

# Audited Financial Statements

December 31, 2009



# Sutter Health and Affiliates

## Combined Financial Statements

Years ended December 31, 2009 and 2008

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## Report of Independent Auditors

The Board of Directors  
Sutter Health and Affiliates

We have audited the accompanying combined balance sheets of Sutter Health and Affiliates as of December 31, 2009 and 2008, and the related combined statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Sutter Health and Affiliates' management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Sutter Health and Affiliates at December 31, 2009 and 2008, and the combined results of their operations and changes in their net assets, and their cash flows for the years then ended in conformity with United States generally accepted accounting principles.

*Ernst & Young LLP*

April 2, 2010

# Sutter Health and Affiliates

## Combined Balance Sheets

(Dollars in millions)

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 398	\$ 430
Short-term investments	1,552	1,106
Patient accounts receivable (less allowance for doubtful accounts of \$245 in 2009 and \$223 in 2008)	1,066	998
Other receivables	164	210
Securities lending receivable	170	82
Inventories	97	90
Other	63	58
Total current assets	<b>3,510</b>	2,974
Non-current investments	1,078	1,376
Property, plant and equipment, net	4,829	4,432
Other	393	304
	<b>\$ 9,810</b>	<b>\$ 9,086</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable	\$ 228	\$ 270
Accrued salaries and related benefits	446	465
Other accrued expenses	406	389
Securities lending collateral payable	176	85
Current portion of long-term obligations	66	31
Total current liabilities	<b>1,322</b>	1,240
Non-current liabilities:		
Long-term obligations, less current portion	2,497	2,950
Other	606	559
Net assets:		
Unrestricted	5,064	4,054
Temporarily restricted	208	185
Permanently restricted	113	98
	<b>5,385</b>	4,337
	<b>\$ 9,810</b>	<b>\$ 9,086</b>

See accompanying notes.

## Sutter Health and Affiliates

### Combined Statements of Operations and Changes in Net Assets

*(Dollars in millions)*

	<b>Years ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Unrestricted net assets:</b>		
Operating revenues:		
Patient service revenues	\$ 7,410	\$ 6,874
Capitation revenues	1,019	1,025
Contributions	10	18
Other	333	353
Total operating revenues	8,772	8,270
Operating expenses:		
Salaries and employee benefits	4,032	3,675
Purchased services	1,728	1,672
Supplies	955	929
Depreciation and amortization	435	410
Capitated purchased services	242	268
Provision for doubtful accounts	329	269
Rentals and leases	119	110
Interest	88	95
Insurance	36	26
Other	355	355
Total operating expenses	8,319	7,809
Income from operations	453	461
Investment income	11	11
Change in net unrealized gains and losses on investments classified as trading	233	(285)
Income	697	187

## Sutter Health and Affiliates

### Combined Statements of Operations and Changes in Net Assets (continued)

*(Dollars in millions)*

	<b>Years ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Unrestricted net assets (continued):</b>		
Income	\$ 697	\$ 187
Change in net unrealized gains and losses on investments classified as other-than-trading	23	(24)
Net assets released from restrictions for equipment acquisition	15	30
Donated long-lived assets	1	1
Pension-related changes other than net periodic pension cost	285	(535)
Cumulative effect of change in accounting principle	–	(24)
Other	(11)	–
Increase (decrease) in unrestricted net assets	<b>1,010</b>	<b>(365)</b>
<b>Temporarily restricted net assets:</b>		
Contributions	34	44
Investment income (loss)	4	(2)
Change in net unrealized gains and losses on investments	27	(34)
Net assets released from restrictions	(45)	(61)
Other	3	2
Increase (decrease) in temporarily restricted net assets	<b>23</b>	<b>(51)</b>
<b>Permanently restricted net assets:</b>		
Contributions	7	1
Change in net unrealized gains and losses on investments	3	(5)
Other	5	2
Increase (decrease) in permanently restricted net assets	<b>15</b>	<b>(2)</b>
Increase (decrease) in net assets	<b>1,048</b>	<b>(418)</b>
Net assets, beginning of year	<b>4,337</b>	4,755
Net assets, end of year	<b>\$ 5,385</b>	<b>\$ 4,337</b>

*See accompanying notes.*

Sutter Health and Affiliates  
 Combined Statements of Cash Flows

*(Dollars in millions)*

	<b>Years ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Operating activities</b>		
Increase (decrease) in net assets	\$ 1,048	\$ (418)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Loss from extinguishment of debt	–	8
Depreciation and amortization	435	410
Change in net unrealized gains and losses from investments	(286)	348
Provision for doubtful accounts	329	269
Restricted contributions and investment income	(15)	(12)
Loss on impairment of property, plant and equipment	7	–
Loss on disposal of property, plant and equipment	6	1
Net changes in operating assets and liabilities:		
Patient accounts receivable and other receivables	(439)	(157)
Inventories and other assets	(118)	94
Accounts payable and accrued expenses	47	(148)
Other non-current liabilities	47	(14)
Net cash provided by operating activities	<b>1,061</b>	381
<b>Investing activities</b>		
Purchases of property, plant and equipment	(830)	(1,027)
Proceeds from disposal of property, plant and equipment	1	2
Purchases and sales or maturities of investments, net	138	192
Other	1	–
Net cash used in investing activities	<b>(690)</b>	(833)

## Sutter Health and Affiliates

### Combined Statements of Cash Flows (continued)

*(Dollars in millions)*

	<b>Years ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Financing activities</b>		
Proceeds from borrowings on line of credit	\$ 742	\$ 392
Payments on line of credit	(1,134)	–
Payments of long-term obligations	(31)	(31)
Payments for refunding of debt	–	(371)
Proceeds from issuance of long-term obligations	8	628
Amortization of bond issuance costs and discount (premium)	(3)	(3)
Net proceeds from restricted contributions and investment income	15	12
Net cash (used in) provided by financing activities	(403)	627
Net (decrease) increase in cash and cash equivalents	(32)	175
Cash and cash equivalents at beginning of year	430	255
Cash and cash equivalents at end of year	\$ 398	\$ 430
 <b>Supplementary disclosures of cash flow information and schedule of noncash investing and financing activities:</b>		
Cash paid during the year for interest (net of capitalized interest costs of \$47 in 2009 and \$32 in 2008)	\$ 89	\$ 86

*See accompanying notes.*

# Sutter Health and Affiliates

## Notes to Combined Financial Statements

December 31, 2009 and 2008

*(Dollars in millions)*

### **1. ORGANIZATION**

Sutter Health is a California not-for-profit multi-provider integrated health care delivery system headquartered in Sacramento, California, which includes a centralized support group and various health care-related businesses operating primarily in five geographic regions, principally in Northern California. Sutter Health and its affiliates and subsidiaries provide health care, education, research and administration services.

The five geographic regions include acute care and psychiatric hospitals, skilled nursing facilities, medical foundations, fundraising foundations and a variety of other specialized health care service providers. These entities are commonly referred to as the Affiliates. Most acute care hospitals provide a full range of medical services (e.g., surgical, intensive care, emergency room, obstetrics). All emergency rooms provide emergency care, regardless of a patient's ability to pay. Sutter Health and its Affiliates also serve their communities with programs including health education, health libraries, school-based clinics, home health care, hospice care, adult day care, prenatal clinics, community clinics, immunization services, and training health professionals.

### **2. ACCOUNTING POLICIES**

Basis of Combination: The combined financial statements include the accounts of Sutter Health and its controlled affiliates and subsidiaries (Sutter). All significant intercompany accounts and transactions have been eliminated in combination.

Change in Reporting Entity: Marin General Hospital Foundation (MGHF) is a California nonprofit public benefit corporation that is engaged in philanthropic activities for the benefit of Marin General Hospital (MGH). In 2009, the Marin Health Care District (the "Marin District") replaced MGH as the sole corporate member of MGHF. The replacement of MGH as the sole corporate member of MGHF has been accounted for as a change in reporting entity; therefore, the 2008 combined financial statements have been restated to exclude the financial position and activities of MGHF. The effect of this change did not have a material impact on the combined financial position, results of operations, or cash flows.

