PROVIDENCE
Health & Services

Meeting the needs of our communities remains at the heart of Providence Health & Services and drives our fiscal operations. Our Mission is firmly rooted in the work started 150 years ago by the Sisters of Providence and we honor and live by their commitment every day.

Benefiting Our Communities
As a not-for-profit Catholic health care ministry, Providence embraces its responsibility to provide for the needs of the communities we serve – especially the poor and vulnerable. All Providence regions continued to increase contributions to community benefit programs in 2007, for a total of $412.6 million. This is a Providence-wide increase of 11% over 2006. Combined with our capital spending projects, our 2007 investments in our communities totaled over $1.1 billion.

Providing for the Poor and Vulnerable
The cornerstone of the Providence Mission is to provide quality health care that is accessible for all people in our communities, regardless of their economic situation. In 2007, Providence offered $143 million in charity care to ensure the uninsured and underinsured in our communities could access health care. Consistent with other Catholic health care organizations, Providence does not include the unpaid cost of Medicare, Medicaid or bad debt in its cost of charity care numbers.

Sustaining Our Mission
Our commitment to financial sustainability allows us to continue to deliver the highest quality care, provide increased community benefit assets and offer charity and discounted care to those who cannot afford access to health care. Providence produced a net income of $655 million and a net operating income of $305 million for the 12 months ending December 31, 2007. A significant part of the 2007 net income was due to the accounting of $150 million in unrealized investment gains and losses recorded in the month of December. This reflects a non-cash change in our accounting standards to re-classify all investments, including for years prior to 2007.

A comprehensive annual report for 2007 will be distributed in June and will provide more detail on the benefit Providence provides to the communities we serve.

3/10/08

PROVIDENCE HEALTH & SERVICES

Consolidated Financial Statements

December 31, 2007 and 2006

(With Independent Auditors' Report Thereon)

KPMG

KPMG LLP
Suite 900
801 Second Avenue
Seattle, WA 98104

Independent Auditors' Report

The Board of Directors,
Providence Health & Services:

We have audited the accompanying consolidated balance sheets of Providence Health & Services (the Health System) as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Health System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 Health System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Providence Health & Services as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in the notes 2 and 7 to the consolidated financial statements, the Health System adopted Statement of Financial Accounting Standards No. 158, *Employers' Accounting for the Defined Benefit Pension and Other Postretirement Plans,* as of December 31, 2007.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual regions. The consolidating information for 2007 has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

KPMG LLP

March 7, 2008

PROVIDENCE HEALTH & SERVICES

Consolidated Balance Sheets

December 31, 2007 and 2006

(In thousands of dollars)

Assets		2007	2006
Current assets:			
Cash and cash equivalents	$	359,390	410,937
Assets held under securities lending		257,001	159,169
Accounts receivable, less allowance for bad debts of $226,562 in 2007 and $206,585 in 2006		751,915	714,824
Premiums receivable		6,323	4,862
Other receivables, net		120,658	112,400
Supplies inventory		87,092	80,297
Other current assets		51,595	53,474
Current portion of assets whose use is limited		71,403	67,619
Total current assets		1,705,377	1,603,582
Assets whose use is limited:			
Board-designated cash and investments		2,189,463	2,115,003
Funds held for long-term purposes		7,660	27,572
Gift annuities and trusts		45,204	41,672
Funds held by trustee		346,299	322,731
Assets whose use is limited, net of current portion		2,588,626	2,506,978
Property, plant, and equipment, net		3,289,435	2,929,823
Other assets		189,480	223,253
Total assets	$	7,772,918	7,263,636

(Continued)

PROVIDENCE HEALTH & SERVICES

Consolidated Balance Sheets

December 31, 2007 and 2006

(In thousands of dollars)

