SEATTLE CHILDREN’S HOSPITAL

EIN No. 91-0564748
OMB Circular A-133

Supplementary Financial Report

Year ended September 30, 2009

(With Independent Auditors’ Report Thereon)
## Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Auditors’ Report</td>
<td>1</td>
</tr>
<tr>
<td>Balance Sheets</td>
<td>2</td>
</tr>
<tr>
<td>Statements of Operations and Changes in Net Assets</td>
<td>3</td>
</tr>
<tr>
<td>Statements of Cash Flows</td>
<td>5</td>
</tr>
<tr>
<td>Notes to Financial Statements</td>
<td>6</td>
</tr>
<tr>
<td>Report on Internal Control over Financial Reporting and on Compliance</td>
<td>29</td>
</tr>
<tr>
<td>and Other Matters Based on an Audit of Financial Statements Performed</td>
<td></td>
</tr>
<tr>
<td>in Accordance with Government</td>
<td></td>
</tr>
<tr>
<td>Auditing Standards</td>
<td></td>
</tr>
<tr>
<td>Report on Compliance with Requirements Applicable to Each Major</td>
<td>31</td>
</tr>
<tr>
<td>Program and on Internal Control over Compliance in Accordance with</td>
<td></td>
</tr>
<tr>
<td>OMB Circular A-133</td>
<td></td>
</tr>
<tr>
<td>Schedule of Expenditures of Federal Awards</td>
<td>33</td>
</tr>
<tr>
<td>Notes to Schedule of Expenditures of Federal Awards</td>
<td>39</td>
</tr>
<tr>
<td>Schedule of Findings and Questioned Costs</td>
<td>41</td>
</tr>
</tbody>
</table>
Independent Auditors’ Report

The Board of Trustees
Seattle Children’s Hospital:

We have audited the accompanying balance sheets of Seattle Children’s Hospital (a Washington not-for-profit corporation and a controlled affiliate of Seattle Children’s Healthcare System) (the Hospital) as of September 30, 2009 and 2008, and the related statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the balance sheet of Seattle Children’s Hospital as of September 30, 2009 and 2008 and the results of its operations and changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued our reports dated January 14, 2010, on our consideration of the Hospital’s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in assessing the results of our audits.

January 14, 2010
<table>
<thead>
<tr>
<th>Assets</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$22,366</td>
<td>8,501</td>
</tr>
<tr>
<td>Accounts receivable, net of allowance for uncollectible accounts of $1,249 in 2009 and $2,864 in 2008</td>
<td>103,537</td>
<td>87,035</td>
</tr>
<tr>
<td>Receivables from affiliates</td>
<td>10,624</td>
<td>14,069</td>
</tr>
<tr>
<td>Other current assets</td>
<td>26,409</td>
<td>25,622</td>
</tr>
<tr>
<td>Current portion of assets whose use is limited</td>
<td>15,499</td>
<td>9,612</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td><strong>178,435</strong></td>
<td><strong>144,839</strong></td>
</tr>
<tr>
<td>Assets whose use is limited:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td>173,743</td>
<td>144,785</td>
</tr>
<tr>
<td>Pooled investments held at SCHS</td>
<td>212,930</td>
<td>207,881</td>
</tr>
<tr>
<td>Investments under bond indenture and other agreements, noncurrent portion</td>
<td>72,907</td>
<td>7,005</td>
</tr>
<tr>
<td><strong>459,580</strong></td>
<td><strong>359,671</strong></td>
<td></td>
</tr>
<tr>
<td>Beneficial interest in SCHS</td>
<td>36,312</td>
<td>38,554</td>
</tr>
<tr>
<td>Land, buildings and equipment, at cost, less accumulated depreciation of $329,799 in 2009 and $302,144 in 2008</td>
<td>602,607</td>
<td>554,045</td>
</tr>
<tr>
<td>Other assets, net</td>
<td>67,747</td>
<td>14,874</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>1,344,681</strong></td>
<td><strong>1,111,983</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities and Net Assets</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current portion of long-term debt</td>
<td>$6,175</td>
<td>5,885</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>44,485</td>
<td>41,844</td>
</tr>
<tr>
<td>Accrued salaries, wages, and benefits</td>
<td>39,815</td>
<td>32,409</td>
</tr>
<tr>
<td>Other payables</td>
<td>1,676</td>
<td>1,046</td>
</tr>
<tr>
<td>Interest payable</td>
<td>4,782</td>
<td>3,727</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td><strong>96,933</strong></td>
<td><strong>84,911</strong></td>
</tr>
<tr>
<td>Other liabilities</td>
<td>48,747</td>
<td>37,485</td>
</tr>
<tr>
<td>Long-term debt, net of current portion</td>
<td>433,189</td>
<td>296,894</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td><strong>578,869</strong></td>
<td><strong>419,290</strong></td>
</tr>
<tr>
<td>Commitments and contingencies (note 10)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrestricted</td>
<td>576,152</td>
<td>503,888</td>
</tr>
<tr>
<td>Temporarily restricted</td>
<td>41,102</td>
<td>26,382</td>
</tr>
<tr>
<td>Permanently restricted</td>
<td>148,558</td>
<td>162,423</td>
</tr>
<tr>
<td><strong>Total net assets</strong></td>
<td><strong>765,812</strong></td>
<td><strong>692,693</strong></td>
</tr>
<tr>
<td><strong>Total liabilities and net assets</strong></td>
<td><strong>1,344,681</strong></td>
<td><strong>1,111,983</strong></td>
</tr>
</tbody>
</table>

See accompanying notes to financial statements.
# Statements of Operations and Changes in Net Assets

## Years ended September 30, 2009 and 2008

(In thousands of dollars)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating revenues:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net patient service revenues</td>
<td>$605,380</td>
<td>543,174</td>
</tr>
<tr>
<td>Other operating revenues</td>
<td>33,548</td>
<td>36,904</td>
</tr>
<tr>
<td>Research revenues</td>
<td>46,240</td>
<td>37,747</td>
</tr>
<tr>
<td>Net assets released from restriction for operations:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uncompensated care</td>
<td>12,430</td>
<td>15,344</td>
</tr>
<tr>
<td>Other</td>
<td>13,253</td>
<td>6,552</td>
</tr>
<tr>
<td><strong>Total operating revenues</strong></td>
<td>710,851</td>
<td>639,721</td>
</tr>
<tr>
<td><strong>Operating expenses:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries, wages, and benefits</td>
<td>333,014</td>
<td>292,407</td>
</tr>
<tr>
<td>Purchased services</td>
<td>130,875</td>
<td>134,061</td>
</tr>
<tr>
<td>Supplies and other expenses</td>
<td>132,175</td>
<td>133,592</td>
</tr>
<tr>
<td>Provision for uncollectible accounts</td>
<td>2,666</td>
<td>2,889</td>
</tr>
<tr>
<td>Depreciation</td>
<td>49,053</td>
<td>40,511</td>
</tr>
<tr>
<td>Interest</td>
<td>12,833</td>
<td>13,416</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td>660,616</td>
<td>616,876</td>
</tr>
<tr>
<td><strong>Operating income</strong></td>
<td>50,235</td>
<td>22,845</td>
</tr>
<tr>
<td><strong>Nonoperating income (expenses):</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment income, net</td>
<td>237</td>
<td>6,553</td>
</tr>
<tr>
<td>Unrealized losses on trading securities, net</td>
<td>(279)</td>
<td>(29,664)</td>
</tr>
<tr>
<td>Loss on refinancing of debt</td>
<td>—</td>
<td>(4,471)</td>
</tr>
<tr>
<td>Valuation adjustment on swap agreements</td>
<td>(9,814)</td>
<td>(6,915)</td>
</tr>
<tr>
<td>Other nonoperating expenses, net</td>
<td>(1,440)</td>
<td>(396)</td>
</tr>
<tr>
<td><strong>Net nonoperating expenses</strong></td>
<td>(11,296)</td>
<td>(34,893)</td>
</tr>
<tr>
<td><strong>Excess (deficiency) of revenues over expenses</strong></td>
<td>38,939</td>
<td>(12,048)</td>
</tr>
</tbody>
</table>
## SEATTLE CHILDREN’S HOSPITAL

**Statements of Operations and Changes in Net Assets**

Years ended September 30, 2009 and 2008

(In thousands of dollars)

<table>
<thead>
<tr>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess (deficiency) of revenues over expenses, brought forward</td>
<td>$ 38,939</td>
</tr>
<tr>
<td>Other changes in unrestricted net assets:</td>
<td></td>
</tr>
<tr>
<td>Net assets released from restriction for capital</td>
<td>1,717</td>
</tr>
<tr>
<td>Net assets used to replenish funds with deficiencies (note 5)</td>
<td>(1,655)</td>
</tr>
<tr>
<td>Transfer from SCHS (note 1)</td>
<td>33,263</td>
</tr>
<tr>
<td>Reclassification of cumulative hedge effectiveness</td>
<td>—</td>
</tr>
<tr>
<td>Increase (decrease) in unrestricted net assets</td>
<td>72,264</td>
</tr>
<tr>
<td>Changes in temporarily restricted net assets:</td>
<td></td>
</tr>
<tr>
<td>Net realized and unrealized gains (losses) on investments</td>
<td>5,778</td>
</tr>
<tr>
<td>Restricted donations</td>
<td>18,744</td>
</tr>
<tr>
<td>Net assets released from restriction</td>
<td>(27,400)</td>
</tr>
<tr>
<td>Net assets reclassified based on adoption of WA-UPMIFA (note 5)</td>
<td>15,253</td>
</tr>
<tr>
<td>Change in beneficial interest in SCHS</td>
<td>2,345</td>
</tr>
<tr>
<td>Increase (decrease) in temporarily restricted net assets</td>
<td>14,720</td>
</tr>
<tr>
<td>Changes in permanently restricted net assets:</td>
<td></td>
</tr>
<tr>
<td>Investment change, restricted by donors</td>
<td>(66)</td>
</tr>
<tr>
<td>Restricted donations</td>
<td>6,041</td>
</tr>
<tr>
<td>Net assets reclassified based on adoption of WA-UPMIFA (note 5)</td>
<td>(15,253)</td>
</tr>
<tr>
<td>Change in beneficial interest in SCHS</td>
<td>(4,587)</td>
</tr>
<tr>
<td>(Decrease) increase in permanently restricted net assets</td>
<td>(13,865)</td>
</tr>
<tr>
<td>Increase (decrease) in net assets</td>
<td>73,119</td>
</tr>
<tr>
<td>Net assets, beginning of year</td>
<td>692,693</td>
</tr>
<tr>
<td>Net assets, end of year</td>
<td>$ 765,812</td>
</tr>
</tbody>
</table>

