series A-1 bonds from an annual put mode to a long-term fixed interest rate mode. The remarketing of the 2008 Series A-1 Bonds at a long-term interest generated an original issue premium of approximately $140; that, pursuant to the requirements of the underlying documents, was used to reduce the principal amount of the bonds from $70,500 to $70,360.

Additionally in June 2010, CHFFA, on behalf of SHC, issued fixed rate revenue bonds in the aggregate principal amount of $296,055 (the "2010 Bonds") to refund the 1998 Series B Bonds and the 2003 Series B, C and D Bonds. The 2010 Bonds were comprised of $149,345 of 2010 Series A bonds, proceeds of which were used to refund the 1998B Bonds, and $146,710 of 2010 Series B bonds, proceeds of which were used to refund the 2003 Series B, C and D bonds. As a result of the bond refinancing, the unamortized bond issuance costs to the 1998 and 2003 and unamortized original issue discount related to the 1998 Bonds were included in loss on extinguishment of debt of $12,994 for the year ended August 31, 2010.

The 2008 Series A-2 Bonds, in the aggregate principal amount of $104,100, are in a weekly interest rate mode and secured by a direct pay letter of credit which expires June 2011. The 2008 Series B Bonds are in a weekly interest rate mode and supported by SHC's self-liquidity. The Bonds in a weekly interest rate mode are remarketed every 7 days at the then prevailing interest rate. Holders of bonds in a weekly mode have the option of tendering their bonds on a weekly basis. The 2008 Series A-3 Bonds, in the aggregate principal amount of $85,700, are in a multi-annual long-term mode and subject to a mandatory tender in June 2011. In order to ensure the availability of funds to purchase any bonds tendered that the remarketing agent is unable to remarket, SHC entered into a liquidity agreement with the University. The agreement allows access on a same-day basis to up to $200,000 of SHC's investments in University managed pools. All of the 2008 Series A-2, Series A-3 and Series B Bonds are classified as current liabilities.

The 2010 Bonds, together with the 2008 Bonds and 2003 Bonds are collectively referred to as the "Revenue Bonds". The Revenue Bonds are limited obligations 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 secured under a master trust indenture between SHC and the master trustee. The master trust indenture 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 $807,815 and $829,950 as of August 31, 2010 and 2009, respectively.

(in thousands of dollars)

9. Long-Term Debt (Continued)

Scheduled principal payments on long-term debt including unsecured promissory notes are summarized below:

	Scheduled Maturities	Bonds Supported by SHC Liquidity	Bonds Supported by Credit Facilities	Total
2011	$ 4,969	$ 253,900	$ 104,100	$ 362,969
2012	9,746	-	-	9,746
2013	10,330	-	-	10,330
2014	10,739	-	-	10,739
2015	11,075	-	-	11,075
Thereafter	403,660	-	-	403,660
	$ 450,519	$ 253,900	$ 104,100	$ 808,519

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 2011, 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. The VRDB's supported by self liquidity provide the bondholder with an option to tender the bonds to SHC. The VRDB's supported by credit facilities provide the bondholder the option of tendering the bonds to the credit 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, 2010 and 2009 was $832,180 and $823,864, 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, 2010 and 2009, $27,295 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. SHC uses swap agreements, also known as risk management or derivative instruments, principally to manage interest rate risk and has entered into derivatives to lock in fixed rates for anticipated issuance and refunding of debt. By using swap agreements to manage the risk of changes in interest rates, SHC exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes SHC, which creates credit risk. When the fair value of a derivative contract is negative, SHC owes the counterparty and, therefore, it does not possess credit risk. SHC minimizes its credit risk by entering into derivative agreements with at least two counterparties and requiring the counterparty to post collateral for the benefit of SHC based on the credit rating of the counterparty and the fair value of the derivative contract. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

(in thousands of dollars)

9. Long-Term Debt (Continued)

Interest Rate Swap Agreements (continued)