Use of Estimates: The preparation of financial statements in conformity with United States (U.S.) generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the combined financial statements and accompanying notes. Actual results could differ from those estimates.

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

### 2. ACCOUNTING POLICIES (continued)

Cash Equivalents: Cash equivalents include all highly liquid investments with original maturities of 90 days or less, including money market accounts with limited market risk. Financial instruments that potentially subject Sutter to concentrations of credit risk include cash equivalents and investments. Sutter places certain of its cash in banks that are federally insured in limited amounts and in investment-grade debt instruments, many of which are backed by the U.S. Government or other government agencies. Cash equivalents are stated at fair market value.

Investments: Investments consist principally of corporate debt and equity securities, U.S. Government and agency securities, and foreign government and corporate debt securities, all of which are designated as either trading or other-than-trading and carried at fair market value. Certain investments are held in trust. These include assets held by trustees in accordance with the indentures relating to long-term obligations. In addition, certain investments are designated by the appropriate Sutter governing boards for future capital improvements.

Patient Accounts Receivable: Sutter's primary concentration of credit risk is patient accounts receivable, which consist of amounts owed by various governmental agencies, insurance companies and private patients. Sutter manages the receivables by regularly reviewing its patient accounts and contracts and by providing appropriate allowances for uncollectible amounts. Significant concentrations of gross patient accounts receivable are as follows:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Medicare	<b>27%</b>	28%
Medi-Cal	<b>20%</b>	19%

During 2009 and 2008, certain Affiliates collected on accounts that were previously deemed uncollectible and reserved. Such recoveries are recognized in the period that cash is received and were not material. Due to the inherent variability in this area of patient receivable collections, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

### **2. ACCOUNTING POLICIES (continued)**

Securities Lending: Sutter participates in securities lending transactions with its custodian whereby Sutter lends a portion of its investments to various brokers in exchange for collateral for the securities loaned, usually on a short-term basis. Collateral provided by brokers consists of cash and cash equivalents and is maintained at levels of at least 100% of the fair value of the securities on loan and is subject to market fluctuations. Sutter maintains effective control of the loaned securities through its custodian during the term of the arrangement in that they may be recalled at any time. Under the terms of the agreement, the borrower must return the same, or substantially the same, investments that were borrowed. The market value of loaned securities is reported as a securities lending receivable, and a corresponding obligation is reported for repayment of related collateral upon settlement of the lending transaction. At December 31, 2009 and 2008, the market value of the securities on loan was \$170 and \$82, respectively.

Inventories: Inventories, which consist principally of medical and other supplies, are stated on the basis of cost determined by the first-in, first-out method, which is not in excess of market.

Property, Plant and Equipment: Property, plant and equipment are stated on the basis of cost, or in the case of donated items, on the basis of fair market value at the date of donation, less depreciation and any impairment write-downs. Equipment includes medical equipment, furniture and fixtures, and software development. Routine maintenance and repairs are charged to expense as incurred. Expenditures that increase values, change capacities or extend useful lives are capitalized, as is interest on amounts borrowed to finance constructed assets.

Depreciation is computed by the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years for buildings and improvements and leasehold improvements and from 3 to 20 years for equipment. Amortization of equipment under capital leases is included in depreciation and amortization expense.

Asset Impairment: Sutter routinely evaluates the carrying value of its long-lived assets for impairment. The evaluations address the estimated recoverability of the assets' carrying value, which is principally determined based on projected undiscounted net cash flows generated by the underlying tangible assets. When the carrying value of an asset exceeds estimated recoverability, an asset impairment is recognized.

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

### **2. ACCOUNTING POLICIES (continued)**

Other Assets: Goodwill represents the excess of purchase price over the fair market value of net assets acquired. The portion of goodwill subject to amortization is \$11 as of December 31, 2009. Goodwill is being amortized over periods ranging from 3 to 15 years using the straight-line method. Sutter assesses the recoverability of its goodwill by determining whether the amortization of the goodwill balance over its remaining life can be recovered through undiscounted future operating cash flows from the net assets acquired. The amount of goodwill impairment, if any, is measured based on projected discounted future operating cash flows. The assessment of the recoverability of goodwill will be impacted if estimated future operating cash flows are not achieved.

Unamortized financing costs associated with the issuance of long-term bonds are amortized ratably over the estimated average period the bonds will be outstanding.

Other Liabilities: Other non-current liabilities consist of (i) insurance liabilities, including estimated liabilities for professional liability losses and workers' compensation, (ii) minority interests in net assets of subsidiaries, (iii) the portion of estimated third-party settlements not expected to be settled within a year, (iv) other postretirement benefits liabilities, and (v) certain other liabilities.

Risk Management: Sutter is self-insured for workers' compensation for certain Affiliates. Also, certain Affiliates are insured by a wholly owned self-insured captive insurance company for professional liability claims and comprehensive general liability. In addition, certain Affiliates purchase (i) workers' compensation insurance coverage and (ii) claims-made professional liability insurance coverage from third parties. The provisions for estimated workers' compensation, professional liability and comprehensive general liability claims include estimates of the ultimate costs for both uninsured reported claims and claims incurred-but-not-reported (IBNR), in accordance with actuarial projections based on past experience. Such claim reserves are based on the best data available to Sutter; however, these estimates are subject to a significant degree of inherent variability. Accordingly, there is at least a reasonable possibility that a material change to the estimated reserves will occur in the near term. Such estimates are continually monitored and reviewed, and as reserves are adjusted, the differences are reflected in current operations. While the ultimate amount of workers' compensation, professional liability and comprehensive general liability claims is dependent on future developments, management is of the opinion that the associated liabilities recognized in the accompanying combined financial statements are adequate to cover such claims.

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

### **2. ACCOUNTING POLICIES (continued)**

Sutter has entered into reinsurance and excess policy agreements with independent insurance companies to limit its losses on workers' compensation, professional liability and comprehensive general liability claims.

Workers' compensation liabilities were \$144 and \$130 discounted using at a rate of 3.7% and 4.8%, as of December 31, 2009 and 2008, respectively. Sutter has other workers' compensation plans administered at certain Affiliates that are discounted using rates ranging from 3.7% to 5.0% with reserves amounting to \$48 and \$43 as of December 31, 2009 and 2008, respectively. Professional liabilities were \$94 and \$79 discounted at a rate of 2.6% and 4.1% as of December 31, 2009 and 2008, respectively. Management is not aware of any potential professional liability claims whose settlement would have a material adverse effect on Sutter's combined financial position.

In lieu of a security deposit requirement, most of Sutter's self-insured workers' compensation plans paid assessment charges to participate in California Self Insurers' Alternative Security Program, which provided coverage of \$103 and \$116 as of December 31, 2009 and 2008, respectively.

Asset Retirement Obligations: Sutter has recorded an estimated liability of \$56 and \$58 at December 31, 2009 and 2008, respectively, related to the fair value of costs for asbestos abatement that will result from Sutter's current plans to renovate and/or demolish certain acute care facilities.

Contingencies: Estimated losses from contingencies are recorded when they are probable and reasonably estimable.

Net Assets: Net resources that are not restricted by donors are included in unrestricted net assets. Resources restricted by donors for a specified time or purpose are reported as temporarily restricted net assets. When the specific purposes are achieved, either through passage of a stipulated time period or when the purpose for restriction is accomplished, they are released to other operating revenues in the combined statement of operations and changes in net assets. Resources temporarily restricted by donors for additions to property, plant and equipment are initially reported as temporarily restricted net assets and are transferred to unrestricted net assets when expended. Donor-imposed restrictions, which stipulate that the resources be maintained permanently, are reported as permanently restricted net assets. Investment income related to temporarily or permanently restricted net assets is classified as either temporarily restricted or unrestricted based on the intent of the donor, or is added to permanently restricted net assets if required by the donor.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### **2. ACCOUNTING POLICIES (continued)**

Patient Service Revenues: Patient service revenues are reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement programs with third-party payers. Estimated settlements under third-party reimbursement programs are accrued in the period the related services are rendered and adjusted in future periods, primarily as a result of final cost report settlements with government agencies.

