Stanford Hospital and Clinics and Subsidiaries

Consolidated Financial Statements
August 31, 2012 and 2011

Stanford Hospital and Clinics and Subsidiaries
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August 31, 2012 and 2011

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, 2012 and 2011 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 12, 2012

Stanford Hospital and Clinics and Subsidiaries
Consolidated Balance Sheets
August 31, 2012 and 2011
(in thousands of dollars)

	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	$ 509,119	$ 414,604
Assets limited as to use, held by trustee	510	279
Patient accounts receivable, net of allowance for doubtful accounts of $85,000 and $79,000 at August 31, 2012 and 2011, respectively	324,929	287,211
Other receivables	86,970	31,965
Inventories	23,406	19,657
Prepaid expenses and other	15,092	22,230
Total current assets	960,026	775,946
Investments	84,260	117,417
Investments in University managed pools	971,436	844,139
Assets limited as to use, held by trustee, net of current portion	529,097	709
Property and equipment, net	973,160	865,330
Other assets	312,969	145,808
Total assets	$ 3,830,948	$ 2,749,349
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued liabilities	$ 174,351	$ 124,487
Accrued salaries and related benefits	118,188	92,965
Due to related parties	33,542	28,219
Third-party payor settlements	24,543	22,659
Current portion of long-term debt	10,664	11,396
Debt subject to short-term remarketing arrangements	228,200	168,200
Self-insurance reserves and other	25,341	23,125
Total current liabilities	614,829	471,051
Self-insurance reserves and other, net of current portion	105,267	101,679
Other long-term liabilities	246,129	174,151
Pension liability	64,796	51,569
Long-term debt, net of current portion	1,097,797	639,414
Total liabilities	2,128,818	1,437,864
Net assets:		
Unrestricted:		
Stanford Hospital and Clinics	1,251,306	1,078,759
Noncontrolling interests	15,212	10,649
Total unrestricted	1,266,518	1,089,408
Temporarily restricted	428,021	215,585
Permanently restricted	7,591	6,492
Total net assets	1,702,130	1,311,485
Total liabilities and net assets	$ 3,830,948	$ 2,749,349

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, 2012 and 2011
(in thousands of dollars)

	2012	2011
Operating revenues:		
Net patient service revenue	$ 2,398,832	$ 2,123,685
Premium revenue	42,007	31
Provision for doubtful accounts, net	(99,110)	(82,247)
Net patient service revenue less provision for doubtful accounts	2,341,729	2,041,469
Other operating revenues	84,006	61,885
Net assets released from restrictions used for operations	4,753	5,503
Total operating revenues	2,430,488	2,108,857
Operating expenses:		
Salaries and benefits	988,008	890,497
Professional services	33,344	25,329
Supplies	325,073	294,543
Purchased services	559,776	490,096
Depreciation and amortization	94,299	96,918
Interest	48,324	45,821
Other	221,524	171,978
Expense recoveries from related parties	(76,590)	(78,902)
Total operating expenses	2,193,758	1,936,280
Income from operations	236,730	172,577
Interest and investment income	10,167	7,295
Increase in value of University managed pools	21,627	116,058
Interest rate swaps mark to market adjustments	(69,805)	672
Loss on extinguishment of debt and swaps	(3,783)	-
Excess of revenues over expenses	194,936	296,602
Other changes in unrestricted net assets:		
Transfer to Stanford University	(10,809)	(6,968)
Transfer from (to) University Healthcare Alliance	6,530	(13,224)
Transfer from Lucile Salter Packard Children's Hospital	9	5,859
Change in net unrealized gains on investments	(259)	(186)
Net assets released from restrictions used for:		
Purchase of property and equipment	3,022	3,590
Change in pension and postretirement liability	(16,319)	12,902
Noncontrolling capital contribution, net	-	3,425
Increase in unrestricted net assets	177,110	302,000
Changes in temporarily restricted net assets:		
Transfer from Stanford University	437	352
Transfer from Lucile Salter Packard Children's Hospital	-	3
Contributions and other	219,414	128,475
Transfer to permanently restricted net assets	(1,099)	-
Investment income	396	364
Gains on University managed pools	1,063	2,422
Net assets released from restrictions for:		
Operations	(4,753)	(5,503)
Purchase of property and equipment	(3,022)	(3,590)
Increase in temporarily restricted net assets	212,436	122,523
Changes in permanently restricted net assets:		
Transfer from temporarily restricted net assets	1,099	-
Increase in permanently restricted net assets	1,099	-
Increase in net assets	390,645	424,523
Net assets, beginning of year, as previously reported	1,311,485	884,646
Cumulative effect of change in accounting principle	-	2,316
Net assets, beginning of year, as adjusted	1,311,485	886,962
Net assets, end of year	$ 1,702,130	$ 1,311,485

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, 2012 and 2011
(in thousands of dollars)

