PEACEHEALTH

Consolidated Financial Statements

June 30, 2012 and 2011

(With Independent Auditors’ Report Thereon)

PEACEHEALTH

Consolidated Financial Statements

June 30, 2012 and 2011

Table of Contents

KPMG LLP
Suite 3800
1300 South West Fifth Avenue
Portland, OR 97201

Independent Auditors' Report

The Board of Directors
PeaceHealth:

We have audited the accompanying consolidated balance sheets of PeaceHealth (the Corporation) (a Washington not-for-profit corporation) as of June 30, 2012 and 2011, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PeaceHealth as of June 30, 2012 and 2011, and the results of its operations, changes in net assets, and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included on pages 40 to 43 is presented for purposes of additional analysis of the consolidated financial statements and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

The other data included on pages 44 and 45 designated as unaudited information in the table of contents has not been audited by us and accordingly we express no opinion on such data.

KPMG LLP

October 18, 2012

PEACEHEALTH

Consolidated Balance Sheets

June 30, 2012 and 2011

(In thousands)

Assets	2012	2011
Current assets:		
Cash and cash equivalents	$ 147,179	147,345
Short-term investments (note 4)	300,926	245,396
Accounts receivable, net (note 6)	253,312	251,312
Other receivables	31,620	28,243
Assets under securities lending agreement (note 4)	—	23,459
Inventory of supplies	33,820	33,030
Prepaid expenses and other	20,912	25,476
Assets whose use is limited that are required for current liabilities	23,258	22,578
Total current assets	811,027	776,839
Assets whose use is limited:		
Cash and investments (note 4)	619,483	555,762
Investments in joint ventures and other	40,838	56,214
Total assets whose use is limited	660,321	611,976
Less current portion	(23,258)	(22,578)
Net assets whose use is limited	637,063	589,398
Property, plant, and equipment:		
Land and improvements	118,297	115,184
Buildings, fixed equipment, and other	1,565,987	1,550,109
Moveable equipment	570,371	530,680
Construction in progress	61,236	57,355
Total property, plant, and equipment	2,315,891	2,253,328
Less accumulated depreciation	(928,722)	(800,696)
Net property, plant, and equipment	1,387,169	1,452,632
Deferred financing costs, net	6,829	8,088
Interest in net assets of related foundations	32,663	30,099
Other assets	54,516	45,791
Total assets	$ 2,929,267	2,902,847

(Continued)

PEACEHEALTH

Consolidated Balance Sheets

June 30, 2012 and 2011

(In thousands)

Liabilities and Net Assets		2012	2011
Current liabilities:			
Accounts payable	$	70,644	87,726
Accrued payroll, payroll taxes, and employee benefits		136,200	138,584
Accrued interest payable		4,545	4,701
Other current liabilities		40,745	33,878
Medical claims payable		6,533	7,649
Reimbursement settlements payable		22,089	8,500
Payable under securities lending agreement (note 4)		—	23,459
Current portion of long-term debt (note 7)		18,033	15,891
Total current liabilities		298,789	320,388
Other long-term liabilities		324,921	186,838
Long-term debt due after one year (note 7)		830,381	833,529
Net assets:			
Unrestricted		1,428,152	1,504,629
Temporarily restricted (note 12)		35,644	46,295
Permanently restricted (note 12)		11,380	11,168
Total net assets		1,475,176	1,562,092
Total liabilities and net assets	$	2,929,267	2,902,847

See accompanying notes to consolidated financial statements.

PEACEHEALTH

Consolidated Statements of Operations

Years ended June 30, 2012 and 2011

(In thousands)

	2012	2011
Revenues:		
Net patient service revenue (note 2)	$ 2,126,236	1,774,469
Premium revenue	141,598	67,303
Other operating revenue	67,041	57,054
Total revenues	2,334,875	1,898,826
Expenses:		
Salaries and wages	961,564	809,703
Payroll taxes and benefits	237,300	208,587
Professional fees	26,274	19,626
Medical claims expense	104,007	47,232
Supplies and other expenses	668,059	535,880
Provision for bad debts	133,814	91,862
Depreciation and amortization of other assets	146,517	126,050
Interest and amortization of deferred financing costs	43,810	39,770
Total expenses	2,321,345	1,878,710
Excess of revenues over expenses from operations	13,530	20,116
Other income (loss):		
Contribution from the Southwest affiliation (note 1(b))	—	487,026
Investment income, net (note 4)	12,629	66,034
Gain on investments recorded on the equity method	6,474	3,865
Change in valuation of interest rate swaps	(77,564)	15,558
Other	1,628	961
Total other income, net	(56,833)	573,444
(Deficiency) excess of revenues over expenses	(43,303)	593,560
Donations for land, buildings, and equipment	3,808	1,753
Net assets released from restrictions	19,208	8,101
Change in interest in net assets of related foundations	653	3,932
Change in pension liability	(57,499)	(1,699)
Other changes in unrestricted net assets	656	4,356
(Decrease) increase in unrestricted net assets	$ (76,477)	610,003

See accompanying notes to consolidated financial statements.

PEACEHEALTH

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2012 and 2011

(In thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Net assets at June 30, 2010	$ 894,626	20,611	3,437	918,674
Excess of revenues over expenses	593,560	1,064	—	594,624
Restricted contribution from the Southwest affiliation	—	23,476	7,324	30,800
Other restricted contributions	—	11,518	—	11,518
Donations for land, buildings and equipment	1,753	—	—	1,753
Net assets released from restrictions	8,101	(11,928)	—	(3,827)
Change in interest in net assets of related foundations	3,932	2,520	190	6,642
Change in pension liability	(1,699)	—	—	(1,699)
Other changes in net assets	4,356	(966)	217	3,607
Change in net assets	610,003	25,684	7,731	643,418
Net assets at June 30, 2011	1,504,629	46,295	11,168	1,562,092
(Deficiency) excess of revenues over expenses	(43,303)	17	—	(43,286)
Other restricted contributions	—	1,718	8	1,726
Donations for land, buildings and equipment	3,808	6,484	—	10,292
Net assets released from restrictions	19,208	(20,322)	—	(1,114)
Change in interest in net assets of related foundations	653	1,708	203	2,564
Change in pension liability	(57,499)	—	—	(57,499)
Other changes in net assets	656	(256)	1	401
Change in net assets	(76,477)	(10,651)	212	(86,916)
Net assets at June 30, 2012	$ 1,428,152	35,644	11,380	1,475,176

See accompanying notes to consolidated financial statements.

PEACEHEALTH

Consolidated Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

		2012	2011
Cash flows from operating activities:			
Change in net assets	$	(86,916)	643,418
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Contribution from the Southwest affiliation		—	(517,826)
Depreciation and amortization		149,648	126,435
(Gain) loss on sale of land held for sale and property, plant, and equipment		(2,180)	6,204
Provision for bad debts		133,814	91,862
Change in pension liability		57,499	1,699
Restricted contributions		(10,300)	(1,753)
Net change in unrealized gains (losses) on investments		7,920	(42,575)
Realized gains on investments		(471)	(3,706)
Valuation adjustments on swap arrangements		77,564	(15,637)
Equity investment gain		(6,474)	(3,865)
Increase in interest in net assets of related foundations		(2,564)	(6,642)
Changes in operating assets and liabilities:			
Increase in:			
Accounts receivable, net		(139,191)	(116,388)
Other assets		(4,951)	(31,937)
Increase (decrease) in:			
Accounts payable (net of capital expenditures)		(17,082)	17,249
Accrued payroll, payroll taxes, and employee benefits		(2,384)	20,576
Other liabilities		22,204	(8,478)
Net cash provided by operating activities		176,136	158,636
Cash flows from investing activities:			
Contribution of cash from the Southwest affiliation		—	32,738
Purchase of property, plant, and equipment		(82,257)	(89,910)
Proceeds from sale of land held for sale and property, plant, and equipment		3,383	1,255
Purchase of investments		(303,915)	(78,764)
Sales and maturities of investments		193,879	50,957
Change in securities lending asset		23,459	(7,132)
Decrease in assets whose use is limited, other		5,186	9,573
Net cash used in investing activities		(160,265)	(81,283)
Cash flows from financing activities:			
Proceeds from long-term borrowings		213,500	9,131
Principal payments on long-term debt		(216,378)	(10,967)
Proceeds from restricted contributions		10,300	1,753
Change in securities lending liability		(23,459)	3,107
Net cash (used in) provided by financing activities		(16,037)	3,024
Net (decrease) increase in cash and cash equivalents		(166)	80,377
Cash and cash equivalents at beginning of year		147,345	66,968
Cash and cash equivalents at end of year	$	147,179	147,345
Supplemental disclosure of cash flow information:			
Contribution from the Southwest affiliation	$	—	(517,826)

See accompanying notes to consolidated financial statements.

(1) Organization

(a) Corporate Structure

PeaceHealth (the Corporation) is a Washington not-for-profit corporation with its corporate office located in Vancouver, Washington, which is sponsored by the Sisters of St. Joseph of Peace, and is recognized to be a Private Pontifical Juridic Person by the Roman Catholic Church. At June 30, 2012, the following regional healthcare delivery systems and operating divisions were components of the Corporation:

Southeast Alaska Region:
- PeaceHealth Ketchikan Medical Center

Whatcom Region:
- PeaceHealth St. Joseph Medical Center

Lower Columbia Region:
- PeaceHealth St. John Medical Center

Southwest Washington Health System (Southwest):
- PeaceHealth Southwest Medical Center
- Southwest Medical Group
- PeaceHealth Southwest Medical Center Foundation
- Property and Building Company, LLC
- Columbia United Providers (CUP)

Oregon Region:
- PeaceHealth Sacred Heart Medical Center at University District
- PeaceHealth Sacred Heart Medical Center at RiverBend
- PeaceHealth Cottage Grove Community Medical Center

Siuslaw Region:
- PeaceHealth Peace Harbor Hospital

Systemwide Organizations:
- PeaceHealth Medical Group
- PeaceHealth Laboratories
- PeaceHealth Self-insured Trusts

These healthcare delivery systems and operating divisions, provide inpatient, outpatient, primary care and home care services in Alaska, Washington and Oregon. The Corporation operates these businesses primarily in Ketchikan, Alaska; Bellingham, Longview and Vancouver, Washington; Springfield, Eugene, Florence and Cottage Grove, Oregon.