SHC maintains interest rate swap programs on certain of its variable rate revenue bonds. These bonds expose SHC to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of its interest payments. To meet this objective and to take advantage of low interest rates, SHC entered into various interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. Certain of these agreements involve the exchange of fixed rate payments for variable rate payments based on a percentage of the One Month London Interbank Offered Rate ("LIBOR"). SHC has also entered into agreements for the basis exchange of variable rate payments by SHC based on a fixed percentage of LIBOR for variable rate payments from a counterparty based on scaled percentage of LIBOR. As of August 31, 2010 and 2009, this scaled percentage was 93% of One Month LIBOR, but can range from 61% to 93% based upon the One Month LIBOR Rate on the reset date. The following is a summary of the outstanding positions under these interest rate swap agreements at August 31, 2010:

Description	Current Notional	Maturity Date	Rate Paid	Rate Received
Series 2003B	$ 48,800	11/15/2036	3.365%	70% 1-month LIBOR
Series 2003C	48,700	11/15/2036	3.365%	70% 1-month LIBOR
Series 2003D	52,500	11/15/2036	3.365%	70% 1-month LIBOR
Subtotal LIBOR Swaps	150,000			
Series 2003B	48,800	11/15/2036	70% 1-month LIBOR	93% 1-month LIBOR
Series 2003C	48,700	11/15/2036	70% 1-month LIBOR	93% 1-month LIBOR
Series 2003D	52,500	11/15/2036	70% 1-month LIBOR	93% 1-month LIBOR
Subtotal Basis Swaps	150,000 *			
Series 2008A1	70,500	11/01/2040	3.693%	70% 1-month LIBOR
Series 2008A2	104,100	11/01/2040	3.714%	70% 1-month LIBOR
Series 2008A3	85,700	11/01/2040	3.716%	70% 1-month LIBOR
Series 2008B1	84,100	11/15/2016	3.627%	70% 1-month LIBOR
Series 2008B2	84,100	11/15/2016	3.627%	70% 1-month LIBOR
Subtotal LIBOR Swaps	428,500			
Series 2010 A	68,350	11/15/2045	3.942%	70% 1-month LIBOR
Series 2010 B	68,375	11/15/2045	3.936%	70% 1-month LIBOR
Series 2010 C	34,175	11/15/2045	3.900%	70% 1-month LIBOR
Subtotal Forward Swaps	170,900			
Total	$ 749,400 *			

* Overlay swaps not included in total notional amount.

SHC designates its interest rate swaps that are used to minimize the variability in cash flows of interest-bearing liabilities or forecasted transactions caused by changes in interest rates as hedging instruments at the inception of each contract, with the intention of maintaining hedge accounting treatment over the term of the agreement. However, circumstances may arise whereby the representations made at the inception of the agreement became invalid, or the structure of the bonds is changed, resulting in de-designation of the hedge. In June 2008, the underlying bonds that were being hedged were refinanced and as a result, none of the swap agreements are treated as a hedge for accounting purposes.

(in thousands of dollars)

9. Long-Term Debt (Continued)

Interest Rate Swap Agreements (continued)

The fair value of interest rate swaps (all of which are designated as non-hedging instruments) is shown on the balance sheets as of August 31 as follows:

Description	Fair Value 2010	Fair Value 2009	Balance Sheet Location
Fixed Payment Swaps	$ (166,677)	$ (87,419)	Other long-term liabilities
Basis Swaps	312	108	Other long-term liabilities
Total	$ (166,365)	$ (87,311)	

The change in fair value of the interest rate swaps (all of which are designated as non-hedging instruments) is shown on the consolidated statements of operations and changes in net assets for the years ended August 31 as follows:

Description	Unrealized Gains (Losses) 2010	Unrealized Gains (Losses) 2009	Statement of Operations Location
Fixed Payment Swaps	$ (79,258)	$ (51,090)	Interest rate swap mark to market adjustments
Basis Swaps	204	2,752	Interest rate swap mark to market adjustments
Total	$ (79,054)	$ (48,338)	

Certain swap agreements require posting of collateral by SHC or the counterparties should the fair market value of the swap agreements exceed a predetermined threshold dollar amount. The collateral thresholds reflect the current credit ratings issued by major credit rating agencies on SHC's and the counterparty's debt. Declines in SHC's or the counterparty's credit ratings would result in decreases in the collateral thresholds and consequently, the potential for additional collateral postings by SHC or the counterparty. 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. In fiscal year 2010, the stated amount of the letters of credit related to the swap agreements was reduced to $75,000. No amounts have been drawn on these letters of credit as of August 31, 2010. Other than the stand-by letters of credit, SHC was not required to post additional collateral as of August 31, 2010.