Purchased Services: Purchased services expense is made up of a wide variety of contracted and other purchased services, including medical group compensation, other professional fees, and repairs and maintenance. Medical group compensation is accrued by Sutter according to professional services agreements between affiliated medical foundations and their contracted medical groups.

Capitated Services: Sutter has agreements with various Health Maintenance Organizations (HMOs) to provide medical services to subscribing participants. Under these agreements, Sutter receives monthly capitation payments based on the number of each HMO's participants that are covered by the contract, regardless of services provided by Sutter. Certain of these agreements also contain provisions whereby additional amounts may be due or paid. Sutter accrues costs for out-of-area services when services are rendered under these contracts, including estimates of IBNR claims and amounts receivable/payable under risk-sharing arrangements. The IBNR accrual is an estimate of the cost of services for which Sutter is responsible.

Performance Indicator: "Income" as reflected in the accompanying combined statements of operations and changes in net assets is a performance indicator. Income includes changes in unrestricted net assets other than contributions of long-lived assets, changes in net unrealized gains and losses on investments classified as other-than-trading, retirement plans and post-retirement benefits actuarial gains and losses and prior service costs, discontinued operations, cumulative effects of changes in accounting principles and extraordinary items.

Advertising: Sutter expenses advertising costs as incurred. Advertising expense (included in other operating expenses) was \$19 in 2009 and \$20 in 2008.

Research and Development: Sutter expenses research and development costs as incurred. Research and development expense (included in other operating expenses) was \$46 in 2009 and \$45 in 2008.

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

### **2. ACCOUNTING POLICIES (continued)**

Income Taxes: Sutter Health and most Affiliates have been determined to be exempt organizations by the Internal Revenue Service, (pursuant to Internal Revenue Code Section 501(c)(3)), and the California Franchise Tax Board (pursuant to California Revenue and Taxation Code 23701(d)) and, generally, are not subject to taxes on income.

Certain activities of Sutter are subject to income taxes; however, such activities are not significant to the combined financial statements. With respect to its for-profit subsidiaries and taxable activities, Sutter records income taxes using the liability method under which deferred tax assets and liabilities are determined based on the differences between the financial accounting and tax bases of assets and liabilities. Deferred tax assets or liabilities at the end of each period are determined using the currently enacted tax rate expected to apply to taxable income in the periods that the deferred tax asset or liability is expected to be realized or settled.

Adoption of New Accounting Pronouncements: In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-07, *Not for Profit Entities (Topic 958) – Mergers and Acquisitions* (ASU 2010-07). ASU 2010-07 amends the Accounting Standards Codification (ASC) for the issuance of FASB Statement No. 164, *Not-for-Profit Entities: Mergers and Acquisitions*. The amendments in ASU 2010-07 provide guidance on accounting for combinations of not-for-profit entities. Those transactions or other events include mergers of two or more not-for-profit entities and acquisitions by a not-for-profit entity that result in its initially recognizing another not-for-profit entity, a business, or a nonprofit activity in its financial statements. Management is currently evaluating the potential impact of this guidance, which will be effective beginning January 1, 2010, but does not expect it to have a material impact on the combined financial condition, results of operations, or cash flows.

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosure About Fair Value Measurements* (ASU 2010-06). ASU 2010-06 requires new disclosures and clarifies some existing disclosure requirements about fair value measurement as set forth in Subtopic 820-10. Management is currently evaluating the potential impact of this guidance, which will be effective beginning January 1, 2010, but does not expect it to have a material impact on the combined financial condition, results of operations, or cash flows.

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

(Dollars in millions)

### 2. ACCOUNTING POLICIES (continued)

In September 2009, the FASB issued ASU No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820) – Investments in Certain Entities that Calculate Net Asset Value per Share or the Equivalent* (ASU 2009-12). ASU 2009-12 amends Subtopic 820-10, *Fair Value Measurements and Disclosures*, to provide guidance on the fair value measurement of investments in certain entities that calculate net asset value per share (or its equivalent). The adoption of this guidance did not have a material impact on the combined financial position, results of operations, or cash flows.

In August 2009, the FASB issued ASU No. 2009-05, *Fair Value Measurements and Disclosures (Topic 820) – Measuring Liabilities at Fair Value* (ASU 2009-05). ASU 2009-05 amends ASC 820 to provide guidance concerning the measurement of liabilities at fair value. The adoption of this guidance did not have a material impact on the combined financial position, results of operations, or cash flows.

In June 2009, the FASB issued an accounting standard, currently included in ASC Topic 105 (ASC 105), *Generally Accepted Accounting Principles* (GAAP), which established only two levels of GAAP, authoritative and nonauthoritative (formerly Statement of Financial Accounting Standards (SFAS) No. 168, *The FASB Accounting Standards Codification<sup>TM</sup> and the Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162*). The FASB ASC became the only source of authoritative nongovernmental GAAP, except for rules and interpretive releases of the Securities and Exchange Commission (SEC), which are sources of authoritative GAAP for SEC registrants. All other nongrandfathered, non-SEC accounting literature not included in the ASC will become nonauthoritative. ASC 105 was not intended to change or alter existing GAAP; consequently the adoption of this guidance did not have a material impact on the combined financial position, results of operations, or cash flows.

In May 2009, the FASB issued guidance, currently included in ASC Topic 855 (ASC 855), *Subsequent Events*, which established general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or available to be issued (formerly SFAS No. 165, *Subsequent Events*). In particular, ASC 855 sets forth (a) the period after the balance sheet date during which a reporting entity shall evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (b) the circumstances under which an entity shall recognize events or transactions occurring after the balance sheet date in its financial statements, and (c) the disclosures that an entity shall make about events or transactions that occurred after the balance sheet date. ASC 855 became

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

### **2. ACCOUNTING POLICIES (continued)**

effective on June 30, 2009, and the adoption of this new accounting standard now requires Sutter to assess significant subsequent events through the date the financial statements are issued.

In April 2009, the FASB issued three accounting standards that were intended to provide additional application guidance and enhance disclosures about fair value measurements and impairments of securities. The provisions included in these standards were intended to (i) clarify the objective and method of fair value measurement even when there has been a significant decrease in market activity for the asset being measured (formerly FASB Staff Position (FSP) SFAS No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*), currently included in ASC 820, *Fair Value Measurements and Disclosures*, (ii) establish a new model for measuring other-than-temporary impairments for debt securities, including establishing criteria for when to recognize a write-down through earnings versus other comprehensive income (formerly FSP SFAS No. 115-2 and FSP SFAS No. 124-2, *Recognition of Other-Than-Temporary Impairment*), currently included in ASC Topic 320, *Investments-Debt and Equity Securities*, and (iii) require fair value disclosures in interim periods for all financial instruments within the scope of ASC Topic 825, *Financial Instruments* (formerly SFAS No. 107-1 and Accounting Principles Board (APB) 28-1, *Interim Disclosures about Fair Value of Financial Instruments*). The adoption of this guidance did not have a material impact on the combined financial position, results of operations, or cash flows.

In December 2008, the FASB issued guidance, currently included in ASC Topic 715, *Compensation Retirement Benefits*, which requires disclosure of additional information about assets held in a defined benefit pension or other post-retirement plan (formerly SFAS No. 132(R)-1, *Employers' Disclosures about Post-retirement Benefit Plan Assets*). Specifically, this guidance requires an employer to disclose (i) investment policies and strategies including target allocation percentages, (ii) major categories of plan assets, (iii) inputs and valuation techniques used to measure the fair value of plan assets, and (iv) significant concentration of risk within plan assets. The adoption of this guidance did not have a material impact on the combined financial position, results of operations, or cash flows.

In August 2008, FASB issued guidance ASC Topic 958-205 (formerly FAS 117-1), *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (FSP FAS 117-1). The FSP provides

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

(Dollars in millions)

### 2. ACCOUNTING POLICIES (continued)

guidance on the net asset classification of donor-restricted endowment funds for a Not-for-Profit Organization (NPO) that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). It also establishes disclosure requirements for all NPOs regarding both donor-restricted and board-designated endowment funds. The adoption of this guidance did not have a material impact on the combined financial position, results of operations, or cash flows.