(b) Southwest Washington Health System Affiliation

On January 1, 2011, the Corporation became the sole corporate member of Southwest. The financial position and results of operations of Southwest have been included in the consolidated financial statements of the Corporation since that date. Southwest's operations primarily consist of two hospital campuses, several medical groups, a fundraising foundation, a Medicaid health plan (CUP), and certain other entities located in the Vancouver, Washington service area.

(In thousands of dollars)

This transaction was accounted for as an acquisition under Accounting Standards Codification (ASC) 958-805, *Not-for-Profit Entities – Business Combinations*. No consideration was paid by the Corporation to acquire the net assets of Southwest. The affiliation resulted in an excess of assets acquired over liabilities assumed, or a contribution from Southwest to the Corporation of approximately $517,826. The unrestricted portion of the contribution of $487,026 is included in other income in the accompanying consolidated statement of operations. The remaining $30,800 of the contribution was restricted and is recorded in restricted net assets in the consolidated statement of changes in net assets.

The following table summarizes the fair value estimates of the Southwest assets acquired and liabilities assumed as of January 1, 2011:

Tangible assets acquired	$	808,028
Intangible assets acquired		22,717
Liabilities assumed		(310,893)
Noncontrolling interests		(2,026)
Total identifiable net assets assumed/ contribution	$	517,826

The fair value of the intangible assets acquired of $22,717 consisted primarily of trade names (Southwest and Southwest Medical Center) valued at approximately $21,990, which has been assigned an indefinite useful life.

The following are the financial results of Southwest included in the Corporation's 2011 consolidated statement of operations during the six-month period from the date of the affiliation through June 30, 2011:

Total revenues	$	351,960
Deficiency of revenues over expenses from operations		(1,307)
Excess of revenues over expenses		8,690

The following pro forma consolidated financial information presents the Corporation's results as if the affiliation had been reported as of the beginning of the Corporation's fiscal year of July 1:

		2011	
		Actual	**Pro forma**
Total revenues	$	1,898,826	2,239,666
Excess of revenues over expenses from operations		20,116	17,241
Excess of revenues over expenses		593,560	635,744
Total assets		2,902,847	2,902,848

(2) Summary of Significant Accounting Policies

(a) Consolidation

The consolidated financial statements include the accounts of the Corporation and its controlled affiliates. All significant intercompany transactions and balances have been eliminated.

(b) 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. The significant estimates in the Corporation’s consolidated financial statements include accounts receivable allowances, reimbursement settlements payable, valuation of alternative investments, interest rate swaps, pension obligations, incurred but not reported amounts related to accrued healthcare costs, and liabilities related to self-insurance programs.

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of petty cash, cash in demand bank accounts, and all highly liquid debt instruments purchased with an original maturity of three months or less other than those amounts included in assets whose use is limited by the board of directors. The Corporation held cash equivalents of approximately $117,787 and $86,159 as of June 30, 2012 and 2011, respectively.

(d) Short-Term Investments

Short-term investments consist primarily of certificates of deposit, U.S. government, and other investment-grade securities, which are carried at fair value. Investment income or loss (including realized and unrealized gains and losses and interest and dividends) is included in the excess of revenues over expenses.

(e) Inventory of Supplies

Inventory is valued on a last-in, first-out basis, weighted average cost.

(f) Other Receivables

Other receivables primarily consist of amounts receivable from the states of Oregon and Washington and third-party payors related to Medicaid programs, amounts receivable from excess insurance carriers, and other miscellaneous amounts due for rent, meals, various settlements, and other items.

(g) Assets Whose Use is Limited

The majority of these assets have been set aside by management of the Corporation for future capital improvements and other purposes, over which management retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of the Corporation

(Continued)

(In thousands of dollars)

have been reclassified as current in the consolidated balance sheets at June 30, 2012 and 2011. These items consist primarily of assets held by trustees under indenture agreements, investments in marketable equity and fixed income securities, mutual funds, and investments in joint ventures. Money market funds and all marketable securities have readily determinable market values and are, therefore, carried at fair value. The investments in joint ventures and other are accounted for using the equity or cost method.

(h) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Improvements and replacements of plant and equipment are capitalized. Maintenance and repairs are expensed as they are incurred. When property, plant, and equipment is sold or retired, the cost and the related accumulated depreciation are removed from the accounts, and the resulting gain or loss is recorded.

The Corporation assesses potential impairment of its long-lived assets when there is evidence that events or changes in circumstances have made recovery of the asset's carrying value unlikely. An impairment loss is indicated when the sum of expected undiscounted future net cash flows is less than the carrying amount. The loss recognized is the difference between the fair value and the carrying amount. No impairment losses were recognized during the years ended June 30, 2012 and 2011.

(i) Depreciation

Depreciation on property, plant, and equipment is computed using the straight-line method over the following estimated useful lives:

Land improvements	5 – 25 years
Buildings and improvements	5 – 80 years
Fixed equipment	10 – 25 years
Leasehold improvements	Shorter of remaining length of the lease or useful life
Moveable equipment	3 – 20 years

(j) Deferred Financing Costs

These costs are amortized over the lives of the related debt issuances using the effective interest method.

(k) Other Assets

Other assets includes the estimated fair value associated with the plan assets of the Corporation's 457(b) and 457(f) postretirement savings plans, in the amount of approximately $21,360 and $13,865 at June 30, 2012 and 2011, respectively, with a corresponding amount included in other long-term liabilities. In addition, other assets include the estimated fair value associated with intangible assets, primarily the tradenames "Southwest Washington Health System" and "Southwest Medical Center." As a result of the affiliation transaction, approximately $21,990 was assigned to these intangible assets, which have indefinite useful lives. Intangible assets with indefinite lives are evaluated annually for impairment. No impairment losses were recognized during the years ended June 30, 2012 and 2011.

(l) Other Long-Term Liabilities

The caption other long-term liabilities on the consolidated balance sheets consists primarily of the estimated fair value associated with the Corporation's interest rate swaps of approximately $154,591 and $77,106 at June 30, 2012 and 2011, respectively; the liability for the Southwest pension plan of approximately $85,857 and $41,101 at June 30, 2012 and June 30, 2011, respectively; and the long-term portion of the liability for the self-insurance programs of approximately $39,849 and $27,620 at June 30, 2012 and 2011, respectively.

(m) Contributions and Grants

Contributions and grants are recognized as revenue upon receipt of the donor's pledge to contribute. Contributions and grants are considered to be available for unrestricted use unless specifically restricted by the donor. Amounts pledged that are restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support. Unconditional promises to give that are silent as to the due date are presumed to be time restricted by the donor until received and are reported as temporarily restricted net assets.

A donor restriction expires when an unconditional promise with an implied time restriction is collected or when the purpose for the restriction is accomplished. Upon expiration, temporarily restricted net assets are reclassified to unrestricted net assets and are reported in the consolidated statements of operations as net assets released from restrictions. Restricted contributions received in the same year in which the restrictions are met are recorded as an increase in restricted support at the time of receipt and as net assets released from restrictions at the time restrictions are met.

Permanently restricted net assets include the principal amount of contributions with the stipulation from the donor that the principal be maintained in perpetuity and only the income is available to be expended for purposes specified by the donor, if any.

(n) Interest in Net Assets of Related Foundations

The Corporation accounts for activities with its unconsolidated related foundations in accordance with applicable accounting guidance. That guidance requires the Corporation to recognize its interests in the net assets of these foundations on the consolidated balance sheet as the asset caption interest in net assets of related foundations, and the annual changes as shown in the consolidated statement of changes in net assets.

(In thousands of dollars)

(o) Net Patient Service Revenues

The Corporation has agreements with third-party payors that provide for payments of amounts different from established charges. The Corporation's net patient service revenue came from the following sources:

	2012	2011
Medicare	34%	33%
Medicaid	9	11
Commercial and other	49	50
Private pay	8	6
	100%	100%

There is a corresponding significant concentration of credit risk in net accounts receivable balances at June 30, 2012 and 2011:

	2012	2011
Medicare	27%	31%
Medicaid	9	10
Commercial and other	64	53
Private pay	—	6
	100%	100%

The Corporation has estimated payments for services rendered to Medicare and Medicaid patients during the year by applying the payment principles of the applicable governmental agencies and believes that an adequate provision has been made in the accompanying consolidated financial statements for final settlement. Estimates of final settlements due to and due from Medicare, Medicaid, and other third-party payors have been reflected as a reimbursement settlement payable and other receivables in the accompanying consolidated balance sheets. Differences between the net amounts accrued and subsequent settlements are recorded in operations at the time of settlement.

Reimbursement for inpatient services rendered to Medicare recipients has been made principally under a prospective pricing system based on diagnosis-related groups. Most outpatient services provided to Medicare patients are reimbursed based on prospectively determined rates. Services to Medicaid patients are also reimbursed based on a combination of prospectively determined rates and cost reimbursement methodology. Continuation of these reimbursement programs at the present level, and on the present basis, is dependent upon future policies of federal and state governmental agencies. The Corporation has three critical access hospitals that are exempt from both inpatient and outpatient prospective payment systems. Inpatient and outpatient services rendered to Medicare and Medicaid program beneficiaries at critical access hospitals are reimbursed based on costs. Interim reimbursement to critical access hospitals is based upon tentative rates and retroactive adjustment is made to actual cost during final settlement by either the Medicare fiscal intermediary or the applicable state's Medicaid agency. Charges made on behalf of providers employed by the medical groups in the Corporation are generally reimbursed on a fee schedule for Medicare and commercial patients and on a cost basis for Medicaid patients.

The Corporation has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Corporation under these agreements includes prospectively determined rates per unit of service and discounts from established charges. Most arrangements provide for payment or reimbursement to the Corporation at amounts different than established rates. Contractual discounts represent the difference between established rates for services and amounts paid or reimbursed by these third-party payors.

(p) Premium Revenue and Accrued Healthcare Costs

The Corporation's majority-owned subsidiary, CUP, receives premium revenues that consist of premiums paid by the State of Washington for healthcare services. Premium revenues are received on a prepaid basis and are recognized as revenue during the month with which the premiums are associated. All of CUP's premium revenues were received under two primary contract sources at the State of Washington (the State), the Basic Health Plan and Healthy Options. The Corporation recognized premium revenues of $141,598 and $67,303 for the year ended June 30, 2012 and the six months ended June 30, 2011, respectively, which is included as premium revenue in the accompanying consolidated statements of operations. The related medical expense recognized by CUP was $124,019 and $59,682 for the year ended June 30, 2012 and the six months ended June 30, 2011, respectively, and is included in medical claims expense in the consolidated statements of operations.