See accompanying notes to financial statements.
# SEATTLE CHILDREN’S HOSPITAL

**Statements of Cash Flows**

Years ended September 30, 2009 and 2008

(In thousands of dollars)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash flows from operating activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase (decrease) in net assets</td>
<td>$73,119</td>
<td>(38,148)</td>
</tr>
<tr>
<td>Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>50,786</td>
<td>41,035</td>
</tr>
<tr>
<td>Provision for uncollectible accounts</td>
<td>2,666</td>
<td>2,889</td>
</tr>
<tr>
<td>Realized losses (gains) on investments, net</td>
<td>5,399</td>
<td>(6,588)</td>
</tr>
<tr>
<td>Restricted donations</td>
<td>(6,041)</td>
<td>(7,085)</td>
</tr>
<tr>
<td>Unrealized (gains) losses on investments, net</td>
<td>(2,204)</td>
<td>59,845</td>
</tr>
<tr>
<td>Equity interest in net losses of certain investments</td>
<td>—</td>
<td>4,079</td>
</tr>
<tr>
<td>Equity losses (earnings) on investments in joint venture, net of cash distributions</td>
<td>—</td>
<td>(1,230)</td>
</tr>
<tr>
<td>Change in beneficial interest in SCHS</td>
<td>2,242</td>
<td>8,159</td>
</tr>
<tr>
<td>Transfer from SCHS, net (note 1)</td>
<td>(33,263)</td>
<td>—</td>
</tr>
<tr>
<td>Loss on refinancing of debt</td>
<td>—</td>
<td>4,471</td>
</tr>
<tr>
<td>Valuation adjustment of swap agreements</td>
<td>9,814</td>
<td>7,492</td>
</tr>
<tr>
<td>Changes in assets and liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase in accounts receivable, net</td>
<td>(19,167)</td>
<td>(16,412)</td>
</tr>
<tr>
<td>Decrease (increase) in other current assets</td>
<td>2,658</td>
<td>(12,107)</td>
</tr>
<tr>
<td>(Increase) decrease in other assets</td>
<td>(26,615)</td>
<td>2,622</td>
</tr>
<tr>
<td>Increase in payables and other liabilities</td>
<td>13,179</td>
<td>5,025</td>
</tr>
<tr>
<td>Net cash provided by operating activities</td>
<td>72,632</td>
<td>54,047</td>
</tr>
<tr>
<td>Cash flows from investing activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>(92,472)</td>
<td>(56,011)</td>
</tr>
<tr>
<td>Proceeds from sale of investments</td>
<td>152,830</td>
<td>94,928</td>
</tr>
<tr>
<td>Purchases of investments</td>
<td>(261,762)</td>
<td>(95,770)</td>
</tr>
<tr>
<td>Net cash used in investing activities</td>
<td>(201,404)</td>
<td>(56,853)</td>
</tr>
<tr>
<td>Cash flows from financing activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Restricted donations</td>
<td>6,041</td>
<td>7,085</td>
</tr>
<tr>
<td>Proceeds from short-term debt</td>
<td>24,337</td>
<td>238,540</td>
</tr>
<tr>
<td>Repayment of short-term debt</td>
<td>(24,337)</td>
<td>(238,540)</td>
</tr>
<tr>
<td>Repayment of long-term debt</td>
<td>(5,885)</td>
<td>(5,630)</td>
</tr>
<tr>
<td>Proceeds from long-term debt</td>
<td>145,022</td>
<td>239,340</td>
</tr>
<tr>
<td>Retirement of long-term debt</td>
<td>—</td>
<td>(236,275)</td>
</tr>
<tr>
<td>Payment of deferred financing costs</td>
<td>(2,541)</td>
<td>(3,194)</td>
</tr>
<tr>
<td>Net cash provided by financing activities</td>
<td>142,637</td>
<td>1,326</td>
</tr>
<tr>
<td>Net increase (decrease) in cash and cash equivalents</td>
<td>13,865</td>
<td>(1,480)</td>
</tr>
<tr>
<td>Cash and cash equivalents, beginning of year</td>
<td>8,501</td>
<td>9,981</td>
</tr>
<tr>
<td>Cash and cash equivalents, end of year</td>
<td>$22,366</td>
<td>8,501</td>
</tr>
<tr>
<td>Supplemental disclosure of cash flow information:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash paid during the year for interest</td>
<td>$13,227</td>
<td>13,200</td>
</tr>
</tbody>
</table>

See accompanying notes to financial statements.
(1) Organization and Summary of Significant Accounting Policies

(a) Organization

Seattle Children’s Hospital, (the Hospital), is a not-for-profit regional pediatric medical center and research institute. The Hospital also functions as the parent organization for Seattle Children’s Research Holdings LLC (SCRH). SCRH was formed to develop, construct and lease portions of the Hospital’s research facility.

The Hospital is a member of a group of controlled corporations that have common representation on certain boards of governance. The memberships of the boards of trustees of the Hospital and Seattle Children’s Healthcare System (SCHS) are currently identical. The following are affiliates of the Hospital, each of which is a Washington not-for-profit corporation and a 501(c)(3) organization:

Seattle Children’s Healthcare System (SCHS) – The parent corporation of the Hospital and affiliated-controlled corporate entities.

Seattle Children’s Hospital Foundation (the Foundation) – A corporation established to support SCHS and its affiliates, primarily the Hospital, through fundraising activities.

Seattle Children’s Hospital Guild Association (the Guild Association) – A corporation established to support SCHS and its affiliates, primarily the Hospital, through fundraising events and memberships.

Seattle Children’s Retail (Retail) – A corporation established to support SCHS, through the operation of six thrift stores.

Children’s Physicians (CP) – A corporation established to support SCHS through cooperative arrangements with other healthcare organizations. CP is a corporate member of the Association of Children’s and University Physicians, doing business as Children’s University Medical Group.

Seattle Children’s Research Investors LLC (SCRI) – A limited liability company (LLC) formed to facilitate the development of a portion of the Hospital’s research facility by SCRH by making loans to certain entities in connection with the New Market Tax Credit financing (NMTC).

Contributions raised by the Foundation, the Guild Association and Retail have been transferred to the Hospital or to SCHS. Restricted contributions are distributed to the Hospital to comply with the purposes specified by donors.

During the years 2009 and 2008, the Hospital recorded as contributions net transfers from the Foundation and the Guild Association of $27,570 and $34,520, respectively.
In 2009, SCHS transferred land and buildings, previously recorded on the financial statements of SCHS, in the amount of $33,263 to the Hospital. These assets were acquired by SCHS for various purposes to support operations and growth of the Hospital’s business. The transferred assets are included in land, building and equipment and other assets.

(b) **Tax Exemption**

The Commissioner of the Internal Revenue Service has granted the Hospital exemption from federal income taxes under Section 501(c)(3) of the Internal Revenue Code as an organization formed to operate a hospital for charitable, educational, scientific and medical purposes.

(c) **Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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. Actual results could differ from those estimates. Critical estimate areas include the provision for uncollectible accounts and contractual allowances and self-insurance reserves for professional and general liability and workers’ compensation.

(d) **Cash and Cash Equivalents**

Included in cash and cash equivalents are cash equivalents of $17,398 and $8,478 as of September 30, 2009 and 2008, respectively, invested in money market funds, which are highly liquid investments with purchased maturities of three months or less, that are readily convertible to known amounts of cash.

(e) **Assets Whose Use is Limited**

Assets whose use is limited includes designated unrestricted assets set aside by the board of trustees for future capital and program purposes, over which the board of trustees retains control and may at its discretion subsequently use for other purposes. Assets whose use is limited also includes temporarily and permanently restricted assets and assets held by trustees under indenture and other agreements.

Investment income or losses, interest and dividend income, realized investment gains and losses and net unrealized gains or losses on trading securities are reported separately in nonoperating income and expenses in the accompanying statements of operations and changes in net assets.

Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Due to the level of risks associated with certain investment securities, it is reasonably possible that changes in the value of investments could occur in the near term and that such changes could materially affect the amounts reported in the accompanying balance sheets.
Investments

Investments carried at fair value include money market funds, corporate stocks and bonds, mutual funds, U.S. agency notes, and pooled investments held at SCHS. Cash and cash equivalents, accounts receivable, accounts payable and accrued expenses are reported at cost, which approximates the fair value because of their short-term nature.