	2012	2011
Cash flows from operating activities:		
Increase in net assets	$ 390,645	$ 424,523
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	(4,562)	(10,649)
Transfer of Menlo Health Alliance net assets to UHA	-	8,324
Loss on extinguishment of debt and swaps	3,183	-
Depreciation and amortization	93,073	95,940
Provision for doubtful accounts	99,110	82,247
Change in fair value of interest rate swaps	69,805	(672)
Increase in value of University managed pools	(21,627)	(116,058)
Unrealized losses (gains) on investments	184	(1,371)
Realized gains on investments	-	(31)
Contributions pledged for long lived assets or endowment and net equity transfers to/from related parties	(206,501)	(114,158)
Premiums received from bond issuance	39,974	1,534
Changes in operating assets and liabilities:		
Patient accounts receivable	(136,828)	(113,343)
Due to related parties	18,124	1,209
Other receivables, inventory, other assets, prepaid expenses and other	(44,513)	(10,934)
Accounts payable, accrued liabilities and pension liabilities	55,201	11,784
Accrued salaries and related benefits	25,223	(6,249)
Third-party payor settlements	1,884	2,752
Self-insurance reserves	5,804	(1,256)
Cash provided by operating activities	388,179	255,908
Cash flows from investing activities:		
Purchases of investments	(47,500)	(47,867)
Sales of investments	80,398	11,112
Purchases of investments in University managed pools	(106,359)	(50,984)
Sales of investments in University managed pools	764	1,058
(Increase) decrease in assets limited as to use and other	(528,619)	4
Purchases of property plant equipment and other	(191,657)	(109,241)
Cash used in investing activities	(792,973)	(195,918)
Cash flows from financing activities:		
Proceeds from issuance of debt	568,320	272,365
Costs of issuance of debt	(3,937)	(1,802)
Payment of long-term debt and capital lease obligations	(91,547)	(280,817)
Contributions received for long lived assets or endowment and net equity transfers to/from related parties	26,473	30,524
Cash provided by financing activities	499,309	20,270
Net increase in cash and cash equivalents	94,515	80,260
Cash and cash equivalents, beginning of year	414,604	334,344
Cash and cash equivalents, end of year	$ 509,119	$ 414,604
Supplemental disclosures of cash flow information:		
Interest paid	$ 56,003	$ 45,551
Supplemental disclosures of non cash information:		
Payables for property and equipment	$ 14,572	$ (503)
Equity transfers from (to) related parties, net	13,519	(6,624)

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 15.

The consolidated financial statements include Stanford Hospital's interest in University Healthcare Alliance ("UHA"), Menlo Health Alliance, LLC ("MHA") (through December 31, 2010), SUMIT Insurance Company Ltd ("SUMIT"), CareCounsel, LLC ("CareCounsel"), 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. Effective January 1, 2011, MHA's tax identification number was utilized to create 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 for fiscal year ending August 31, 2011. UHA, a physician practice management organization, supports Stanford University Medical Center's mission of delivery of quality care to the community and conduct research and education. In addition, UHA leads the development of a high quality clinical delivery network, built on collaboration with and sponsorship of community hospitals, on behalf of the SoM, SHC, and UHA physicians. The SoM and SHC are the members of UHA, and appoint directors to the governing board. 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 was $33,747 and $4,900 for the years ending August 31, 2012 and 2011, respectively.

In fiscal year 2012, the bylaws of UHA were amended and restated and the resulting effect afforded control of UHA to SHC; therefore, the activities of UHA have been consolidated in the 2012 financial statements of SHC. UHA's ending fiscal year August 31, 2011 net assets of $6,530 is recorded in other changes in unrestricted net assets in the fiscal year ended August 31, 2012 statements of operations and changes in net assets. In fiscal year ending August 31, 2012, the funding is treated as an investment in UHA and is eliminated in the consolidation. In fiscal year ending August 31, 2011, the funding is 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 74.5% and 82.3% for the years ended August 31, 2012 and 2011, respectively. LPCH's share of net assets in SUMIT was 25.5% and 17.7% for the years ended August 31, 2012 and 2011, respectively, and is recorded as a noncontrolling interest in unrestricted net assets on the consolidated balance sheets.

1. Organization (Continued)

Effective July 18, 2012, SHC acquired CareCounsel, LLC, a leading provider of employer-sponsored health advocacy and health care assistance services. The Bay Area company was founded in 1996 with a mission to help employees, retirees and their families navigate the complex health care environment through an employer-sponsored benefit that provides consumer education, advocacy and access to expert health care resources and information.

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, 2012 and 2011. The remaining interest of 40% is recorded as a noncontrolling interest in unrestricted net assets on the consolidated balance sheets as of August 31, 2012 and 2011.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements of SHC include the accounts of Stanford Hospital and its subsidiaries, UHA, MHA (through December 31, 2010), SUMIT, SEROC and CareCounsel, LLC 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.

2. Summary of Significant Accounting Policies (Continued)

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

Assets Limited as to Use, Held by Trustee
Assets limited as to use include various accounts held by a trustee in accordance with indenture requirements. The indenture terms require that the trustee control the expenditure of bond proceeds for capital projects. Assets limited as to use consist of cash and cash equivalents and short-term investments, recorded at cost, which approximates fair value. Amounts required to fund current liabilities of SHC have been classified as current assets in the consolidated balance sheets at August 31, 2012 and 2011.

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 9. 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.

(in thousands of dollars)

2. Summary of Significant Accounting Policies (Continued)

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

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

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

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

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

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

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 $286 and $317 in the consolidated statements of operations and changes in net assets for the years ended August 31, 2012 and 2011, respectively. ARO liability of $7,422 and $7,099 is included in other long-term liabilities on the consolidated balance sheets as of August 31, 2012 and 2011, respectively.