The contract with the State expired on July 1, 2012. CUP has entered into an agreement with another health plan that has been awarded the contract from the State for the period July 1, 2012 through December 31, 2013. Under this contract, in return for receiving a defined premium amount from the other health plan, CUP will be responsible for providing medical, hospital, pharmaceutical and related medical services to Healthy Options and Basic Health members assigned to CUP from the other plan. Under the terms of its contract with the other health plan, CUP will continue to perform most of the administrative services for assigned members that it previously performed under the expiring contract.

CUP has stop-loss reinsurance indemnifying it against the cost of providing services to individual enrolled participants at 90% in excess of $125,000 for hospital charges up to a maximum of $1,000,000 per year for each enrolled member.

(q) Provision for Bad Debts

The Corporation provides for an allowance against patient accounts receivable for amounts that could become uncollectible. The Corporation estimates this allowance based on the aging of accounts receivable, historical collection experience by payor, and other relevant factors. There are various factors that can impact the collection trends, such as changes in the economy, which in turn have an impact on unemployment rates and the number of uninsured and underinsured patients, the increased burden of copayments to be made by patients with insurance coverage and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and the estimation process used by the Corporation.

(r) Other Operating Revenue

Other operating revenue includes revenue from nonpatient care services, clinical space rental revenues, and contributions both unrestricted in nature and those released from restriction (other than the Southwest affiliation contribution) to support operating activities.

(s) Excess of Revenues over Expenses

Excess of revenues over expenses includes results from the Corporation's operating and investing activities. Changes in unrestricted net assets not included in excess of revenues over expenses include net assets released from restriction for the purchase of property, changes in the Corporation's interest in the net assets of noncontrolled foundations, certain changes in funded status of postretirement benefit plans, and other.

(t) Federal and State Income Taxes

The Corporation has received determination letters from the Internal Revenue Service stating that it is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code except for tax on unrelated business income. It is management's belief that none of its activities have produced material unrelated business income.

The Corporation recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that exceeds a 50% probability of being realized. Changes in recognition or measurement are reflected in the period in which the change in estimate occurs.

(u) Recently Adopted or Issued Accounting Standards

In 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-24, *Health Care Entities – Presentation of Insurance Claims and Related Insurance Recoveries*, which clarifies that insurance recoveries should not be netted against a related claim liability. The claim liability amount should be calculated without consideration of insurance recoveries. This standard is effective for the 2012 fiscal year and permits retrospective application but it is not required. The adoption of this standard resulted in an increase in other payables and corresponding increase in other long-term receivables of $5,587 in the accompanying consolidated balance sheet as of June 30, 2012. Management determined that the amount related to 2011, was not significant and, therefore, has not applied the standard to the balances as of June 30, 2011.

In 2010, the FASB issued ASU No. 2010-23, *Health Care Entities – Measuring Charity Care for Disclosure*, which requires a standardized process be used by healthcare entities that provide charity care to determine the measurement basis. Cost will be used as the measurement basis for disclosure purposes and should include both the direct and indirect costs for providing charity care. This standard is effective for the 2012 fiscal year. The adoption of this standard resulted in a change in presentation of balances reported as of June 30, 2011 within note 5 from $139,925 of charges foregone to $70,058 of estimated costs related to providing charity care.

In 2011, the FASB issued ASU No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities,* which provides financial statement users with greater transparency about a healthcare entity's net patient service revenue and the related allowance for doubtful accounts. This update provides information to assist financial statement users in assessing an entity's sources of net patient service revenue and related changes in its allowance for doubtful accounts. The amendments require healthcare entities that recognize significant amounts of patient service revenue at the time the services are rendered even though they do not assess the patient's ability to pay, to present the provision for bad debts related to patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) on their statement of operations. This standard is effective for the 2013 fiscal year. The adoption of this standard is not expected to have a material impact on the Corporation's consolidated financial statements.

(v) Healthcare Reform

As enacted, the Health Reform Law will change how healthcare services are covered, delivered and reimbursed through expanded coverage of uninsured individuals, reduced growth in Medicare program spending, reductions in Medicare and Medicaid Disproportionate Share Hospital payments, and the establishment of programs in which reimbursement is tied to quality and integration. In addition, the law reforms certain aspects of health insurance, expands existing efforts to tie Medicare and Medicaid payments to performance and quality, and contains provisions intended to strengthen fraud and abuse enforcement. Further, it provides for a value-based purchasing program, the establishment of Accountable Care Organizations (ACO's) and bundled payment pilot programs, which may create sources of additional revenue. On June 28, 2012, the United States Supreme Court upheld the constitutionality of the individual mandate provisions of the Health Reform Law but struck down the provisions that would have allowed Health and Human Services to penalize states that do not implement the Medicaid expansion provisions with the loss of existing federal Medicaid funding. States that choose not to implement the Medicaid expansion will forego funding established by the Health Reform Law to cover most of the expansion costs.

(w) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation to more consistently present financial information between years.

(3) Fair Value of Financial Instruments

ASC Topic 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The Corporation uses a practical expedient for the estimation of the fair value of investments in funds for which the investment does not have a readily determinable fair value. The practical expedient used by the Corporation is the net asset value (NAV) per share, or its equivalent. In some instances, the NAV may not equal the fair value that would be calculated under fair value accounting standards. Valuations provided by fund administrators consider variables such as the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information. In addition, actual market exchanges at year-end provide additional observable market inputs of the exit price. Management reviews the valuations and assumptions provided by fund administrators for reasonableness and believes that the carrying amounts of these financial instruments are reasonable estimates of fair value. Because the net asset value reported for these funds is used as a practical expedient to estimate the fair value of the Corporation's interest therein, its classification in Level 2 is based on the Corporation's ability to redeem its interest at or near the balance sheet date. The initial valuation is adjusted when changes to inputs and assumptions are corroborated by evidence, such as transactions of similar securities, completed or pending third-party transactions in the underlying security or comparable entities, offerings in the capital markets, and changes in financial results, data, or cash flows. For positions that are not traded in active markets or are subject to notice provisions, valuations are adjusted to reflect such provisions, and such adjustments are generally based on available market evidence.

The fair value of long-term debt is based on Level 2 inputs, such as the discounted value of the future cash flows using current rates for debt with the same remaining maturities, considering the existing call premium and protection. When available, quoted market prices are also used. The carrying value and fair value of debt, was approximately $826,216 and $847,046, respectively, as of June 30, 2012, and approximately $825,669 and $827,876, respectively, as of June 30, 2011.

Other financial instruments of the Corporation include cash and cash equivalents and other receivables. The carrying amount of these instruments approximates fair value because these items mature in less than one year. The carrying amount of other long-term investments approximates fair value.

(Continued)

(In thousands of dollars)

(4) Investments

The composition of cash and investments at June 30, 2012 is set forth in the following table. Investments are stated at fair value.

	June 30, 2012	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Assets:				
Short-term investments:				
Cash and money market funds	$ 16,729	—	16,729	—
Fixed income:				
Government obligations	46,987	—	46,987	—
Corporate obligations	43,281	—	43,281	—
Mortgage-backed securities:				
Commercial	9,343	—	9,343	—
Residential	53,434	—	53,434	—
Municipal, foreign, and other				—
fixed income	10,902	—	10,902	—
Mutual funds:				
Domestic debt securities	112,122	112,122	—	—
International debt securities	7,327	7,327	—	—
Other short-term investments	801	—	801	—
Total	300,926	119,449	181,477	—
Designated for capital acquisition:				
Cash and money market funds	22,529	1,797	20,732	—
Fixed income:				
Government obligations	35,062	—	35,062	—
Corporate obligations	57,621	—	57,621	—
Mortgage-backed securities:				
Commercial	10,383	—	10,383	—
Residential	69,265	—	69,265	—
Municipal, foreign, and other				
fixed income	8,626	—	8,626	—
Mutual funds:				
Fixed income	49,069	49,069	—	—
Domestic equities:				
Large capitalization	100,583	100,583	—	—
Medium-small capitalization	39,173	39,173	—	—

(In thousands of dollars)

		Fair value measurements at reporting date using		
	June 30, 2012	Level 1	Level 2	Level 3
International equities:				
Foreign stock	$ 64,527	64,527	—	—
Emerging markets	18,796	18,796	—	—
Real estate trusts	12,588	12,588	—	—
Real estate	424	—	424	—
Commodities	20,784	—	20,784	—
Options	(309)	—	(309)	—
Total	509,121	286,533	222,588	—
Trustee-held funds:				
Cash and money market funds	27,729	—	27,729	—
Fixed income:				
Government obligations and other	3,725	—	3,725	—
Mortgage-backed securities:				
Residential	6,042	—	6,042	—
Mutual funds:				
Domestic equities:				
Large capitalization	11,178	11,178	—	—
Medium-small capitalization	6,244	6,244	—	—
International equities:				
Foreign stock and emerging markets	10,682	10,682	—	—
Domestic debt securities	19,467	19,467	—	—
International debt securities	2,038	2,038	—	—
Real estate	960	960	—	—
Total	88,065	50,569	37,496	—
Total assets	$ 898,112	456,551	441,561	—
Liabilities:				
Interest rate swaps	154,591	—	154,591	—
Total liabilities	$ 154,591	—	154,591	—

The table above does not include $11,658 of private equity funds, $9,170 of distressed debt funds, or $1,469 of real estate funds at June 30, 2012, which are accounted for under the equity method of accounting.

(In thousands of dollars)

The composition of cash and investments at June 30, 2011 is set forth in the following table. Investments are stated at fair value.