In February 2008, the FASB issued guidance which amended ASC 820, *Fair Value Measurements and Disclosures*, to delay the effective date until January 1, 2009 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, at least annually (formerly FSP No. FAS 157-2, *Effective Date of FASB Statement No. 157*). ASC 820, as amended, was effective for financial statements issued for fiscal years beginning after November 15, 2008 and for interim periods within those fiscal years. The adoption of this guidance did not have a material impact on the combined financial position, results of operations, or cash flows.

Reclassifications: Certain amounts in Sutter's 2008 combined financial statements have been reclassified to conform with the presentation of its 2009 combined financial statements. These reclassifications had no impact on previously reported income or net assets.

### 3. INVESTMENTS

Investments are held for the following uses:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Assets held in trust:		
Principal, interest and other reserves held in trust under bond indentures	\$ 394	\$ 675
Internally designated	629	673
Investments	<b>1,607</b>	1,134
	<b>2,630</b>	2,482
Less short-term investments	<b>(1,552)</b>	(1,106)
Non-current investments	<b>\$ 1,078</b>	\$ 1,376

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 3. INVESTMENTS (continued)

Investment income includes the following:

	<b>Years ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Interest and dividends	\$ 76	\$ 123
Investment fees	(9)	(9)
Net realized loss on sales of securities, including net loss from other-than-temporary impairment	(16)	(55)
	<b>51</b>	<b>59</b>
Amounts included in changes in restricted net assets	(4)	2
Interest earned on unspent bond project funds	(36)	(50)
Investment income	<b>\$ 11</b>	<b>\$ 11</b>

Sutter uses the specific-identification method to compute realized gains and losses on U.S. and foreign equity securities, U.S. Government and agency securities, U.S. corporate debt securities, and foreign government and corporate debt securities. Sutter uses the average cost method to compute realized gains and losses on mutual funds. Marketable equity securities, which include stocks and mutual funds, are primarily held for endowments, future capital improvements, and investment diversification.

#### 4. FAIR VALUE MEASUREMENTS

All financial assets and liabilities are recognized or disclosed at fair value in the financial statements on a recurring basis. Fair value is the price that would be received upon sale of an asset or paid upon the 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 including Sutter's own credit risk.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### **4. FAIR VALUE MEASUREMENTS (continued)**

A fair value hierarchy for valuation inputs has been established to prioritize the valuation 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.

*Level 2:* Pricing inputs are based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, 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.

*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 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 judgment and interpretations including, but not limited to, private and public comparables, third party appraisals, discounted cash flow models, fund manager estimates and net asset valuations provided by the underlying private investment companies and/or their administrators.

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

### 4. FAIR VALUE MEASUREMENTS (continued)

The fair value of Sutter's assets and liabilities measured on a recurring basis consist of the following:

	December 31, 2009			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance at December 31, 2009
<b>Liquid investments</b>				
Cash equivalents	\$ 373	\$ –	\$ –	\$ 373
<b>Equity securities</b>				
U.S. equity securities	418	43	–	461
Foreign equity securities	216	23	–	239
<b>Fixed income securities</b>				
U.S. government securities	71	–	–	71
U.S. government agencies securities	23	116	–	139
U.S. state and local government securities	–	56	–	56
U.S. federal agency mortgage-backed securities	–	406	–	406
Foreign government securities	–	260	–	260
U.S. corporate securities	50	449	–	499
Foreign corporate securities	–	63	–	63
<b>Other investments</b>				
Multi-strategy hedge funds	–	–	52	52
Commodity linked funds	–	–	11	11
	<u>\$ 1,151</u>	<u>\$ 1,416</u>	<u>\$ 63</u>	<u>\$ 2,630</u>

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

### 4. FAIR VALUE MEASUREMENTS (continued)

	December 31, 2008			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance at December 31, 2008
<b>Liquid investments</b>				
Cash equivalents	\$ 363	\$ –	\$ –	\$ 363
<b>Equity securities</b>				
U.S. equity securities	347	9	–	356
Foreign equity securities	138	9	–	147
<b>Fixed income securities</b>				
U.S. government securities	53	–	–	53
U.S. government agencies securities	54	57	–	111
U.S. state and local government securities	–	85	–	85
U.S. federal agency mortgage-backed securities	–	552	–	552
Foreign government securities	–	351	–	351
U.S. corporate securities	13	384	–	397
Foreign corporate securities	–	42	–	42
<b>Other investments</b>				
Multi-strategy hedge funds	–	–	20	20
Commodity linked funds	–	–	5	5
	\$ 968	\$ 1,489	\$ 25	\$ 2,482

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 4. FAIR VALUE MEASUREMENTS (continued)

The change in the balance of Level 3 financial assets and liabilities measured on a recurring basis consist of the following:

	<b>Multi-Strategy Hedge Funds</b>	<b>Commodity Linked Funds</b>	<b>Total</b>
Balance at January 1, 2008	\$ —	\$ —	\$ —
Total net realized and unrealized gains (losses), included in earnings	(3)	(2)	(5)
Purchases, issuances, and settlements	23	7	30
Balance at December 31, 2008	20	5	25
Total net realized and unrealized gains (losses), included in earnings	7	1	8
Purchases, issuances, and settlements	25	5	30
Balance at December 31, 2009	<b>\$ 52</b>	<b>\$ 11</b>	<b>\$ 63</b>
Change in unrealized gains and losses on investments as of December 31, 2009	\$ 10	\$ 3	\$ 13

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 4. FAIR VALUE MEASUREMENTS (continued)

Certain of the investments above report fair value using a calculated net asset value per share (NAV) or its equivalent. The following table and explanations identify attributes relating to the nature and risk of such investments:

	December 31, 2009			
	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period (if currently eligible)
<b>Level 2</b>				
Commingled funds – equity securities	\$ 65	\$ –	Daily, Monthly, Quarterly	3-60 days
Commingled funds – debt securities	5	–	Monthly	10 days
Total Level 2	70	–		
<b>Level 3</b>				
Multi-strategy hedge funds	52	–	Quarterly	60-65 days
Private equity funds	–	5		
Commodity linked funds	11	–	Monthly	5 days
Total Level 3	63	5		
Total Level 2 and Level 3	\$ 133	\$ 5		

Commingled Funds – Equity Securities: This category includes investments in commingled funds that invest primarily in domestic or foreign equity securities and attempt to match the returns of specific equity indices. A redemption limitation has been imposed for investments representing approximately 31% of the value of this category and no withdrawals are currently permitted. The redemption limitation has been in place since June 30, 2009, and is expected to lapse on July 1, 2010, at which time liquidity will be limited to 10% quarterly gate withdrawals with 60 days notice. Approximately 51% of the value of this category is redeemable monthly, with a notice period of 6 to 30 days. Other investments representing approximately 18% of this category are redeemable daily with three days notice.

Commingled Funds – Debt Securities: This category includes investments in commingled funds that invest primarily in domestic and foreign debt and fixed income securities, of which the majority are traded in over-the-counter markets. These funds are redeemable monthly with 10 days notice.

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

### **4. FAIR VALUE MEASUREMENTS (continued)**

Multi-Strategy Hedge Funds: This category includes investments in hedge funds that pursue diversification of both domestic and foreign fixed income and equity securities through multiple investment strategies. The primary objective for these funds is to maximize returns while limiting volatility by allocating capital to external portfolio managers selected for expertise in one or more investment strategies which may include, but are not limited to, long/short equity, event driven, relative value, and global asset allocation. A redemption limitation has been imposed for investments representing approximately 53% of the value of this category and no withdrawals are currently permitted. These funds have a three year lock-up, and 52% of the funds will be available for withdrawal at December 31, 2011 with the remaining 48% becoming available by September 30, 2012, with 60 days written notice. The remaining 47% of the value of the multi-strategy hedge funds is available for redemption with a notice period of 65 days.

Private Equity Funds: This category includes private equity funds that specialize in providing capital to a variety of investment groups, including but not limited to venture capital, leveraged buyout, mezzanine debt, distressed debt, and other strategies, which may include land, water processing, and alternative energy. There is no provision for redemptions during the life of these funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated over the next 2 to 12 years.