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

2. Summary of Significant Accounting Policies (Continued)

Other Assets (Continued)
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, 2012 and 2011. As SHC has 50% ownership and does not have control, these investments are recorded using the equity method.

Contributions Receivable
Unconditional promises to give ("contributions") are recorded at fair value at the date the promise is received. Donations for specific purposes are reported as either temporary or permanently restricted net assets. 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. All swaps are recognized on the consolidated balance sheets at their fair value in accordance with current accounting guidance. Changes in the fair value of interest rate swaps are included in excess of revenues over expenses. The net cash payments or receipts under the interest rate swap agreements have been recorded as an increase (decrease) to interest expense.

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.

The provision for doubtful accounts is based upon management's assessment of expected net collections considering historical experience and other collection indicators. Throughout the year, Management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience. The results of this review are then used to make any modifications to the provision for doubtful accounts to establish an appropriate allowance for uncollectible accounts.

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.

Premium Revenue

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

Income Taxes

Stanford Hospital and UHA are a not-for-profit corporation and tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code. SHC has no uncertain tax positions pertaining to unrelated business income. SUMIT is currently exempt from all taxes until March 31, 2035.

2. Summary of Significant Accounting Policies (Continued)

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 $6,364. 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.

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.

2. Summary of Significant Accounting Policies (Continued)

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 2012, SHC adopted guidance to disclose or record the impact of two updates to the ASC which requires cost to be used as the measurement for charity care disclosure purposes and which eliminates the ability for health care entities to net insurance recoveries against related claim liabilities. SHC has early adopted an update to the ASC which requires reclassification of provision for doubtful accounts associated with patient service revenue from operating expense to a deduction from net patient service revenue as a separate line item. This guidance is applied retrospectively.

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.

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.

(in thousands of dollars)

3. Net Patient Service Revenue (Continued)

- ***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.

- ***Managed Care Organizations*** – 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.

- ***Uninsured -*** For uninsured patients that do not qualify for charity care, SHC recognizes revenue on the basis of its standard rates for services less an uninsured discount applied to the patient's account that approximates the average discount for managed care payers.

Patient service revenue, net of contractual allowances (but before provision for doubtful accounts) including premium revenue, by major payor for the years ended August 31 is as follows:

	2012	2011
Medicare	$ 460,560	$ 420,799
Medi-Cal	67,536	66,112
Managed Care - Capitation	42,007	31
Managed Care - Discounted Fee for Services	1,616,564	1,392,481
Self pay and other	210,767	201,952
Related party	43,405	42,341
Patient service revenue, net of contractual allowances	$ 2,440,839	$ 2,123,716
Provision for doubtful accounts, net	99,110	82,247
Net patient service revenue	$ 2,341,729	$ 2,041,469

SHC recognized net patient service revenue adjustment of $4,817 and $2,816 as a result of prior years unfavorable and favorable developments related to reimbursement for the years ended August 31, 2012 and 2011, respectively. SHC also recognized revenues of $341 and $2,372 as a result of prior years appeals settled during the years ended August 31, 2012 and 2011, respectively.

(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:

	2012	2011
Blue Cross	19%	22%
Medicare	13%	14%
Blue Shield	13%	10%

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

California Hospital Quality Assurance Fee Program

The State of California enacted legislation in 2009 which established a Hospital Quality Assurance Fee ("QAF") Program and a Hospital Fee Program. These programs imposed a provider fee on certain 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 this 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. Subsequent legislation extended the QAF and Hospital Fee programs from January 1, 2011 through June 30, 2011, which was approved by CMS in December 2011. Additional legislation extended the QAF and Hospital Fee programs from July 1, 2011 through December 31, 2013. In June 2012, CMS approved only the fee-for-service Medi-Cal supplement payments portion of this thirty month extension. The managed care supplemental payments portion of this thirty month extension is pending approval by CMS.

SHC recognized $49,645 and $37,421 in net revenue under these programs and paid $43,541 and $29,535, in other expense for QAF to the California Department of Health Care Services for the years ended August 31, 2012 and 2011, respectively.

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 communities 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:

	2012	2011
Charity care at established rates	$ 107,492	$ 86,190
Estimated cost of charity care	$ 26,592	$ 21,677

(in thousands of dollars)

4. Charity Care and Uncompensated Costs (Continued)

The estimated cost of providing charity care is based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on SHC's total expenses (less provision for doubtful accounts) divided by gross patient service charges.

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

	2012	2011
Charity care	$ 26,592	$ 21,677
Medi-Cal	112,012	115,521
Medicare	227,298	188,569
Total	$ 365,902	$ 325,767

5. The American Recovery and Reinvestment Act of 2009

The American Recovery and Reinvestment Act of 2009 ("ARRA") increased domestic spending on education, infrastructure and health care, including up to $31 billion in new spending on health information technology, most of which is for incentive payments to physicians and hospitals through the Medicare and Medicaid ("Medi-Cal") programs. On July 13, 2010, CMS issued two final rules related to the adoption and dissemination of electronic health records ("EHRs"). One of the rules defines the "meaningful use" requirements that hospitals and other providers must meet to qualify for federal incentive payments for adopting certified EHRs under ARRA, and the other final rule describes the technical capabilities required for certified EHR technology.