Liabilities and Net Assets		2007	2006
Current liabilities:			
Current portion of long-term debt	$	33,240	36,769
Accounts payable		276,523	275,762
Accrued compensation		256,314	246,300
Payable to contractual agencies		79,977	91,756
Unearned premiums/deferred revenue		31,686	30,384
Liability for unpaid medical claims		41,511	42,153
Liability for risk-sharing		13,826	18,056
Liabilities under securities lending		257,001	159,169
Current portion of self-insurance liability		68,934	64,667
Other, including accrued interest		52,123	48,120
Total current liabilities		1,111,135	1,013,136
Long-term debt, net of current portion		1,484,974	1,559,559
Other long-term liabilities:			
Self-insurance liability, net of current portion		194,478	187,719
Pension benefit obligation		225,956	171,111
Gift annuity obligations and trusts		17,173	16,640
Other liabilities		66,644	89,593
Total other long-term liabilities		504,251	465,063
Total liabilities		3,100,360	3,037,758
Net assets:			
Unrestricted		4,446,971	4,012,733
Temporarily restricted		170,957	162,460
Permanently restricted		54,630	50,685
Total net assets		4,672,558	4,225,878
Total liabilities and net assets	$	7,772,918	7,263,636

See accompanying notes to consolidated financial statements.

PROVIDENCE HEALTH & SERVICES

Consolidated Statements of Operations

Years ended December 31, 2007 and 2006

(In thousands of dollars)

		2007	2006
Operating revenues:			
Net patient service revenues	$	5,092,729	4,637,229
Premium revenues		912,904	854,120
Other revenues		342,404	329,944
Total operating revenues		6,348,037	5,821,293
Operating expenses (including the cost of charity and unsponsored community benefit expenses of $412,640 in 2007 and $370,815 in 2006):			
Salaries and wages		2,413,085	2,232,082
Employee benefits		621,115	594,909
Purchased healthcare		539,351	492,461
Professional fees		186,276	169,355
Supplies		869,909	816,892
Depreciation		292,368	262,805
Interest and amortization		62,884	52,160
Bad debts		226,578	174,201
Provider tax		10,664	8,649
Purchased services and other		820,646	750,359
Total operating expenses		6,042,876	5,553,873
Excess of revenues over expenses from operations		305,161	267,420
Net nonoperating gains, principally investment income and gains		349,421	189,723
Excess of revenues over expenses		654,582	457,143
Net assets released from restriction and other		21,566	18,540
Change in accrued additional minimum pension liability		25,925	52,493
Implementation of SFAS 158		(96,304)	—
Change in net unrealized gains (losses) on investments		42,856	10,708
Reclassification of investment portfolio to trading		(214,387)	—
Discontinued operations – Benefis Healthcare		—	(190,521)
Increase in unrestricted net assets	$	434,238	348,363

See accompanying notes to consolidated financial statements.

PROVIDENCE HEALTH & SERVICES

Consolidated Statements of Changes in Net Assets

Years ended December 31, 2007 and 2006

(In thousands of dollars)

		Unrestricted	Temporarily restricted	Permanently restricted	Total net assets
Balance, December 31, 2005	$	3,664,370	143,145	51,397	3,858,912
Excess of revenues over expenses		457,143	—	—	457,143
Contributions, grants, and investment income		—	69,796	4,254	74,050
Net assets released from restriction		13,978	(45,895)	—	(31,917)
Other changes in unrestricted net assets		4,562	—	—	4,562
Decrease in accrued additional minimum pension liability		52,493	—	—	52,493
Change in net unrealized gains (losses) on investments		10,708	175	—	10,883
Discontinued operations – Benefis Healthcare		(190,521)	(4,761)	(4,966)	(200,248)
Increase (decrease) in net assets		348,363	19,315	(712)	366,966
Balance, December 31, 2006		4,012,733	162,460	50,685	4,225,878
Excess of revenues over expenses		654,582	—	—	654,582
Contributions, grants, and investment income		—	60,410	3,945	64,355
Net assets released from restriction and other		21,566	(51,913)	—	(30,347)
Decrease in accrued additional minimum pension liability		25,925	—	—	25,925
Implementation of SFAS 158		(96,304)	—	—	(96,304)
Change in net unrealized gains (losses) on investments		42,856	—	—	42,856
Reclassification of investment portfolio to trading		(214,387)	—	—	(214,387)
Increase in net assets		434,238	8,497	3,945	446,680
Balance, December 31, 2007	$	4,446,971	170,957	54,630	4,672,558

See accompanying notes to consolidated financial statements.