Commodity Linked Funds: This category includes commodity linked funds that pursue long-only fully collateralized commodity futures strategies to provide diversification and inflation protection. These funds are redeemable monthly with five days notice before month end.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Land improvements	\$ 87	\$ 77
Leasehold improvements	210	193
Buildings and improvements	3,488	3,236
Equipment	2,425	2,195
	<b>6,210</b>	<b>5,701</b>
Less amortization and accumulated depreciation	(3,390)	(3,026)
	<b>2,820</b>	<b>2,675</b>
Land	569	559
Construction-in-progress	1,440	1,198
	<b>\$ 4,829</b>	<b>\$ 4,432</b>

#### 6. OTHER ASSETS

Other assets consist of the following:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Reinsurance recoveries receivable	\$ 44	\$ 47
Cost report settlements	40	47
Non-current portion of notes receivable	39	41
Non-current portion of pledges receivable	35	40
Goodwill, net	29	35
Unamortized financing costs	14	16
Prepaid pension asset	107	-
Other	85	78
	<b>\$ 393</b>	<b>\$ 304</b>

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 7. LONG-TERM OBLIGATIONS

Long-term obligations consist of the following:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Hospital revenue bonds and Certificates of Participation under the Sutter Health Master Indenture of Trust, fixed interest at 4.0% to 6.3%, due from 2010 to 2048 (net of premium of \$31 and \$34 at December 31, 2009 and 2008, respectively)	<b>\$ 2,526</b>	<b>\$ 2,555</b>
Hospital revenue bonds through the City of Modesto, fixed interest at 5.1% to 6.0%, due from 2010 to 2021	<b>15</b>	16
Line of credit, variable interest at 2.1% at December 31, 2009	–	392
Various collateralized and unsecured obligations	<b>15</b>	9
Obligations under capital leases	<b>7</b>	9
	<b>2,563</b>	2,981
Less current portion	<b>(66)</b>	(31)
	<b>\$ 2,497</b>	<b>\$ 2,950</b>

The aggregate estimated fair market values of Sutter's long-term obligations at December 31, 2009 and 2008, of \$2,378 and \$2,481, respectively, were established using discounted cash flow analyses based on (i) the current market yield to maturity for similar types of publicly traded debt issues, and (ii) Sutter's current incremental borrowing rates for all other debt instruments.

The central financing vehicle of credit for Sutter is the Obligated Group. Sutter and certain Affiliates are members of the Sutter Health Obligated Group, and the assets of such Affiliates are subject to the indebtedness of the Obligated Group. Although the Obligated Group is not a legal entity, members of the Obligated Group are jointly and severally liable for repayment of the bonds under the terms of the California Health Facilities Financing Authority (CHFFA) and California Statewide Communities Development Authority (CSCDA) bonds. The related financing documents and various other debt agreements contain certain restrictive covenants requiring compliance by all members, including a pledge of gross revenue.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### **7. LONG-TERM OBLIGATIONS (continued)**

In May 2008, Sutter issued \$321 of Series A CHFFA revenue bonds, \$253 of Series B CSCDA revenue bonds, and \$47 of Series C CSCDA revenue bonds. The proceeds of these borrowings were designated to finance certain capital improvements, finance new construction, and to prepay bond issues. A total of \$329 in bonds was prepaid, which resulted in a loss of \$7 in 2008 (included in other operating expenses). In addition, Sutter converted \$88 of its bonds from variable interest rates to fixed rates, resulting in a loss of \$1.

During 2008, Sutter prepaid \$42 of Series 1993 Certificates of Participation using existing assets, which did not result in a loss.

As of December 31, 2009, Sutter did not participate in interest rate swap agreements.

In January 2010, four tax-exempt obligation issues totaling \$39 million of par value were redeemed or prepaid, which did not result in a loss.

Aggregate payments of long-term obligations, excluding capital leases, various collateralized and unsecured obligations and bond premiums, are as follows as of December 31, 2009:

2010	\$	60
2011		23
2012		22
2013		21
2014		22
Thereafter		2,362
		<u>2,510</u>
	\$	<u>2,510</u>

Sutter has an available \$392 revolving line of credit with a syndicate of banks with \$0 in outstanding borrowings as of December 31, 2009.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 8. LEASES

Sutter leases various buildings, office space and equipment. The leases expire at various times and contain certain contingent rental provisions, guarantees and various renewal options. These leases are classified as either capital leases, which were not material as of December 31, 2009 and 2008, or operating leases based on the terms of the respective agreements. Certain operating leases relate to acute care facilities leased from various municipalities. Such operating lease agreements require Sutter to make specified capital improvements to the municipalities' facilities at various times.

Future minimum payments, by year and in the aggregate, under noncancellable operating leases with terms of one year or more at inception consist of the following as of December 31, 2009:

	<b>Lease Payments</b>	<b>Sublease Receipts</b>	<b>Net Lease Payments</b>
2010	\$ 89	\$ 5	\$ 84
2011	77	4	73
2012	65	3	62
2013	55	2	53
2014	49	–	49
Thereafter	280	–	280
	\$ 615	\$ 14	\$ 601

#### 9. NET ASSETS AND CONTRIBUTIONS

Sutter receives donations through its philanthropic affiliates and the generosity of donors supports certain programs and services. Donations with a restriction included in temporarily and permanently restricted net assets were maintained for the following purposes:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Temporarily restricted:		
Capital projects and medical equipment	\$ 100	\$ 106
Time restricted under trust agreements	30	22
Research and education	43	36
Other	35	21
	\$ 208	\$ 185
Permanently restricted - endowment	\$ 113	\$ 98

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### **9. NET ASSETS AND CONTRIBUTIONS (continued)**

Unconditional promises to give cash or other assets are reported at fair market value at the date the promises are received. Conditional promises to give and indications of intentions to give are reported at fair market value when the conditions are met. Conditional promises were not material at December 31, 2009 and 2008.

As of December 31, 2009, pledges receivable (included in other receivables and other assets) consisted of the following unconditional promises to give:

Pledges due in 2010	\$	17
Pledges due 2011-2014		31
Pledges due after 2014		19
Less allowance for uncollectible pledges		(2)
Less discount on pledges receivable		(13)
	\$	<u>52</u>

Gifts of long-lived operating assets, such as property, plant or equipment, are reported as unrestricted support and excluded from income, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about the period that long-lived assets must be maintained, expirations of donor restrictions are reported when the donated long-lived assets are acquired and placed in service.

Endowments: In September 2008, California Senate Bill No. 1329 was signed into law, enacting UPMIFA. UPMIFA became effective on January 1, 2009, replacing the Uniform Management of Institutional Funds Act. UPMIFA applies to institutional funds created after January 1, 2009 and to decisions made after January 1, 2009 for existing institutional funds. UPMIFA eliminates the concept of “historic dollar value” and allows an institution to spend or accumulate as the board determines is prudent for the uses, benefits, purposes and duration of the endowment fund unless the gift instrument states a particular spending rate or formula. California’s version of UPMIFA also includes a rebuttable provision that spending greater than 7% of the average fair market value (calculated at least quarterly over a minimal period of three years) is presumed to be imprudent.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### **9. NET ASSETS AND CONTRIBUTIONS (continued)**

In accordance with UPMIFA, Sutter considers the following factors when appropriating or accumulating an endowment fund: (1) general economic conditions, (2) effects of inflation and deflation, (3) the purposes of the institution and the endowment fund, (4) expected total return from income and appreciation of investments, (5) Sutter's other resources, (6) the duration and preservation of the endowment fund and (7) Sutter's investment policies.

From time to time, the fair value of assets associated with individual endowment funds may fall below the level that the donor or UPMIFA requires Sutter to retain as a fund of perpetual duration. Deficiencies of this nature that are reported in unrestricted net assets were not material as of December 31, 2009 and 2008. These deficiencies resulted from unfavorable investment market fluctuations.

Sutter has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results while assuming a moderate level of investment risk.

