Stanford Hospital and Clinics and Subsidiaries

Consolidated Financial Statements
August 31, 2011 and 2010

Stanford Hospital and Clinics and Subsidiaries
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August 31, 2011 and 2010

Report of Independent Auditors

To the Board of Directors
Stanford Hospital and Clinics and Subsidiaries

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and changes in net assets and cash flows present fairly, in all material respects, the financial position of Stanford Hospital and Clinics and subsidiaries ("SHC") at August 31, 2011 and 2010 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of SHC's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

December 14, 2011

Stanford Hospital and Clinics and Subsidiaries
Consolidated Balance Sheets
August 31, 2011 and 2010
(in thousands of dollars)

	2011	2010
Assets		
Current assets:		
Cash and cash equivalents	$ 414,604	$ 334,344
Assets limited as to use, held by trustee	279	280
Patient accounts receivable, net of allowance for doubtful accounts of $79,000 and $78,000 at August 31, 2011 and 2010, respectively	287,211	258,553
Other receivables	31,965	28,562
Inventories	19,657	19,148
Prepaid expenses and other	22,230	9,893
Total current assets	775,946	650,780
Investments	117,417	80,817
Investments in University managed pools	844,139	676,598
Assets limited as to use, held by trustee, net of current portion	709	712
Property and equipment, net	865,330	860,273
Other assets	145,808	63,521
Total assets	$ 2,749,349	$ 2,332,701
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	$ 124,487	$ 102,723
Accrued salaries and related benefits	92,965	101,378
Due to related parties	28,219	22,885
Third-party payor settlements	22,659	19,907
Current portion of long-term debt	11,396	4,969
Debt subject to short-term remarketing arrangements	168,200	358,000
Self-insurance reserves and other	23,125	21,892
Total current liabilities	471,051	631,754
Self-insurance reserves and other, net of current portion	101,679	104,168
Other long-term liabilities	174,151	174,286
Pension liability	51,569	74,629
Long-term debt, net of current portion	639,414	463,218
Total liabilities	1,437,864	1,448,055
Net assets:		
Unrestricted:		
Stanford Hospital and Clinics	1,078,759	785,092
Noncontrolling interests	10,649	-
Total unrestricted	1,089,408	785,092
Temporarily restricted	215,585	93,062
Permanently restricted	6,492	6,492
Total net assets	1,311,485	884,646
Total liabilities and net assets	$ 2,749,349	$ 2,332,701

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

Stanford Hospital and Clinics and Subsidiaries
Consolidated Statements of Operations and Changes in Net Assets
Years Ended August 31, 2011 and 2010
(in thousands of dollars)

	2011	2010
Operating revenues:		
Net patient service revenue	$ 2,123,716	$ 1,891,342
Other revenue	61,885	71,193
Net assets released from restrictions used for operations	5,503	4,771
Total operating revenues	2,191,104	1,967,306
Operating expenses:		
Salaries and benefits	890,497	839,916
Professional services	25,329	22,118
Supplies	294,543	271,026
Purchased services	490,096	453,532
Provision for doubtful accounts, net	82,247	68,426
Depreciation and amortization	96,918	96,198
Interest	45,821	39,749
Other	171,978	153,058
Expense recoveries from related parties	(78,902)	(76,787)
Total operating expenses	2,018,527	1,867,236
Income from operations	172,577	100,070
Interest and investment income	7,295	4,240
Increase in value of University managed pools	116,058	68,138
Interest rate swaps mark to market adjustments	672	(79,054)
Loss on extinguishment of debt	-	(12,994)
Excess of revenues over expenses	296,602	80,400
Other changes in unrestricted net assets:		
Transfer to Stanford University, net	(6,968)	(7,956)
Transfer to University Healthcare Alliance	(13,224)	-
Transfer from Lucile Salter Packard Children's Hospital	5,859	-
Change in net unrealized gains on investments	(186)	680
Net assets released from restrictions used for:		
Purchase of property and equipment	3,590	11,872
Change in pension and postretirement liability	12,902	(30,467)
Noncontrolling capital contribution, net	3,425	-
Increase in unrestricted net assets	302,000	54,529
Changes in temporarily restricted net assets:		
Transfer from Stanford University	352	2,789
Transfer from (to) Lucile Salter Packard Children's Hospital	3	(10)
Contributions and other	128,475	34,729
Investment income	364	140
Gains on University managed pools	2,422	2,106
Net assets released from restrictions for:		
Operations	(5,503)	(4,771)
Purchase of property and equipment	(3,590)	(11,872)
Increase in temporarily restricted net assets	122,523	23,111
Increase in net assets	424,523	77,640
Net assets, beginning of year, as previously reported	884,646	807,006
Cumulative effect of change in accounting principle	2,316	-
Net assets, beginning of year, as adjusted	886,962	807,006
Net assets, end of year	$ 1,311,485	$ 884,646

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

Stanford Hospital and Clinics and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended August 31, 2011 and 2010
(in thousands of dollars)

	2011	2010
Cash flows from operating activities:		
Increase in net assets	$ 424,523	$ 77,640
Cumulative effect of change in accounting principle	2,316	-
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Noncontrolling interests in subsidiaries	(10,649)	-
Transfer of Menlo Health Alliance net assets to UHA	8,324	-
Loss on extinguishment of debt	-	12,994
Depreciation and amortization of bond premiums/discounts	95,940	96,535
Provision for doubtful accounts	82,247	68,426
Change in fair value of interest rate swaps	(672)	79,054
Increase in value of University managed pools	(116,058)	(68,138)
Unrealized gains on investments	(1,371)	(1,755)
Realized gains on investments	(31)	(110)
Contributions received for long lived assets or endowment and net equity transfers to/from related parties	(114,158)	(25,779)
Premiums received from bond issuance	1,534	14,236
Changes in operating assets and liabilities:		
Patient accounts receivable	(113,343)	(73,680)
Due to related parties	1,209	(4,933)
Other receivables, inventory, other assets, prepaid expenses and other	(10,934)	(10,036)
Accounts payable, accrued liabilities and pension liabilities	11,784	(9,285)
Accrued salaries and related benefits	(6,249)	9,543
Third-party payor settlements	2,752	474
Self-insurance reserves	(1,256)	16,946
Cash provided by operating activities	255,908	182,132
Cash flows from investing activities:		
Purchases of investments	(47,867)	(20,095)
Sales of investments	11,112	16,660
Purchases of investments in University managed pools	(50,984)	(78,099)
Sales of investments in University managed pools	1,058	4,530
Decrease in assets limited as to use and other	4	48,116
Purchases of property and equipment	(109,241)	(124,300)
Cash used in investing activities	(195,918)	(153,188)
Cash flows from financing activities:		
Proceeds from issuance of debt	272,365	366,415
Costs of issuance of debt	(1,802)	(3,665)
Payment of long-term debt and capital lease obligations	(280,817)	(390,661)
Contributions received for long lived assets or endowment and net equity transfers to/from related parties	30,524	1,809
Cash provided by (used in) financing activities	20,270	(26,102)
Net increase in cash and cash equivalents	80,260	2,842
Cash and cash equivalents, beginning of year	334,344	331,502
Cash and cash equivalents, end of year	$ 414,604	$ 334,344
Supplemental disclosures of cash flow information:		
Interest paid	$ 45,551	$ 40,042
Supplemental disclosures of non cash information:		
Payables for property and equipment	$ (503)	$ (8,784)
Equity transfers (to) from related parties, net	(6,624)	6,022

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

1. Organization

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

The Board of Trustees of Leland Stanford Junior University (the "University") is the sole corporate member of Stanford Hospital and LPCH. As part of their ongoing operations, Stanford Hospital and LPCH engage in certain related party transactions as described further in Note 13.