PROVIDENCE HEALTH & SERVICES

Consolidated Statements of Cash Flows

Years ended December 31, 2007 and 2006

(In thousands of dollars)

		2007	2006
Cash flows from operating activities:			
Change in net assets	$	446,680	366,966
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		298,684	269,980
Provision for bad debt		226,578	174,201
Gain on sale of property, plant, and equipment		(2,866)	(6,857)
Equity income from joint ventures		(24,687)	(24,500)
Restricted contributions and investment income received		(60,413)	(62,295)
Net realized and unrealized gains on investments		(175,757)	(202,996)
Discontinued operations of Benefis Healthcare		—	209,262
Implementation of SFAS 158		96,304	—
Changes in certain current assets and current liabilities		(287,930)	(225,634)
Change in other long-term liabilities and other		(22,966)	(4,653)
Net cash provided by operating activities		493,627	493,474
Cash flows from investing activities:			
Property, plant, and equipment additions		(653,285)	(762,290)
Proceeds from disposal of property, plant, and equipment		8,204	11,869
Purchases of investments		(3,604,214)	(3,089,852)
Proceeds from sales of investments		3,697,236	3,165,045
Capital contributions to joint ventures		(9,416)	(2,621)
Distributions from joint ventures		25,755	33,069
Change in other long-term assets and other		19,366	(7,513)
Net cash used in investing activities		(516,354)	(652,293)
Cash flows from financing activities:			
Proceeds from restricted contributions and restricted income		60,413	62,295
Long-term debt borrowings		4,163	685,494
Long-term debt payments		(90,877)	(398,755)
Payment of deferred financing costs and other		527	(6,746)
Change in funds held by trustee, net		(3,046)	(122,415)
Net cash (used in) provided by financing activities		(28,820)	219,873
(Decrease) increase in cash and cash equivalents		(51,547)	61,054
Cash and cash equivalents, beginning of year		410,937	349,883
Cash and cash equivalents, end of year	$	359,390	410,937
Supplemental disclosure of cash flow information:			
Cash paid for interest (net of amounts capitalized)	$	55,221	55,138

See accompanying notes to consolidated financial statements.

(1) Organization

(a) Sisters of Providence

Sisters of Providence (the Congregation), a religious congregation of Roman Catholic women, was founded in 1843. The religious congregation's central headquarters is in Montreal, Quebec, Canada. Sisters of Providence – Mother Joseph Province (the Province) was formed in 2000 through the combination of the Sacred Heart Province (founded in 1856) and the St. Ignatius Province (founded in 1891). The activities of the Province include apostolic works in healthcare, social services, and education. Members of the Province serve in these works through related and unrelated organizations. The Province is compensated for the services of its members. The Province has 170 professed members and maintains Provincial Administration facilities in both Seattle and Spokane, Washington. The members of the Province represent the Congregation in the following:

- Archdiocese of Los Angeles
- Archdiocese of Portland in Oregon
- Archdiocese of Seattle
- Archdiocesis de San Salvador
- Diocese of Boise
- Diocese of Great Falls – Billings
- Diocese of Orange in California
- Diocese of Spokane
- Diocese of Yakima
- Diocese of Stockton
- Diocesis Santiago de Maria, El Salvador

(b) Providence Health & Services

The Provincial Superior and the members of the Provincial Council of the Sisters of Providence – Mother Joseph Province sponsor various corporations comprising Providence Health & Services:

- Providence Health System – Washington
- Providence Health System – Oregon
- Providence Health System – Southern California (cosponsored by the Congregation and the American Province of the Little Company of Mary Sisters)
- Providence Everett Medical Center
- Hospice of Snohomish
- Providence Health Care
- St. Patrick Hospital and Health Sciences Center