Pooled Investments Held at SCHS

Pooled investments held at SCHS represent the Hospital’s interest in a pool of investments held and managed by SCHS. Pooled investment amounts represent the Hospital’s share of the fair value of the SCHS investment pool. Investment income and losses from the SCHS investment pool are allocated between SCHS and the Hospital based upon investment balances. The Hospital recognizes the changes in its interest in the SCHS investment pool using a method that is similar to the equity method of accounting.

Investments under Bond Indenture and Other Agreements

Investments under bond indenture and other agreements primarily include assets held by trustees under the terms of the Revenue Bonds, and certain deferred compensation arrangements. Amounts required to meet current liabilities of the Hospital have been classified as current assets in the accompanying balance sheets at September 30, 2009 and 2008.

(f) Land, Buildings and Equipment

Land, buildings and equipment are stated at cost, less accumulated depreciation. Improvements and replacements of land, buildings and equipment are capitalized. Maintenance and repairs are expensed as incurred. Interest costs incurred on borrowed funds during construction, net of interest earned on the project funds, are capitalized. In addition, interest is capitalized on those assets that require a period of time to get them ready for their intended use. The Hospital capitalized net interest of $1,294 and $1,811 in 2009 and 2008, respectively. Land, buildings and equipment consist of the following at September 30:

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and improvements</td>
<td>$76,323</td>
<td>$61,206</td>
</tr>
<tr>
<td>Buildings and improvements</td>
<td>511,309</td>
<td>477,196</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>290,474</td>
<td>270,261</td>
</tr>
<tr>
<td>Construction in progress</td>
<td>54,300</td>
<td>47,526</td>
</tr>
<tr>
<td></td>
<td>932,406</td>
<td>856,189</td>
</tr>
<tr>
<td>Less accumulated depreciation</td>
<td>(329,799)</td>
<td>(302,144)</td>
</tr>
<tr>
<td></td>
<td>$602,607</td>
<td>$554,045</td>
</tr>
</tbody>
</table>
Construction in progress primarily relates to the construction of the Bellevue clinic and surgery center and development of certain information technology projects. The Hospital has various commitments for future construction and development totaling $49,077 as of September 30, 2009.

(g) **Depreciation**

Depreciation is provided using the straight-line method, which allocates the cost of the asset ratably over its estimated useful life. An estimated life of 40 years is used for buildings and 8 to 15 years for building and land improvements. Various lives ranging from 4 to 25 years are used for furniture and equipment.

(h) **Joint Ventures and Investments in Affiliated Companies**

The equity method of accounting is used for joint ventures and investments in affiliated companies in which the Hospital has significant influence, but does not have effective control. Significant influence is generally deemed to exist when the ownership interest in the investee is at least 20% and not more than 50% of net assets, although other factors, such as representation on the investee’s board of directors, are considered in determining whether the equity method of accounting is appropriate.

(i) **Deferred Financing Costs**

Deferred financing costs are included in other assets and are amortized using the effective interest method over the term of the related outstanding obligation or over the expected repayment term of the credit facility.

(j) **Net Patient Service Revenues**

Net patient service revenues are reported at the estimated net realizable amounts from patients and third-party payors for services rendered. Approximately 43% of gross patient service charges for both 2009 and 2008 relate to services rendered to patients covered by the Medicaid program. Provisions for contractual allowances for inpatient services are recorded based on the difference between charges and estimated receipts based upon a prospective diagnosis-related groupings (DRGs) system. Payments for Medicaid outpatient services are reimbursed on a percentage of charges or a fee schedule. Provision for contractual allowances under commercial health plans is based on the payment terms of contractual arrangements.

(k) **Other Operating Revenues**

Other operating revenues primarily include revenues from a federal graduate medical education grant, the Hospital’s equity earnings from its participation in a joint venture and amounts received from Children’s University Medical Group (CUMG).
(l) **Net Assets, Endowment and Endowment Distribution**

Donations and bequests are reported at fair value at the date of donation. Such amounts are reported as either unrestricted, temporarily restricted or permanently restricted net assets, based on donor stipulations (if any) that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the accompanying statements of operations and changes in net assets as net assets released from restriction.

SCHS and the Hospital share in a Unified Endowment Fund (UEF) that is managed by SCHS. The Hospital’s temporarily and permanently restricted net assets reflect endowments whose purpose is designated to support the Hospital. The underlying investments making up the UEF assets related to these restricted net assets are held at SCHS. The UEF assets consist of separate funds established over many years for a variety of purposes. Endowment fund balances, including funds functioning as endowments, are classified and reported as permanently restricted, temporarily restricted or unrestricted net assets in accordance with donor or Board specifications. Funds functioning as endowments include board-designated named endowments and other board-designated funds. See note 5 for additional information on endowment net assets.

(m) **Reclassifications**

Certain reclassifications have been made to the 2008 information to be consistent with the current year presentation.

(n) **Recently Adopted Accounting Standards**

In June 2009, the Financial Accounting Standards Board (FASB) established the FASB Accounting Standards Codification™ (Codification) to become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. The Codification did not change GAAP, except in limited circumstances, and the content of the Codification carries the same level of GAAP authority. The GAAP hierarchy was modified to include only two levels of GAAP: authoritative and nonauthoritative. The Hospital adopted the Codification in September 2009 and as a result references to legacy GAAP accounting pronouncements in the Hospital’s financial statement disclosures have been modified to either reflect Codification citations or plain English descriptions.

In September 2006, the FASB issued Accounting Standards Codification (ASC) Topic 820 (Topic 820) *Fair Value Measurements and Disclosures*. Topic 820 defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements. Effective October 1, 2008, the Hospital adopted the provisions of Topic 820 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The adoption of topic 820 did not have a significant impact to the Hospital’s financial statements. Refer to note 4 for more information regarding the Hospital’s fair value disclosures under Topic 820.
In October 2008, the FASB issued Accounting Standards Codification (ASC) Topic 820 Subtopic 10 Section 35, which was effective immediately. ASC Topic 820 Subtopic 10 Section 35, clarifies the application of Topic 820 in cases where the market for a financial instrument is not active and provides an example to illustrate key considerations in determining fair value in those circumstances. The Hospital has considered the guidance provided by ASC Topic 820 Subtopic 10 Section 35, in its determination of estimated fair values during 2009.

Additionally, in April 2009, the FASB issued ASC Topic 820 Subtopic 10 Section 65, which is effective for periods ending after June 15, 2009. ASC Topic 820 Subtopic 10 Section 65 provides additional guidance for estimating fair value in accordance with ASC Topic 820, when the volume and level of activity for the asset or liability have significantly decreased; includes guidance on identifying circumstances that indicate a transaction is not orderly; and provides additional clarification on disclosures related to fair value. The Hospital has considered the guidance provided by ASC Topic 820 Subtopic 10 Section 65 in its determination of estimated fair values during 2009.

In conjunction with the adoption of Topic 820, the Hospital has elected to early adopt the measurement provisions of Accounting Standards Update No. 2009-12, Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent), to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. This guidance amends Topic 820 and allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent. Net asset value, in many instances may not equal fair value that would be calculated pursuant to Topic 820.

In February 2007, the FASB issued ASC Topic 825 Subtopic 10 Section 65 (Topic 825), Financial Instruments, Fair Value Option. Topic 825 permits an organization to measure certain financial instruments at fair value that are not currently required to be measured at fair value. Topic 825 permits organizations to choose, at specified election dates, to measure certain items at fair value and report unrealized gains and losses on such items in earnings. Effective October 1, 2008, the Hospital adopted Topic 825 and elected not to change the measurement of any existing financial instruments that were not previously recorded at fair value. SCHS did adopt Topic 825 in 2009 for certain pooled investments of which the Hospital has an interest. Other than that impact, which is not significant, the adoption of Topic 825 did not have an effect on the Hospital’s financial statements.

In August 2008, the FASB released guidance within ASC 958 Subtopic 205 Not-for-Profit Entities – Presentation of Financial Statements, effective for fiscal years ending after December 15, 2008. ASC 58 Subtopic 205 was updated providing guidance on the net asset classification of donor-restricted endowment funds and requires additional disclosures about an organization’s endowment funds. The Hospital adopted the updated provisions ASC 958 Subtopic 205 as of October 1, 2008. Refer to note 4 for more details.
In May 2009, the FASB issued ASC Topic 855 (Topic 855), *Subsequent Events*. Topic 855 modifies the definition of what qualifies as a subsequent event as events or transactions that occur following the balance sheet date, but before the financial statements are issued, or are available to be issued. Topic 855 requires entities to disclose the date through which it has evaluated subsequent events and the basis for determining that date. The Hospital adopted Topic 855 as of September 30, 2009. The Hospital has performed an evaluation of subsequent events through January 14, 2010, which is the date these financial statements were available to be issued.

(2) **Uncompensated and under-Compensated Care**

*Care Provided*

The Hospital provides care to patients in its region regardless of the families’ ability to pay for those services. Uncompensated and under-compensated care primarily includes the cost of patient care services for charity care and unpaid costs associated with services provided to patients covered under the Medicaid program (Medicaid payment shortfall).

The Hospital provides charity care in accordance with its charity care policy based on family need and maintains records to identify the level of charity care it provides. The determination of family need is evaluated during a patient’s course of care and can be updated after care is complete.