To satisfy its long-term rate-of-return objectives, Sutter relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Sutter targets a diversified asset allocation that places a great emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Sutter Health and Affiliates

Notes to Combined Financial Statements (continued)

(Dollars in millions)

**9. NET ASSETS AND CONTRIBUTIONS (continued)**

The endowment net asset composition by type of fund consists of the following:

	<b>December 31, 2009</b>			
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Donor-restricted endowment funds	\$ 11	\$ 21	\$ 113	\$ 145
Board-designated funds	10	–	–	10
Total funds	<u>\$ 21</u>	<u>\$ 21</u>	<u>\$ 113</u>	<u>\$ 155</u>

  

	<b>December 31, 2008</b>			
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Donor-restricted endowment funds	\$ (1)	\$ 8	\$ 98	\$ 105
Board-designated funds	4	–	–	4
Total funds	<u>\$ 3</u>	<u>\$ 8</u>	<u>\$ 98</u>	<u>\$ 109</u>

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

### 9. NET ASSETS AND CONTRIBUTIONS (continued)

The changes in endowment net assets are as follows:

	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Balance at January 1, 2008	\$ 26	\$ 23	\$ 100	\$ 149
Investment return:				
Investment income	2	1	1	4
Net depreciation (realized and unrealized)	(25)	(14)	(4)	(43)
Total investment return	(23)	(13)	(3)	(39)
Contributions	2	–	1	3
Appropriation of endowment assets for expenditure	(1)	(2)	–	(3)
Other charges:				
Transfers to fund endowments	(1)	1	–	–
Other	–	(1)	–	(1)
Balance at December 31, 2008	3	8	98	109
Investment return:				
Investment income	2	1	–	3
Net appreciation (realized and unrealized)	20	13	2	35
Total investment return	22	14	2	38
Contributions	–	–	7	7
Appropriation of endowment assets for expenditure	(3)	(2)	–	(5)
Other charges:				
Reversal of unrestricted as funds were not appropriated	(1)	1	–	–
Transfers of endowment funds	–	–	6	6
Balance at December 31, 2009	<b>\$ 21</b>	<b>\$ 21</b>	<b>\$ 113</b>	<b>\$ 155</b>

# Sutter Health and Affiliates

## Notes to Combined Financial Statements (continued)

(Dollars in millions)

### 10. PATIENT SERVICE AND CAPITATION REVENUES

Sutter has agreements with third-party payers that provide for payments to Sutter at amounts different from its established rates. A summary of the payment arrangements with major third-party payers follows:

- *Medicare* – Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per diagnosis. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Certain inpatient nonacute services and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. Sutter is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Sutter and audits thereof by the Medicare fiscal intermediary. Sutter’s classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review. Sutter’s Medicare cost reports have been audited by the Medicare fiscal intermediary generally through December 31, 2006.
- *Medi-Cal* – Inpatient and outpatient services rendered to Medi-Cal program beneficiaries are reimbursed either under contracted rates or reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Sutter and audits thereof by Medi-Cal. Sutter’s Medi-Cal cost reports have been audited generally through December 31, 2006.

Gross patient charges, including charges related to capitated patients, from the Medicare and Medi-Cal programs accounted for the following percentages of Sutter’s gross patient service revenues:

	Years ended December 31,	
	2009	2008
Medicare	39%	39%
Medi-Cal	15%	14%

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### **10. PATIENT SERVICE AND CAPITATION REVENUES (continued)**

The healthcare industry is subject to voluminous and complex laws and regulations of federal, state and local governments. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement laws and regulations, anti-kickback and anti-referral laws and false claims prohibitions, and in the case of tax-exempt hospitals, the requirements of tax-exemption. In recent years, government activity has increased with respect to investigations and allegations concerning possible violations of reimbursement, false claims, anti-kickback and anti-referral statutes and regulations by healthcare providers. Sutter also operates an Ethics and Compliance Program, which reviews compliance with government healthcare program requirements and investigates allegations of non-compliance received from internal and external sources. From time to time findings may result in repayment of monies previously received from government payers and/or disclosure of such overpayments, including, but not limited to, disclosure to CMS and its contracted agents, or the Office of Inspector General, Department of Health and Human Services. As a result, there is at least a reasonable possibility that the recorded estimates may change by a material amount in the near term. Adjustments from the finalization of prior-year cost reports from both Medicare and Medi-Cal resulted in an increase to patient service revenues of approximately \$7 in 2009 and a decrease of \$2 in 2008.

Sutter also has entered into payment agreements with certain commercial insurance carriers, HMOs and preferred provider organizations. The basis for payment to Sutter under these agreements includes capitated arrangements, prospectively determined rates per diagnosis, discounts from established charges and prospectively determined daily rates.

Sutter, in the ordinary course of business, enters into various incentive-based risk sharing agreements with managed care payers and other providers. These agreements require retroactive settlement based on data that may not be available or finalized until all claims are processed. Settlement amounts have been estimated for such risk-based incentives based on available information. However, it is reasonably possible that these estimates may change in the near term.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 11. COMMUNITY BENEFIT EXPENSE

Traditional charity care covers health care services provided to persons who meet certain criteria and cannot afford to pay. Sutter had write-offs of charges for charity care services to its patients totaling \$431 in 2009 and \$372 in 2008.

The following is a summary of Sutter's estimated costs of providing services to the poor and broader community:

	<b>Years ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
<b>Services for the poor and underserved</b>		
Traditional charity care	\$ 108	\$ 96
Unpaid costs of public programs:		
Medi-Cal	371	312
Other public programs	36	35
Other benefits for the poor and underserved	26	36
Total services for the poor and underserved	541	479
 <b>Benefits for the broader community</b>		
Nonbilled services	24	22
Education and research	90	81
Cash and in-kind donations	10	13
Other community benefits	2	2
Total benefits for the broader community	126	118
	<b>\$ 667</b>	<b>\$ 597</b>

Services for the poor and underserved includes services provided to persons who cannot afford health care because of inadequate resources and/or are uninsured or underinsured, as well as the unpaid costs of public programs treating Medi-Cal and indigent beneficiaries. Costs are computed based on a relationship of costs to charges. Services for the poor and underserved also includes the cost of other services for indigent populations, and cash donations on behalf of the poor and needy.

Benefits for the broader community includes costs of providing the following services: health screenings and other health-related services, training health professionals, educating the community with various seminars and classes, the cost of performing medical research and the costs associated with providing free clinics and community services. Benefits for the broader community also includes contributions Sutter makes to community agencies to fund charitable activities.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS

Sutter sponsors and participates in various employee benefit plans, including a noncontributory defined benefit plan (the "Retirement Plan") and several contributory defined contribution plans. Sutter's total retirement benefit expense was \$247 in 2009 and \$170 in 2008.

Sutter's measurement date for plan assets, pension obligations and net periodic pension cost associated with the Retirement Plan is December 31. The changes in benefit obligations and plan assets for the Retirement Plan are as follows:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Projected benefit obligation at beginning of year	\$ 1,383	\$ 1,193
Effect of eliminating early measurement date	–	35
Service cost	110	111
Interest cost	89	78
Actuarial loss	26	10
Benefits paid	(47)	(44)
Projected benefit obligation at measurement date	\$ 1,561	\$ 1,383
Fair value of plan assets at beginning of year	\$ 1,355	\$ 1,323
Effect of eliminating early measurement date	–	14
Actual gain (loss) return on plan assets	360	(443)
Employer contributions	–	505
Benefits paid	(47)	(44)
Fair value of plan assets at measurement date	\$ 1,668	\$ 1,355
Net prepaid (accrued) benefit cost at end of year	\$ 107	\$ (28)

The accumulated benefit obligation for the Retirement Plan was \$1,325 and \$1,125 at December 31, 2009 and 2008, respectively.