	June 30, 2011	Fair value measurements at reporting date using Level 1	Level 2	Level 3
Assets:				
Short-term investments:				
Cash and money market funds	$ 8,489	2,300	6,189	—
Fixed income:				
Government obligations	37,164	—	37,164	—
Corporate obligations	40,035	—	40,035	—
Mortgage-backed securities:				
Commercial	6,595	—	6,595	—
Residential	49,808	—	49,808	—
Municipal, foreign, and other fixed income	6,872	—	6,872	—
Mutual funds:				
Domestic debt securities	91,298	91,298	—	—
International debt securities	5,135	5,135	—	—
Total	245,396	98,733	146,663	—
Designated for capital acquisition:				
Cash and money market funds	22,505	16,274	6,231	—
Fixed income:				
Government obligations	20,383	325	20,058	—
Corporate obligations	37,998	—	37,998	—
Mortgage-backed securities:				
Commercial	4,839	—	4,839	—
Residential	47,353	—	47,353	—
Municipal, foreign, and other fixed income	9,959	4,856	5,103	—
Mutual funds:				
Treasury Inflation-Protected Securities	7,394	7,394	—	—
Fixed income	60,402	60,402	—	—
Domestic equities:				
Large capitalization	74,879	74,879	—	—
Medium-small capitalization	29,968	29,968	—	—

(Continued)

(In thousands of dollars)

	June 30, 2011	Fair value measurements at reporting date using Level 1	Level 2	Level 3
International equities:				
Foreign stock	$ 67,600	67,600	—	—
Emerging markets	17,740	17,740	—	—
Real estate	14,549	14,549	—	—
Commodities	19,707	6,935	12,772	—
Options	17,580	—	17,580	—
Other investments	307	307	—	—
Total	453,163	301,229	151,934	—
Trustee held funds:				
Cash and money market funds	18,342	178	18,164	—
Fixed income:				
Government obligations and other	2,334	—	2,334	—
Mortgage backed securities:				
Residential	5,969	—	5,969	—
Mutual funds:				
Domestic equities:				
Large capitalization	14,815	14,815	—	—
Medium-small capitalization	5,770	5,770	—	—
International equities:				
Foreign stock and emerging markets	8,724	8,724	—	—
Domestic debt securities	12,639	12,639	—	—
International debt securities	6,563	6,563	—	—
Real estate	866	866	—	—
Total	76,022	49,555	26,467	—
Total assets	$ 774,581	449,517	325,064	—
Liabilities:				
Interest rate swaps	77,106	—	77,106	—
Total liabilities	$ 77,106	—	77,106	—

The table above does not include $9,862 of private equity funds, $13,714 of distressed debt funds, or $3,001 of real estate funds at June 30, 2011, which are accounted for under the equity method of accounting.

The Corporation holds alternative investments, as defined by the American Institute of Certified Public Accountants, in two limited partnerships of $20,423 and $12,772 at June 30, 2012 and 2011 respectively, which are not publicly traded. These amounts are included as a part of commodities in the table above. The underlying assets in the limited partnership are based on fair market values, and the redemption period related to these investments is between 3 to 30 days.

(In thousands of dollars)

At June 30, 2012 and 2011, the Corporation had $22,297 and $26,577, respectively, in alternative investments, referred to as Private Equity, Real Estate Trusts and Distressed Debt, accounted for using the equity method, which are not publicly traded. These amounts are not included in the tables above. These investment instruments contain elements of both credit and market risk. Such risks may include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (nonmarketable investments), and nondisclosure of portfolio composition. Because these investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a readily available market for such investments existed. The majority of these investments are accounted for under the equity method of accounting. These investments represented 2.42% and 3.32% of total investments and 0.02% and 0.02% of total net assets of the Corporation at June 30, 2012 and 2011, respectively.

Investment income is comprised of the following for the years ended June 30, 2012 and 2011.

		2012	2011
Interest and dividend income	$	20,085	19,753
Net realized gains (losses) on sales of investments		(118)	3,706
Change in net unrealized gains (losses) on investments		(7,338)	42,575
Investment income, net	$	12,629	66,034

Securities Lending Agreement

The Corporation entered into a securities lending agreement whereby a portion of investments are loaned to various financial institutions in return for cash or other securities as collateral for the securities loaned. Pursuant to the agreement, the collateral received is required to be at least 102% of the fair value of the securities loaned, which is determined at the end of each business day. The securities on loan are comprised entirely of fixed income securities. Net investment gains and losses, which are not significant for the years ended June 30, 2012 or 2011, are included in investment income, in the accompanying consolidated statements of operations. There were no securities on loan as of June 30, 2012.

Other Investments

Health Ventures is a not-for-profit corporation that has entered into joint ventures to provide radiology, oncology, and surgery services. The Corporation is the sole member of Health Ventures. Health Ventures is included in the consolidated financial statements but is not part of either obligated group. See note 7 for further discussion on the obligated groups.

The Corporation is a minority investor in both Premier Purchasing Partners (Premier) and American Excess Insurance Exchange (AEIX). The Corporation has invested in Premier with other healthcare providers for the purpose of lowering costs through group purchasing. The Corporation accounts for its interest in Premier on the cost method. AEIX is owned by a group of healthcare providers and provides them with excess professional liability insurance coverage. The Corporation accounts for its interest in AEIX on the equity method of accounting less mandatory withdrawal penalties and an estimated discount to present value. As of June 30, 2012 and 2011, the carrying value of Premier and AEIX was approximately $14,868 and $15,614, respectively, and is recorded in investments in joint ventures and other on the consolidated balance sheets.

(In thousands of dollars)

(5) Charity Care

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenues.

The Corporation maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies under its charity care policy. Estimated costs (based on the proportion of overall costs to charges foregone for charity care) for services and supplies furnished under the charity care policy for the years ended June 30, 2012 and 2011 were approximately $78,922 and $70,058, respectively.

(6) Accounts Receivable

Accounts receivable at June 30 consisted of the following:

		2012	2011
Patient accounts receivable	$	630,628	601,472
Less:			
Allowance for doubtful accounts		(74,128)	(83,127)
Allowance for estimated contractual discounts		(303,188)	(267,033)
Net patient accounts receivable	$	253,312	251,312

(Continued)

(In thousands of dollars)

(7) Long-Term Debt

Long-term debt at June 30 consisted of the following:

		2012	2011
Series 1995 (PeaceHealth) Oregon Bonds, variable interest rate (0.15% at June 30, 2012) payable each December 1, due in annual installments through December 2015	$	4,770	5,805
Series 1999 (Southwest) Washington bonds, 3.00% to 5.00% payable annually through September 2028.		47,885	49,665
Series 2001 (PeaceHealth) Oregon Bonds, 5.00% to 5.25%, interest payable each May 15 and November 15, due in annual installments from 2016 through November 2032		70,000	70,000
Series 2004 (PeaceHealth) Oregon Bonds, Series A, 3.00% to 5.00%, interest payable each February 1 and August 1, due in annual installments from 2010 through August 2014.		9,280	12,180
Series 2008 (PeaceHealth) Washington Bonds, Series A, fixed interest rate of 5% payable on each May 1 and November 1, through November 2018.		80,650	80,650
Series 2008 (PeaceHealth) Oregon Bonds, Series A-B, variable interest rate (0.13% at June 30, 2012), principal payable each August, due in annual installments from 2030 to 2034 for Series A and B		145,975	295,975
Series 2008 (Southwest) Washington Bonds, variable interest rate (0.19% at June 30, 2012), principal payable each September, due in annual installments through 2034		54,500	109,475
Series 2009 (PeaceHealth) Oregon Bonds, Series A, fixed interest rates of 3.25% to 5.00% payable each May and November, due in installments from 2013 to 2039.		100,795	100,795
Series 2009 (PeaceHealth) Washington Bonds, Series A, fixed interest rates of 3.0% to 5.0% payable each in May and November, due in installments through 2028		87,550	91,685
Series 2011 (PeaceHealth) Oregon Bonds, Series A-B, variable interest rates (0.87% at June 30, 2012) principal payable each May, due in installments from 2036 to 2047		150,000	—
2011 (PeaceHealth) Direct Note Obligation to Union Bank 2.46% payable monthly based on a ten-year amortization with remaining amount due November 2016		9,500	—

(In thousands of dollars)

		2012	2011
2012 (Southwest) Bridge Loan Obligation to Bank of America, variable interest rate (0.90% at June 30, 2012) due on July 31, 2013	$	54,000	—
Long-term debt at par value		814,905	816,230
Premium and other on long-term debt		8,927	6,901
Other long-term debt		24,582	26,289
Total long-term debt		848,414	849,420
Less amounts due within one year		(18,033)	(15,891)
Total long-term debt due after one year	$	830,381	833,529

Prior to the affiliation with Southwest, the regional networks of care or operating units that consisted of the Southeast Alaska Region, Whatcom Region, Lower Columbia Region, Oregon Region, Siuslaw Region; PeaceHealth Laboratories; the PeaceHealth Self-insured Trusts; and the PeaceHealth System Office together formed the PeaceHealth Obligated Group. These entities are not separate legal entities; PeaceHealth is the sole member of its Obligated Group and the assets of any one of the regions listed are available for the satisfaction of debts of the others (subject to the limitations of certain contractual commitments). These entities are obligated under the PeaceHealth Master Trust Indenture.

PeaceHealth Southwest Medical Center is the obligated member under a separate Master Trust Indenture created prior to the affiliation of Southwest with the Corporation. PeaceHealth Southwest Medical Center is not a part of the PeaceHealth Obligated Group as of June 30, 2012 and 2011.

The Corporation is taking steps to make each party a member of the other's obligated group. It is anticipated that all Southwest Master Notes will be retired during the course of various refinancing activities.

The Series 1995 Oregon (PeaceHealth), the Series 2008 Oregon Series A-B (PeaceHealth) bonds, and the Series 2011 Oregon Series A-B (PeaceHealth) bonds have variable interest rates that may bear interest at a daily, weekly, 28-day, monthly, semiannual, or annual rates. The rate determination mode may be changed upon request of the Corporation. The bonds are subject to optional redemption by PeaceHealth, in whole or in part at 100% of the principal amount plus accrued interest. The bonds are backed by letters of credit in the amount of approximately $147,600 for the 2008 Oregon bonds and $4,800 for the 1995 Oregon bonds. The letter of credit for Series A-B of the 2008 Oregon bonds will expire in June 2014. The letter of credit for the 1995 Oregon bonds will expire in January 2017. The 2011 Oregon bonds are held directly by two financial institutions subject to continuing covenant agreements, which contain substantially the same credit terms as the letters of credit, but which are not subject to the same remarketing and put risk as the 1995 and 2008 bonds. The 2011 Oregon bonds can be converted to publicly held variable rate demand bonds if the Corporation chooses. The continuing covenant agreements expire in August 2014. The letters of credit and the continuing covenant agreements are extendable annually at the option of the bank upon request from the Corporation for an additional year. The 2008 and 2011 bonds are matched to fixed payor swaps ranging between 3.92% and 4.10% for approximately their par value, the notional amounts of swaps amortizing proportionately to the bonds.