The following were the components of uncompensated and under-compensated care, measured at cost, for the years ended September 30:

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charity care</td>
<td>$11,180</td>
<td>8,915</td>
</tr>
<tr>
<td>Medicaid payment shortfall</td>
<td>85,225</td>
<td>77,325</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$96,405</strong></td>
<td><strong>86,240</strong></td>
</tr>
</tbody>
</table>
(3) **Investments**

*Assets Whose Use is Limited*

Investments consist of the following at September 30:

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investments:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money market</td>
<td>$53,895</td>
<td>187</td>
</tr>
<tr>
<td>Corporate stock</td>
<td>16,306</td>
<td>17,197</td>
</tr>
<tr>
<td>Corporate bonds and other debt securities</td>
<td>21,041</td>
<td>574</td>
</tr>
<tr>
<td>Mutual funds:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic debt securities</td>
<td>68,902</td>
<td>126,760</td>
</tr>
<tr>
<td>U.S. agency notes</td>
<td>13,528</td>
<td>—</td>
</tr>
<tr>
<td>Other</td>
<td>71</td>
<td>67</td>
</tr>
<tr>
<td><strong>Total Investments</strong></td>
<td>173,743</td>
<td>144,785</td>
</tr>
</tbody>
</table>

Pooled investments held at SCHS

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Held by trustee:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Principal, interest and cost of issuance funds – money market</td>
<td>11,463</td>
<td>9,612</td>
</tr>
<tr>
<td>Project fund – money market</td>
<td>69,903</td>
<td>—</td>
</tr>
<tr>
<td>Deferred compensation – mutual funds</td>
<td>7,040</td>
<td>7,005</td>
</tr>
<tr>
<td><strong>Total Held by Trustee</strong></td>
<td>88,406</td>
<td>16,617</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$475,079</td>
<td>369,283</td>
</tr>
</tbody>
</table>

Pooled investments held at SCHS are recorded at the Hospital’s share of the fair value of the SCHS investment pool. The SCHS investment pool was invested as follows at September 30 (in percentages):

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate stocks</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Mutual funds:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic equities</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>International equities</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Domestic debt securities</td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td>Alternative investments, at fair value</td>
<td>67</td>
<td>27</td>
</tr>
<tr>
<td>Alternative investments, at equity method</td>
<td>—</td>
<td>40</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>
Alternative Investments

Alternative investments included within pooled investments held at SCHS, include limited partnerships, limited liability corporations, investment trusts, institutional funds and off-shore investment funds. Included in these funds are certain types of financial instruments, including, among others, futures and forward contracts, options, swaps and securities sold not yet purchased, intended to hedge against changes in the market value of investments. These financial instruments involve varying degrees of risk. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed. Such difference could be material.

Unrestricted investment return comprises the following for the years ended September 30:

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest and dividend income</td>
<td>$3,773</td>
<td>7,794</td>
</tr>
<tr>
<td>Realized (losses) gains on investments, net</td>
<td>(3,536)</td>
<td>2,838</td>
</tr>
<tr>
<td>Equity interest in net losses of certain investments</td>
<td>—</td>
<td>(4,079)</td>
</tr>
<tr>
<td>Unrealized losses on trading securities, net</td>
<td>(279)</td>
<td>(29,664)</td>
</tr>
<tr>
<td></td>
<td>$ (42)</td>
<td>(23,111)</td>
</tr>
</tbody>
</table>

(4) Fair Value of Financial Instruments

The Hospital adopted Topic 820 effective October 1, 2008. In accordance with Topic 820, fair value is determined as the price the Hospital would receive upon selling an investment in an orderly transaction to an independent buyer in the principal or most advantageous market of the investment. Topic 820 established a three-tier hierarchy to maximize the use of observable market data and minimize the use of unobservable inputs, and to establish classification of fair value measurements for disclosure purposes. Inputs refer broadly to the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk. Inputs may be observable or unobservable. Observable inputs are inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based upon market data obtained from sources independent of the reporting entity. Unobservable inputs are inputs that reflect the reporting entity’s own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available. The three-tier hierarchy of inputs is summarized in the three broad levels below:

Level 1 – Quoted prices in active markets for identical assets or liabilities. Investments generally include certain money market funds, investments in debt and equity marketable securities, and mutual funds;

Level 2 – Other significant observable inputs. Investments generally include certain money market funds, corporate bonds and other debt securities, certain U.S. agency notes and interest rate swap agreements;

Level 3 – Significant unobservable inputs, including assets and liabilities that are traded infrequently.
The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The fair value hierarchy does not correspond to a financial instrument’s relative liquidity in the market or to its level of risk.

Investments in equity and debt securities are based on quoted market prices, if available, or estimated using quoted market prices for similar securities. The fair value of alternative investments, included within pooled investments held at SCHS, is reported based on information provided by the fund managers. Cash and cash equivalents, trustee-held funds, accounts receivable, accounts payable and accrued expenses are reported at cost, which approximates the fair value because of their short-term nature. Interest rate swaps are valued based on the net present value of the associated variable cash flows, adjusted for the Hospital’s and the respective counterparty’s nonperformance risk.

The following table presents assets and liabilities that are measured at fair value on a recurring basis (including items that are required to be measured at fair value and items for which the fair value option has been elected) at September 30, 2009:

<table>
<thead>
<tr>
<th>September 30, 2009</th>
<th>Fair value measurements at reporting date using</th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money market</td>
<td>$53,895</td>
<td>28,329</td>
<td>25,566</td>
<td></td>
</tr>
<tr>
<td>Corporate stocks</td>
<td>16,306</td>
<td>16,306</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate bonds and other debt securities</td>
<td>21,041</td>
<td></td>
<td>21,041</td>
<td></td>
</tr>
<tr>
<td>U.S. agency notes</td>
<td>13,528</td>
<td></td>
<td>13,528</td>
<td></td>
</tr>
<tr>
<td>Mutual funds:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic debt securities</td>
<td>68,902</td>
<td>68,902</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pooled investments</td>
<td>212,930</td>
<td></td>
<td></td>
<td>212,930</td>
</tr>
<tr>
<td>Trustee-held funds</td>
<td>81,366</td>
<td>81,366</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred compensation – mutual funds</td>
<td>7,040</td>
<td>7,040</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>$475,008</td>
<td>201,943</td>
<td>60,135</td>
<td>212,930</td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest rate swap agreements</td>
<td>$15,749</td>
<td></td>
<td>15,749</td>
<td></td>
</tr>
<tr>
<td>Total liabilities</td>
<td>$15,749</td>
<td></td>
<td>15,749</td>
<td></td>
</tr>
</tbody>
</table>

The fair value of long-term debt, estimated based on the quoted market prices for similar issues, was $456,199 and $290,683 at September 30, 2009 and 2008, respectively. The carrying value was $439,364 and $302,779 at September 30, 2009 and 2008, respectively.
The following table presents the Hospital’s activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in Topic 820 for the year ended September 30, 2009:

<table>
<thead>
<tr>
<th>Description</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning balance at September 30, 2008</td>
<td>$207,881</td>
</tr>
<tr>
<td>Total realized and unrealized gains, net included in income</td>
<td>338</td>
</tr>
<tr>
<td>Other changes</td>
<td>4,711</td>
</tr>
<tr>
<td>Balance at September 30, 2009</td>
<td>$212,930</td>
</tr>
</tbody>
</table>

Net unrealized gains included in income, relating to assets held at September 30, 2009 were $2,025.

(5) **Endowments and Temporary and Permanently Restricted Net Assets**

SCHS has developed policies for the endowments of SCHS and the Hospital, for which the Hospital follows. The following is a discussion of the policies for the endowments.

Effective October 1, 2008, SCHS adopted authoritative guidance that, among other things, provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Washington State Uniform Prudent Management of Institutional Funds Act of 2006 (WA-UPMIFA), and also requires enhanced disclosures for all endowment funds, including funds designated as endowments by the Board of Trustees. SCHS has interpreted WA-UPMIFA as requiring the preservation of the fair value of the original gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary.

For financial statement presentation purposes, SCHS classifies as permanently restricted net assets (a) all funds explicitly stated by the donor to be retained permanently (b) absent such stipulation, the fair value on the date of gift for gifts donated to the permanent endowment and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets represents net un-appropriated endowment investment income and is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by SCHS in a manner consistent with the standards of prudence prescribed by WA-UPMIFA. If, as a result of investment losses or appropriations (Board authorized distributions), the fair value of endowment assets is less than the donor-restricted amounts, the deficiencies are reported as reductions of SCHS unrestricted net assets.

SCHS had previously operated under an enacted version of the Uniform Management of Institutional Funds Act. Consistent with ASC 958 Subtopic 205 Sections 45 and 50, the change in law promoted a change in the net asset classification of some of SCHS’s endowments, as depicted in the tables in the following pages.
When considering appropriation for distribution or accumulation of endowment funds, absent a specially stated requirement in the gift instrument, SCHS makes a good faith application of the approved SCHS spending policy, considering (a) the duration and preservation of the fund; (b) the purposes of SCHS and the donor-restricted endowment; (c) general economic conditions; (d) the appreciation of investments; (e) other resources of SCHS; and (f) the investment policy of SCHS. The good faith application of the approved SCHS spending policy may result in the fair value of endowment assets being below the amount determined as permanently restricted net assets for financial statement presentation.

SCHS has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for donor-specified periods as well as board-designated named endowments and other board-designated funds. Under the policy, as approved by the Board, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the market average, after fees, while assuming a moderate level of investment risk. SCHS expects its endowment funds, over time, to provide a real rate of return of greater than 5% (net of fees and adjusted for inflation) as calculated based on rolling three-year periods. Actual returns in any given year may vary from this amount.