The Medi-Cal Electronic Health Record Incentive Program provides incentive payments to eligible hospitals, physicians and certain other professionals ("Providers") as they adopt, implement, or upgrade certified EHR technology in their first year of participation and demonstrate meaningful use for up to five remaining participation years. Medi-Cal EHR incentive payments to Providers are paid through the state Department of Health Care Services ("DHCS"), but 100% federally funded.

The Medicare incentive payments to individual hospitals are made over a four-year, front-weighted period. Hospitals that fail to become meaningful users of EHRs (and fail to submit quality data) by 2015 will be subject to penalties in the form of a reduction in Medicare payments. The Medi-Cal incentives are also received in four frontweighted annual payments, but are subject to more flexible payment and compliance standards than Medicare incentive payments. There are no Medi-Cal payment adjustments related to the failure to comply with meaningful use requirements. During the year ended August 31, 2012, the Hospital recognized $11,403 of EHR incentives related to the first year of the Medi-Cal EHR incentive program.

(in thousands of dollars)

6. 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 1.13% to 2.34% and 0.11% to 0.37% as of 2012 and 2011 respectively.

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

	2012	2011
In one year or less	$ 31,138	$ 14,157
Between one year and five years	201,327	61,124
More than five years	109,351	65,859
	341,816	141,140
Less: discount/allowance	(30,825)	(5,431)
Total contributions receivable, net	310,991	135,709
Less: current portion	(30,749)	(14,101)
Contributions receivable, net of current portion	$ 280,242	$ 121,608

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

	2012	2011
Plant replacement and expansion	$ 331,205	$ 139,195
Indigent care and other	10,611	1,945
Total	$ 341,816	$ 141,140

Conditional pledges, which depend on the occurrence of a specified future and uncertain event, were $49,700 at August 31, 2011 and were subsequently recorded in the August 31, 2012 consolidated balance sheet.

7. Assets Limited As to Use, Held by Trustee

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

	2012		2011	
	Cost	Fair Value	Cost	Fair Value
Cash and cash equivalents	$ 529,607	$ 529,607	$ 988	$ 988
Less: Current portion of assets limited as to use, held by trustee		(510)		(279)
Assets limited as to use, held by trustee, net of current portion		$ 529,097		$ 709

(in thousands of dollars)

8. Investments and Investments in University Managed Pools

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

	2012		2011	
	Cost	**Fair Value**	**Cost**	**Fair Value**
Investments:				
Cash and cash equivalents	$ 36,071	$ 36,071	$ 71,118	$ 71,118
Mutual funds	46,588	48,189	44,439	46,299
Total	$ 82,659	$ 84,260	$ 115,557	$ 117,417

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

	Fair Value	
	2012	**2011**
Investments in University managed pools:		
Merged Pool	$ 967,282	$ 840,228
Expendable Funds Pool	4,154	3,911
Total	$ 971,436	$ 844,139

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, 2012 and 2011 consist of approximately 4% and 1% cash and cash equivalents, 4% and 3% fixed income, 21% and 22% public equity securities, 11% and 11% real estate, 8% and 9% natural resources, 26% and 27% absolute returns, and 26% and 27% private equity securities, respectively.

9. 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 are 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)

9. 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:

	2012		
	Level 1	Level 2	Total
Assets			
Cash and cash equivalents	$ 509,119	$ -	$ 509,119
Assets limited as to use, held by trustee	529,607	-	529,607
Investments	36,071	48,189	84,260
Investments in University managed pools	-	971,436	971,436
Total assets	$1,074,797	$1,019,625	$2,094,422
Liabilities			
Interest rate swap instruments	$ -	$ 236,183	$ 236,183

	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

(in thousands of dollars)

10. Property and Equipment

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

	2012	2011
Land and improvements	$ 27,383	$ 27,383
Buildings and improvements	855,928	829,976
Equipment	662,902	626,598
	1,546,213	1,483,957
Less: Accumulated depreciation	(892,170)	(803,791)
Construction-in-progress	319,117	185,164
Property and equipment, net	$ 973,160	$ 865,330

Depreciation and amortization expense totaled $94,299 and $96,918 for the years ending August 31, 2012 and 2011, respectively, and is included in the consolidated statements of operations and changes in net assets.

As of August 31, 2012, 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 $6,293 and $5,194 as of August 31, 2012 and 2011, 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 $7,063 and $1,701 for the years ended August 31, 2012 and 2011, respectively.

(in thousands of dollars)