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

Stanford Hospital's interest in MHA was 100% for the four month period ended December 31, 2010 and the year ended August 31, 2010. Effective January 1, 2011, MHA's tax identification number was utilized to create University Healthcare Alliance ("UHA"). Stanford Hospital transferred all existing assets and liabilities of MHA to UHA, which totaled $8,324 at January 1, 2011, and is reflected as an equity transfer on the consolidated statements of operations and changes in net assets. UHA, a physician practice management organization, will support Stanford University Medical Center's mission of delivery of quality care to the community and conduct research and education. In addition, UHA will lead the development of a high quality clinical delivery network, built on collaboration with and sponsorship of community hospitals, on behalf of the SoM, SHC, LPCH, and UHA physicians. The SoM, SHC and LPCH comprise the three members of UHA, and appoint directors to the governing board. For the year ended August 31, 2011, SHC does not have control or exert significant influence over UHA and therefore the activities of UHA have not been consolidated or recorded using the equity method of accounting into the consolidated financial statements of SHC.

Effective January 1, 2011, SHC entered into a sponsorship agreement with UHA; whereby, SHC agreed to certain funding for the development and operation of UHA and continued additional funding for future or alternative clinical sites of UHA. Additional funding by SHC to UHA for operations and capital of $4,900 is also treated as an equity transfer and is recorded in other changes in unrestricted net assets in the statements of operations and changes in net assets.

Stanford Hospital's share of net assets in SUMIT, a captive insurance carrier, was 82.3% and 97.1% for the years ended August 31, 2011 and 2010, respectively. LPCH's share of net assets in SUMIT was 17.7% for the year ended August 31, 2011 and is recorded as a noncontrolling interest in unrestricted net assets on the consolidated balance sheets. LPCH's share of net assets in SUMIT was 2.9% for the year ended August 31, 2010 and is recorded as a minority interest in accounts payable and accrued liabilities on the consolidated balance sheets.

1. Organization (Continued)

SEROC is a joint venture between Stanford Hospital and Emanuel Medical Center ("EMC"). SEROC operates an outpatient clinic that provides radiation oncology services to patients in Turlock, California and surrounding communities. Stanford Hospital's interest in SEROC was 60% during the years ended August 31, 2011 and 2010. The remaining interest of 40% is recorded as a noncontrolling interest in unrestricted net assets on the consolidated balance sheets as of August 31, 2011. At August 31, 2010 the remaining 40% was recorded as a minority interest in accounts payable and accrued liabilities on the consolidated balance sheets.

2. Summary of Significant Accounting Policies

Principles of Consolidation
The consolidated financial statements of SHC include the accounts of Stanford Hospital and its subsidiaries, MHA (through December 31, 2010), SUMIT and SEROC, which are controlled and owned more than 50% by Stanford Hospital. All significant inter-company accounts and transactions are eliminated in the consolidation.

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

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

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

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

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

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

2. Summary of Significant Accounting Policies (Continued)

Assets Limited as to Use, Held by Trustee
Assets limited as to use include accounts held with a trustee to cover professional liability claims and consist of cash and cash equivalents. Amounts required to fund current liabilities of SHC have been classified as current assets in the consolidated balance sheets at August 31, 2011 and 2010.

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

Investments
Investments held directly by SHC consist of cash and cash equivalents and mutual funds and are stated at fair value. Fair value is determined in accordance with current accounting guidance as further described in Note 7. Investment earnings (including realized gains and losses on investments, interest, dividends and impairment loss on investment securities) are included in investment income unless the income or loss is restricted by donor or law. Income on investments of donor restricted funds is added to or deducted from the appropriate net asset category based on the donor's restriction. Unrestricted unrealized gains and losses on other than trading securities are separately reported below the excess of revenues over expenses.

Investments in University managed pools
Investments in University managed pools consist of funds invested in the University's Merged Pool ("MP") and Expendable Funds Pool ("EFP") (collectively the "Pools"). Under the terms of SHC's agreement with the University, the University has discretion to invest the funds in the Pools. SHC may deposit funds in the Pools at its discretion. Withdrawals from the MP and EFP require advance notice to the University. SHC accounts for its share of the Pools in accordance with current accounting guidance. The value of its share of the Pools is determined by the University and is based on the fair value of the underlying assets in the Pools.

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

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

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

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

2. Summary of Significant Accounting Policies (Continued)

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

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

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

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

Asset Retirement Obligations
Asset retirement obligations ("ARO") are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value as other long-term liabilities and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently accreted over the useful lives of the related assets. SHC recorded current period accretion expense of $317 and $324 in the consolidated statements of operations and changes in net assets for the years ended August 31, 2011 and 2010, respectively. ARO liability of $7,099 and $6,782 is included in other long-term liabilities on the consolidated balance sheets as of August 31, 2011 and 2010, respectively.

Other Assets
Other assets include deferred financing costs, long-term portion of contributions receivable, investments in Stanford PET-CT, LLC ("PET-CT") and other long-term assets.

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

PET-CT is a California limited liability company which provides radiological services to patients of the community, including patients served by SHC and physicians affiliated with the SoM. SHC and the University each appoint one-half of the members of the governing board of PET-CT and are its only members. SHC's interest in PET-CT was 50% for the years ended August 31, 2011 and 2010. As SHC has 50% ownership and does not have control, these investments are recorded using the equity method.

2. Summary of Significant Accounting Policies (Continued)

Contributions Receivable

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

Premiums and Discounts on Long-Term Debt

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

Interest Rate Swap Agreements

SHC has entered into several interest rate swap agreements, also known as risk management or derivative instruments, to reduce the effect of interest rate fluctuation on its variable rate bonds. SHC designates at inception whether the swap agreement is considered hedging or non-hedging for accounting purposes in accordance with current accounting guidance. All swaps are recognized on the consolidated balance sheets at their fair value in accordance with current accounting guidance. The net cash payments or receipts under the interest rate swap agreements have been recorded as an increase (decrease) to interest expense.

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

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

Excess of Revenues over Expenses

The consolidated statements of operations include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, include transfers of assets to and from affiliates for other than goods and services, change in unrealized gains and losses on marketable investments, contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), changes in pension and postretirement liability and other changes related to noncontrolling interests.

2. Summary of Significant Accounting Policies (Continued)

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers including Medicare and Medi-Cal, and others for services rendered, including estimated retroactive audit adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. Contracts, laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates may change by a material amount in the near term.

Charity Care

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

Income Taxes

Stanford Hospital is a not-for-profit corporation and tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code. Stanford Hospital has no uncertain tax positions pertaining to unrelated business income. SUMIT is currently exempt from all taxes until March 28, 2016.