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

SCHS has a spending policy of appropriating for distribution each year 5% of the twelve quarter average market value of donor-restricted and board-designated named endowments (SCHS does not apply its spending policy to other board-designated funds). In establishing this policy, SCHS considered the long-term expected return on these endowment funds. During 2009, the Board approved resetting the 5% appropriation based on the June 30, 2009 market value and restarting the use of 12-quarter average as of September 30, 2009. Over the long term, SCHS expects the current appropriation policy to allow its endowments to grow at an average real rate of return (adjusted for inflation) of greater than 5% annually. This is consistent with SCHS’s objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the Board has interpreted WA-UPMIFA to require the Hospital to retain as permanently restricted. For the years-ended September 30, 2009 and 2008, the reduction from unrestricted net assets, related to the donor restricted amounts at the Hospital, totaled $1,655 and $2,243, respectively. The reporting of such deficiencies as a reduction of the Hospital’s unrestricted net assets does not legally create an affirmative obligation of the Hospital to restore the fair value of those funds from the Hospital’s unrestricted net assets.

In accordance with the spending policy noted above, prior to the adoption of WA-UPMIFA in 2009, as of September 30, 2008, the Hospital had a cumulative net deficiency of $6,717 resulting from the difference
between the annual total return and spending policy, which whether positive or negative was included in temporarily restricted net assets. After adoption, and the resulting reclassifications, this deficiency in temporarily restricted net assets was replenished.

Composition of Endowment by Net Asset Classification

<table>
<thead>
<tr>
<th></th>
<th>September 30, 2009</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unrestricted</td>
<td>Temporarily restricted</td>
<td>Permanently restricted</td>
<td>Total</td>
<td></td>
</tr>
<tr>
<td>Donor-restricted</td>
<td>$ (3,898)</td>
<td>4,754</td>
<td>113,208</td>
<td>114,064</td>
<td></td>
</tr>
<tr>
<td>Board-designated:</td>
<td>Named endowment funds</td>
<td>3,117</td>
<td>—</td>
<td>—</td>
<td>3,117</td>
</tr>
<tr>
<td></td>
<td>Other endowment funds</td>
<td>107,743</td>
<td>—</td>
<td>—</td>
<td>107,743</td>
</tr>
<tr>
<td></td>
<td>$ 106,962</td>
<td>4,754</td>
<td>113,208</td>
<td>224,924</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>September 30, 2008</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unrestricted</td>
<td>Temporarily restricted</td>
<td>Permanently restricted</td>
<td>Total</td>
<td></td>
</tr>
<tr>
<td>Donor-restricted</td>
<td>$ (2,243)</td>
<td>(6,717)</td>
<td>120,459</td>
<td>111,499</td>
<td></td>
</tr>
<tr>
<td>Board-designated:</td>
<td>Named endowment funds</td>
<td>3,338</td>
<td>—</td>
<td>—</td>
<td>3,338</td>
</tr>
<tr>
<td></td>
<td>Other endowment funds</td>
<td>107,095</td>
<td>—</td>
<td>—</td>
<td>107,095</td>
</tr>
<tr>
<td></td>
<td>$ 108,190</td>
<td>(6,717)</td>
<td>120,459</td>
<td>221,932</td>
<td></td>
</tr>
</tbody>
</table>
**Changes In Endowment Net Assets are as follows**

<table>
<thead>
<tr>
<th></th>
<th>September 30, 2009</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unrestricted</td>
<td>Temporarily restricted</td>
<td>Permanently restricted</td>
<td>Total</td>
</tr>
<tr>
<td>Endowment net assets,</td>
<td>$108,190</td>
<td>(6,717)</td>
<td>120,459</td>
<td>221,932</td>
</tr>
<tr>
<td>September 30, 2008</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net assets reclassified based</td>
<td>-</td>
<td>15,253</td>
<td>(15,253)</td>
<td>-</td>
</tr>
<tr>
<td>on change in law</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Endowment net assets after</td>
<td>108,190</td>
<td>8,536</td>
<td>105,206</td>
<td>221,932</td>
</tr>
<tr>
<td>reclassification</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment return:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment income, net</td>
<td>1,647</td>
<td>1,704</td>
<td>-</td>
<td>3,351</td>
</tr>
<tr>
<td>of fees</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net realized losses</td>
<td>(2,481)</td>
<td>(2,140)</td>
<td>-</td>
<td>(4,621)</td>
</tr>
<tr>
<td>Net unrealized gains</td>
<td>949</td>
<td>142</td>
<td>-</td>
<td>1,091</td>
</tr>
<tr>
<td>Total investment return</td>
<td>115</td>
<td>(294)</td>
<td>-</td>
<td>(179)</td>
</tr>
<tr>
<td>Contributions</td>
<td>-</td>
<td>-</td>
<td>8,002</td>
<td>8,002</td>
</tr>
<tr>
<td>Appropriation of endowment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>assets for expenditure:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Donor-restricted</td>
<td>(1,196)</td>
<td>(3,488)</td>
<td>-</td>
<td>(4,684)</td>
</tr>
<tr>
<td>Board-designated named</td>
<td>(147)</td>
<td>-</td>
<td>-</td>
<td>(147)</td>
</tr>
<tr>
<td>Total appropriations</td>
<td>(1,343)</td>
<td>(3,488)</td>
<td>-</td>
<td>(4,831)</td>
</tr>
<tr>
<td>Endowment net assets,</td>
<td>$106,962</td>
<td>4,754</td>
<td>113,208</td>
<td>224,924</td>
</tr>
<tr>
<td>September 30, 2009</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## SEATTLE CHILDREN’S HOSPITAL

Notes to Financial Statements

September 30, 2009 and 2008

(In thousands of dollars)

### Endowment net assets,

**September 30, 2007**

<table>
<thead>
<tr>
<th></th>
<th>Unrestricted</th>
<th>Temporarily restricted</th>
<th>Permanently restricted</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Endowment net assets,</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>$ 134,999</td>
<td>25,812</td>
<td>109,056</td>
<td>269,867</td>
</tr>
<tr>
<td>Investment return:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment income,</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>of fees</td>
<td>2,100</td>
<td>2,095</td>
<td>—</td>
<td>4,195</td>
</tr>
<tr>
<td>Net realized gains</td>
<td>3,135</td>
<td>2,630</td>
<td>—</td>
<td>5,765</td>
</tr>
<tr>
<td>Net unrealized</td>
<td>(31,744)</td>
<td>(32,136)</td>
<td>2,243</td>
<td>(61,637)</td>
</tr>
<tr>
<td>(losses) gains</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total investment</td>
<td>(26,509)</td>
<td>(27,411)</td>
<td>2,243</td>
<td>(51,677)</td>
</tr>
<tr>
<td>return</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributions</td>
<td>—</td>
<td>—</td>
<td>9,160</td>
<td>9,160</td>
</tr>
<tr>
<td>Appropriation of</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>endowment assets for</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>expenditure:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Donor-restricted</td>
<td>(110)</td>
<td>(5,118)</td>
<td>—</td>
<td>(5,228)</td>
</tr>
<tr>
<td>Board-designated</td>
<td>(190)</td>
<td>—</td>
<td>—</td>
<td>(190)</td>
</tr>
<tr>
<td>named</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>(300)</td>
<td>(5,118)</td>
<td>—</td>
<td>(5,418)</td>
</tr>
<tr>
<td>appropriations</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Endowment net assets,</td>
<td>$ 108,190</td>
<td>(6,717)</td>
<td>120,459</td>
<td>221,932</td>
</tr>
<tr>
<td><strong>September 30, 2008</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Healthcare services</td>
<td>$15,745</td>
<td>7,181</td>
</tr>
<tr>
<td>Trusts and annuities</td>
<td>4,392</td>
<td>2,046</td>
</tr>
<tr>
<td>Research</td>
<td>20,407</td>
<td>16,598</td>
</tr>
<tr>
<td>Purchase of equipment and other property</td>
<td>558</td>
<td>557</td>
</tr>
<tr>
<td></td>
<td>$41,102</td>
<td>26,382</td>
</tr>
</tbody>
</table>

(Continued)
Permanently restricted net assets are restricted to investments in perpetuity, the income from which is expendable to support the following at September 30:

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Healthcare services</td>
<td>$85,128</td>
<td>$96,485</td>
</tr>
<tr>
<td>Research</td>
<td>$63,430</td>
<td>$65,938</td>
</tr>
<tr>
<td></td>
<td>$148,558</td>
<td>$162,423</td>
</tr>
</tbody>
</table>

(6) Related-Party Transactions

(a) Airlift Northwest

Airlift Northwest (ALNW), a not-for-profit 501(c)(3) corporation, whose members are the Hospital, Harborview Medical Center and the University of Washington Medical Center (UWMC), provides aeromedical transportation services in the region. As a member, the Hospital has the rights to 17% of the net assets of ALNW upon dissolution. The Hospital accounts for its investment under the cost method of accounting.

The Hospital provides nursing services to ALNW, at cost, for pediatric patient transport services. During 2009 and 2008, the Hospital was paid $1,723 and $1,779, respectively, for the services it provided to ALNW.

(b) Children’s University Medical Group

Children’s Physicians (CP) and the University of Washington School of Medicine (UWSOM) formed a jointly owned not-for-profit corporation, Children’s University Medical Group, in 1986. CUMG is a pediatric practice plan that employs and manages the clinical practices of 415 professional members who are both members of the Hospital’s medical staff and full-time pediatric faculty members of the UWSOM. Contractually, CUMG distributes excess funds to faculty and related entities and does not accumulate significant net assets. Accordingly, CP has not recorded any proportional equity interest in CUMG.