11. Long-Term Debt

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

	Year of Maturity	Interest Rates 2012/2011	Outstanding Principal 2012	Outstanding Principal 2011
Fixed Rate Obligations				
2003 Series A Revenue Bonds	2023	2.00% to 5.00%	$ -	$ 78,595
2008 Series A1 Refunding Revenue Bonds	2040	2.25% to 5.15%	69,760	70,360
2008 Series A2 Refunding Revenue Bonds	2040	1.00% to 5.25%	103,200	104,100
2008 Series A3 Refunding Revenue Bonds	2040	1.00% to 5.50%	83,415	84,165
2010 Series A Refunding Revenue Bonds	2031	4.00% to 5.75%	144,860	149,345
2010 Series B Refunding Revenue Bonds	2036	4.50% to 5.75%	146,710	146,710
2012 Series A Revenue Bonds	2051	5.00%	340,000	-
2012 Series B Refunding Revenue Bonds	2023	2.00% to 5.00%	68,320	-
Promissory note	2014	7.03%	363	539
Variable Rate Obligations				
2008 Series B Refunding Revenue Bonds	2045	0.17%	168,200	168,200
2012 Series C Revenue Bonds	2051	0.25%	60,000	-
2012 Series D Revenue Bonds	2051	0.78%	100,000	-
Total principal amounts			1,284,828	802,014
Unamortized original issue premiums/discounts, net			51,833	16,996
Current portion of long-term debt			(10,664)	(11,396)
Debt subject to short-term remarketing arrangements			(228,200)	(168,200)
Long-term portion, net of current portion			$ 1,097,797	$ 639,414

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.

11. Long-Term Debt (Continued)

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.

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.

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.

In May 2012, CHFFA, on behalf of SHC, issued four series of revenue bonds in the aggregate principal amount of $568,320 (the "2012 Bonds"). The 2012 Bonds were comprised of $340,000 of 2012 Series A bonds, $68,320 of Series B bonds, $60,000 of Series C bonds and $100,000 of Series D bonds. Proceeds of the 2012 Series A, C and D bonds will be used to finance a portion of the new Stanford Hospital. Proceeds of the 2012 Series B bonds were used to advance refund the 2003 Series A bonds. As a result of the bond refinancing, the unamortized bond issuance costs and original issue premium related to the 2003 Series A bonds were included in loss on extinguishment of debt and swaps of $2,499 for the year ended August 31, 2012.

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 interest rate mode have the option of tendering their bonds on a weekly basis. The 2012 Series C bonds are in a Windows weekly floating index mode and cannot be tendered for 180 days after a 30 day notice and remarketing period. The 2008 Series B bonds and the 2012 Series C bonds are supported by SHC's self-liquidity and are classified as current liabilities. The 2012 Series D bonds are also in a floating index mode with monthly interest rate resets and were directly placed with U.S. Bank. The 2012 Series D bonds are not subject to remarketing or tender until May 23, 2019 and are classified as long-term liabilities.

(in thousands of dollars)

11. Long-Term Debt (Continued)

The 2012 Bonds, together with the 2010 Bonds and 2008 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 $1,284,465 and $801,475 as of August 31, 2012 and 2011, respectively.

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

	Scheduled Maturities	Bonds Supported by SHC Liquidity	Total
2013	$ 10,664	$ 228,200	$ 238,864
2014	12,654	-	12,654
2015	11,700	-	11,700
2016	13,255	-	13,255
2017	13,240	-	13,240
Thereafter	995,115	-	995,115
	$ 1,056,628	$ 228,200	$ 1,284,828

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 2013 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, 2012 and 2011 was $1,401,769 and $834,517, respectively.

In 1998, SHC advance refunded its 1993 bonds in the amount of $89,520 by issuing the 1998 Series B bonds. In 2012, SHC advance refunded its 2003 Series A bonds in the amount of $74,110 by issuing the 2012 Series B bonds. As of August 31, 2012 and 2011, $101,405 and $27,295, respectively, of advance refunded bonds, which are considered extinguished, remain outstanding.

Interest Rate Swap Agreements

SHC has entered into various interest rate swap agreements ("swap agreements") with varying maturities through November 2045. 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.

(in thousands of dollars)

11. Long-Term Debt (Continued)

Interest Rate Swap Agreements (continued)

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.

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 also had entered into three 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. In July 2012, SHC terminated these basis exchange agreements. As a result of the termination, a loss of $1,284 was included in loss on extinguishment of debt and swaps for the year ended August 31, 2012.

The following is a summary of the outstanding positions under these interest rate swap agreements at August 31, 2012:

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 2008A1	69,900	11/01/2040	3.693%	70% 1-month LIBOR
Series 2008A2	103,200	11/01/2040	3.714%	70% 1-month LIBOR
Series 2008A3	84,950	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	426,250			
Series 2012A	68,350	11/15/2045	4.081%	67% 1-month LIBOR
Series 2012B	68,375	11/15/2045	4.077%	67% 1-month LIBOR
Series 2012C	34,175	11/15/2045	4.008%	67% 1-month LIBOR
Subtotal Forward Swaps	170,900			
Total	$ 747,150			

(in thousands of dollars)

11. 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:

	Fair Value		
Description	**2012**	**2011**	**Balance Sheet Location**
Fixed Payment Swaps	$ 236,183	$ 165,340	Other long-term liabilities
Basis Swaps	-	353	Other long-term liabilities
Total	$ 236,183	$ 165,693	

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:

	Unrealized (Losses) Gains		
Description	**2012**	**2011**	**Statement of Operations Location**
Fixed Payment Swaps	$ (69,805)	$ 1,337	Interest rate swap mark to market adjustments
Basis Swaps	-	(665)	Interest rate swap mark to market adjustments
Total	$ (69,805)	$ 672	

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 years 2012 and 2011, SHC had one letter of credit related to the swap agreements in the amount of $30,000 and $20,000, respectively. No amounts have been drawn on this letter of credit as of August 31, 2012. Other than the standby letter of credit, no additional collateral was posted as of August 31, 2012.