- St. Mary Medical Center
- St. Thomas Child and Family Center Corporation
- University of Great Falls
- Providence Plan Partners
- Providence Health Plan
- Providence Health Assurance
- Providence Home Services
- Providence Health System Housing; The St. Luke Association; The Lundberg Association; Providence St. Francis Association; Providence Blanchet Association; Providence Rossi Association; Providence Peter Claver Association; The Gamelin Association; The Gamelin Oregon Association; The Gamelin California Association; The Gamelin St. Elizabeth Association; The Gamelin Washington Association
- Providence Oregon Management Corporation
- The John Gabriel Ryan Association
- Lifecare Ventures, Inc.
- Providence Assurance, Inc.

The corporations own or operate 26 general acute care hospitals, six assisted living projects, six long-term care facilities, seven homecare and hospice entities, a children's nursing center and Montessori school, a high school, a university, 12 low-income housing projects, a preferred provider organization, a health services contractor, two programs of all inclusive care for the elderly, and 20 controlled fundraising foundations.

The Health System provides inpatient, outpatient, primary care, and home care services in Alaska, Washington, Montana, Oregon, and Southern California. The Health System operates these businesses primarily in the greater metropolitan areas of Anchorage, Alaska; Everett, Seattle, Spokane, and Olympia, Washington; Missoula, Montana; Portland and Medford, Oregon; and Los Angeles, California.

(c) Discontinued Operations

Effective September 30, 2006, Benefis Healthcare (Benefis) disaffiliated from the Health System. In accordance with U.S. generally accepted accounting principles, revenues and expenses from discontinued operations have been reclassified on the consolidated statements of operations of the Health System for all periods presented, and are shown as discontinued operations – Benefis Healthcare. In connection with the effective date of the disaffiliation agreement, the remaining net assets at September 30, 2006 were removed from the consolidated balance sheet of the Health System and are shown as a loss from discontinued operations during the year ended December 31, 2006.

In accordance with the terms of the disaffiliation agreement, the remaining Series 2002 Montana Facilities Financing Authority revenue bonds issued under the Providence Services Master Indenture, and guaranteed by the Health System, were included as a component of long-term debt on the consolidated balance sheet at December 31, 2006. The Series 2002 bonds, totaling $22,270,000 at December 31, 2006, were defeased in April 2007. The defeasement was funded by Benefis. A corresponding receivable from Benefis of $22,270,000 had been recorded as a component of other assets on the consolidated balance sheet at December 31, 2006, and was satisfied in full through the defeasement of the Series 2002 bonds.

In accordance with the disaffiliation agreement, Benefis agreed to make a $10,000,000 contribution to the Health System, payable over no more than 10 years, with the first installment of $2,000,000 due at closing. The payments must be used by the Health System exclusively for charitable purposes, selected at the sole discretion of the Health System, in the Great Falls and north central region of Montana. The amounts outstanding of $7,200,000 and $8,000,000 are included as a component of other assets on the consolidated balance sheets at December 31, 2007 and 2006, respectively.

(d) *The Strategic Alliance Agreement*

In connection with the transfer of certain entities to Swedish Health Services (SHS) in 2000, certain obligations remained on the Health System's consolidated balance sheets as a component of long-term debt. In December 2006, SHS satisfied its obligation in full by paying the remaining receivable balance and accrued interest to the Health System. During 2007, the Health System repaid $26,895,000 of the outstanding long-term debt related to the entities that were transferred to SHS. In connection with this debt extinguishment, the Health System recognized a loss on extinguishment of $422,000. The Health System charged SHS interest on the outstanding note based on the actual interest incurred for the underlying bonds, which was $2,510,000 in 2006.

The Strategic Alliance Agreement (the Agreement) between Providence Health System – Washington and SHS also provided for the establishment of a company to be jointly owned by Providence Health System – Washington and SHS. This joint venture was established to provide opportunities for joint development and delivery of certain new healthcare services and various administrative and billing functions. As part of this transaction, SHS has pledged to make an annual donation to Providence Health System – Washington, if certain financial thresholds have been met at SHS, to support the charitable tax-exempt purposes of Providence Health System – Washington. During 2007 and 2006, contributions of approximately $2,386,000 and $3,400,000, respectively, were received under the terms of the Agreement and were included in other operating revenues in the accompanying consolidated statements of operations.