Upon the occurrence of certain events of default or termination events identified in the derivative contracts, either SHC or the counterparty could terminate the contracts in accordance with their terms. Termination results in the payment of a termination amount by one party that attempts to compensate the other party for its economic losses. If interest rates at the time of termination are lower than those specified in the derivatives contract, SHC will make a payment to the counterparty. Conversely, if interest rates at such time are higher, the counterparty will make a payment to SHC.

(in thousands of dollars)

9. Long-Term Debt (Continued)

Bond Interest Expense

The components of bond interest expense for the years ended August 31 are as follows:

	2010	2009
Interest and fees	$ 19,684	$ 21,918
Swap settlements	19,641	15,550
Bond interest expense	$ 39,325	$ 37,468
Interest capitalized as a cost of construction	$ 1,283	$ 2,049
Bond interest income	$ 19	$ 711

10. Retirement Plans

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

In fiscal year 2009, in order to comply with current accounting guidance, 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, the measurement date 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 $42,550 and $38,593 for the years ended August 31, 2010 and 2009, 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.

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 $477 and $433 in cash for the years ending August 31, 2010 and 2009, 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.

(in thousands of dollars)

10. Retirement Plans (Continued)

Postretirement Medical Benefit Plan (continued)

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, 2010 and 2009, respectively.

The tables for the Postretirement Medical Benefit Plan include SHC and LPCH leased employees. The total postretirement medical benefit liability was $90,850 and $78,828 as of August 31, 2010 and 2009, respectively. SHC recorded a liability within self-insurance reserves in the consolidated balance sheets of $73,110 and $63,227 as of August 31, 2010 and 2009, respectively, which represents the liability for SHC employees excluding LPCH leased employees.

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	
	2010	2009	2010	2009
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 112,203	$ 140,777	$ -	$ -
Adjustment due to change in measurement date				
Changes due to gap period benefit payments	-	(1,134)	-	(575)
Actual return on plan assets	13,876	(23,171)	-	-
Employer contributions	13,750	3,075	3,298	4,490
Plan settlements	(2,348)	-	-	-
Participants contributions	-	-	782	665
Benefits paid	(7,193)	(7,344)	(4,080)	(4,580)
Fair value of plan assets at end of year	$ 130,288	$ 112,203	$ -	$ -
Change in benefit obligation:				
Benefit obligation at beginning of year	$ 177,391	$ 146,828	$ 78,828	$ 63,543
Adjustments due to change in measurement date				
Service and interest costs during gap period	-	2,008	-	962
Changes due to gap period benefit payments	-	(1,134)	-	(575)
Service cost	1,723	1,497	2,357	1,427
Interest cost	10,559	10,548	4,458	4,343
Plan settlements	(1,872)	-	-	-
Participants contributions	-	-	782	665
Benefits paid	(7,193)	(7,344)	(4,080)	(4,580)
Plan amendment	-	-	-	3,632
Actuarial loss	24,309	24,988	8,505	9,411
Benefit obligation at end of year	$ 204,917	$ 177,391	$ 90,850	$ 78,828

(in thousands of dollars)

10. Retirement Plans (Continued)

	Staff Pension Plan Obligations		Postretirement Medical Benefits Net of Medicare Part D Subsidy	
	2010	**2009**	**2010**	**2009**
Amounts recognized in consolidated balance sheets:				
Plan assets minus benefit obligation	$ (74,629)	$ (65,188)	$ (90,850)	$ (78,828)
Net benefit liability recognized	$ (74,629)	$ (65,188)	$ (90,850)	$ (78,828)
Amounts recognized in consolidated balance sheets consist of:				
Current liabilities	$ -	$ -	$ (4,827)	$ (4,739)
Noncurrent liabilities	(74,629)	(65,188)	(86,023)	(74,089)
Net benefit liability recognized	$ (74,629)	$ (65,188)	$ (90,850)	$ (78,828)
Amounts recognized in accumulated other comprehensive income:				
Prior service cost (credit)	$ -	$ -	$ 2,594	$ 2,020
Net loss (gain)	87,960	65,583	9,895	1,495
Accumulated other comprehensive income	$ 87,960	$ 65,583	$ 12,489	$ 3,515

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 $4,896.

The estimated net loss and prior service credit 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 $696 and $574, respectively.