Included in net assets at December 31, 2009 and 2008 are the following amounts that have not yet been recognized in net periodic benefit cost: unrecognized prior service costs of \$32 and \$39, respectively, and unrecognized actuarial losses of \$218 and \$495, respectively. The amounts included in net assets that are expected to be recognized in net periodic benefit cost during the year ended December 31, 2010, are \$6 for prior service cost and \$6 for actuarial loss.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

The benefits expected to be paid from the Retirement Plan in each of the next five years, and in the aggregate for the next five years are as follows:

2010	\$	65
2011		76
2012		89
2013		101
2014		111
2015-2019		727
		727
	\$	1,169

The actuarial assumptions used by the Retirement Plan are as follows:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Weighted average discount rates for calculating pension expense	<b>6.1%</b>	6.2%
Weighted average discount rates for calculating projected benefit obligation	<b>6.0%</b>	6.1%
Weighted average rates of compensation increase for calculating pension expense	<b>7.3%</b>	7.4%
Weighted average rates of compensation increase for calculating projected benefit obligation	<b>5.3%</b>	5.5-9.0%
Expected long-term rates of return on plan assets for calculating pension expense	<b>7.8%</b>	8.3%

The components of the Retirement Plan's net periodic benefit cost are as follows:

	<b>Years ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Service cost	\$ <b>110</b>	\$ 111
Interest cost	<b>89</b>	78
Expected return on plan assets	<b>(105)</b>	(105)
Amortization of actuarial loss	<b>48</b>	-
Amortization of prior service cost	<b>6</b>	6
	<b>\$ 148</b>	\$ 90

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

In addition to the Retirement Plan, Sutter also has noncontributory postretirement health benefit plans (the “Health Plans”). The changes in benefit obligations for the Health Plans are as follows:

	<b>December 31,</b>	
	<b>2009</b>	<b>2008</b>
Projected benefit obligation at beginning of year	\$ 151	\$ 161
Prior period benefit (credit) cost	5	(1)
Effect of eliminating early measurement date	–	3
Service cost	7	7
Interest cost	10	10
Actuarial loss (gain)	7	(23)
Other change in benefit obligation	1	–
Benefits paid	(5)	(6)
Benefit obligation at measurement date	\$ 176	\$ 151
Fair value of plan assets at beginning of year	\$ 38	\$ 32
Actual gain (loss) on plan assets	11	(10)
Employer contributions	23	21
Benefits paid	(5)	(5)
Fair value of plan assets at measurement date	\$ 67	\$ 38
Net accrued benefit cost	\$ (109)	\$ (113)

The Health Plans had projected benefit obligations of \$176 and \$151 at December 31, 2009 and 2008, respectively.

The current portion of the net accrued benefit cost recorded was \$1 and \$1 at December 31, 2009 and 2008, respectively.

Included in net assets at December 31, 2009 and 2008 are the following amounts that have not yet been recognized in net periodic benefit cost: unrecognized prior service costs of \$33 and \$34, respectively, and unrecognized actuarial losses \$4 and \$4, respectively. The amount included in net assets that is expected to be recognized in net periodic benefit cost during the year ended December 31, 2010 is approximately \$6 for prior service cost.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

The benefits expected to be paid from the Health Plans in each of the next five years, and in the aggregate for the next five years are as follows:

2010	\$	9
2011		11
2012		13
2013		15
2014		17
2015-2019		100
	\$	165

The weighted average assumed discount rates used for the Health Plans was from 6.0% to 6.1% and 6.1% to 6.2% in 2009 and 2008, respectively. The expected long-term rate of return on plan assets used for calculating retiree medical expense was 7.8% and 8.3% in 2009 and 2008, respectively.

The components of the Health Plans' net periodic benefit cost are as follows:

	<b>Years ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Service cost	\$ 7	\$ 7
Interest cost	10	10
Expected return on plan assets	(3)	(3)
Amortization of prior service cost	6	6
Actuarial loss	-	1
	\$ 20	\$ 21

Sutter's projected medical cost trend rate related to the Health Plans for 2009 through 2012 is 8%. The assumed medical cost trend rate is expected to gradually decrease in subsequent years to 5% in 2018 and thereafter. A one-percentage-point change in assumed health care cost trend rates would not have a material effect on Sutter's combined financial statements.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

The assets of the Sutter Health Retirement Plan and the Health Plans are under a single master trust (the “Master Trust”) with oversight from the Pension and Investment Committee of the Board of Directors. Management of the assets is governed by the application of modern portfolio theory, resulting in asset class diversification and mean-variance optimization. Sutter’s investment strategy for the Master Trust’s assets is to balance the liquidity needs of the Master Trust with the long-term return goals necessary to satisfy future obligations.

The target asset allocation seeks to reduce volatility while capturing the equity premium from the capital markets over the long-term and maintaining security of principal to meet near term expenses and obligations through the fixed income allocation. Periodically an asset allocation study is completed. As a result of the latest study, the weighted average target asset allocation compared to actual asset allocations at December 31, 2009 and 2008, by major asset category are as follows:

<b>Major Asset Category</b>	<b>Target Allocation 2009</b>	<b>Percentage of Actual Plan Assets at December 31,</b>	
		<b>2009</b>	<b>2008</b>
Cash and cash equivalents	1%	<b>2%</b>	1%
Equity securities	59%	<b>68%</b>	53%
Fixed income securities	20%	<b>20%</b>	35%
Other investments - alternative	15%	<b>8%</b>	7%
Real estate investments	5%	<b>2%</b>	4%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Equity securities are comprised of U.S. and foreign equity securities, common and collective trusts and comingled funds. The equity security’s target asset allocation of 59% is further comprised of 29% domestic large capitalization, 7% small capitalization and 23% international.

The Master Trust’s portfolio return assumption of 8.5% is based on the weighted-average return of comparative market indices for the major asset classes represented in the portfolio, net of administrative expenses.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

A fair value hierarchy has been established with three levels that prioritize the valuation inputs into each level (see Note 4). The fair value of the Master Trust's assets consists of the following as of December 31, 2009:

	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance at December 31, 2009
<b>Liquid investments</b>				
Cash equivalents	\$ 35	\$ –	\$ –	\$ 35
<b>Equity securities</b>				
U.S. equity securities	540	–	–	540
Foreign equity securities	64	–	–	64
Common collective trusts and comingled funds	–	567	–	567
<b>Fixed income securities</b>				
U.S. government and agencies securities	30	7	–	37
U.S federal agencies mortgage- backed securities	–	67	–	67
Foreign government securities	–	140	–	140
U.S. corporate securities	–	81	–	81
Foreign corporate securities	–	26	–	26
<b>Other investments</b>				
Private equity funds	–	–	98	98
Real estate	–	–	38	38
Commodity linked funds	15	–	22	37
Accrued income	5	–	–	5
<b>Total Master Trust</b>	<b>\$ 689</b>	<b>\$ 888</b>	<b>\$ 158</b>	<b>\$ 1,735</b>

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 12. RETIREMENT PLANS AND POSTRETIREMENT BENEFITS (continued)

The change in the balance of Level 3 financial assets and liabilities measured on a recurring basis consist of the following:

	Private Equity Funds	Real Estate Investments	Commodity Linked Funds	Total
<b>Balance at January 1, 2009</b>	\$ 93	\$ 55	\$ –	\$ 148
Total net realized and unrealized (losses) gains	(12)	(14)	2	(24)
Purchases, issuances, and settlements	17	(3)	20	34
<b>Balance at December 31, 2009</b>	<u>\$ 98</u>	<u>\$ 38</u>	<u>\$ 22</u>	<u>\$ 158</u>

One Affiliate is a member of a multiemployer defined benefit retirement plan that covers substantially all of its employees. For the multiemployer plan as a whole, the net assets available for benefits exceeded the actuarially computed value of vested benefits as of the most recent actuarial valuation (January 1, 2009). The funding policy for employers participating in this plan requires a contribution of a percentage of the employer's unfunded liability when the employer's attributable assets are less than ninety percent of their liabilities. The expense associated with these plans was \$33 in 2009 and \$23 in 2008.

Sutter maintains various defined contribution plans for eligible employees. Sutter's contributions to such plans were \$46 in 2009 and \$36 in 2008.

#### 13. INCOME TAXES

Deferred income tax assets, which as of December 31, 2009 and 2008 were fully reserved, reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for income tax purposes. As of December 31, 2009 and 2008, Sutter had deferred tax assets of \$13 relating principally to net operating loss carryovers. As of December 31, 2009 and 2008, such deferred tax assets were offset by a valuation allowance of \$13. The valuation allowance did not change in 2009 and decreased \$1 in 2008.