(e) *Affiliated Transactions*

Interaffiliate Borrowings

The Health System has a policy to loan funds among its affiliates at various interest rates.

Self-insurance Liability

The Health System has established self-insurance funds for the deductible portion of professional and general liability and workers' compensation insurance coverage. These funds provide insurance coverage for healthcare institutions associated with the Health System. The Health System also operates an insurance captive, Providence Assurance, Inc., to self-insure certain layers of professional and general liability risk. In addition, the Health System maintains excess coverage with independent insurance carriers.

The Health System's funding for estimated self-insured professional and general liability and workers' compensation insurance coverage is based on management's estimate of the ultimate costs for both reported claims and actuarially determined estimates of claims incurred but not reported. The Health System discounts the ultimate cost of claims at a discount rate of 5.5% as of December 31, 2007 and 2006.

(2) Summary of Significant Accounting Policies

(a) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Health System and the various corporations noted above. All significant transactions and accounts between consolidated divisions and affiliates of the Health System have been eliminated.

(b) 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.

(c) Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less.

(d) Supplies Inventory

Supplies inventory is stated at the lower of cost (first in, first out) or market.

(e) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Improvements and replacements of plant and equipment are capitalized. Maintenance and repairs are expensed. The cost of the property, plant, and equipment sold or retired and the related accumulated depreciation are removed from the accounts, and the resulting gain or loss is recognized at the time of disposal.

The Health System assesses potential impairment to their long-lived assets when there is evidence that events or changes in circumstances have made recovery of the carrying value of the assets unlikely. An impairment loss, equal to the excess of the carrying value over the fair value less disposal costs, is recognized when the sum of the expected future undiscounted net cash flows is less than the carrying amount of the asset.

(f) Depreciation

The provision for depreciation is determined by the straight-line method, which allocates the cost of tangible property equally over its estimated useful life.

(g) Interest During Construction

Interest capitalized on internally generated and borrowed funds expended for construction is a component of the cost of plant additions to be allocated to future periods through the provision for depreciation. Capitalization of interest ceases when the plant addition is placed into service. The Health System capitalized $14,288,000 and $12,394,000 of interest costs during the years ended December 31, 2007 and 2006, respectively.

(h) Financing Costs

Financing costs are recorded in other assets and are amortized using the effective interest method over the term of the related debt.

(i) Goodwill

Goodwill is recorded in other assets as the excess of cost over fair value of the acquired net assets. The provision for amortization is determined using the straight-line method over a period not to exceed 20 years. Additionally, goodwill is tested at least annually for impairment.

(j) Assets Whose Use is Limited

On December 1, 2007, the Health System changed the designation of the majority of its investments in debt and equity securities to trading. Prior to December 1, 2007, investments in debt or equity securities with readily determined fair values had been considered available-for-sale. All investments in debt and equity securities are reported at fair value principally based on quoted market price on the consolidated balance sheets. At December 31, 2007, the fair value of investments designated as trading totaled $2,497,472,000 which represents 94% of assets whose use is limited.

Assets whose use is limited primarily include assets held by trustees under indenture agreements, self-insurance funds, funds held for the payment of health plan medical claims, assets held by related foundations, and designated assets set aside by the Board of Directors of Providence Health & Services for future capital improvements and other purposes, over which the board retains control. Amounts required to meet current liabilities of the Health System have been reclassified as current in the consolidated balance sheets at December 31, 2007 and 2006.

A decline in fair value below cost, for available-for-sale securities, that is deemed to be other-than-temporary is recorded as an impairment loss and is classified as nonoperating in the accompanying consolidated statements of operations. A new cost basis is then established for the security.