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

(in thousands of dollars)

11. Long-Term Debt (Continued)

Bond Interest Expense

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

	2012	2011
Interest and fees	$ 28,058	$ 25,534
Swap settlements	19,926	19,864
Bond interest expense	$ 47,984	$ 45,398
Interest capitalized as a cost of construction	$ 7,063	$ 1,701

12. 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 15) totaling $45,962 and $44,082 for the years ended August 31, 2012 and 2011, respectively, and for UHA employer contributions to this plan totaling $536 for the year ended August 31, 2012, 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 $548 and $505 in cash for the years ending August 31, 2012 and 2011, 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)

12. 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, 2012 and 2011, respectively.

The tables for the Postretirement Medical Benefit Plan include SHC and LPCH leased employees. The total postretirement medical benefit liability was $87,150 and $88,206 as of August 31, 2012 and 2011, respectively. SHC recorded a liability within self-insurance reserves in the consolidated balance sheets of $70,220 and $70,661 as of August 31, 2012 and 2011, 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	
	2012	**2011**	**2012**	**2011**
Change in plan assets:				
Fair value of plan assets at beginning of year	$ 154,592	$ 130,288	$ -	$ -
Actual return on plan assets	28,675	13,814	-	-
Employer contributions	10,850	19,200	3,617	3,733
Participants contributions	-	-	1,152	992
Benefits paid	(8,448)	(7,939)	(4,769)	(4,725)
Expenses paid	(558)	(771)	-	-
Fair value of plan assets at end of year	$ 185,111	$ 154,592	$ -	$ -
Change in benefit obligation:				
Benefit obligation at beginning of year	$ 206,161	$ 204,917	$ 88,206	$ 90,850
Service cost	2,589	2,516	2,528	2,775
Interest cost	10,125	10,000	4,108	4,157
Participants contributions	-	-	1,152	992
Benefits paid	(8,448)	(7,939)	(4,769)	(4,725)
Expenses paid	(558)	(771)	-	-
Actuarial (gain) loss	40,038	(2,562)	(4,075)	(5,843)
Benefit obligation at end of year	$ 249,907	$ 206,161	$ 87,150	$ 88,206

(in thousands of dollars)

12. Retirement Plans (Continued)

	Staff Pension Plan Obligations		Postretirement Medical Benefits Net of Medicare Part D Subsidy	
	2012	2011	2012	2011
Amounts recognized in consolidated balance sheets:				
Plan assets minus benefit obligation	$ (64,796)	$ (51,569)	$ (87,150)	$ (88,206)
Net benefit liability recognized	$ (64,796)	$ (51,569)	$ (87,150)	$ (88,206)
Amounts recognized in consolidated balance sheets:				
Current liabilities	$ -	$ -	$ (4,549)	$ (4,912)
Noncurrent liabilities	(64,796)	(51,569)	(82,601)	(83,294)
Net benefit liability recognized	$ (64,796)	$ (51,569)	$ (87,150)	$ (88,206)
Amounts recognized in accumulated other comprehensive income:				
Prior service cost	$ -	$ -	$ (2,904)	$ (3,168)
Net (loss) gain	(98,972)	(79,584)	964	(3,356)
Accumulated other comprehensive income	$ (98,972)	$ (79,584)	$ (1,940)	$ (6,524)

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 $10,345.

The estimated net gain 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 $71 and $312, respectively.

Total benefit obligation at the end of the year for Postretirement Medical Benefits excluding Medicare Part D subsidiary decreased to $92,138.

The accumulated benefit obligation for the defined benefit pension plan was $245,556 and $202,509 as of August 31, 2012 and 2011, respectively.

(in thousands of dollars)

12. Retirement Plans (Continued)

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

	Staff Pension Plan Obligations	
	2012	2011
Service cost	$ 2,589	$ 2,516
Interest cost	10,125	10,000
Expected return on plan assets	(13,407)	(12,896)
Amortization of net actuarial loss	5,382	4,896
Total net periodic benefit cost	$ 4,689	$ 4,516

	Postretirement Medical Benefits			
	Net of Medicare Part D Subsidy		Excluding Medicare Part D Subsidy	
	2012	2011	2012	2011
Service cost	$ 2,528	$ 2,775	$ 2,529	$ 2,779
Interest cost	4,108	4,157	4,455	4,516
Amortization of prior service cost (credit)	264	(574)	264	(574)
Amortization of net actuarial loss	245	696	418	1,267
Total net periodic benefit cost	$ 7,145	$ 7,054	$ 7,666	$ 7,988

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	
	2012	2011	2012	2011
Net loss (gain) arising during period	$ 24,770	$ (3,480)	$ (4,075)	$ (5,843)
Amortizations				
Prior service (cost) credit	-	-	(264)	574
Loss	(5,382)	(4,896)	(245)	(696)
Total recognized in other comprehensive income	$ 19,388	$ (8,376)	$ (4,584)	$ (5,965)
Total recognized in net periodic benefit cost and other comprehensive income	$ 24,077	$ (3,860)	$ 2,561	$ 1,089

(in thousands of dollars)

12. 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	
	2012	2011	2012	2011
Weighted-average assumptions				
Discount rate	3.62%	5.03%	3.43%	4.79%
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	
	2012	2011	2012	2011
Weighted-average assumptions				
Discount rate	5.03%	4.99%	4.79%	4.70%
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, 2012 averaged 8.5%. 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, 2012, an 8% annual rate of increase in the pre-65 per capita costs, an 8% annual rate of increase in the post-65 prescription drug per capita costs, and a 6.8% rate of increase in the post-65 per capita cost of all other medical benefits were assumed for 2012, 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 $2,917 and the aggregate service and interest cost by $218. Decreasing the health care cost trend rate by 1% in each future year would decrease the accumulated post-retirement benefit obligation by $2,675 and the aggregate service and interest cost by $197.