Total benefit obligation at the end of the year for Postretirement Medical Benefits excluding Medicare Part D subsidiary increased to $98,959.

The accumulated benefit obligation for the defined benefit pension plan was $200,545 and $173,319 as of August 31, 2010 and 2009, 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	
	2010	2009
Service cost	$ 1,723	$ 1,497
Interest cost	10,559	10,548
Expected return on plan assets	(12,588)	(11,914)
Amortization	1,120	-
Total net periodic benefit cost	$ 814	$ 131

	Postretirement Medical Benefits			
	Net of Medicare Part D Subsidy		Excluding Medicare Part D Subsidy	
	2010	2009	2010	2009
Service cost	$ 2,357	$ 1,427	$ 2,367	$ 1,541
Interest cost	4,458	4,343	4,891	4,869
Amortization of prior service cost	(574)	(834)	(574)	(834)
Recognized net actuarial loss (gain)	105	(905)	225	(593)
Total net periodic benefit cost	$ 6,346	$ 4,031	$ 6,909	$ 4,983

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	
	2010	2009	2010	2009
Prior service cost arising during period	$ -	$ -	$ -	$ 3,632
Net loss arising during period	23,497	62,059	8,505	9,411
Amortizations				
Prior service credit	-	-	574	973
(Loss) gain	(1,120)	-	(105)	1,056
Total recognized in other comprehensive income	$ 22,377	$ 62,059	$ 8,974	$ 15,072
Total recognized in net periodic benefit cost and other comprehensive income	$ 23,191	$ 62,190	$ 15,320	$ 19,103

(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	
	2010	**2009**	**2010**	**2009**
Weighted-average assumptions				
Discount rate	4.99%	6.10%	4.70%	5.83%
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	
	2010	**2009**	**2010**	**2009**
Weighted-average assumptions				
Discount rate	6.10%	7.38%	5.83%	7.12%
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 from inception through June 30, 2010 averaged 8.1%. 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, 2010, an 8.5% annual rate of increase in the pre-65 per capita costs, an 8.5% annual rate of increase in the post-65 prescription drug per capita costs, and a 7.0% rate of increase in the post-65 per capita cost of all other medical benefits were assumed for 2010, all declining gradually to 4.75% by 2024, 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 $3,257 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 $2,940 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, 2010 and 2009, respectively, by asset category are as follows:

Asset Category	August 31, 2010	August 31, 2009
Equity securities	44%	42%
Debt securities	50%	42%
Real estate	6%	7%
Other	0%	9%
Total	100%	100%

The following table summarizes SHC's staff pension plan assets measured at fair value on a recurring basis as of August 31, 2010, based on the inputs used to value them as defined in Note 7:

	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 607	$ -	$ -	$ 607
Mutual funds	122,223	-	-	122,223
Real estate	-	-	7,458	7,458
Total assets	$ 122,830	$ -	$ 7,458	$ 130,288

The following table summarizes the changes in the fair value of the staff pension plan Level 3 assets as of August 31, 2010:

	Real estate
Balance, beginning of year	$ 8,301
Realized gains	473
Unrealized losses	(1,170)
Purchases, sales, issuances and settlements (net)	(146)
Balance, end of year	$ 7,458

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%

10. Retirement Plans (Continued)

Plan Investments (continued)

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.

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.

Concentration of Risk

SHC manages a variety of risks, including market, credit, and liquidity risks, across plan assets through investment managers. Concentration of risk is defined as an undiversified exposure to one of the above–mentioned risks that increases the exposure of the loss of plan assets unnecessarily. Risk is minimized by diversifying our exposure to such risks across a variety of instruments, markets, and counterparties. As of August 31, 2010, SHC did not have concentrations of risk in any single entity, manager, counterparty, sector, industry or country.

Expected Contributions

SHC expects to contribute $26,086 to its Staff Pension Plan for both SHC and LPCH leased employees during the fiscal year ending August 31, 2011. SHC expects to contribute $4,827 to its Postretirement Medical Plan for both SHC and LPCH leased employees during the fiscal year ending August 31, 2011.