The Series 1995 Oregon (PeaceHealth) and Series 2008 Oregon (PeaceHealth) variable rate demand bonds, which have long-term amortization periods, may be put back to the letter of credit bank on any interest rate reset date when the bonds are due to be remarketed. In the event of a failed remarketing, the letter of credit bank is obligated under the terms of the letter of credit agreement to buy the bonds. If the bonds continue to fail to be remarketed, and become a term loan from the letter of credit bank to the Corporation, the payments commence not less than 367 days after the purchase of the bonds by the letter of credit bank, and are payable in equal quarterly installments thereafter.

The Series 1999 Washington bonds (Southwest) and the Series 2008 Washington bonds Series A (Southwest) are secured by PeaceHealth Southwest Medical Center's gross revenues. The 1999 Washington bonds maturing on or after September 1, 2010 are redeemable at the option of Southwest at a redemption price of 101%, beginning September 1, 2009, declining to 100.5% on September 1, 2010 and 100% on September 1, 2011 and thereafter. The 2008 Washington bonds are redeemable in whole or in part at the option of Southwest at no premium. During the current year, the 2008 Washington bonds Series B were redeemed with proceeds from a taxable variable rate loan (the Bridge Loan), which is matched to a fixed payor swap bearing a rate of 3.509%. The Bridge Loan is secured by PeaceHealth Southwest Medical Center's gross revenues, and further is guaranteed by the PeaceHealth Obligated Group.

The Series 2008 Washington bonds Series A (Southwest) bear variable interest based on weekly remarketing, not to exceed 12% per annum, and further a fixed payor swap at the rate of 3.603% on approximately 98% of the outstanding balance of the bonds remains in place. In conjunction with the issuance of the 2008 Washington bonds Series A, Southwest entered into a three-year Letter of Credit and Reimbursement Agreement, which expires in December 2013. These bonds, while subject to a long-term amortization period, may be put to the underlying letters of credit upon a failed remarketing. In an event of a draw under agreements, and amounts remain outstanding after 30 days, such amounts are converted to a term loan due in either equal semiannual payments with the first principal installment not due less than one year after the draw and the balance paid in full on the third anniversary of the draw or paid in full upon expiration of the agreement.

Other long-term debt primarily includes a $12,000 note payable paying interest of 6% with principal due and payable through 2017, as well as amounts related to capital lease obligations.

(In thousands of dollars)

Scheduled principal payments of long-term debt, excluding the premium on bonds and fair value adjustment due to affiliation, as due according to their long-term amortization schedule and other debt according to its maturity schedule for the next five years and thereafter are as follows:

		Long-term debt	Other	Total
Year ending June 30:				
2013	$	12,150	5,883	18,033
2014		70,740	2,060	72,800
2015		17,500	1,656	19,156
2016		13,585	1,432	15,017
2017		17,850	1,054	18,904
Thereafter		683,080	10,113	693,193
Total	$	814,905	22,198	837,103

The PeaceHealth Master Trust Indenture, the PeaceHealth Southwest Medical Center agreements with the Washington Healthcare Facilities Authority, and the loan agreements and other contractual documents under which the Corporation's bonds were issued include covenants, which among others, obligate the Corporation to: maintain net patient service revenues at levels sufficient to achieve specified debt service coverage ratios; meet certain financial tests before additional debt can be incurred; and meet certain financial tests before there can be any significant disposition of property.

Cash paid for interest totaled approximately $44,415 and $38,355 for the years ended June 30, 2012 and 2011, respectively. Interest totaling approximately $663 and $595 was capitalized in connection with construction projects during the years ended June 30, 2012 and 2011, respectively.

(8) Accounting for Derivative Instruments and Hedging Activities

In accordance with the policy adopted by the Board of Directors, the Corporation may use interest rate swap contracts to manage its net exposure to interest rate changes in attempting to reduce its overall cost of borrowing over time. Interest rate swap contracts generally involve the exchange of fixed and floating interest rate payments without the exchange of underlying principal (the swap of fixed or floating rates are on a notional amount). The Corporation accounts for its interest rate hedging transactions in accordance with ASC 815 – *Derivatives and Hedging*. That standard requires that every derivative instrument be recorded on the balance sheet as either an asset or a liability measured at its estimated fair value. The interest rate swaps do not meet the criteria for hedge accounting and all changes in the valuation of the interest rate swaps are recognized in the statement of operations.

The Corporation had the following interest rate swap contracts outstanding as of June 30, 2012 with a total notional amount of approximately $551,366: a $40,000 basis swap where the Corporation receives 81.9% of 30 day LIBOR and pays a 30 day tax-exempt index rate, and approximately $511,366 (fixed payer swaps) which the Corporation uses to convert a portion of the outstanding variable rate bonds to fixed rates ranging from 2.58% to 4.1%. The interest rate swaps while associated with the variable rate bonds, have not been designated to any of the underlying debt.

The fair value of interest rate swaps designated as cash flow hedges as of June 30, 2012 and 2011 was a liability of $154,591 and $77,106, respectively, which is included in other long term liabilities on the accompanying consolidated balance sheets. Change in the fair value of the interest rate swap, which was a decrease of $77,564 and an increase of $15,558 for the years ended June 30, 2012 and 2011, respectively, has been included in the change in fair value of interest rate swap in the statements of operations and changes in net assets.

Derivative instruments are recorded at fair value taking into consideration the Corporation's nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. The impact of taking into account the nonperformance risk on the fair value of the interest rate swaps was a benefit of approximately $19,644 and $7,763, as of June 30, 2012 and June 30, 2011, respectively. Recording the interest rate swaps at fair value results in a total liability of $154,591 reflected in the consolidated balance sheet rather than the $174,235 that would be paid if all of the swaps were terminated as of June 30, 2012. The inputs used to determine the impact of the counterparty nonperformance risk are Level 2 inputs; as such derivative liabilities have been recorded as Level 2 in the Corporation's disclosure of fair value instruments, see note 4. Interest payments made and received on the interest rate swaps are included in interest expense on the statement of operations. For the years ended June 30, 2012 and 2011, interest expense for the interest rate swaps was $17,819 and $15,523, respectively.

The Corporation currently has five swap counterparties which minimize counterparty risk and collateral posting requirements. These swap agreements contain various credit thresholds that if breached by the Corporation would constitute an additional termination event whereby the swap counterparties could terminate the swap by either making a payment to, or receiving a payment from the Corporation, depending upon the termination value of the swaps as of the date of termination. PeaceHealth retains the right to terminate the swaps at any point, which would also require either making or receiving a payment depending on the termination value of the swap as of the termination date. For the swaps specifically related to Southwest, the counterparty can terminate the swaps, requiring full settlement of any interest or termination value, only if Southwest's credit rating falls to BBB – or equivalent.

Subsequent to June 30, 2012, PeaceHealth terminated fixed payor swaps with a notional value of approximately $114 million, which were in a liability position of approximately $12,859 at June 30, 2012.

(9) Medicare and Medicaid Revenue

Net revenue for services provided to Medicare patients for the years ended June 30, 2012 and 2011 was approximately $721,129 and $582,969, respectively. Medicaid net patient service revenue for the years ended June 30, 2012 and 2011 was approximately $194,701 and $193,849, respectively.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, 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 or new information is obtained. The net amount of adjustments from finalization and adjustment of prior years cost reports and other third-party settlements did not result in a significant change in net patient service revenues in either 2012 or 2011.

The Medicare cost reports are subject to retroactive adjustment for three years after settlement, unless held open longer for disputed items. The cost reports receive either full-or limited-scope audits by the fiscal intermediary appointed by Medicare. Settlements for open years will be finalized after review by the appropriate government agencies.

(10) Benefit Plans

Defined Benefit Pension Plan

The Corporation sponsors a noncontributory defined benefit pension plan, the Southwest Washington Health System Retirement Plan (the Plan), covering all employees at Southwest who meet requirements as specified in the Plan. The assets of the Plan are available to pay the benefits of all eligible employees of the Plan. The Plan has two benefit structures that include a cash balance and a final average pay structure. Effective December 31, 2010, the Plan was frozen. No new participants were admitted to the Plan after this date. This event did not terminate the Plan. Benefits earned before the plan was frozen will continue to be paid as participants qualify to receive benefits. All related charges related to this event were recorded prior to the affiliation of Southwest with PeaceHealth.

(In thousands of dollars)

The following table sets forth disclosures related to the Plan in accordance with FASB ASC 715-20-65, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, as of June 30, 2012 and 2011.

		Year ended June 30, 2012	**6 months ended June 30, 2011**
Change in projected benefit obligation:			
Projected benefit obligation (PBO) at beginning of period	$	168,844	166,268
Interest cost		9,150	4,514
Actuarial loss on PBO		44,484	37
Benefits paid		(4,232)	(1,975)
Projected benefit obligation at June 30	$	218,246	168,844
Change in fair value of plan assets:			
Fair value of assets at beginning of period	$	127,743	116,943
Actual return on plan assets		(2,966)	3,465
Employer contribution		11,844	9,310
Benefits paid		(4,232)	(1,975)
Fair value of assets at June 30	$	132,389	127,743
Reconciliation of funded status:			
Funded status	$	(85,857)	(41,101)
Net amount recognized	$	(85,857)	(41,101)
Amounts recognized in the consolidated balance sheets consist of:			
Accrued pension liability	$	85,857	41,101
Accumulated change in net assets		(59,198)	(1,699)

The accumulated benefit obligation for the Plan was $218,246 and $168,844 at June 30, 2012 and 2011, respectively.

Net periodic benefit cost for the year ended June 30, 2012 and the six months ended June 30, 2011 included the following components and is included in payroll taxes and benefits in the accompanying consolidated statements of operations and changes in net assets:

		2012	**2011**
Interest cost	$	9,150	4,514
Expected return on plan assets		(10,837)	(5,313)
Amortization of gain		788	185
Net periodic pension benefit	$	(899)	(614)

(In thousands of dollars)

(a) Assumptions

The Corporation used the following actuarial assumptions to determine its benefit obligations at June 30, 2012 and 2011, with measurement dates of June 30, 2012 and 2011:

	2012	2011
Discount rate	4.0%	5.5%

The Corporation used the following actuarial assumptions to determine its net periodic benefit cost for the year ended June 30, 2012 and the six months ended June 30, 2011:

	2012	2011
Discount rate	4.0%	5.5%
Expected long-term rate of return on plan assets	8.5	8.5

This discount rate is based on a proprietary yield curve tool used by the Plan's actuary, which uses a composite of high-yield, investment-grade corporate bonds, and the projected payouts from the Plan to develop an equivalent yield rate to use in determining plan liabilities.