(in thousands of dollars)

12. Retirement Plans (Continued)

Plan Assets

SHC's staff pension plan weighted-average asset allocations as of the measurement date August 31, 2012 and 2011, respectively, by asset category are as follows:

Asset Category	August 31, 2012	August 31, 2011
Equity securities	49%	45%
Debt securities	51%	55%
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 9:

	2012			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	$ 879	$ -	$ -	$ 879
Mutual funds	184,232	-	-	184,232
Total assets	$ 185,111	$ -	$ -	$ 185,111

	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

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%	50%
Debt securities	36% to 60%	50%
Real estate	0% to 12%	0%
Cash equivalents	0% to 4%	0%

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.

12. Retirement Plans (Continued)

Plan Investments (Continued)

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, 2012, SHC did not have concentrations of risk in any single entity, manager, counterparty, sector, industry or country.

Expected Contributions

SHC expects to contribute $10,220 to its Staff Pension Plan for both SHC and LPCH leased employees during the fiscal year ending August 31, 2013. SHC expects to contribute $4,549 to its Postretirement Medical Plan for both SHC and LPCH leased employees during the fiscal year ending August 31, 2013.

(in thousands of dollars)

12. Retirement Plans (Continued)

Expected Benefit Payments

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

	Pension Benefits	Postretirement Medical Benefits: Net of Medicare Part D Subsidy	Postretirement Medical Benefits: Excluding Medicare Part D Subsidy
2013	$ 10,508	$ 4,549	$ 5,052
2014	11,215	4,804	5,347
2015	11,991	5,056	5,642
2016	12,650	5,290	5,917
2017	13,235	5,545	6,211
2018 - 2022	72,794	32,543	34,218

13. 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	Unrestricted Net Assets: Controlling Interest	Unrestricted Net Assets: Noncontrolling Interests
Balance September 1, 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
Excess of revenues over expenses	194,936	190,328	4,608
Other changes in unrestricted net assets	(17,826)	(17,781)	(45)
Balance August 31, 2012	$ 1,266,518	$ 1,251,306	$ 15,212

(in thousands of dollars)

14. Temporarily and Permanently Restricted Net Assets

Temporarily Restricted Net Assets

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

	2012	2011
Plant replacement and expansion	$ 387,477	$ 186,940
Other patient services	26,746	15,997
Indigent care	6,049	5,573
Clinical services	4,191	3,687
Education	3,558	3,388
Total	$ 428,021	$ 215,585

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.

(in thousands of dollars)

14. Temporarily and Permanently Restricted Net Assets (Continued)

Endowment funds by net asset classification as of August 31, 2012 and 2011 are as follows:

	2012			2011		
	Temporarily Restricted	Permanently Restricted	Total	Temporarily Restricted	Permanently Restricted	Total
Donor restricted endowment	$ 7,231	$ 7,591	$ 14,822	$ 7,028	$ 5,611	$ 12,639
Pledge receivable	-	-	-	-	881	881
Total endowment	$ 7,231	$ 7,591	$ 14,822	$ 7,028	$ 6,492	$ 13,520

Changes in SHC's endowment for the years ended August 31, 2012 and 2011 are as follows:

	2012			2011		
	Temporarily Restricted	Permanently Restricted	Total	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 7,028	$ 6,492	$ 13,520	$ 5,435	$ 6,492	$ 11,927
Investment return:						
Investment income	397	-	397	289	-	289
Mark to market adjustments	67	-	67	1,557	-	1,557
Total investment return	464	-	464	1,846	-	1,846
Transfer from Temp Restricted Funds	-	1,099	1,099	-		-
Expenditures	(261)	-	(261)	(253)	-	(253)
Endowment net assets, end of year	$ 7,231	$ 7,591	$ 14,822	$ 7,028	$ 6,492	$ 13,520

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, 2012 and 2011 is as follows:

	2012			2011		
	Temporarily Restricted	Permanently Restricted	Total	Temporarily Restricted	Permanently Restricted	Total
Clinical services	$ 687	$ 4,000	$ 4,687	$ 784	$ 4,000	$ 4,784
Education	2,795	1,235	4,030	2,686	1,235	3,921
Plant replacement and expansion	-	-	-	6	901	907
Indigent care and other	3,749	2,356	6,105	3,552	356	3,908
Total endowment classified as net assets	$ 7,231	$ 7,591	$ 14,822	$ 7,028	$ 6,492	$ 13,520

14. Temporarily and Permanently Restricted Net Assets (Continued)

Temporarily Restricted Net Assets (Continued)

All of SHC's endowment, totaling $14,822 and $13,520 at August 31, 2012 and 2011, 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.