(k) Liability for Unpaid Medical Claims

The liability for unpaid medical claims represents a provision for services provided for which payment had not been made, and includes claims received but not yet paid, estimated claims incurred

(Continued)

but not yet billed by providers, and outstanding amounts due to contracted providers for primary care services.

(l) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Health System has been limited by donors to a specific time period and/or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Health System in perpetuity.

(m) Donor-restricted Gifts

Unconditional promises to give cash and other assets to the Health System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets. When the terms of a donor restriction are met, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restriction.

(n) Net Patient Service Revenues

The divisions of the Health System have agreements with governmental and other third-party payers that provide for payments to the divisions at amounts different from their established charges. Payment arrangements for major third-party payers may be based on prospectively determined rates, reimbursed cost, discounted charges, per diem payments, predetermined rates per HMO enrollee per month, or other methods.

Net patient service revenues are reported at the estimated net realizable amounts due from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with governmental payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Adjustments from finalization of prior years' cost reports and other third-party settlement estimates resulted in an increase in net patient service revenues of approximately $22,575,000 and $17,091,000 for the years ended December 31, 2007 and 2006, respectively.

(o) Premium Revenues, Premiums Receivable, and Unearned Premiums

Health plan revenues consist of premiums paid by employers, individuals, and agencies of the federal and state governments for healthcare services. Health plan revenues are received on a prepaid basis and are recognized as revenue during the month for which the premium is associated. Premiums received for future months are recorded as unearned premiums.

(p) Charity and Unsponsored Community Benefit Costs

The divisions of the Health System have policies that provide for serving those without the ability to pay. The policies also provide for discounted sliding scale payments based on the income and assets of the person responsible for the bill. In addition to direct charity, the Health System's divisions also provide services that benefit the poor and others in the communities they serve. The cost of providing these community benefits can exceed the revenue sources available.

Information for the Health System for the years ended December 31, 2007 and 2006 is summarized below:

		2007	2006
		(In thousands of dollars)	
Cost of charity care provided	$	142,947	128,027
Unpaid cost of Medicaid services		158,343	152,415
Education and research programs, net cost		26,169	26,297
Nonbilled services, net cost		26,088	23,924
Negative margin services and other, net cost		59,093	40,152
Unsponsored community benefit costs	$	412,640	370,815
Percentage of total operating expenses, excluding purchased healthcare		7.5%	7.3%

The cost of charity care provided is based on each division's aggregate relationship of costs to charges. The unpaid cost of Medicaid services is the cost of treating Medicaid patients in excess of government payments. Education includes the unpaid cost of training health professionals, such as medical residents. Research programs include the unpaid cost of controlled studies of therapeutic protocols and development of new treatment protocols. Nonbilled services include the cost of services for which a patient is not billed or for which a nominal fee has been assessed. Negative margin services include programs for which net patient service revenue is less than cost provided to meet a need in the community. Nonbilled and negative margin services benefit the poor and the broader community but are not expected to be financially self-supporting.

Charity care has also been measured in terms of charges forgone for services furnished under the charity care policy. The forgone charges for services to persons unable to pay were $391,767,000 and $330,756,000 for the years ended December 31, 2007 and 2006, respectively.

(q) Income Taxes

The Health System and the various corporations within the Health System, except for Providence Assurance, Inc., Lifecare Ventures, Inc., Bourget Health Services, Inc., d/b/a Pathology Associates Medical Laboratories, Providence Physician Services, and Caron Health Corporation, are not-for-profit organizations, and have been recognized as exempt from federal income taxes, except on unrelated business income, under Section 501(c)(3) of the Internal Revenue Code (IRC).

Providence Plan Partners (PPP) is a not-for-profit entity and has been recognized as exempt from federal income taxes, except on unrelated business income, as a social welfare organization under Section 501(c)(4) of the IRC.

For the taxable corporations, deferred income taxes are provided for the future tax consequences of temporary differences between financial and tax reporting. Deferred tax assets and liabilities are measured based on enacted tax laws and rates expected to apply to taxable income in the years in which temporary differences are expected to be recorded or settled. Income taxes did not have a material impact on the financial position or results of operations of the Health System as of and for the years ended December 31, 2007 and 2006.