(in thousands of dollars)

10. Retirement Plans (Continued)

Expected Benefit Payments

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

	Pension Benefits	Postretirement Medical Benefits Net of Medicare Part D Subsidy	Postretirement Medical Benefits Excluding Medicare Part D Subsidy
2011	$ 9,044	$ 4,827	$ 5,330
2012	9,733	5,363	5,927
2013	10,355	5,920	6,547
2014	11,036	6,395	7,086
2015	11,789	6,744	7,504
2016 - 2020	67,147	34,974	39,807

11. Temporarily and Permanently Restricted Net Assets

Temporarily Restricted Net Assets

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

	2010	2009
Plant replacement and expansion	$ 66,579	$ 48,767
Other patient services	14,134	8,457
Indigent care	5,653	6,318
Clinical services	3,483	3,382
Education	3,213	3,027
Total	$ 93,062	$ 69,951

Permanently Restricted Net Assets

In 2009, California adopted a version of the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”). 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, and (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 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 the 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.

(in thousands of dollars)

11. Temporarily and Permanently Restricted Net Assets (Continued)

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, 2010 and 2009 are as follows:

	2010			2009		
Donor restricted endowment	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Donor restricted endowment	$ 5,435	$ 5,611	$ 11,046	$ 4,373	$ 5,611	$ 9,984
Pledge receivable	-	881	881	-	881	881
Total endowment	$ 5,435	$ 6,492	$ 11,927	$ 4,373	$ 6,492	$ 10,865

Changes in SHC's endowment for the years ended August 31, 2010 and 2009 are as follows:

	2010			2009		
Change in endowment net assets	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Endowment net assets, beginning of year	$ 4,373	$ 6,492	$ 10,865	$ 7,007	$ 6,492	$ 13,499
Investment return:						
Investment income	98	-	98	22	-	22
Mark to market adjustments	1,075	-	1,075	(2,594)	-	(2,594)
Total investment return	1,173	-	1,173	(2,572)	-	(2,572)
Expenditures	(111)	-	(111)	(62)	-	(62)
Endowment net assets, end of year	$ 5,435	$ 6,492	$ 11,927	$ 4,373	$ 6,492	$ 10,865

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, 2010 and 2009 is as follows:

	2010			2009		
Endowment classified as net assets	**Temporarily Restricted**	**Permanently Restricted**	**Total**	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Restricted for:						
Clinical services	$ 279	$ 4,000	$ 4,279	$ (97)	$ 4,000	$ 3,903
Education	2,109	1,235	3,344	1,749	1,235	2,984
Plant replacement and expansion	2	901	903	(1)	901	900
Indigent care and other	3,045	356	3,401	2,722	356	3,078
Total endowment classified as net assets	$ 5,435	$ 6,492	$ 11,927	$ 4,373	$ 6,492	$ 10,865

Most of SHC's endowment, $11,927 and $10,865, are invested in the MP at August 31, 2010 and 2009, respectively. The funds are held in perpetuity and invested to generate income to support operating and strategic initiatives.

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.

11. Temporarily and Permanently Restricted Net Assets (Continued)

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 consolidated 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 $264,846 and $249,237 for the years ended August 31, 2010 and 2009, respectively.

Services provided by the University include telecommunications, transportation, utilities, blood products, and certain administrative services, which consist of legal and internal audit. Total costs incurred by SHC were $86,214 and $85,833 for the years ended August 31, 2010 and 2009, 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 $3,564 and $4,155 for the years ended August 31, 2010 and 2009, 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 23 years total $42,479. Annual service fees range from approximately $3,491 for the year ending August 31, 2011 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 $32,564 and $33,910 for the years ended August 31, 2010 and 2009, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

12. Related-Party Transactions (Continued)

Transactions with the University and SoM (continued)
In addition, SHC received certain grant monies for clinical trials from the University. Grant revenue totaled $6,613 and $4,912 for the years ended August 31, 2010 and 2009, respectively, and is reflected in the consolidated 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, 2010 and 2009. The remaining amount included in other assets in the consolidated balance sheets is $4,457 and $4,565 as of August 31, 2010 and 2009, respectively.

For the years ended August 31, 2010 and 2009, SHC transferred $6,249 and $7,459, respectively, to the University related to academic grants.