Self-Insurance Plans

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

- ***Professional Liability*** — SHC is self-insured through SUMIT for medical malpractice and general liability losses under claims-made coverage. SHC also maintains professional liability reserves for claims not covered by SUMIT which totals $5,756. Since September 1, 2005, SUMIT has retained 100% of the risk related to the first $15,000 per occurrence. The next $115,000 is transferred to various reinsurance companies. Prior to September 1, 2005, SHC maintained various coverage limits.

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

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

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

2. Summary of Significant Accounting Policies (Continued)

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

Concentration of Credit Risk
Financial instruments, which potentially subject SHC to concentrations of credit risk, consist principally of cash and cash equivalents, patient accounts receivable, and investments in University managed pools.

SHC's concentration of credit risk relating to patient accounts receivable is limited by the diversity and number of patients and payers. Patient accounts receivable consist of amounts due from commercial insurance companies, governmental programs, private pay patients and other third-party payers.

Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant estimates relate to patient accounts receivable allowances, amounts due to third party payers, retirement plan obligations, and self insurance reserves. Actual results could differ from those estimates.

Recent Pronouncements
The Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") is the sole source of authoritative non-governmental U.S. generally accepted accounting principles ("U.S. GAAP").

During 2011, SHC adopted guidance on noncontrolling interests applicable to not-for-profit entities, which requires that the noncontrolling interests of consolidated entities be reported as a component of unrestricted net assets. In order to conform to this new guidance, the August 31, 2011 net asset beginning balance was adjusted to incorporate these noncontrolling interests.

In January 2010, an update to the ASC was issued which expanded the required disclosures about fair value measurements. In particular, this guidance requires: (1) separate disclosure of the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements along with the reasons for such transfers; (2) information about purchases, sales, issuances and settlements to be presented separately in the reconciliation for Level 3 fair value measurements; (3) fair value measurement disclosures for each class of assets and liabilities; and (4) disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements that fall in either Level 2 or Level 3. This guidance is effective for the fiscal year beginning September 1, 2010 except for (2) above which is effective for the fiscal year beginning September 1, 2011. This guidance did not impact SHC's financial statement disclosures.

2. Summary of Significant Accounting Policies (Continued)

Recent Pronouncements (continued)
For the fiscal year ending August 31, 2012, SHC will be required to disclose or record the impact of two updates to the ASC which will require cost to be used as the measurement for charity care disclosure purposes and will eliminate the ability for health care entities to net insurance recoveries against related claim liabilities. SHC does not believe these accounting standards will have a material impact on the financial position of the hospital or disclosures required in the financial statements.

3. Net Patient Service Revenue

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

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

  Inpatient non-acute services, certain outpatient services and medical education costs related to Medicare beneficiaries are paid based, in part, on a cost reimbursement methodology. SHC is reimbursed for cost reimbursable items at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The estimated amounts due to or from the program are reviewed and adjusted annually based on the status of such audits and any subsequent appeals. Differences between final settlements and amounts accrued in previous years are reported as adjustments to net patient service revenue in the year examination is substantially completed. SHC's Medicare cost reports have been audited by the Medicare fiscal intermediary through August 31, 2004.

  Professional services are reimbursed based on a fee schedule.

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

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

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

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

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

(in thousands of dollars)

3. Net Patient Service Revenue (Continued)

Amounts due from Blue Cross, Medicare, and Blue Shield as a percentage of net patient accounts receivable at August 31 are as follows:

	2011	2010
Blue Cross	22%	20%
Medicare	14%	15%
Blue Shield	10%	10%

SHC does not believe significant credit risks exist with these payers.

SHC recognized net patient service revenue of $2,816 and $5,271 as a result of prior years favorable developments related to reimbursement for the years ended August 31, 2011 and 2010, respectively. SHC also recognized revenues of $2,372 and $2,662 as a result of prior years appeals settled during the years ended August 31, 2011 and 2010, respectively.

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

	2011	2010
Medicare	$ 420,799	$ 380,837
Medi-Cal	66,112	32,175
Managed Care - Capitation	31	7,296
Managed Care - Discounted Fee for Services	1,392,481	1,252,327
Self pay and other	201,952	173,204
Related party	42,341	45,503
Total	$ 2,123,716	$ 1,891,342

Provider Fee

The State of California enacted AB 1383 in 2009, as amended by AB 1653 in 2010, which established a Hospital Quality Assurance Fee Program ("QAF") and a Hospital Fee Program. These programs imposed a provider fee on California general acute care hospitals that, combined with federal matching funds, would be used to provide supplemental payments to certain hospitals and support the State's effort to maintain health care coverage for children. The effective period of the Hospital Fee Program was April 1, 2009 through December 31, 2010. The State received final approval from the Centers for Medicare & Medicaid Services ("CMS") in December of 2010 on the rates to pay Medi-Cal managed care plans.

For the year ended August 31, 2011, SHC recognized $37,421 in net revenue for Medi-Cal Fee-For-Service ("FFS") and Managed Care supplemental payments and $29,535, in other expense for QAF paid to California Department of Health Care Services ("DHCS").

(in thousands of dollars)

3. Net Patient Service Revenue (Continued)

Provider Fee (continued)
SB 90, which passed in 2011, extended the QAF program for another six months, from January 1, 2011 through June 30, 2011. For the year ended August 31, 2011, SHC submitted QAF to the DHCS and received FFS related to this six month extension. However, in order to recognize any of the components of the QAF Program as Expenses and Hospital Fee Program as Revenue, all items of SB 90 had to have been approved by CMS as of August 31, 2011. CMS did not provide their approvals by August 31, 2011 and, as a result, SHC recorded $14,284 of FFS in accounts payable and accrued liabilities and $9,900 of QAF in prepaid expenses and other. Managed care expected payments as part of this six month extension were not recorded, as they have not been paid, nor have they been approved by CMS.

4. Charity Care and Uncompensated Costs

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

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

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

	2011	2010
Charity care at established rates	$ 86,190	$ 72,665
Estimated cost of charity care	$ 21,677	$ 18,839

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

	2011	2010
Charity care	$ 21,677	$ 18,839
Medi-Cal	87,994	85,406
Medicare	95,252	94,804
Total	$ 204,923	$ 199,049

5. Contributions Receivable

Contributions receivable and contribution revenue are included in the financial statements in the appropriate net asset category. Contributions are recorded at the discounted net present value of the future cash flows, adjusted for the risk of donor default, using discount rates ranging from 0.11% to 0.37% as of 2011 and 2010.

(in thousands of dollars)

5. Contributions Receivable (Continued)

Contributions receivable at August 31 are expected to be realized in the following periods:

	2011	2010
In one year or less	$ 14,157	$ 11,703
Between one year and five years	61,124	33,397
More than five years	65,859	6,717
	141,140	51,817
Less: discount/allowance	(5,431)	(5,154)
Total contributions receivable, net	135,709	46,663
Less: current portion	(14,101)	(11,551)
Contributions receivable, net of current portion	$ 121,608	$ 35,112

Contributions receivable at August 31 are to be utilized for the following purposes:

	2011	2010
Plant replacement and expansion	$ 139,195	$ 51,664
Indigent care and other	1,945	153
Total	$ 141,140	$ 51,817

Conditional pledges, which depend on the occurrence of a specified future and uncertain event, were $49,700 at August 31, 2011 and were not recorded in the consolidated balance sheets.