The expected long-term rate of return on plan assets was based on the asset allocation mix and the long-term historical return for each asset class, taking into account current and expected market conditions. The actual (loss) return on pension plan assets was approximately (1.8)% and 2.8% for the year ended June 30, 2012 and the six months ended June 30, 2011, respectively. In the calculation of pension plan expense, the expected long-term rate of return on plan assets is applied to a calculated value of plan assets that recognizes changes in fair value over a four-year period. This practice is intended to reduce year-to-year volatility in pension expense, but it can have the effect of delaying the recognition of differences between actual returns and expected returns based on the long-term rate of return assumptions.

(b) Pension Plan Assets

The asset allocation of the Corporation's pension plan at June 30, 2012 and 2011 is as follows:

		2012	2011
Equity securities	$	76,763	86,224
Debt securities		46,931	31,361
Other		8,695	10,158
Total	$	132,389	127,743

Pension plan assets are managed according to an investment policy adopted by the Plan's trustees. Professional investment managers are retained to manage specific asset classes and professional consulting is utilized for investment performance reporting. The primary objective of the Plan's trustees is to achieve the highest possible total return commensurate with safety and preservation of capital in real, inflation-adjusted terms. The objective includes having funds invested in the long term, which protect the principal and produce returns sufficient to meet future benefit obligations. The investment policy includes an asset allocation that includes equity securities, debt securities, and cash/other investments. The target allocations are 7% cash and bonds, 19% low volatility hedge, 54% global equity, and 20% long-short hedge. Assets are rebalanced quarterly when balances fall outside of the approved range for each asset class.

In accordance with FASB ASC 820, financial assets and financial liabilities measured at fair value are grouped in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to estimate fair value. These levels and the adoption of FASB ASC 820 are further discussed in note 4.

Following is a description of the valuation methodologies used for plan assets measured at fair value.

- Mutual Funds: Valued at the NAV of shares held by the plan at year-end.
- Common and Collective Trusts: Valued at fair value of the underlying assets on close of the valuation date and expressed in units. The unit value is determined at the valuation date by dividing the value of the entire common and collective trust by the number of units.
- Real Estate Investment Fund and Hedge Fund: Valued based on the fair value of the underlying assets as supported by audited financial statements.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

(In thousands of dollars)

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2012:

Assets		Total fair value	Level 1	Level 2	Level 3
Cash and money markets	$	8,695	8,695	—	—
Mutual funds:					
Fixed income		24,506	24,506	—	—
Large cap		23,418	8,083	—	15,335
Mid cap		6,176	6,176	—	—
Small cap		4,027	4,027	—	—
Emerging market funds		27,180	22,381	—	4,799
Hedge capital appreciation Fund		22,425			22,425
Long-short hedge		8,410	—	—	8,410
Distressed debt		6,459	—	—	6,459
Private equity		1,093	—	—	1,093
Total plan assets at fair value	$	132,389	73,868	—	58,521

The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2011:

Assets		Total fair value	Level 1	Level 2	Level 3
Cash and money markets	$	10,158	10,158	—	—
Mutual funds:					
Fixed income		13,227	13,227	—	—
Hedge capital appreciation		18,133	—	—	18,133
Large cap		39,843	39,843	—	—
Mid cap		6,188	6,188	—	—
Small cap		9,832	9,832	—	—
Emerging markets		11,344	5,885	—	5,459
Long-short hedge		11,885	—	—	11,885
Distressed debt		6,577	—	—	6,577
Private equity		556	—	—	556
Total plan assets at fair value	$	127,743	85,133	—	42,610

(In thousands of dollars)

The following table presents a reconciliation of the beginning and ending balances of those Level 3 assets:

		Fair value measurements Level 3
Fair value June 30, 2011	$	42,610
Realized and unrealized gains, net		2,052
Purchases, issuances, and settlements, net		13,859
Fair value June 30, 2012	$	58,521

At June 30, 2012 and 2011, the Plan held $58,521 and $42,610, respectively, in alternative investments, reflected as Level 3 assets in the above table, which are not publicly traded. These investment instruments contain elements of both credit and market risk. Such risks may include, but are not limited to, limited liquidity, absence of regulatory oversight, dependence upon key individuals, emphasis on speculative investments (nonmarketable investments), and nondisclosure of portfolio composition. Because these investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a readily available market for such investments existed. These investments represented 44.2% and 33.4% of plan assets at June 30, 2012 and 2011, respectively.

(c) Cash Flows

The Corporation's policy with respect to funding the Plan is to fund at least the minimum required by the Employee Retirement Income Security Act of 1974, as amended, plus such additional amounts deemed appropriate. In fiscal year 2013, Southwest expects to contribute approximately $5,776 to the Plan.

Benefit payments are expected to be paid as follows for the fiscal years ended June 30:

		Pension benefits
2013	$	5,783
2014		6,612
2015		7,222
2016		8,049
2017		8,761
2018 – 2022		55,018

Expected benefit payments presented above are based on actuarial estimates. Actual benefit payments may vary significantly from these estimates.

(In thousands of dollars)

Management is not aware of any settlements or curtailments that would require additional recognition during 2012.

(11) Defined Contribution Retirement Plans

The Corporation sponsors two defined contribution retirement plans for the employees of PeaceHealth and Southwest. At June 30, 2012, employees of Southwest are eligible for the Southwest plan and employees of the PeaceHealth operating divisions are eligible for the PeaceHealth Plan. There had not been an integration of the plans as of June 30, 2012 or 2011.

PeaceHealth Southwest Medical Center Employer Contribution Plan

Employees who complete one hour of service are eligible to participate in the PeaceHealth Southwest Medical Center Employer Contribution Plan, a defined contribution retirement plan. The level of contribution depends on, among other things, the level of employee contributions to the plan and years of service, with Southwest contributing between 4% – 15% of the employees' eligible annual compensation. Employer contributions under this plan were $15,589 for the year ended June 30, 2012 and $7,941 for the six-month period ended June 30, 2011 and are included in payroll taxes and benefits expense in the consolidated statement of operations.

PeaceHealth Defined Contribution Retirement Plan

The Corporation has a defined contribution retirement plan that covers substantially all employees of PeaceHealth meeting certain age and length of service requirements. Total retirement plan costs charged to operations were approximately $49,632 and $44,221 for the years ended June 30, 2012 and 2011, respectively, and are included in payroll taxes and benefits in the accompanying consolidated statements of operations.

(12) Restricted Net Assets

Restricted net assets are those whose use by the Corporation has been limited by donor-imposed restrictions to a specific time period and/or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

Temporarily restricted net assets are available for the following purposes at June 30:

	2012	2011
Purchase of property, plant, and equipment	$ 14,015	32,954
Hospice and indigent care	2,946	1,503
Patient care	13,993	6,475
Other	4,690	5,363
	$ 35,644	46,295

(In thousands of dollars)

The income on the following permanently restricted net assets is available for these purposes at June 30:

	2012	2011
Purchase of property, plant, and equipment	$ 545	2,436
Hospice and indigent care	7,322	4,001
Patient care operating activities	2,543	3,310
Other	970	1,421
	$ 11,380	11,168

During fiscal year 2012 and 2011, net assets were released from donor restrictions by incurring operating expenses satisfying the restricted purposes of approximately $1,114 and $3,827, respectively. Further, approximately $19,208 and $8,101 were released from restriction for capital expenditures made during 2012 and 2011, respectively.

Endowment Funds

The Corporation accounts for endowments consistent with the provisions of ASC Section 950-205-45. The ASC provides guidance on classifying net assets associated with donor-restricted endowment funds held by organizations that are subject to an enacted version of Uniform Prudent Management of Institutional Funds Act (UPMIFA). The ASC requires that unexpended earnings on endowment funds are classified as temporarily restricted net assets until appropriate for expenditure. The Corporation’s endowment consists of twelve individual funds established for a variety of purposes. Its endowment includes donor-restricted endowments and unrestricted funds functioning as endowments through board designation. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

As of June 30, 2012 and 2011, donor-restricted endowments totaled $6,879 and $6,871, respectively, and board-designated endowments totaled $2,235 and $2,460, respectively.

The Corporation’s management has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Corporation classifies as permanently restricted net assets (a) the original value of the 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 remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Corporation in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Corporation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the fund

(In thousands of dollars)

- The purposes of the Corporation and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Corporation
- The investment policies of the Corporation

In accordance with UPMIFA and board policy, assets classified as permanent endowments in accordance with donor intention are only utilized for current period expenditures to the extent that cumulative earnings on the endowment exceed the original fair value of the donation.

Substantially all investments the Corporation holds for endowments are pooled for investment purposes. Income earned on endowment fund investments is allocated on the basis of each fund's proportionate interest in the pooled investment portfolio. There were no funds with significant deficiencies as of June 30, 2012 and 2011.

Charitable Gift Annuities

The Corporation has been granted a license by the State of Washington, Office of Insurance Commissioner, to issue Charitable Gift Annuities in support of its charitable activities. The Corporation has delegated all its charitable fund raising activities to several fund raising foundations whose net assets, held for the beneficial interest of the Corporation, are shown on the balance sheet of the Corporation. Accordingly, the liability for annuity contracts and the separately maintained reserve accounts are recorded by the foundations which support the hospitals that the donors designated to benefit from their charitable gift annuity contributions. As of June 30, 2012 and 2011, the following liabilities for annuity contracts issued under the Corporation license and reserve account investments were recorded by the foundations:

	2012	2011
State of Washington gift annuity liabilities	$ (540)	(569)
Gift annuity reserve accounts	629	706

In addition the Corporation has issued two charitable gift annuities in the states of Alaska and Oregon for which the liability for annuity contracts as of June 30, 2012 and 2011 was $56 and $58, respectively, and separately maintained the reserve account balance of $73 and $80, respectively, which is recorded on the balance sheets of the supporting foundations located in those states. The St. John Medical Center Foundation and the PeaceHealth Southwest Medical Center Foundation have been granted separate licenses to issue charitable gift annuities by the state of Washington.