(r) ***Recently Adopted Accounting Standards***

In September 2006, the FASB issued SFAS No. 158 (SFAS 158), *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, which requires the employer to recognize the overfunded or underfunded status of a defined benefit plan as an asset or liability in its balance sheet and to recognize changes in that funded status in the year in which the changes occur through changes in unrestricted net assets. Under SFAS 158, the measurement of the funded status is the difference between the fair value of the plan assets compared with the projected benefit obligation of the plan. SFAS 158 requires the Health System to recognize in unrestricted net assets any unrecognized net actuarial gains or losses and any unrecognized prior service costs or credits as they arise, and disclose in the notes to the financial statements additional information about the effect on net periodic benefit cost on the next fiscal year that arise from the delayed recognition of these items. Effective December 31, 2007, the Health System adopted SFAS 158. The adoption of SFAS 158 resulted in a charge of $96,304,000 to unrestricted net assets and increase in the pension obligation at December 31, 2007. Refer to note 7 for more information regarding the Health System's pension plan disclosures under SFAS 158. SFAS 158 also requires employers, beginning in fiscal year 2008, to use a measurement date for these types of plans that is the same as the Health System's fiscal year end. The Health System has historically used a September 30 measurement date. This change in measurement date is not expected to have a material impact on the determination of pension expense for the year ended December 31, 2008.

The Health System adopted FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 also prescribes a recognition threshold and measurement standard for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption. In addition, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The adoption of FIN 48 did not have a significant impact on the consolidated financial statements of the Health System

(s) ***New Accounting Pronouncements***

In September 2006, the FASB issued SFAS No. 157 (SFAS 157), *Fair Value Measurement.* SFAS 157 defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements. SFAS 157 does not require any new fair value measures. SFAS 157 is effective for fair value measures already required or permitted by other standards for fiscal years after November 15, 2007. The Health System is required to adopt SFAS 157 beginning in fiscal year 2008. SFAS 157 is required to be applied prospectively, except for certain financial instruments. Any transition adjustment will be recognized as an adjustment to the beginning balance of net assets in the year of adoption. In November 2007, the FASB proposed a one-year deferral of the fair value measurement requirements for nonfinancial assets and liabilities that are not required or permitted to be measured at fair value on a recurring basis. Management is evaluating the potential impact of SFAS 157, but does not currently expect SFAS 157 to have a material impact on the consolidated financial statements of the Health System.

In February 2007, the FASB issued SFAS No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 permits an organization to measure certain financial instruments at fair value that are not currently required to be measured at fair value. The objective of SFAS 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 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. SFAS 159 is effective for the Health System beginning in fiscal year 2008. Management is evaluating the potential impact of SFAS 159, but does not currently expect SFAS 159 to have a material impact on the consolidated financial statements of the Health System.

(t) Reclassifications

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

(3) Investments

(a) Board-designated Cash and Investments and Funds Held by Trustee

The composition of board-designated cash and investments and funds held by trustee at December 31, 2007 and 2006 is set forth in the following table. Investments are stated at fair value.

		2007	2006
		(In thousands of dollars)	
Board-designated cash and investments:			
Cash and cash equivalents	$	118,465	144,836
Government securities		613,319	435,275
Equity securities		893,295	922,328
Fixed income obligations		544,251	598,868
Accrued investment income		20,133	13,696
Total board-designated cash and investments	$	2,189,463	2,115,003
Funds held by trustee:			
Cash and cash equivalents	$	106,189	140,878
Government securities		112,894	69,418
Equity securities		94,311	91,053
Fixed income obligations		104,308	89,001
Total funds held by trustee	$	417,702	390,350

The Health System's funds held by trustee are segregated from other cash and investments for various purposes. Included in funds held by trustee are $62,137,000 and $85,834,000 obtained from borrowings under the Health System's master trust indenture for construction and other ongoing projects as of December 31, 2007 and 2006, respectively. The Health System holds $289,899,000 and $261,550,000 at December 31, 2007 and 2006, respectively, related to the self-insured trusts. The remainder of funds held by trustee are for the Health System's employee benefit plans, borrowing arrangements, and other items.