Sutter Health and its affiliates paid tax of \$2 during 2009.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### 13. INCOME TAXES (continued)

Federal net operating loss carryovers totaled \$33 at December 31, 2009 and will expire between 2010 and 2029. State of California net operating loss carryovers totaled \$2 at December 31, 2008 and will expire between 2010 and 2019.

#### 14. FUNCTIONAL CLASSIFICATION OF EXPENSES

The following is a functional classification of Sutter's expenses:

	Years ended December 31,	
	2009	2008
Health services	\$ 7,668	\$ 7,241
General and administrative	651	568
	<u>\$ 8,319</u>	<u>\$ 7,809</u>

#### 15. CONTINGENCIES AND COMMITMENTS

Contingencies: MGH, an Affiliate, leases a hospital in Greenbrae, California from Marin District, pursuant to a lease between MGH and the Marin District. In accordance with a Settlement Agreement and Mutual Release and a separate Transfer Agreement (collectively, the "Transfer Agreements"), Sutter will resign as the sole member of MGH and the Marin District will become the sole member of MGH on June 29, 2010 (the "Transfer Date"). After the Transfer Date, MGH will no longer be an affiliate of Sutter and Sutter will have no further obligation or responsibility for MGH or its operations and will likely have no further contractual or other obligation or responsibility to the Marin District other than certain indemnification obligations. Sutter and the Marin District will each retain certain assets and liabilities and will be required to meet certain obligations as stipulated in the Transfer Agreements. The transition is complex and there may be uncertainties that arise from the implementation of the transition of MGH to the Marin District.

Sutter and its affiliated health care provider entities were named in a class action lawsuit alleging unlawful charge and collection practices with respect to uninsured patients, which was resolved through a settlement agreement. Sutter is in the process of undertaking the activities required by the settlement agreement and, in the opinion of management, these financial obligations will not have a material adverse effect on Sutter's combined financial position or results of operations.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### **15. CONTINGENCIES AND COMMITMENTS (continued)**

Sutter is named in three class action lawsuits alleging wage and hour violations on behalf of nurses and technicians which have been coordinated in the Alameda County Superior Court. Until recently, an affiliate was also under examination by the California Division of Labor Standards Enforcement (DLSE) regarding potential wage and hour violations. The DLSE dropped its enforcement action, but is now processing individual meal period claims. Sutter received a new class action, lawsuit filed in Alameda County Superior Court on July 30, 2009. The lawsuit purports to represent a class of the employees in the information systems field. The lawsuit alleges that Sutter misclassified these employees as “exempt” employees and, accordingly did not properly provide them overtime pay, meal and rest periods and accurate wage statements. These matters, if decided adversely, individually or in the aggregate, may result in liability material to Sutter’s combined financial condition or results of operations.

On November 16, 2007, the Office of Inspector General for the United States Department of Health and Human Services (OIG) issued an administrative investigation subpoena to one Affiliate, seeking information relating to the Affiliate’s Medicare outlier payments and hospital charging practices for the period from January 1, 1996 through December 31, 2005. On March 4, 2010, Sutter received notification that the investigation was closed with no adverse findings. There was no repayment required and no further activity predicted.

A Sutter Affiliate has a dispute with its contracted medical group related to the calculation of amounts due under the professional service agreement for 2008. Sutter has recorded a liability that is based on the demand for payment by the medical group. The parties’ discussions are nearing resolution, which is not expected to have a material adverse effect on Sutter’s combined financial position or results of operations.

In January 2007, a class action lawsuit was filed against Sutter alleging lack of accessibility to Sutter facilities for people with disabilities. In 2008, Sutter entered into a settlement agreement with the plaintiffs. The settlement terms address: (i) correction to certain physical barriers that may limit a disabled person’s access to facilities; (ii) modification to or purchase of medical equipment to provide improved accessibility to medical equipment; and (iii) adoption of new policies and procedures to improve access to facilities. Assessment of physical barriers and potential modification is currently in progress and is expected to continue for several years. It is difficult to estimate the cost of these proposed modifications and there can be no assurance that the resolution of these matters will not adversely affect Sutter’s combined financial position or results of operations in the future.

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### **15. CONTINGENCIES AND COMMITMENTS (continued)**

Sutter has undertaken a physician lease review for all acute and medical foundation affiliates to assess physician office lease compliance with certain applicable laws. During this review, a team of personnel are evaluating the terms of each lease, including each lease's duration, premises, compensation terms and related fair market value analysis. This review is in its initial stage and no estimates of liability or conclusions have been or can be reached relative to either the individual or aggregate impact of non-compliant leases; however, there can be no assurance that this matter will not adversely affect Sutter's combined financial position or results of operations in the future.

Sutter is involved in other litigation, as both plaintiff and defendant, and other routine labor matters, tax examinations and regulatory examinations arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, these matters should be resolved without a material adverse effect on Sutter's combined financial position or results of operations. However, there can be no assurance that this will be the case.

As of December 31, 2009, approximately 28% of employees of Sutter were represented by collective bargaining units. Of these employees, approximately 12% are represented by collective bargaining agreements that will expire in 2010. In addition, approximately 28% are represented by collective bargaining agreements that expired between 2007 and 2009 and new agreements are in the process of being negotiated. As of March 2010, certain collective bargaining agreements were resolved reducing the number of employees covered under expired agreements to 7%. Employee strikes or other adverse labor actions may have a material adverse impact on Sutter's operations in the future.

Commitments: Eden Medical Center (EMC), a Sutter affiliate, leases a hospital facility known as San Leandro Hospital in San Leandro, California (San Leandro Hospital) from Eden Township Healthcare District (the "Eden District"). Pursuant to the terms of the initial lease, EMC agreed, subject to certain terms and conditions, to build a replacement for EMC's hospital facility. Sutter guaranteed EMC's performance of its obligations to build this replacement facility.

In March of 2008, the Eden District, Sutter, and EMC entered into a series of agreements (collectively, the "2008 Agreements") to address certain disputes arising between the parties related to their respective rights and obligations under the initial lease and guaranty. Pursuant to the 2008 Agreements, Sutter agreed to develop and construct a 130-bed replacement facility on property adjacent to the existing hospital and demolish the existing Eden Hospital. The 2008 Agreements also included an Amended and

## Sutter Health and Affiliates

### Notes to Combined Financial Statements (continued)

*(Dollars in millions)*

#### **15. CONTINGENCIES AND COMMITMENTS (continued)**

Restated Lease and Hospital Operations Agreement (the “Amended Lease”) for San Leandro Hospital. Pursuant to the Amended Lease and the 2008 Agreements, EMC received an option to purchase San Leandro Hospital and certain other properties (the “Option”).

EMC exercised the Option to purchase San Leandro Hospital in July 2009, with a specified closing date of September 1, 2009. The Eden District declined to convey title. Sutter pursued the dispute resolution provisions of the 2008 Agreements and initiated the arbitration process. In March of 2010, Sutter and the Eden District entered into a stipulation pursuant to which the Eden District agreed to an arbitrator’s award which requires the Eden District to convey title to San Leandro Hospital to Sutter on or before March 31, 2010. The Eden District further stipulated to waive any claim for damages, but Sutter preserved its right to pursue damages in later proceedings before the arbitrator.

The Eden District has filed a cross complaint in the pending action alleging that the 2008 Agreements, including the Option to purchase, are void in their entirety because two of the District Board members had conflicts of interest within the meaning of Government Code Section 1090. This cross complaint was filed in March of 2010. No trial date has been set.

Sutter is required to remediate certain of its healthcare facilities to comply with earthquake retrofit requirements under a State of California law. Sutter has obtained approved extensions through 2013 for its facilities and is evaluating its remaining facilities by considering all options including regulatory relief to delay the retrofit requirements. The cost of facilities not under construction to meet the regulatory extension is estimated at \$2,247 (unaudited). Sutter’s capital allocation plan, which includes amounts for seismic retrofits, replacements, and relocations is projected at \$4,765 (unaudited) from January 1, 2010 to December 31, 2014. Management and the Board of Directors evaluate Sutter’s capital needs on an ongoing basis and are considering options given the current economic conditions.

#### **16. SUBSEQUENT EVENT**

Sutter has evaluated subsequent events through April 2, 2010, which is the date the audited financial statements of Sutter were issued.