6. Investments and Investments in University Managed Pools

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

	2011		2010	
	Cost	Fair Value	Cost	Fair Value
Investments:				
Cash and cash equivalents	$ 71,118	$ 71,118	$ 34,634	$ 34,634
Mutual funds	44,439	46,299	44,137	46,183
Total	$ 115,557	$ 117,417	$ 78,771	$ 80,817

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

	Fair Value	
	2011	2010
Investments in University managed pools:		
Merged Pool	$ 840,228	$ 672,495
Expendable Funds Pool	3,911	4,103
Total	$ 844,139	$ 676,598

6. Investments and Investments in University Managed Pools (Continued)

The Merged Pool ("MP") is the primary investment pool in which funds are invested. The MP is invested with the objective of maximizing long-term total return. It is a unitized pool in which the fund holders purchase investments and withdraw funds based on a monthly share value. The MP's investments at August 31, 2011 and 2010 consist of approximately 1% and 4% cash and cash equivalents, 3% and 2% fixed income, 22% and 22% public equity securities, 11% and 9% real estate, 9% and 9% natural resources, 27% and 30% absolute returns, and 27% and 24% private equity securities, respectively.

7. Fair Value Measurements

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

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

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

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

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

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

(in thousands of dollars)

7. Fair Value Measurements (Continued)

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

	2011		
	Level 1	**Level 2**	**Total**
Assets			
Cash and cash equivalents	$ 414,604	$ -	$ 414,604
Assets limited as to use, held by trustee	988	-	988
Investments	71,118	46,299	117,417
Investments in University managed pools	-	844,139	844,139
Total assets	$ 486,710	$ 890,438	$1,377,148
Liabilities			
Interest rate swap instruments	$ -	$ 165,693	$ 165,693

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

8. Property and Equipment

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

	2011	**2010**
Land and improvements	$ 27,383	$ 27,369
Buildings and improvements	829,976	809,558
Equipment	626,598	605,355
	1,483,957	1,442,282
Less: Accumulated depreciation	(803,791)	(729,273)
Construction-in-progress	185,164	147,264
Property and equipment, net	$ 865,330	$ 860,273

(in thousands of dollars)

8. Property and Equipment (Continued)

Depreciation and amortization expense totaled $96,918 and $96,198 for the years ending August 31, 2011 and 2010, respectively, and is included in the consolidated statements of operations and changes in net assets.

As of August 31, 2011, medical equipment acquired under capital leases totaled $6,472 and is included in property and equipment in the consolidated balance sheet. Amortization expense under capital leases is included in depreciation expense in the consolidated statements of operations and changes in net assets. Accumulated amortization was $5,194 and $3,900 as of August 31, 2011 and 2010, respectively.

Interest expense on debt issued for construction projects and income earned on the funds held pending use are capitalized until the projects are placed in service and depreciated over the estimated useful life of the asset. Capitalized interest expense net of capitalized investment income was $1,701 and $1,283 for the years ended August 31, 2011 and 2010, respectively.

9. Long-Term Debt

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

	Year of Maturity	Interest Rates 2011/2010	Outstanding Principal 2011	Outstanding Principal 2010
Fixed Rate Obligations				
2003 Series A Revenue Bonds	2023	2.00% to 5.00%	$ 78,595	$ 83,400
2008 Series A1 Refunding Revenue Bonds	2040	2.25% to 5.15%	70,360	70,360
2008 Series A2 Refunding Revenue Bonds	2040	1.00% to 5.25%/0.26%	104,100	104,100
2008 Series A3 Refunding Revenue Bonds	2040	1.00% to 5.50%/3.45%	84,165	85,700
2010 Series A Refunding Revenue Bonds	2031	4.00% to 5.75%	149,345	149,345
2010 Series B Refunding Revenue Bonds	2036	4.50% to 5.75%	146,710	146,710
Promissory note	2014	7.03%	539	704
Variable Rate Obligations				
2008 Series B Refunding Revenue Bonds	2045	0.17%/0.24%	168,200	168,200
Total principal amounts			802,014	808,519
Unamortized original issue premiums/discounts, net			16,996	17,668
Current portion of long-term debt			(11,396)	(4,969)
Debt subject to short-term remarketing arrangements			(168,200)	(358,000)
Long-term portion, net of current portion			$ 639,414	$ 463,218

9. Long-Term Debt (Continued)

In June 2008, the California Health Facilities Financing Authority ("CHFFA"), on behalf of SHC, issued Variable Rate Demand Bonds ("VRDB's") in the aggregate principal amount of $428,500 (the "2008 Bonds") to refund its previously issued 2006 Bonds. The 2008 Bonds were comprised of $260,300 of 2008 Series A VRDB's that were issued as Series A-1, Series A-2, and Series A-3; and $168,200 of 2008 Series B VRDB's that were issued as Series B-1 and Series B-2.

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

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

In June 2011, SHC remarketed the 2008 Series A-2, A-3 and B-2 bonds in the aggregate principal amount of $272,365. SHC converted both the 2008 Series A-2 bonds from a weekly interest rate mode and the 2008 Series A-3 bonds from a multi-annual put mode to a long-term fixed interest rate mode. The remarketing of the 2008 Series A-3 bonds generated an original issue premium of approximately $1,535; that, pursuant to the requirements of the underlying documents, was used to reduce the principal amount of the bonds from $85,700 to $84,165. SHC converted the 2008 Series B-2 bonds from a weekly interest rate mode to a commercial paper mode. As a part of the conversion, the 2008 Series B-2 bonds were split into two sub-series in the amount of $42,050 each. Bonds in a commercial paper mode are remarketed for various periods that can be no longer than 270 days and are established at the beginning of each commercial paper rate period. Bondholders in a commercial paper mode have the option to tender their bonds only at the end of the commercial paper rate period.

The 2008 Series B-1 bonds are in a weekly interest rate mode and are remarketed every 7 days at the then prevailing interest rate. Bondholders in a weekly mode have the option of tendering their bonds on a weekly basis. The 2008 Series B bonds are supported by SHC's self-liquidity. In order to ensure the availability of funds in prior years, SHC had a liquidity agreement with the University. The University and SHC mutually agreed to terminate the agreement effective June 30, 2011. All of the 2008 Series B bonds are classified as current liabilities.

The 2010 Bonds, together with the 2008 Bonds and 2003 Series A Revenue Bonds are collectively referred to as the "Revenue Bonds". The Revenue Bonds are limited obligations of CHFFA and are payable solely from payments made by SHC. Payments of principal and interest on the Revenue Bonds are collateralized by a pledge against the revenues of SHC secured under a master trust indenture between SHC and the master trustee. The master trust indenture includes, among other things, limitations on additional indebtedness, liens on property, restrictions on the disposition or transfer of assets, and maintenance of certain financial ratios. SHC may redeem the Revenue Bonds, in whole or in part, prior to the stated maturities. Total debt outstanding under the master trust indenture is in the aggregate principal amounts of $801,475 and $807,815 as of August 31, 2011 and 2010, respectively.