The Hospital purchases medical direction services from and provides faculty support to CUMG. During 2009 and 2008, the Hospital paid CUMG $42,352 and $34,478, respectively, for these purchased services. The Hospital received payments from CUMG of $5,249 and $4,539 in 2009 and 2008, respectively, for the Hospital’s share of the Clinical Medicine Fund and expenses it incurs related to plan practice operations.
(c) **Providence-Children’s Neonatal Services, LLC**

The Hospital participates in a jointly owned venture with Providence Everett Medical Center, which operates as Providence-Children’s Neonatal Services, LLC (PCNS). The Hospital’s ownership interest in PCNS is accounted for using the equity method of accounting. As of September 30, 2009 and 2008, the Hospital’s investment balance in PCNS totaled $7,627 and $7,686, respectively, which is included in other assets in the accompanying balance sheets. Earnings on the Hospital’s investment for 2009 and 2008, totaling $1,441 and $2,530, respectively, are included in other operating revenues in the accompanying statements of operations and changes in net assets.

The Hospital provides clinical management and neonatal nurse practitioner services to PCNS. During 2009 and 2008, the Hospital earned $1,216 and $1,156, respectively, for these services, which are included in other operating revenues in the accompanying statements of operations and changes in net assets.

(d) **Seattle Cancer Care Alliance**

The Seattle Cancer Care Alliance (SCCA), a not-for-profit corporation, was organized in 1998 by SCHS, the UWSOM and Fred Hutchinson Cancer Research Center for the purpose of offering a comprehensive program of integrated cancer care services. SCCA operates an ambulatory cancer care facility and a 20-bed licensed hospital inside the UWMC. Members of SCCA share equally in the results of its operations.

The Hospital purchases services from SCCA and provides services to SCCA in connection with the SCCA’s comprehensive program of integrated cancer care services. During 2009 and 2008, the Hospital purchased services from SCCA incurring $1,551 and $1,491, respectively, which are included in purchased services in the accompanying statements of operations and changes in net assets. Additionally, the Hospital provided services to SCCA and recorded other operating revenues of $76 and $66 in 2009 and 2008, respectively.

(7) **Beneficial Interest in Seattle Children’s Healthcare System**

The Hospital recognizes an interest in a portion of the net assets of SCHS representing certain temporarily and permanently restricted funds that will ultimately benefit the Hospital. At September 30, 2009 and 2008, the Hospital recorded a beneficial interest in SCHS of $36,312 and $38,554, respectively, which corresponds to temporarily and permanently restricted net assets held by SCHS on the Hospital’s behalf. The Hospital recognizes changes in this beneficial interest as a change in temporarily and permanently restricted net assets.
(8) **Long-Term Debt**

Long-term debt consists of the following at September 30:

<table>
<thead>
<tr>
<th>Description</th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Bonds, Series 1998, interest paid semiannually at rates ranging</td>
<td>$50,912</td>
<td>54,276</td>
</tr>
<tr>
<td>between 4.4% to 5.25% with annual principal payments ranging from $2,635</td>
<td></td>
<td></td>
</tr>
<tr>
<td>in 2010 to $4,970 in 2023, net of unamortized discount of $558 in 2009 and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$634 in 2008, secured by an interest in certain bond funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue Bonds, Series 2001, interest paid semiannually at rates ranging</td>
<td>7,515</td>
<td>9,191</td>
</tr>
<tr>
<td>between 3.75% to 5.375% with annual principal payments ranging from $1,735</td>
<td></td>
<td></td>
</tr>
<tr>
<td>in 2010 to $2,015 in 2013, net of unamortized premium of $25 in 2009 and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$41 in 2008, secured by an interest in certain bond funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue Bonds, Series 2008A, interest paid monthly at variable rates with</td>
<td>72,175</td>
<td>72,480</td>
</tr>
<tr>
<td>annual principal payments ranging from $1,295 in 2010 to $8,935 in 2029,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>secured by an interest in certain bond funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue Bonds, Series 2008B, interest paid monthly at variable rates with</td>
<td>75,580</td>
<td>76,060</td>
</tr>
<tr>
<td>annual principal payments ranging from $510 in 2010 to $5,255 in 2032,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>secured by an interest in certain bond funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue Bonds, Series 2008C, interest paid semi-annually at rates ranging</td>
<td>90,690</td>
<td>90,772</td>
</tr>
<tr>
<td>from 5.375% to 5.5% with principal payments ranging from $8,400 in 2030 to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$13,500 in 2036, net of unamortized premium of $1,935 in 2009 and $2,017</td>
<td></td>
<td></td>
</tr>
<tr>
<td>in 2008, secured by an interest in certain bond funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue Bonds, Series 2009, interest paid semi-annually at rates ranging</td>
<td>112,636</td>
<td>—</td>
</tr>
<tr>
<td>from 2.0% to 5.625% with principal payments ranging from $850 in 2011 to</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$24,945 in 2039, net of unamortized discount of $2,529 in 2009, secured by</td>
<td></td>
<td></td>
</tr>
<tr>
<td>an interest in certain bond funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes payable with US Bank, interest paid quarterly at 1.5% through</td>
<td>29,856</td>
<td>—</td>
</tr>
<tr>
<td>2038 with principal due in full at the maturity date of December 31, 2038;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>secured by a leasehold deed of trust and assets of SCRH</td>
<td>439,364</td>
<td>302,779</td>
</tr>
<tr>
<td></td>
<td>(6,175)</td>
<td>(5,885)</td>
</tr>
<tr>
<td></td>
<td>$433,189</td>
<td>296,894</td>
</tr>
</tbody>
</table>

Less current portion
Scheduled principal payments of long-term debt as due according to their long-term amortization schedule for the next five years and thereafter are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>$6,175</td>
</tr>
<tr>
<td>2011</td>
<td>7,285</td>
</tr>
<tr>
<td>2012</td>
<td>7,585</td>
</tr>
<tr>
<td>2013</td>
<td>7,900</td>
</tr>
<tr>
<td>2014</td>
<td>8,270</td>
</tr>
<tr>
<td>Thereafter</td>
<td>403,276</td>
</tr>
</tbody>
</table>

Deduct unamortized net discounts (1,127)  
$ 439,364

The members of the Obligated Group include the Hospital and SCHS. As of September 30, 2009, total assets, total liabilities, and total unrestricted net assets of the Obligated Group constituted approximately 98%, 95% and 100%, respectively, of the respective SCHS’s combined totals. For the fiscal year ended September 30, 2009, the total operating revenues, operating income and excess of revenues over expenses, from all sources attributable to the Obligated Group were 99%, 100%; and 100%, respectively, of the respective SCHS’s combined totals.

Under the terms of the Revenue Bonds and related indenture agreements, the Obligated Group is required to comply with various covenants, including a requirement to generate net income available for debt service in each year greater than 120% for the Series 2009, Series 2008 and Series 2001 Bonds and greater than 110% for the Series 1998 Bonds, of its debt service for the same year, as defined.

In March 2008, the Hospital advance refunded the Series 2006 Bonds with the proceeds of an interim taxable bank loan and the initial issuance of the Series 2008A Bonds and the Series 2008B Bonds in April 2008, which resulted in a loss on refinancing of debt of $4,471. In May 2008, the Hospital refinanced the taxable bank loan with the proceeds of the Series 2008C Bonds and the Series 2008A Bonds and Series 2008B Bonds were converted to variable-rate demand securities with no resulting gain or loss.

The Series 2008A and 2008B variable rate demand bonds are subject to optional redemption by the bondholders, in whole or in part at 100% of the principal amount plus accrued interest. The Hospital has a reimbursement agreement and a remarketing arrangement for both the Series 2008A and 2008B variable rate demand bonds for the amount of the outstanding principal plus accrued interest. Under the terms of the reimbursement agreement, the Hospital has three years from the date of redemption, before it is required to pay back any and all amounts owed.

In September 2009, the Hospital entered into a $10 million working capital line of credit with Wells Fargo N.A. (Wells) to be used to finance operations if necessary. The line is secured by a supplemental obligation under the Master Trust Indenture that gives Wells a pari passu security interest in the Obligated Group’s gross receivables. As of September 30, 2009, no funds have been drawn on the line of credit.
New Market Tax Credit Financing

In November 2008, SCRH entered into a NMTC arrangement to facilitate the development and construction of a portion of the Hospital’s research facility. The NMTC program provides for a credit against federal income tax under Internal Revenue Code Section 45D for taxpayers who hold a Qualified Equity Investment (QEI). A QEI is any equity investment in a qualified Community Development Entity (CDE) if such investment is used by the CDE to make a Qualified Low-income Community Investment (QLICI Investment) in a Qualified Low-Income Community Business (QLICB Business). A QEI is made by an Investment Fund (IF). SCRH is considered to be a QLICB Business. The NMTC is claimed over a seven-year period.

A tiered ownership structure exists to combine the investor’s loan and equity with other nonrecourse loans to make a QEI. This structure is sometimes referred to as the NMTC leveraged investment model. The leveraged investment model includes loans made from SCRI to IF’s which collectively made QEI’s totaling $22,372 in CDE’s. The CDE’s made QLICI loans totaling $29,856 to SCRH. SCRH does not control or have an economic interest in the assets of either the CDE’s or the QEI’s.

SCRI entered into put/call options with certain CDE’s to take place at the end of the seven-year period. Under the respective agreements, the CDE’s can exercise a put option to sell their interests in the respective QEI’s for $1 each. If the parties do not exercise the put option within 90 days of the end of the seven-year period, SCRI can exercise a call option to purchase the interests at appraised fair market values.