SHC received equity transfers of $2,789 and $15,167 during the years ended August 31, 2010 and 2009, respectively, 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 $20,438 and $20,161 for the years ended August 31, 2010 and 2009, 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 $45,503 and $53,007 for the years ended August 31, 2010 and 2009, 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 $21,197 and $25,559 for the years ended August 31, 2010 and 2009, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries. SHC also leased 2,750 and 2,732 full time and part time employees to LPCH during the years ended August 31, 2010 and 2009, respectively.

Transfers to LPCH
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, 2010 and 2009 was $36,559 and $35,575, respectively.

Net minimum future lease payments under all non-cancelable operating leases and capital lease obligations for periods subsequent to August 31, 2010 are as follows:

Year Ending August 31,	Operating	Capital
2011	$ 26,560	$ 1,396
2012	26,080	976
2013	25,304	136
2014	18,459	57
2015	15,182	-
Thereafter	96,677	-
	$ 208,262	2,565
Less amount representing interest		(90)
Subtotal		2,475
Current portion		(1,336)
Long-term portion, net of current portion		$ 1,139

Capital lease obligations totaled $2,475 of which $1,336 is included in accounts payable and accrued liabilities on the consolidated balance sheet. The remaining capital lease obligation of $1,139 is included in other long term liabilities on the consolidated balance sheets.

SHC leases space in its medical office building to others under non-cancelable operating lease arrangements. Future minimum base rentals to be received under these leases in place as of August 31, 2010 are as follows:

Year Ending August 31,	
2011	$ 897
2012	352
2013	135
2014	56
	$ 1,440

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.

14. Commitments and Contingencies (Continued)

SHC has irrevocable standby letters of credit in the amount of $14,386, 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. No amounts have been drawn on these letters of credit as of August 31, 2010.

At August 31, 2010, SHC had contractual obligations of approximately $71,480 primarily related to the construction of the new Hospital and other capital projects to support SHC's operations.

Effective September 1, 2004, SHC entered into a seven year agreement with a worldwide provider of information technology services and business solutions, pursuant to which SHC will receive certain information technology services. 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 $39,705 for the year ending August 31, 2011.

Effective April 1, 2008, SHC entered into a five year agreement with a global management consulting, technology services and outsourcing company, pursuant to which SHC will receive certain information technology services. Effective September 1, 2010, SHC entered into a new eight year agreement with this global company. Under the terms of the new 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 $24,005 for the year ending August 31, 2011, with the remaining amount of $273,710 due over the life of the contract. 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 changes monthly from $7,450 for the month ending September 30, 2010, up to $14,550 for the month ending September 30, 2011, and then decreasing gradually to $1,350 for the month ending February 28, 2018.

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.

The percentage of SHC employees excluding LPCH leased employees that are covered by collective bargaining arrangements is approximately 36%. The agreement with CRONA expired during fiscal year 2010 and negotiations are ongoing.

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, 2020 or 2030.

(in thousands of dollars)

14. Commitments and Contingencies (Continued)

The California Office of Statewide Health Planning and Development (“OSHPD”) has classified a substantial portion of Stanford Hospital as compliant with seismic safety structural standards until 2030 and beyond. Patient care activities are located in facilities that are structurally compliant until 2030. However, these facilities have utility and other connections to facilities that are only compliant until 2013, or 2015 under prescribed circumstances. Stanford Hospital plans to construct a new hospital facility to address seismic safety requirements and other needs. Applications for state and local approvals are pending.

Recent amendments of the Hospital Seismic Safety Act permit OSHPD to extend the structural compliance deadline for eligible hospitals from 2013 until January 1, 2016 due to local planning delays. In addition, such legislation authorizes OSHPD to grant two additional one-year extensions, until January 1, 2018, to facilities that meet certain criteria in the legislation. Management of Stanford Hospital expects Stanford Hospital to be eligible for such extensions. Based on current estimated schedules for obtaining local approvals and for the construction of the new hospital, management currently projects that the new hospital construction will be complete by January 1, 2018.

15. Functional Expenses

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

	2010	2009
Patient services	$ 1,699,045	$ 1,592,313
Management and general	163,578	136,049
Fundraising	4,613	4,635
Total functional expenses	$ 1,867,236	$ 1,732,997

16. Subsequent Events

SHC has evaluated subsequent events occurring between the end of the most recent fiscal year and December 15, 2010, the date the financial statements were issued.

Hospital Fee Program
AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a “Quality Assurance Fee” and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State’s effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") and managed health care plans in FY11.