(In thousands of dollars)

(13) Commitments and Contingent Liabilities

(a) Litigation

Various laws and regulations of federal, state, and local governments govern the healthcare industry. These laws and regulations are subject to ongoing government review and interpretation, as well as regulatory actions unknown or unasserted at this time. The Corporation is also involved in litigation and regulatory investigations arising in the normal course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Corporation's future financial position or results of operations.

(b) Operating Leases

The Corporation leases, for a nominal amount, the buildings and certain equipment for Ketchikan General Hospital from the City of Ketchikan, Alaska under a 10-year lease that expires in 2013.

Future minimum lease payments under noncancelable capital and operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2012 are as follows:

	Capital leases	Operating leases
Year ending June 30:		
2013	$ 5,875	23,277
2014	1,583	19,864
2015	1,242	16,780
2016	934	15,577
2017	492	14,363
Later years, through 2020	1,341	58,896
Total minimum lease payments	11,467	$ 148,757
Less amount representing interest	(954)	
Present value of net minimum capital lease payments	10,513	
Less current installments of obligations under capital leases	5,530	
Obligations under capital leases, excluding current installments included in Long-term debt	$ 4,983	

(c) Collective Bargaining Agreements

Approximately 27% and 30% of the Corporation's employees are covered under collective bargaining agreements, including nurses, professional employees, and service employees as of June 30, 2012 and 2011, respectively. The Corporation's various collective bargaining agreements expire between September 2012 and April 2014.

(In thousands of dollars)

(14) Insurance Coverages

The Corporation has a self-insurance program for hospital and physician professional and general liability claims under which the Corporation contributes actuarially determined amounts to a trust to fund estimated ultimate losses. In connection with the self-insurance program, the Corporation has accrued estimates for asserted and incurred but not reported claims, including both the expected liability under each claim and the cost to administer the claim. Self-insured professional and general liability retention in 2012 and 2011 was $5,000 per occurrence and $18,000 in aggregate. Individual general and professional liability claims in excess of the above self-insured retention levels are insured through a claims-made excess insurance policy.

The Corporation also self-insures all or a portion of liabilities for medical and dental benefit plans, unemployment, and workers' compensation claims. Funding levels and liabilities are determined based on actuarial studies. Based on the actuarial studies, the Corporation has recorded a liability for all of the self-insurance programs of approximately $70,836 and $50,738 at June 30, 2012 and 2011, respectively. The liabilities are classified within other current liabilities and other long-term liabilities based on the historical amounts paid within one year. Total current amounts included in other current liabilities were approximately $23,090 and $22,118 at June 30, 2012 and 2011, respectively. In accordance with the adoption of ASU No. 2010-24 management has recorded amounts receivable from excess insurance carriers totaled $5,587 as of June 30, 2012, which is included in other receivables in the accompanying consolidated balance sheet.

(15) Functional Expenses

The Corporation provides general healthcare services to residents within its geographic location. Expenses related to providing these services are as follows:

		2012	2011
Healthcare services	$	1,677,011	1,315,420
General and administrative		644,334	563,290
	$	2,321,345	1,878,710

(16) Subsequent Events

In connection with the preparation of the financial statements and in accordance with FASB ASC Topic 855, *Subsequent Events*, the Corporation has evaluated subsequent events through October 18, 2012, which was the date the consolidated financial statements were issued.

On August 17, 2012, Catholic Health Initiatives, a not-for-profit healthcare system headquartered in Colorado, and the Corporation, entered into a nonbinding letter of intent to create a new regional healthcare system.

It is envisioned that the new company would constitute an integrated health system, combining seven Catholic Health Initiatives hospitals and related healthcare operations in Washington and Oregon with nine PeaceHealth hospitals and related healthcare operations in Washington, Oregon, and Alaska. This new organization would include nearly 26,000 employees and about 950 employed physicians serving in hospitals, physician clinics, outpatient care clinics, long-term care facilities, laboratories, and private homes across the region. The transaction is subject to the parties' due diligence and negotiation of definitive agreements.

ADDITIONAL INFORMATION

PEACEHEALTH

Consolidating Balance Sheets

June 30, 2012

(In thousands)

Assets	PeaceHealth Obligated Group	PeaceHealth Nonobligated group	Eliminating or consolidating adjustments	PeaceHealth 2012 Consolidated	Southwest Obligated group	Southwest Nonobligated group	Eliminating or consolidating adjustments	Southwest 2012 Consolidated	Eliminating or consolidating adjustments	Total PeaceHealth 2012 Consolidated
Current assets:										
Cash and cash equivalents	$ 82,021	5,576	—	87,597	31,322	28,260	—	59,582	—	147,179
Short-term investments	296,275	—	—	296,275	—	4,651	—	4,651	—	300,926
Accounts receivable, net	189,780	—	—	189,780	60,251	4,671	(1,390)	63,532	—	253,312
Other receivables	27,091	232	—	27,323	3,992	2,328	(23)	6,297	(2,000)	31,620
Assets under securities lending agreement	—	—	—	—	—	—	—	—	—	—
Inventory of supplies	26,369	—	—	26,369	7,451	—	—	7,451	—	33,820
Prepaid expenses and other	10,086	123	—	10,209	9,271	1,432	—	10,703	—	20,912
Assets whose use is limited that are required for current liabilities	23,123	—	—	23,123	135	—	—	135	—	23,258
Total current assets	654,745	5,931	—	660,676	112,422	41,342	(1,413)	152,351	(2,000)	811,027
Assets whose use is limited by board designation and indenture agreements:										
Cash and investments	366,065	686	—	366,751	233,609	19,123	—	252,732	—	619,483
Investment in affiliates	484,495	—	(16,670)	467,825	—	467,448	(467,448)	—	(467,825)	—
Investments in joint ventures and other	30,201	11,378	(12,766)	28,813	—	12,025	—	12,025	—	40,838
Total assets whose use is limited	880,761	12,064	(29,436)	863,389	233,609	498,596	(467,448)	264,757	(467,825)	660,321
Less current portion	(23,123)	—	—	(23,123)	(135)	—	—	(135)	—	(23,258)
Net assets whose use is limited	857,638	12,064	(29,436)	840,266	233,474	498,596	(467,448)	264,622	(467,825)	637,063
Property, plant, and equipment:										
Land and improvements	75,506	—	—	75,506	11,290	31,501	—	42,791	—	118,297
Buildings, fixed equipment, and other	1,273,105	24,076	(22,246)	1,274,935	290,662	390	—	291,052	—	1,565,987
Moveable equipment	456,366	1,324	—	457,690	107,969	4,712	—	112,681	—	570,371
Construction in progress	46,891	117	—	47,008	11,622	2,606	—	14,228	—	61,236
Total property, plant, and equipment	1,851,868	25,517	(22,246)	1,855,139	421,543	39,209	—	460,752	—	2,315,891
Less accumulated depreciation	(869,095)	(6,034)	6,519	(868,610)	(58,388)	(1,724)	—	(60,112)	—	(928,722)
Net property, plant, and equipment	982,773	19,483	(15,727)	986,529	363,155	37,485	—	400,640	—	1,387,169
Deferred financing costs, net	5,948	—	—	5,948	881	—	—	881	—	6,829
Interest in net assets of related foundations	32,663	—	—	32,663	19,380	—	(19,380)	—	—	32,663
Other assets	30,515	119	—	30,634	23,327	555	—	23,882	—	54,516
Total assets	$ 2,564,282	37,597	(45,163)	2,556,716	752,639	577,978	(488,241)	842,376	(469,825)	2,929,267

(Continued)

PEACEHEALTH

Consolidating Balance Sheets

June 30, 2012

(In thousands)

Liabilities and Net Assets		PeaceHealth Obligated group	PeaceHealth Nonobligated group	Eliminating or consolidating adjustments	PeaceHealth 2012 Consolidated	Southwest Obligated group	Southwest Nonobligated group	Eliminating or consolidating adjustments	Southwest 2012 Consolidated	Eliminating or consolidating adjustments	Total PeaceHealth 2012 Consolidated
Current liabilities:											
Accounts payable	$	54,194	89	(635)	53,648	17,220	1,799	(23)	18,996	(2,000)	70,644
Accrued payroll, payroll taxes, and employee benefits		100,681	44	—	100,725	33,102	2,373	—	35,475	—	136,200
Accrued interest payable		4,194	—	—	4,194	—	351	—	351	—	4,545
Other current liabilities		22,463	2	—	22,465	7,866	11,804	(1,390)	18,280	—	40,745
Medical claims payable		—	—	—	—	—	6,533	—	6,533	—	6,533
Reimbursement settlements payable		12,248	—	—	12,248	9,841	—	—	9,841	—	22,089
Payable under securities lending agreement		—	—	—	—	—	—	—	—	—	—
Current portion of long-term debt		16,394	—	(1,623)	14,771	2,760	502	—	3,262	—	18,033
Total current liabilities		210,174	135	(2,258)	208,051	70,789	23,362	(1,413)	92,738	(2,000)	298,789
Other long-term liabilities		209,634	763	—	210,397	113,796	728	—	114,524	—	324,921
Long-term debt due after one year		675,710	12,754	(25,275)	663,189	156,009	11,183	—	167,192	—	830,381
Net assets:											
Unrestricted		1,409,956	23,845	(17,630)	1,416,171	395,012	521,986	(467,991)	449,007	(437,026)	1,428,152
Temporarily restricted		47,654	100	—	47,754	10,467	11,605	(10,706)	11,366	(23,476)	35,644
Permanently restricted		11,154	—	—	11,154	6,566	9,114	(8,131)	7,549	(7,323)	11,380
Total net assets		1,468,764	23,945	(17,630)	1,475,079	412,045	542,705	(486,828)	467,922	(467,825)	1,475,176
Total liabilities and net assets	$	2,564,282	37,597	(45,163)	2,556,716	752,639	577,978	(488,241)	842,376	(469,825)	2,929,267

See accompanying independent auditors' report.