(in thousands of dollars)

9. Long-Term Debt (Continued)

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

	Scheduled Maturities	Bonds Supported by SHC Liquidity	Total
2012	$ 11,396	$ 168,200	$ 179,596
2013	11,105	-	11,105
2014	12,588	-	12,588
2015	11,775	-	11,775
2016	13,325	-	13,325
Thereafter	573,625	-	573,625
	$ 633,814	$ 168,200	$ 802,014

The scheduled principal payments above represent the annual payments required under debt repayment schedules. The current portion of long-term obligations, including debt subject to short term remarketing arrangements, includes payments scheduled to be made in 2012 and the VRDB’s supported by SHC's liquidity. The VRDB’s supported by self liquidity provide the bondholder with an option to tender the bonds to SHC. Generally accepted accounting principles require that bonds supported by SHC's liquidity be classified as current liabilities.

The estimated fair value of the Revenue Bonds as of August 31, 2011 and 2010 was $834,517 and $832,180, respectively.

In 1998, SHC advance refunded its 1993 and 1995 bonds in the amount of $111,014 by issuing the 1998 bonds. As of August 31, 2011 and 2010, $27,295 of advance refunded bonds, which are considered extinguished, remain outstanding.

Interest Rate Swap Agreements

SHC has entered into various interest rate swap agreements (“swap agreements”) with varying maturities through November 2045. SHC uses swap agreements, also known as risk management or derivative instruments, principally to manage interest rate risk and has entered into derivatives to lock in fixed rates for anticipated issuance and refunding of debt. By using swap agreements to manage the risk of changes in interest rates, SHC exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of a derivative contract is positive, the counterparty owes SHC, which creates credit risk. When the fair value of a derivative contract is negative, SHC owes the counterparty and, therefore, it does not possess credit risk. SHC minimizes its credit risk by entering into derivative agreements with at least two counterparties and requiring the counterparty to post collateral for the benefit of SHC based on the credit rating of the counterparty and the fair value of the derivative contract. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

(in thousands of dollars)

9. Long-Term Debt (Continued)

Interest Rate Swap Agreements (continued)

SHC maintains interest rate swap programs on certain of its variable rate revenue bonds. These bonds expose SHC to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of its interest payments. To meet this objective and to take advantage of low interest rates, SHC entered into various interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. Certain of these agreements involve the exchange of fixed rate payments for variable rate payments based on a percentage of the One Month London Interbank Offered Rate ("LIBOR"). SHC has also entered into agreements for the basis exchange of variable rate payments by SHC based on a fixed percentage of LIBOR for variable rate payments from a counterparty based on scaled percentage of LIBOR. As of August 31, 2011 and 2010, this scaled percentage was 93% of One Month LIBOR, but can range from 61% to 93% based upon the One Month LIBOR Rate on the reset date.

The following is a summary of the outstanding positions under these interest rate swap agreements at August 31, 2011:

Description	Current Notional	Maturity Date	Rate Paid	Rate Received
Series 2003B	$ 48,800	11/15/2036	3.365%	70% 1-month LIBOR
Series 2003C	48,700	11/15/2036	3.365%	70% 1-month LIBOR
Series 2003D	52,500	11/15/2036	3.365%	70% 1-month LIBOR
Subtotal LIBOR Swaps	150,000			
Series 2003B	48,800	11/15/2036	70% 1-month LIBOR	93% 1-month LIBOR
Series 2003C	48,700	11/15/2036	70% 1-month LIBOR	93% 1-month LIBOR
Series 2003D	52,500	11/15/2036	70% 1-month LIBOR	93% 1-month LIBOR
Subtotal Basis Swaps	150,000 *			
Series 2008A1	70,500	11/01/2040	3.693%	70% 1-month LIBOR
Series 2008A2	104,100	11/01/2040	3.714%	70% 1-month LIBOR
Series 2008A3	85,700	11/01/2040	3.716%	70% 1-month LIBOR
Series 2008B1	84,100	11/01/2016	3.712%	70% 1-month LIBOR
Series 2008B2	84,100	11/01/2016	3.712%	70% 1-month LIBOR
Subtotal LIBOR Swaps	428,500			
Series 2012A	68,350	11/15/2045	4.081%	70% 1-month LIBOR
Series 2012B	68,375	11/15/2045	4.077%	70% 1-month LIBOR
Series 2012C	34,175	11/15/2045	4.008%	70% 1-month LIBOR
Subtotal Forward Swaps	170,900			
Total	$ 749,400 *			

* Overlay swaps not included in total notional amount.

(in thousands of dollars)

9. Long-Term Debt (Continued)

Interest Rate Swap Agreements (continued)

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

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

Description	Fair Value 2011	Fair Value 2010	Balance Sheet Location
Fixed Payment Swaps	$ (165,340)	$ (166,677)	Other long-term liabilities
Basis Swaps	(353)	312	Other long-term liabilities
Total	$ (165,693)	$ (166,365)	

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

Description	Unrealized Gains (Losses) 2011	Unrealized Gains (Losses) 2010	Statement of Operations Location
Fixed Payment Swaps	$ 1,337	$ (79,258)	Interest rate swap mark to market adjustments
Basis Swaps	(665)	204	Interest rate swap mark to market adjustments
Total	$ 672	$ (79,054)	

Certain swap agreements require posting of collateral by SHC or the counterparties should the fair market value of the swap agreements exceed a predetermined threshold dollar amount. The collateral thresholds reflect the current credit ratings issued by major credit rating agencies on SHC's and the counterparty's debt. Declines in SHC's or the counterparty's credit ratings would result in decreases in the collateral thresholds and consequently, the potential for additional collateral postings by SHC or the counterparty. In fiscal year 2010, SHC had three standby letters of credit totaling $75,000 to support collateral requirements under certain interest rate swap agreements. In fiscal year 2011, SHC had one letter of credit related to the swap agreements in the amount of $20,000. Subsequent to August 31, 2011 this was increased to $30,000. No amounts have been drawn on this letter of credit as of August 31, 2011. Other than the standby letter of credit, SHC was not required to post additional collateral as of August 31, 2011.

(in thousands of dollars)

9. Long-Term Debt (Continued)

Interest Rate Swap Agreements (continued)

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

Bond Interest Expense

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

	2011	2010
Interest and fees	$ 25,579	$ 19,684
Swap settlements	19,864	19,641
Bond interest expense	$ 45,443	$ 39,325
Interest capitalized as a cost of construction	$ 1,701	$ 1,283
Bond interest income	$ -	$ 19

10. Retirement Plans

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

Defined Contribution Retirement Plan

Employer contributions to the defined contribution retirement plan are based on a percentage of participant annual compensation. Employer contributions to this plan for SHC employees excluding LPCH leased employees (see Note 13) totaling $44,966 and $42,550 for the years ended August 31, 2011 and 2010, respectively, are included in salaries and benefits expense in the consolidated statements of operations and changes in net assets.

Defined Benefit Pension Plan

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

As of August 31, 2004, SHC assumed the pension liability of the employees leased to LPCH. SHC received $505 and $477 in cash for the years ending August 31, 2011 and 2010, respectively, which represented the current year pension expense related to LPCH leased employees.

Postretirement Medical Benefit Plan

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

(in thousands of dollars)

10. Retirement Plans (Continued)

The following tables present information on plan assets and obligations, costs, and actuarial assumptions for the Staff Pension Plan and the Postretirement Medical Benefit Plan for the years ended August 31, 2011 and 2010, respectively.