Accounting for Derivative Instruments

Interest rate swap contracts are used to manage the net exposure to interest rate changes in attempting to reduce the overall cost of borrowing over time. Interest rate swap contracts generally involve the exchange of fixed and floating interest rate payments without the exchange of underlying principal (the swap of fixed or floating rates are on a notional amount). The Hospital accounts for its interest rate hedging transactions in accordance with ASC Topic 815 Derivatives and Hedging (Topic 815). Topic 815 requires that derivative instruments be recorded on the balance sheet as either an asset or liability measured at its individual fair market value. Changes in the derivative instrument’s fair market value are recognized in earnings unless certain specific hedge accounting criteria are met. Accounting for a qualifying fair value hedge (effective hedge) allows a derivative instrument’s gains and losses to be reported as part of the change in net assets (versus the statement of operations) to the extent effective.

The Hospital entered into two interest rate swap agreements (Swap Agreement). The Swap Agreements are with two separate counterparties: Goldman Sachs Mitsui MarineDerivative Products, L.P. (GS) and JPMorgan Chase bank, N.A. (JPMorgan). Under each Swap Agreement, the Hospital is obligated to pay a fixed rate per annum (3.48% on the Series 2008A Bonds and 3.69% on the Series 2008B Bonds) on a notional amount equal to the outstanding principal amount of the applicable series of bonds and receives a variable payment computed as 68% of the one month London Interbank Offered Rate (LIBOR) rate. The bonds’ variable-rate coupons are based upon rates determined by remarketing agents on a weekly basis.
As of and for the years ended September 30, 2009 and 2008 the change in value of $9,814 and $6,915, respectively, were reported as a component of nonoperating income (expenses) in the accompanying combined statements of operations and changes in net assets. In measuring the swaps at fair value, the Hospital has recorded a liability of $15,749 and $5,935 as of September 30, 2009 and 2008, respectively. These amounts have been recorded in other liabilities in the accompanying combined balance sheets. To comply with Topic 820, the Hospital has incorporated its own nonperformance risk and the respective counterparty’s nonperformance risk in the fair value measurements.

The two Credit Support Annexes for the interest rate swaps require either party to post collateral if the fair market value of the swap is negative to them and exceeds the minimum threshold as defined in each respective Credit Support Annex. The amount of collateral required to be posted is equal to the difference of the fair market value over the minimum threshold. As of September 30, 2009, the negative value of the Hospital’s swaps was within the minimum threshold and therefore the Hospital was not required to post any related collateral.

(9) Self-Insurance

The Hospital has purchased professional and general liability insurance on a claims-made basis. The Hospital is self-insured for the deductible portion of its insurance coverage and for unreported incidents and accrues an actuarial estimate for claims within its deductible portion and for unreported incidents. At September 30, 2009 and 2008, the liability for future costs of professional and general liability claims was $6,082 and $4,632, respectively. At September 30, 2009 and 2008, $3,292 and $2,706, respectively, of this liability was included as long term within deferred compensation and other liabilities with the remainder within accounts payable in the accompanying balance sheets.

The Hospital is self-insured for workers’ compensation. The Hospital also carries an excess coverage policy for its workers’ compensation program. The Hospital has accrued an actuarial estimate for claims and unreported incidents. At September 30, 2009 and 2008, the workers’ compensation obligation included within accrued salaries, wages and benefits was $2,542 and $2,629, respectively, in the accompanying balance sheets.

(10) Commitments and Contingencies

(a) Operating Leases

The Hospital leases various equipment and facilities under operating leases expiring at various dates. Total rental expense in 2009 and 2008 was $7,225 and $5,914, respectively.
Operating lease commitments for future years are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>6,025</td>
</tr>
<tr>
<td>2011</td>
<td>4,543</td>
</tr>
<tr>
<td>2012</td>
<td>4,250</td>
</tr>
<tr>
<td>2013</td>
<td>2,967</td>
</tr>
<tr>
<td>2014</td>
<td>1,887</td>
</tr>
<tr>
<td>Thereafter</td>
<td>1,542</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$21,214</strong></td>
</tr>
</tbody>
</table>

In 2008, the Hospital leased medical office space from SCHS. Rental expense paid to SCHS during 2008 was $1,187.

(b) Regulatory Environment and Litigation

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Management believes that the Hospital, in all material respects, is in compliance with the fraud and abuse regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

(c) Other Litigation

The Hospital is subject to litigation arising in the normal course of business. After consultation with legal counsel, management believes that these matters will be resolved without material adverse effect on the Hospital’s future financial position or results of operations.

(11) Retirement Plan and Deferred Compensation

The Hospital participates in the SCHS Employees’ Retirement Plan (the Plan), a defined contribution plan. The Hospital contributes 4% of eligible employee salaries, which increases to 6% upon the employee becoming vested. The Plan also allows employees to contribute. Employee contributions are matched by the Hospital at 25% of the first 4% of eligible compensation contributed by the participant to the Plan. The Plan covers substantially all Hospital employees. Pension expense during 2009 and 2008 totaled $12,704 and $10,440, respectively.
Deferred compensation arrangements are maintained by the Hospital for the benefit of eligible employees. Substantially all amounts deferred under these arrangements are held until such time as these funds become payable to the participants. Assets related to deferred compensation totaling $7,040 and $7,005 at September 30, 2009 and 2008, respectively, are available to general creditors of the Hospital and are included within assets whose use is limited in the accompanying balance sheets. The deferred compensation liability is included within other liabilities in the accompanying balance sheets.

(12) Functional Expenses

Functional expenses were as follows for the years ended September 30:

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Healthcare services</td>
<td>$549,506</td>
<td>510,728</td>
</tr>
<tr>
<td>General and administrative</td>
<td>42,227</td>
<td>45,534</td>
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<tr>
<td>Research</td>
<td>68,883</td>
<td>60,614</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$660,616</strong></td>
<td><strong>616,876</strong></td>
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</tbody>
</table>

(13) Concentration of Credit

The Hospital provides services to its patients insured under third-party payor agreements. The composition of patient accounts receivable was as follows at September 30 (in percentages):

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicaid</td>
<td>41%</td>
<td>43%</td>
</tr>
<tr>
<td>Regence blue shield</td>
<td>13</td>
<td>15</td>
</tr>
<tr>
<td>Premera blue cross</td>
<td>9</td>
<td>12</td>
</tr>
<tr>
<td>Other</td>
<td>37</td>
<td>30</td>
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</table>
Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

The Board of Trustees
Seattle Children’s Hospital:

We have audited the financial statements of Seattle Children’s Hospital (a Washington not-for-profit corporation) (the Hospital) as of and for the year ended September 30, 2009, and have issued our report thereon dated January 14, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Hospital’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital’s internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital’s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.
This report is intended solely for the information and use of management, the Board of Trustees, federal awarding agencies and pass-through entities, others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 14, 2010
Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133

The Board of Trustees
Seattle Children’s Hospital
Seattle, Washington:

Compliance

We have audited the compliance of Seattle Children’s Hospital (the Hospital) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended September 30, 2009. The Hospital’s major federal programs are identified in the summary of auditors’ results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Hospital’s management. Our responsibility is to express an opinion on the Hospital’s compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Hospital’s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Hospital’s compliance with those requirements.

In our opinion, Seattle Children’s Hospital complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2009.

Internal Control over Compliance

The management of the Hospital is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Hospital’s internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the entity’s internal control over compliance.
A control deficiency in an entity’s internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity’s internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity’s internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the entity’s internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the Hospital as of and for the year ended September 30, 2009, and have issued our report thereon dated January 14, 2010. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the board of trustees, the Hospital’s management, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

April 5, 2010, except as to the schedule of expenditures of federal awards, which is as of January 14, 2010
### Schedule of Expenditures of Federal Awards