PEACEHEALTH

Consolidating Statements of Operations

Year ended June 30, 2012

(In thousands)

	PeaceHealth Obligated group	PeaceHealth Nonobligated group	Eliminating or consolidating adjustments	PeaceHealth 2012 Consolidated	Southwest Obligated group	Southwest Nonobligated group	Eliminating or consolidating adjustments	Southwest 2012 Consolidated	Eliminating or consolidating adjustments	Total PeaceHealth 2012 Consolidated
Revenues:										
Net patient service revenue	$ 1,570,824	—	—	1,570,824	556,028	33,149	(33,765)	555,412	—	2,126,236
Premium revenue	—	—	—	—	—	141,598	—	141,598	—	141,598
Other operating revenue	48,903	10,336	(9,029)	50,210	11,851	22,016	(13,616)	20,251	(3,420)	67,041
Total revenues	1,619,727	10,336	(9,029)	1,621,034	567,879	196,763	(47,381)	717,261	(3,420)	2,334,875
Expenses:										
Salaries and wages	710,743	588	—	711,331	214,975	35,258	—	250,233	—	961,564
Payroll taxes and benefits	171,481	124	—	171,605	59,167	6,528	—	65,695	—	237,300
Professional fees	10,024	—	—	10,024	22,219	899	(6,868)	16,250	—	26,274
Medical claims expense	6,886	—	—	6,886	—	124,019	(26,898)	97,121	—	104,007
Supplies and other expenses	487,449	594	11	488,054	159,998	37,042	(13,615)	183,425	(3,420)	668,059
Provision for bad debts	80,191	—	—	80,191	53,061	562	—	53,623	—	133,814
Depreciation and amortization of other assets	104,851	984	(890)	104,945	40,418	1,154	—	41,572	—	146,517
Interest and amortization of deferred financing costs	36,184	1,173	(1,699)	35,658	7,433	719	—	8,152	—	43,810
Total expenses	1,607,809	3,463	(2,578)	1,608,694	557,271	206,181	(47,381)	716,071	(3,420)	2,321,345
Excess (deficiency) of revenues over expenses from operations	11,918	6,873	(6,451)	12,340	10,608	(9,418)	—	1,190	—	13,530
Other income (loss):										
Contribution from the Southwest affiliation	—	—	—	—	—	—	—	—	—	—
Investment income (loss), net	10,510	3	(1,260)	9,253	3,281	95		3,376	—	12,629
Income of consolidated subsidiaries	(62,126)	—	—	(62,126)	—	(50,786)	50,786	—	62,126	—
Gain on investments recorded on the equity method	6,474	—	—	6,474	—	—	—	—	—	6,474
Change in valuation of interest rate swaps	(65,871)	—	—	(65,871)	(11,693)	—	—	(11,693)	—	(77,564)
Other	—	—	—	—	(17)	1,645	—	1,628	—	1,628
Total other income, net	(111,013)	3	(1,260)	(112,270)	(8,429)	(49,046)	50,786	(6,689)	62,126	(56,833)
(Deficiency) excess of revenues over expenses	(99,095)	6,876	(7,711)	(99,930)	2,179	(58,464)	50,786	(5,499)	62,126	(43,303)
Donations for land, buildings and equipment	2,345	1,463	—	3,808	11,720	—	(11,720)	—	—	3,808
Net assets released from restrictions	8,037	—	—	8,037	—	1,332	9,839	11,171	—	19,208
Transfer (to) from related division	(7)	(9,500)	9,500	(7)	(10,113)	13,770	(3,650)	7	—	—
Change in interest in net assets of related foundations	653	—	—	653	369	—	(369)	—	—	653
Change in pension liability	—	—	—	—	(57,499)	—	—	(57,499)	—	(57,499)
Other changes in net assets	333	—	—	333	—	1,668	(1,345)	323	—	656
(Decrease) increase in unrestricted net assets	$ (87,734)	(1,161)	1,789	(87,106)	(53,344)	(41,694)	43,541	(51,497)	62,126	(76,477)

See accompanying independent auditors' report.

PEACEHEALTH

Consolidating Statements of Changes in Net Assets

Years ended June 30, 2012 and 2011

(In thousands)

	PeaceHealth Obligated group	PeaceHealth Nonobligated group	Eliminating or consolidating adjustments	PeaceHealth 2012 Consolidated	Southwest Obligated group	Southwest Nonobligated group	Eliminating or consolidating adjustments	Southwest 2012 Consolidated	Eliminating or consolidating adjustments	Total PeaceHealth 2012 Consolidated
Net assets at June 30, 2010	$ 912,754	25,358	(19,438)	918,674	—	—	—	—	—	918,674
Excess (deficiency) of revenues over expenses	598,784	5,997	(6,481)	598,300	185,292	147,710	(163,537)	169,465	(173,142)	594,623
Southwest contribution	30,800	—	—	30,800	—	—	—	—	—	30,800
Push down of net assets contributed by Southwest	—	—	—	—	295,668	442,524	(381,381)	356,811	(356,811)	—
Other restricted contributions	11,353	165	—	11,518	—	1,715	(1,715)	—	—	11,518
Donations for land, buildings and equipment	—	—	—	—	1,753	—	—	1,753	—	1,753
Net assets released from restrictions	(3,147)	—	—	(3,147)	—	(679)	—	(679)	—	(3,826)
Transfer (to) from related division	—	(6,500)	6,500	—	(5,386)	6,286	(900)	—	—	—
Change in interest in net assets of related foundations	6,642	—	—	6,642	(920)	—	920	—	—	6,642
Change in pension liability	—	—	—	—	(1,699)	—	—	(1,699)	—	(1,699)
Other changes in net assets	(792)	—	—	(792)	1,698	697	2,002	4,397	2	3,607
Change in net assets	643,640	(338)	19	643,321	476,406	598,253	(544,611)	530,048	(529,951)	643,418
Net assets at June 30, 2011	1,556,394	25,020	(19,419)	1,561,995	476,406	598,253	(544,611)	530,048	(529,951)	1,562,092
Excess (deficiency) of revenues over expenses	(99,095)	6,876	(7,711)	(99,930)	2,179	(58,447)	50,786	(5,482)	62,126	(43,286)
Other restricted contributions	8	85	—	93	—	1,633	—	1,633	—	1,726
Donations for land, buildings and equipment	8,828	1,464	—	10,292	11,720	—	(11,720)	—	—	10,292
Net assets released from restrictions	(7)	—	—	(7)	—	(11,172)	10,065	(1,107)	—	(1,114)
Transfer (to) from related division	(7)	(9,500)	9,500	(7)	(10,113)	13,770	(3,650)	7	—	—
Change in interest in net assets of related foundations	2,564	—	—	2,564	(10,648)	—	10,648	—	—	2,564
Change in pension liability	—	—	—	—	(57,499)	—	—	(57,499)	—	(57,499)
Other changes in net assets	79	—	—	79	—	(1,332)	1,654	322	—	401
Change in net assets	(87,630)	(1,075)	1,789	(86,916)	(64,361)	(55,548)	57,783	(62,126)	62,126	(86,916)
Net assets at June 30, 2012	$ 1,468,764	23,945	(17,630)	1,475,079	412,045	542,705	(486,828)	467,922	(467,825)	1,475,176

See accompanying independent auditors' report.

PEACEHEALTH

Inpatient Statistics

Years ended June 30, 2012 and 2011

(Unaudited)

	Alaska Region		Whatcom Region		Lower Columbia Region		Oregon Region		Siuslaw Region		Southwest		PeaceHealth total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011 (6 months)	2012	2011
Adult and pediatric:														
Licensed beds	25	25	253	253	346	346	465	456	21	21	410	410	1,520	1,511
Beds in use	25	25	253	253	180	174	450	453	21	21	316	316	1,245	1,242
Admissions	1,257	1,285	15,410	15,691	9,014	9,491	26,728	27,005	972	1,029	24,744	12,783	78,125	67,284
Patient days	4,000	4,344	58,790	59,714	36,343	36,896	119,525	121,525	3,158	3,400	92,937	48,655	314,753	274,534
Average daily census	11	12	161	164	99	101	327	333	9	9	254	269	860	888
Length of stay	3	3	4	4	4	4	4	5	3	3	4	4	4	4
Nursery:														
Licensed beds	6	6	20	20	27	27	—	—	3	2	40	40	96	95
Bassinets in use	6	6	20	20	20	20	36	36	3	2	40	40	125	124
Admissions	252	254	1,773	1,827	1,059	1,091	2,404	2,507	57	53	2,680	1,427	8,225	7,159
Patient days	534	519	3,438	3,587	2,056	2,118	4,814	4,997	106	90	5,220	2,875	16,168	14,186
Average daily census	1	1	9	10	6	6	13	14	—	—	14	16	44	47
Length of stay	2	2	2	2	2	2	2	2	2	2	2	2	2	2
Long-term care:														
Licensed beds	29	29	—	—	—	—	—	—	—	—	—	—	29	29
Beds in use	29	29	—	—	—	—	—	—	—	—	—	—	29	29
Admissions	159	144	—	—	—	—	—	—	—	—	—	—	159	144
Patient days	7,436	8,230	—	—	—	—	—	—	—	—	—	—	7,436	8,230
Average daily census	20	23	—	—	—	—	—	—	—	—	—	—	20	23
Length of stay	47	57	—	—	—	—	—	—	—	—	—	—	47	57

Notes: Southwest statistics for 2011 are for the six months ended June 30, 2011.

See accompanying independent auditors' report.

PEACEHEALTH

Ancillary and Other Statistics

Years ended June 30, 2012 and 2011

(Unaudited)

	Alaska Region		Whatcom Region		Lower Columbia Region		Oregon Region		Siuslaw Region		Southwest		PeaceHealth total	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011 (6 months)	2012	2011
Total surgeries	1,484	1,638	7,246	7,369	5,704	6,188	15,330	15,996	1,579	1,571	10,834	5,631	42,177	38,393
Surgery minutes	115,603	116,748	929,540	957,849	489,615	535,667	1,976,160	1,990,080	116,280	120,180	1,250,660	671,131	4,877,858	4,391,655
Emergency visits	9,379	9,639	56,947	58,238	50,727	52,970	90,159	88,074	7,385	7,052	82,416	43,176	297,013	259,149
Outpatient registrations	36,464	37,292	98,300	90,477	189,617	194,026	167,956	163,308	23,627	23,709	186,761	134,517	702,725	643,329
Physician clinic RBRVS work RVU’s	69,713	67,462	383,906	408,927	392,243	386,017	615,159	633,892	85,768	82,675	249,162	151,799	1,795,951	1,730,772
Full-time equivalent employees	350	356	2,041	2,011	1,461	1,477	3,703	3,722	412	411	3,334	3,264	13,064	12,916

Notes: Certain PeaceHealth divisions are not shown separately, but are included in the Corporation’s totals. Southwest statistics for 2011 are for the six months ended June 30, 2011.

See accompanying independent auditors’ report.