The tables for the Postretirement Medical Benefit Plan include SHC and LPCH leased employees. The total postretirement medical benefit liability was $88,206 and $90,850 as of August 31, 2011 and 2010, respectively. SHC recorded a liability within self-insurance reserves in the consolidated balance sheets of $70,661 and $73,110 as of August 31, 2011 and 2010, respectively, which represents the liability for SHC employees excluding LPCH leased employees.

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

	Staff Pension Plan Obligations		Postretirement Medical Benefits Net of Medicare Part D Subsidy	
	2011	2010	2011	2010
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 130,288	$ 112,203	$ -	$ -
Actual return on plan assets	13,814	14,555	-	-
Employer contributions	19,200	13,750	3,733	3,298
Plan settlements	-	(2,348)	-	-
Participants contributions	-	-	992	782
Benefits paid	(7,939)	(7,193)	(4,725)	(4,080)
Expenses paid	(771)	(679)	-	-
Fair value of plan assets at end of year	$ 154,592	$ 130,288	$ -	$ -
Change in benefit obligation:				
Benefit obligation at beginning of year	$ 204,917	$ 177,391	$ 90,850	$ 78,828
Service cost	2,516	1,723	2,775	2,357
Interest cost	10,000	10,559	4,157	4,458
Plan settlements	-	(1,872)	-	-
Participants contributions	-	-	992	782
Benefits paid	(7,939)	(7,193)	(4,725)	(4,080)
Expenses paid	(771)	(679)	-	-
Actuarial (gain) loss	(2,562)	24,988	(5,843)	8,505
Benefit obligation at end of year	$ 206,161	$ 204,917	$ 88,206	$ 90,850

(in thousands of dollars)

10. Retirement Plans (Continued)

	Staff Pension Plan Obligations		Postretirement Medical Benefits Net of Medicare Part D Subsidy	
	2011	2010	2011	2010
Amounts recognized in consolidated balance sheets:				
Plan assets minus benefit obligation	$ (51,569)	$ (74,629)	$ (88,206)	$ (90,850)
Net benefit liability recognized	$ (51,569)	$ (74,629)	$ (88,206)	$ (90,850)
Amounts recognized in consolidated balance sheets consist of:				
Current liabilities	$ -	$ -	$ (4,912)	$ (4,827)
Noncurrent liabilities	(51,569)	(74,629)	(83,294)	(86,023)
Net benefit liability recognized	$ (51,569)	$ (74,629)	$ (88,206)	$ (90,850)
Amounts recognized in accumulated other comprehensive income:				
Prior service cost	$ -	$ -	$ 3,168	$ 2,594
Net loss	79,584	87,960	3,356	9,895
Accumulated other comprehensive income	$ 79,584	$ 87,960	$ 6,524	$ 12,489

The estimated net loss for the staff pension plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year is $5,376.

The estimated net loss and prior service cost for the postretirement medical plan that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are $245 and $264, respectively.

Total benefit obligation at the end of the year for Postretirement Medical Benefits excluding Medicare Part D subsidiary decreased to $95,451.

The accumulated benefit obligation for the defined benefit pension plan was $202,509 and $200,545 as of August 31, 2011 and 2010, respectively.

(in thousands of dollars)

10. Retirement Plans (Continued)

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

	Staff Pension Plan Obligations	
	2011	**2010**
Service cost	$ 2,516	$ 1,723
Interest cost	10,000	10,559
Expected return on plan assets	(12,896)	(12,588)
Amortization of net actuarial loss	4,896	1,120
Total net periodic benefit cost	$ 4,516	$ 814

	Postretirement Medical Benefits			
	Net of Medicare Part D Subsidy		Excluding Medicare Part D Subsidy	
	2011	**2010**	**2011**	**2010**
Service cost	$ 2,775	$ 2,357	$ 2,779	$ 2,367
Interest cost	4,157	4,458	4,516	4,891
Amortization of prior service credit	(574)	(574)	(574)	(574)
Amortization of net actuarial loss	696	105	1,267	225
Total net periodic benefit cost	$ 7,054	$ 6,346	$ 7,988	$ 6,909

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

	Staff Pension Plan Obligations		Postretirement Medical Benefits Net of Medicare Part D Subsidy	
	2011	**2010**	**2011**	**2010**
Net (gain) loss arising during period	$ (3,480)	$ 23,497	$ (5,843)	$ 8,505
Amortizations				
Prior service credit	-	-	574	574
Loss	(4,896)	(1,120)	(696)	(105)
Total recognized in other comprehensive income	$ (8,376)	$ 22,377	$ (5,965)	$ 8,974
Total recognized in net periodic benefit cost and other comprehensive income	$ (3,860)	$ 23,191	$ 1,089	$ 15,320

(in thousands of dollars)

10. Retirement Plans (Continued)

Actuarial Assumptions

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

	Staff Pension Plan Obligations		Postretirement Medical Benefits	
	2011	2010	2011	2010
Weighted-average assumptions				
Discount rate	5.03%	4.99%	4.79%	4.70%
Rate of compensation increase	5.50%	5.50%	N/A	N/A

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

	Staff Pension Plan Obligations		Postretirement Medical Benefits	
	2011	2010	2011	2010
Weighted-average assumptions				
Discount rate	4.99%	6.10%	4.70%	5.83%
Expected return on plan assets	8.00%	8.00%	N/A	N/A
Rate of compensation increase	5.50%	5.50%	N/A	N/A

To develop the assumption for the expected rate of return on plan assets, SHC considered the historical and future expected returns. The historical return of the plan assets from inception through June 30, 2011 averaged 8.1%. An independent investment consulting firm provided SHC with an estimate of the future expected returns for each asset class based on SHC's asset allocation targets. The evaluation of the historical returns and the future expected returns resulted in the use of 8.0% as the assumption for the expected return on plan assets.

To determine the accumulated post-retirement benefit obligation as of August 31, 2011, an 8.5% annual rate of increase in the pre-65 per capita costs, an 8.5% annual rate of increase in the post-65 prescription drug per capita costs, and a 7.0% rate of increase in the post-65 per capita cost of all other medical benefits were assumed for 2011, all declining gradually to 4.75% by 2024, and remaining at this rate thereafter.

Assumed healthcare cost trend rates have a significant effect on the amounts reported for the post-retirement medical benefit plan. Increasing the health care cost trend rate by 1% in each future year would increase the accumulated post-retirement benefit obligation by $2,867 and the aggregate service and interest cost by $262. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post-retirement benefit obligation by $2,605 and the aggregate service and interest cost by $236.