**Year ended September 30, 2009**

<table>
<thead>
<tr>
<th>Activity</th>
<th>Federal grantor/pass-through grantor/program title</th>
<th>Federal CFDA number</th>
<th>Pass-through grantor's number</th>
<th>Grant number</th>
<th>Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Research and Development Awards:</strong></td>
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<td>Agency Healthcare Research &amp; Quality:</td>
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<tr>
<td>Childhood Chronic Illness</td>
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<td>93.226</td>
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<td>Subtotal – 93.226 Research on Healthcare Costs, Quality and Outcomes</td>
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<td>University of Washington:</td>
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<td></td>
</tr>
<tr>
<td>A Practical Model to Transform Childhood Asthma Care</td>
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<tr>
<td>HHSAS29020060022</td>
<td>HHSAS29020060022</td>
<td>593031</td>
<td></td>
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<tr>
<td><strong>Centers for Disease Control:</strong></td>
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<tr>
<td>Impact of Rotavirus Vaccination on Childhood Gastroenteritis</td>
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<td>200-2008-M-27366</td>
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<td>200-2008-M-27366</td>
<td>31,889.02</td>
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<td></td>
<td></td>
<td></td>
<td>31,889.02</td>
</tr>
<tr>
<td>Johns Hopkins University:</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Grants for Acute Care, Rehab &amp; Disable’y</td>
<td></td>
<td>93.136</td>
<td>8201-75594-X</td>
<td>R49CCR319701-03-1</td>
<td>(6,735.71)</td>
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<td></td>
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<tr>
<td>Disability from Pediatric TBI</td>
<td></td>
<td>93.136</td>
<td>439243</td>
<td>5 R49 CE 001021-02</td>
<td>(7,659.08)</td>
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<td>Disability from Pediatric TBI</td>
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<td>Subtotal – 93.136 Injury Prevention and Control Research and State and</td>
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<td></td>
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<tr>
<td>Community-Based Programs</td>
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<td></td>
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<td>3,367.85</td>
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<tr>
<td><strong>Spina Bifida Registry</strong></td>
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<td>93.184</td>
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<td>Johns Hopkins University:</td>
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<tr>
<td>Massachusetts General Hospital:</td>
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<td>UCLA, The Regents of University of California:</td>
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<td>93.190</td>
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<td>University of Iowa:</td>
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<td>Intervention for Individuals with Fetal Alcohol Syndrome</td>
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<td>93.283</td>
<td>—</td>
<td>1 U01 DD00038-01</td>
<td>2,764.04</td>
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<td>Intervention for Individuals with Fetal Alcohol Syndrome</td>
<td></td>
<td>93.283</td>
<td>—</td>
<td>5 U01 DD00038-02</td>
<td>(2,764.04)</td>
</tr>
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<td>Intervention for Individuals with Fetal Alcohol Syndrome</td>
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<td>Intervention for Individuals with Fetal Alcohol Syndrome</td>
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<td>Intervention for Individuals with Fetal Alcohol Syndrome</td>
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<td>Subtotal – 93.110 Maternal and Child Health Federal Consolidated Programs</td>
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<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Department of Health &amp; Human Services:</td>
<td></td>
<td></td>
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<tr>
<td>Autism Intervention Research Network for Physical Health</td>
<td></td>
<td>93.110</td>
<td>206808</td>
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<tr>
<td>FAS Diagnostic and Prevention Network</td>
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<td>93.778</td>
<td>572880</td>
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<td>FAS Diagnostic and Prevention Network</td>
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<td>6,299.94</td>
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(Continued)
<table>
<thead>
<tr>
<th>Activity</th>
<th>Federal grantor/pass-through/program title</th>
<th>Federal CFDA number</th>
<th>Pass-through grantor's number</th>
<th>Grant number</th>
<th>Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Drug Administration:</td>
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<td>413350200101</td>
<td>Etanercept for Acute Kawasaki Disease IND 101,223</td>
<td>93.103</td>
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<tr>
<td>413350100101</td>
<td>Triostat in Children During CPB</td>
<td>93.103</td>
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<tr>
<td>413820090101</td>
<td>Triprolidine for Ovary Protection in Child</td>
<td>93.103</td>
<td>CHMC#119-648</td>
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<tr>
<td>University of Medical &amp; Dental, New Jersey:</td>
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<tr>
<td>412830010101</td>
<td>Phase II Trial Aminopterin-Expired</td>
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<tr>
<td>413410090101</td>
<td>PKD2 involvement in the Htr1-PKCIbeta-NFkappaBeta Pathway</td>
<td>93.899</td>
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<tr>
<td>412660120101</td>
<td>Prevention of HIV Resist to Nevirap</td>
<td>93.899</td>
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<td>Subtotal – 93.899 International Research and Research Training</td>
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<tr>
<td>Health Resources &amp; Services Administration:</td>
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<tr>
<td>414420010201</td>
<td>Training CED/COR Pediatric and Child Psychiatry</td>
<td>93.110</td>
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<tr>
<td>414420010301</td>
<td>Training CED/COR Pediatric and Child Psychiatry</td>
<td>93.110</td>
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<tr>
<td>414420010401</td>
<td>Training CED/COR Pediatric and Child Psychiatry</td>
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<tr>
<td>University of Washington:</td>
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<td>414170010101</td>
<td>Pediatric Pulmonary Training Center</td>
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<tr>
<td>413360020301</td>
<td>Improving Injury Prevention Capacity</td>
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<td>Subtotal – 93.127 Emergency Medical Services for Children</td>
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<td>National Institute of Neurological Disorders &amp; Stroke:</td>
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<td>414140010101</td>
<td>GABA-A Receptor Function in Pediatric Focal Cortical</td>
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<td>414850010101</td>
<td>Mechanisms of Neocortical Development Regulated by Tbr1</td>
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Subtotal – 93.396 Cancer Research Manpower: 131,188.27

Fred Hutchinson Cancer Resh: Cancer Center Support Administration: 7,821.76

Subtotal – 93.397 Cancer Centers Support Grants: 47,395.29

Regulation of Telomerase by NFX1: 142,572.87

Subtotal – 93.398 Cancer Research Manpower: 142,572.87

University of Washington: Virologic Study of Children with Colds: (Continued)
### Schedule of Expenditures of Federal Awards

**Year ended September 30, 2009**

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### Schedule of Expenditures of Federal Awards

Year ended September 30, 2009

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<tr>
<td>Etiology of Mastitis in HIV-1 Infected Women</td>
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<td>Etiology of Mastitis in HIV-1 Infected Women</td>
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<td>Eukaryotic-type signaling mediates two-component regulation of TNF signaling in T cells</td>
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Subtotal – 93.849 Kidney Diseases, Urology, and Hematology Research: $879,291.84
Subtotal – 93.855 Thrombosis Research: $3,669.12
Subtotal – 93.855 Lung Diseases Research: $9,782.84
Subtotal – 93.838 Lung Diseases Research: $21,266.89
Subtotal – 93.838 Liver Diseases Research: $1,182.00
Subtotal – 93.838 Respiratory Diseases Research: $74,815.13
Subtotal – 93.838 Neurological Diseases Research: $36,711.10

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<td>Midlife Cognitive Change and Risk of Cognitive Decline</td>
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### Schedule of Expenditures of Federal Awards

**Year ended September 30, 2009**

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<th>Activity</th>
<th>Federal grantor/pass-through grantor/program title</th>
<th>Federal CFDA number</th>
<th>Pass-through grantor’s number</th>
<th>Grant number</th>
<th>Expenditure</th>
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See accompanying notes to schedule of expenditures of federal awards.
(1) **Basis of Presentation**

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Seattle Children’s Hospital (the Hospital) for the fiscal year ended September 30, 2009. This schedule has been prepared on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

(2) **Subrecipients**

Of the federal expenditures presented in the schedule, the Hospital provided federal awards to subrecipients as follows:

<table>
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<tr>
<th>Program title</th>
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<td>Bowel/Bladder Management for Children with Spina Bifida</td>
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<td>Cellular Integrity in Aging and Mild Cognitive Impairment</td>
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<td>Cerebral Edema in Pediatric Diabetic Ketoacidosis</td>
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<td>Child Weight Status and Neighborhood Physical Activity and Nutrition Environment</td>
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<td>Childhood Chronic Illness</td>
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<td>Craniofacial and Genetic Variation in 22q11.2 Deletion Syndrome</td>
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<td>Craniofacial Microsomia and Genetic Variation in Homeostasis and Vasculogenesis</td>
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<td>Developing Quality Measures to Assess Pediatric Inpatient Respiratory Care</td>
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<td>Early Aggressive Therapy in Juvenile Idiopathic Arthritis</td>
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<td>Evolution of Virulence by Gene Acquisition</td>
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<td>FcR Mutations in Kawasaki Disease</td>
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<td>Genetic Disorders of Mucoiliary Clearance</td>
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<td>Health Outcomes for Hodgkin Disease Survivors</td>
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<td>Healthy Steps - Strong Kids</td>
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<td>HHV6 and CNS Disease Following Stem Cell Transplant</td>
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<td>HIV Exposure during Chemo</td>
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### Program title

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<td>Infact study of Inhaled Saline in Cystic Fibrosis</td>
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<td>Interdisciplinary Training in Genome Engineering</td>
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<td>Internet Based Patient Centered Asthma Management System</td>
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<td>Intervention for Individuals with Fetal Alcohol Syndrome</td>
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<td>Mechanism/predictors of Genital Rectal HIV Shedding</td>
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<td>Mechanisms of Tolerance to Renal Maternal Microchimerism</td>
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<td>Media Impact on Preschool Behavior</td>
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<td>Modulation of Immune Responses for Hemophilia</td>
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<td>Oral Health Behavior and Habits of Young Children with Developmental Delay</td>
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<td>Para Influenza Virus Infection in Hematopoietic Cell Transplant Recipients</td>
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<td>Pediatric Brain Tumor Consortium</td>
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<td>Pediatric HIV Trials Network</td>
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<td>Reservoirs of Drug-Resistant HIV-1</td>
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<td>SEARCH for Diabetes in Youth 2: Washington Site</td>
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<td>Telemental Health to Improve Mental Health Care and Outcomes for Children</td>
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<td>The Effect of Light Rail on Physical Activity: A Natural Experiment</td>
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<td>Ultrasound-Mediated Gene Therapy for Hemophilia B</td>
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$\text{Total} \quad 3,945,817$
Section I – Summary of Auditors’ Results

Financial Statements
Type of auditors’ report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? None reported

Noncompliance material to financial statements noted? No

Federal Awards
Internal control over major programs:

- Material weakness(es) identified? No
- Significant deficiency(ies) identified that are not considered to be material weakness(es)? None reported

Type of auditors’ report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? None

Identification of major program:

<table>
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<th>CFDA number</th>
<th>Name of federal program or cluster</th>
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<tbody>
<tr>
<td>RD</td>
<td>Research and Development Cluster</td>
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Dollar threshold used to distinguish between type A and type B programs: $928,028

Auditee qualified as low-risk auditee: Yes

Section II – Financial Statement Findings
No matters reported.

Section III – Federal Award Findings and Questioned Costs
No matters reported.