15. Related-Party Transactions

Transactions with the University and SoM

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

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

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

Services provided by the SoM include physician services that benefit SHC, such as emergency room coverage, physicians providing medical direction to SHC, and physicians providing service to the clinical practice, which are covered by the Professional Services Agreement ("PSA"). Such expenses are reflected as purchased services in the consolidated statements of operations and changes in net assets, and total $314,959 and $291,936 for the years ended August 31, 2012 and 2011, respectively.

Services provided by the University and other SoM non-physician services include telecommunications, transportation, utilities, blood products, and certain administrative services, which consist of legal and internal audit. Total costs incurred by SHC were $92,351 and $87,266 for the years ended August 31, 2012 and 2011, respectively, and are reflected in various categories in the consolidated statements of operations and changes in net assets.

15. Related-Party Transactions (Continued)

Transactions with the University and SoM (Continued)
SHC paid service fees to the University in the amount of $3,112 and $3,461 for the years ended August 31, 2012 and 2011, 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 21 years total $34,408. Annual service fees range from approximately $3,257 for the year ending August 31, 2013 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 $31,630 and $33,051 for the years ended August 31, 2012 and 2011, 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 $6,185 and $7,334 for the years ended August 31, 2012 and 2011, 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, 2012 and 2011. The remaining amount included in other assets in the consolidated balance sheets is $4,242 and $4,350 as of August 31, 2012 and 2011, respectively.

For the years ended August 31, 2012 and 2011, SHC transferred $8,453 and $6,400, respectively, to the University related to academic grants.

SHC received equity transfers of $437 and $352 during the years ended August 31, 2012 and 2011, 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 $19,689 and $17,955 for the years ended August 31, 2012 and 2011, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries.

(in thousands of dollars)

15. Related-Party Transactions (Continued)

Transactions with LPCH (Continued)
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 $43,405 and $42,341 for the years ended August 31, 2012 and 2011, 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 $23,250 and $22,977 for the years ended August 31, 2012 and 2011, respectively, and is reflected in the consolidated statements of operations and changes in net assets as expense recoveries. SHC also leased 3,007 and 2,884 full time and part time employees to LPCH during the years ended August 31, 2012 and 2011, respectively.

Equity Transfers - SHC received equity transfers of $9 and $5,859 during the years ended August 31, 2012 and 2011, respectively, which represented reimbursement for capital projects.

16. 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, 2012 and 2011 was $43,023 and $36,944, respectively.

Net minimum future lease payments under all non-cancelable operating leases and capital lease obligations for periods subsequent to August 31, 2012 are as follows:

Year Ending August 31,	Operating	Capital
2013	$ 30,489	$ 136
2014	23,176	57
2015	19,263	-
2016	18,797	-
2017	17,936	-
Thereafter	71,407	-
	$ 181,068	193
Less amount representing interest		(7)
Subtotal		186
Current portion		(129)
Long-term portion, net of current portion		$ 57

(in thousands of dollars)

16. Operating and Capital Leases (Continued)

Capital lease obligations totaled $186 of which $129 is included in accounts payable and accrued liabilities on the consolidated balance sheets. The remaining capital lease obligation of $57 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, 2012 are as follows:

Year Ending August 31,		
2013	$	287
2014		56
	$	343

17. 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 $13,302, 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, 2012.

At August 31, 2012, SHC had contractual obligations of approximately $97,861 primarily related to the construction of the new hospital and other capital projects to support SHC's operations.

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 services as defined, and additional fees plus expenses for special projects. Effective September 1, 2012, this agreement was amended to end on September 1, 2015. SHC has the right to extend the term of the agreement for a further period of up to twelve months. SHC may exercise such right no more than two times. The annual fixed service charges are subject to adjustment under certain conditions, but unless so adjusted, amount to approximately $17,402 for the year ending August 31, 2013, with the remaining amount of $48,147 due over the remaining 2 years 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 $3,843 for the month ending September 30, 2012 and decreasing gradually to $2,295 for the month ending August 31, 2015.

17. Commitments and Contingencies (Continued)

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

In March 2010, the Patient Protection and Affordable Care Act (the "Act") was signed into law. This Act will affect the delivery of healthcare services, reimbursement of healthcare providers and legal obligations of health insurers, providers and employers. This Act also includes a significant expansion of healthcare coverage, the use of electronic health records and changes to promote innovation and efficiency in healthcare. Some of its provisions were effective immediately; others will be phased in through 2014. The impact of this Act will likely affect SHC; however, due to the number of changes involved, the ultimate impact is uncertain at this time.

The percentage of SHC employees excluding LPCH leased employees that are covered by collective bargaining arrangements is approximately 35%. 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. At this time, SHC has pending applications on file with OSHPD for extensions under SB 608 and SB 90. An administrative extension of up to two years is expected to be received while a final determination is made regarding the actual extension for which SHC will qualify.

(in thousands of dollars)

17. 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, 2012, SHC has recorded $230 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.

18. Functional Expenses

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

	2012	2011
Patient services	$ 1,968,535	$ 1,781,121
Management and general	219,216	150,356
Fundraising	6,007	4,803
Total functional expenses	$ 2,193,758	$ 1,936,280

19. Subsequent Events

SHC has evaluated subsequent events occurring between the end of the most recent fiscal year and December 12, 2012, the date the financial statements were issued.