(in thousands of dollars)

10. Retirement Plans (Continued)

Plan Assets

SHC's staff pension plan weighted-average asset allocations as of the measurement date August 31, 2011 and 2010, respectively, by asset category are as follows:

Asset Category	August 31, 2011	August 31, 2010
Equity securities	45%	44%
Debt securities	55%	50%
Real estate	0%	6%
Total	100%	100%

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

	2011			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 701	$ -	$ -	$ 701
Mutual funds	153,891	-	-	153,891
Total assets	$ 154,592	$ -	$ -	$ 154,592

	2010			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 607	$ -	$ -	$ 607
Mutual funds	122,223	-	-	122,223
Real estate	-	-	7,458	7,458
Total assets	$ 122,830	$ -	$ 7,458	$ 130,288

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

	2011	2010
Balance, beginning of year	$ 7,458	$ 8,301
Realized (losses) gains	(2,457)	473
Unrealized gains (losses)	3,255	(1,170)
Purchases, sales, issuances and settlements (net)	(8,256)	(146)
Balance, end of year	$ -	$ 7,458

(in thousands of dollars)

10. Retirement Plans (Continued)

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

The allowable asset mix range and target asset allocations are:

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

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

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

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

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

Concentration of Risk
SHC manages a variety of risks, including market, credit, and liquidity risks, across plan assets through investment managers. Concentration of risk is defined as an undiversified exposure to one of the above–mentioned risks that increases the exposure of the loss of plan assets unnecessarily. Risk is minimized by diversifying our exposure to such risks across a variety of instruments, markets, and counterparties. As of August 31, 2011, SHC did not have concentrations of risk in any single entity, manager, counterparty, sector, industry or country.

(in thousands of dollars)

10. Retirement Plans (Continued)

Expected Contributions

SHC expects to contribute $9,320 to its Staff Pension Plan for both SHC and LPCH leased employees during the fiscal year ending August 31, 2012. SHC expects to contribute $4,912 to its Postretirement Medical Plan for both SHC and LPCH leased employees during the fiscal year ending August 31, 2012.

Expected Benefit Payments

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

			Postretirement Medical Benefits	
		Pension Benefits	Net of Medicare Part D Subsidy	Excluding Medicare Part D Subsidy
2012		$ 9,711	$ 4,912	$ 5,427
2013		10,349	5,468	6,040
2014		11,036	5,947	6,579
2015		11,770	6,331	7,027
2016		12,421	6,614	7,376
2017 - 2021		69,696	33,609	38,338

11. Unrestricted Net Assets

The changes in consolidated unrestricted net assets attributable to the controlling financial interest of SHC and the noncontrolling interests, for the years ended August 31, are as follows:

	Unrestricted Net Assets		
	Total	Controlling Interest	Noncontrolling Interests
Balance September 1, 2009	$ 730,563	$ 730,563	$ -
Excess of revenues over expenses	80,400	80,400	-
Other changes in unrestricted net assets	(25,871)	(25,871)	-
Balance August 31, 2010	785,092	785,092	-
Cumulative effect of change in accounting principle	2,316	-	2,316
Excess of revenues over expenses	296,602	291,634	4,968
Noncontrolling capital contribution, net	3,425	-	3,425
Other changes in unrestricted net assets	1,973	2,033	(60)
Balance August 31, 2011	$ 1,089,408	$ 1,078,759	$ 10,649

(in thousands of dollars)

12. Temporarily and Permanently Restricted Net Assets

Temporarily Restricted Net Assets

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

	2011	2010
Plant replacement and expansion	$ 186,940	$ 66,579
Other patient services	15,997	14,134
Indigent care	5,573	5,653
Clinical services	3,687	3,483
Education	3,388	3,213
Total	$ 215,585	$ 93,062

Permanently Restricted Net Assets

In 2009, California adopted a version of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). SHC has interpreted UPMIFA as requiring the preservation of the original gift as of the gift date of donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, SHC classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure in a manner consistent with the standard of prudence prescribed by UPMIFA.

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

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

Endowment funds by net asset classification as of August 31, 2011 and 2010 are as follows:

	2011			2010		
	Temporarily Restricted	Permanently Restricted	Total	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment	$ 7,028	$ 5,611	$ 12,639	$ 5,435	$ 5,611	$ 11,046
Pledge receivable	-	881	881	-	881	881
Total endowment	$ 7,028	$ 6,492	$ 13,520	$ 5,435	$ 6,492	$ 11,927

(in thousands of dollars)

12. Temporarily and Permanently Restricted Net Assets (Continued)

Changes in SHC's endowment for the years ended August 31, 2011 and 2010 are as follows:

	2011			2010		
	Temporarily Restricted	Permanently Restricted	Total	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 5,435	$ 6,492	$ 11,927	$ 4,373	$ 6,492	$ 10,865
Investment return:						
Investment income	289	-	289	98	-	98
Mark to market adjustments	1,557	-	1,557	1,075	-	1,075
Total investment return	1,846	-	1,846	1,173	-	1,173
Expenditures	(253)	-	(253)	(111)	-	(111)
Endowment net assets, end of year	$ 7,028	$ 6,492	$ 13,520	$ 5,435	$ 6,492	$ 11,927

The following provides descriptions of amounts classified as permanently restricted net assets and temporarily restricted net assets (endowment only). The portion of endowment funds that is required to be retained permanently or temporarily, either by explicit donor stipulation or by California UPMIFA, as of August 31, 2011 and 2010 is as follows:

	2011			2010		
	Temporarily Restricted	Permanently Restricted	Total	Temporarily Restricted	Permanently Restricted	Total
Clinical services	$ 784	$ 4,000	$ 4,784	$ 279	$ 4,000	$ 4,279
Education	2,686	1,235	3,921	2,109	1,235	3,344
Plant replacement and expansion	6	901	907	2	901	903
Indigent care and other	3,552	356	3,908	3,045	356	3,401
Total endowment classified as net assets	$ 7,028	$ 6,492	$ 13,520	$ 5,435	$ 6,492	$ 11,927

All of SHC's endowment, totaling $13,520 and $11,927 at August 31, 2011 and 2010, respectively, are invested in the MP. The funds are held in perpetuity and invested to generate income to support operating and strategic initiatives.

Return Objectives and Risk Parameters

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

Strategies Employed for Achieving Investment Objectives

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

13. Related-Party Transactions

Transactions with the University and SoM

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

13. Related-Party Transactions (Continued)

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

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

Services provided by the SoM include physician services that benefit SHC, such as emergency room coverage, physicians providing medical direction to SHC, and physicians providing service to the clinical practice, which are covered by the Professional Services Agreement ("PSA"). Such expenses are reflected as purchased services in the consolidated statements of operations and changes in net assets, and total $291,936 and $264,846 for the years ended August 31, 2011 and 2010, respectively.

Services provided by the University include telecommunications, transportation, utilities, blood products, and certain administrative services, which consist of legal and internal audit. Total costs incurred by SHC were $87,266 and $86,214 for the years ended August 31, 2011 and 2010, respectively, and are reflected in various categories in the consolidated statements of operations and changes in net assets.

SHC paid service fees to the University in the amount of $3,461 and $3,564 for the years ended August 31, 2011 and 2010, respectively. The service fees represent costs for the utilization of infrastructure owned by the University such as road improvements, parking garages and generators and are reflected in the consolidated statements of operations and changes in net assets as other expense. Expected payments over the next 22 years total $35,116. Annual service fees range from approximately $3,394 for the year ending August 31, 2012 to $453 for the year ending August 31, 2033.

SHC also received payment for services provided to the University including primarily building maintenance, housekeeping, and security. Costs incurred by SHC in providing these services are reflected in the respective categories in the consolidated statements of operations and changes in net assets. Reimbursement from the University totaled $33,051 and $32,564 for the years ended August 31, 2011 and 2010, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

In addition, SHC received certain grant monies for clinical trials from the University. Grant revenue totaled $7,334 and $6,613 for the years ended August 31, 2011 and 2010, respectively, and is reflected in the consolidated statements of operations and changes in net assets as net patient service revenue and recoveries.

During the year ended August 31, 2004, SHC paid $5,500 to the University. The amount represented a prepayment of a 51 year lease for property owned by the University. The short term portion of $108 is included in prepaid expenses and other in the consolidated balance sheets as of August 31, 2011 and 2010. The remaining amount included in other assets in the consolidated balance sheets is $4,350 and $4,457 as of August 31, 2011 and 2010, respectively.

13. Related-Party Transactions (Continued)

Transactions with the University and SoM (continued)
For the years ended August 31, 2011 and 2010, SHC transferred $6,400 and $6,249, respectively, to the University related to academic grants.

SHC received equity transfers of $352 and $2,789 during the years ended August 31, 2011 and 2010, respectively, which represented gifts originally donated to the University. These gifts were subsequently re-designated mostly for SHC capital projects.

Transactions with LPCH
Shared Services - SHC and LPCH share certain departments, including facilities design and construction, materials management, managed care contracting, payroll, compliance, risk management and general services. Shared service costs are included in the respective categories on the consolidated statements of operations and changes in net assets, and are allocated between SHC and LPCH based on negotiated rates. Reimbursement received from LPCH totaled $17,955 and $20,438 for the years ended August 31, 2011 and 2010, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

Purchased Services - SHC provides various services to LPCH. These services include operating room, cardiac catheterization, interventional radiology, radiation oncology and laboratory. The cost of these services is charged back to LPCH based on a percentage of charges intended to approximate cost or a cost per procedure. Costs of these purchased services are reflected in the appropriate category in the consolidated statements of operations and changes in net assets. Reimbursement of purchased services from LPCH totaled $42,341 and $45,503 for the years ended August 31, 2011 and 2010, respectively, and is reflected in the consolidated statements of operations and changes in net assets as net patient service revenue.

Other Services - Other services provided by SHC include services provided by interns and residents, building maintenance and utilities. Reimbursement of these services totaled $22,977 and $21,197 for the years ended August 31, 2011 and 2010, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries. SHC also leased 2,884 and 2,750 full time and part time employees to LPCH during the years ended August 31, 2011 and 2010, respectively.

Equity Transfers - SHC received equity transfers of $5,859 during the year ended August 31, 2011 which represented reimbursement for capital projects.

14. Operating and Capital Leases

SHC leases various equipment and facilities under non-cancelable lease agreements expiring at various dates. Total rental expense (included in other expense in the consolidated statements of operations and changes in net assets) under these leases for the years ended August 31, 2011 and 2010 was $31,197 and $36,559, respectively.

(in thousands of dollars)

14. Operating and Capital Leases (Continued)

Net minimum future lease payments under all non-cancelable operating leases and capital lease obligations for periods subsequent to August 31, 2011 are as follows:

Year Ending August 31,	Operating	Capital
2012	$ 28,141	$ 976
2013	27,276	136
2014	19,945	57
2015	16,367	-
2016	15,846	-
Thereafter	83,728	-
	$ 191,303	1,169
Less amount representing interest		(30)
Subtotal		1,139
Current portion		(954)
Long-term portion, net of current portion		$ 185

Capital lease obligations totaled $1,139 of which $954 is included in accounts payable and accrued liabilities on the consolidated balance sheets. The remaining capital lease obligation of $185 is included in other long term liabilities on the consolidated balance sheets.

SHC leases space in its medical office building to others under non-cancelable operating lease arrangements. Future minimum base rentals to be received under these leases in place as of August 31, 2011 are as follows:

Year Ending August 31,	
2012	$ 433
2013	135
2014	56
	$ 624

15. Commitments and Contingencies

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

SHC has irrevocable standby letters of credit in the amount of $13,378, which are required as security for the workers' compensation self-insurance arrangement and $9,960 to serve as a security deposit for certain construction projects being undertaken by SHC. No amounts have been drawn on these letters of credit as of August 31, 2011.

At August 31, 2011, SHC had contractual obligations of approximately $96,739 primarily related to the construction of the new hospital and other capital projects to support SHC's operations.

15. Commitments and Contingencies (Continued)

Effective September 1, 2010, SHC entered into an eight year agreement with a global management consulting, technology services and outsourcing company, pursuant to which SHC will receive certain information technology services. Under the terms of the agreement, SHC will be charged a fixed annual service charge including expenses, payable monthly, for core services as defined, and additional fees plus expenses for special projects. The annual fixed service charges are subject to adjustment under certain conditions, but unless so adjusted, amount to approximately $41,123 for the year ending August 31, 2012, with the remaining amount of $233,587 due over the life of the contract. SHC has certain rights to reduce the scope of services to be purchased and to terminate the agreement early for a termination fee. The amount of the termination fee depends on when the right to terminate is exercised and changes monthly from $14,550 for the month ending September 30, 2011 and decreasing gradually to $1,350 for the month ending February 28, 2018.

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

The percentage of SHC employees excluding LPCH leased employees that are covered by collective bargaining arrangements is approximately 36%. There are currently no expired agreements.

California's Hospital Seismic Safety Act requires licensed acute care functions to be conducted only in facilities that meet specified seismic safety standards. Facilities classified by the State of California as non-compliant in the event of an earthquake must be retrofitted, replaced or removed from acute-care service by applicable deadlines in 2013, 2015, 2020 or 2030.

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

Amendments of the Hospital Seismic Safety Act, through SB 608, permit OSHPD to extend the structural compliance deadline for eligible hospitals from 2013 until January 1, 2016 due to local planning delays. In addition, such legislation authorizes OSHPD to grant two additional one-year extensions, until January 1, 2018, to facilities that meet certain criteria. Separately, SB 90, approved earlier in 2011, allows an extension to January 1, 2020 to hospitals that meet certain eligibility requirements. Management expects SHC to be eligible for such extensions under both SB 90 and SB 608.

(in thousands of dollars)

15. Commitments and Contingencies (Continued)

In June 2011, the Palo Alto City Council certified the Final Environmental Impact Report, land use changes, permits and a Development Agreement with SHC, LPCH and the University as part of the Renewal Project. In July 2011, the Palo Alto City Council provided final approval for the Renewal Project at the second reading of the Development Agreement. The Renewal Project will rebuild Stanford Hospital and expand LPCH to assure adequate capacity, meet State-mandated earthquake safety standards, and provide modern, technologically-advanced hospital facilities. The Renewal Project also includes replacement of outdated laboratory facilities at the SoM and remodeling of Hoover Pavilion. SHC's share of the estimated cost is approximately $2 billion. As of August 31, 2011, SHC has recorded $149 million in construction in progress related to this project.

Based on current estimated schedules, management currently projects that the Renewal Project construction will be complete in 2017.

16. Functional Expenses

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

	2011	2010
Patient services	$ 1,863,368	$ 1,699,045
Management and general	150,356	163,578
Fundraising	4,803	4,613
Total functional expenses	$ 2,018,527	$ 1,867,236

17. Subsequent Events

SHC has evaluated subsequent events occurring between the end of the most recent fiscal year and December 14, 2011, the date the financial statements were issued.