The Health System does not hold alternative investments (investments that do not have readily determinable fair values) in its investment portfolios included in assets whose use is limited. Additionally, the Health System does not have significant exposures to sub-prime asset backed securities as amounts of these securities are less than 1% of assets whose use is limited.

Investment income from board-designated cash and investments and funds held by trustee are comprised of the following for the years ended December 31, 2007 and 2006:

		2007	2006
		(In thousands of dollars)	
Nonoperating income:			
Interest income	$	87,025	73,624
Net realized gains on sale of investments		110,673	114,887
Net recognized gains on trading securities		150,037	—
Changes in net assets:			
Change in net unrealized gains (losses) on investments		42,856	10,883
Reclassification of investments to trading		(214,387)	—

As of December 1, 2007, the Health System elected to designate its investment portfolio as trading, which resulted in all gains and losses as being recognized currently as nonoperating activity. The effect of the change in classification of investments to trading resulted in $214,387,000 of cumulative unrealized net gains being recognized as nonoperating gains at December 1, 2007 in the consolidated statements of operations. Subsequent to December 1, 2007, the Health System recorded unrealized losses on investments of $64,350,000 in nonoperating gains (losses) in the consolidated statements of operations.

(Continued)

The following table summarizes the Health System's investments with unrealized losses as of December 31, 2006 (in thousands of dollars):

	Less than 12 months		12 months or longer		Total	
Description of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Government securities and fixed income obligations	$ 377,650	(2,773)	277,966	(7,536)	655,616	(10,309)
Equity securities	31,501	(1,396)	15,978	(325)	47,479	(1,721)
Total temporarily impaired securities	$ 409,151	(4,169)	293,944	(7,861)	703,095	(12,030)

(b) *Securities Lending Agreement*

The Health System has securities lending agreements with financial institutions that serve as the lending agent. These agreements authorize the lending agents to lend securities owned by the Health System to an approved list of borrowers. Under the agreements, the lending agents are responsible for negotiating each loan for an unspecified term while retaining the power to terminate the loan at any time. At the time each loan is made, the lending agents require collateral equal to 102% of the market value of the loaned securities and accrued interest. While any securities are loaned, the Health System retains all rights of ownership, except it waives its right to vote such securities. The collateral related to the securities loaned totaled $257,001,000 and $159,169,000 at December 31, 2007 and 2006, respectively. The Health System has recorded income related to the securities lending program of $461,000 and $126,000, which is included in net nonoperating gains in the accompanying consolidated statements of operations for the years ended December 31, 2007 and 2006, respectively.

(4) Property, Plant, and Equipment

Property, plant, and equipment and the total accumulated depreciation at December 31, 2007 and 2006 are shown below:

	Approximate useful life (years)		2007	2006
			(In thousands of dollars)	
Land and improvements	5 – 25	$	364,163	323,583
Buildings and improvements	5 – 40		2,437,692	2,218,170
Equipment:				
Fixed	5 – 25		660,719	637,072
Major movable and minor	3 – 20		2,032,582	1,855,695
Rental property	15 – 40		524,124	413,902
Construction in progress	—		490,908	448,339
			6,510,188	5,896,761
Less accumulated depreciation			3,220,753	2,966,938
Property, plant, and equipment, net		$	3,289,435	2,929,823

Rental property represents buildings and related improvements that are owned by the Health System and rented to outside parties. These properties are primarily medical office buildings leased to physicians.

Construction in progress primarily represents renewal and replacement of various facilities in the Health System's operating divisions.

(5) Other Assets

Other assets at December 31, 2007 and 2006 are shown as follows:

		2007	2006
		(In thousands of dollars)	
Unamortized financing costs, net	$	21,919	23,176
Investment in joint ventures		80,479	58,880
Receivable from Benefis (note 1)		7,200	30,270
Long-term reinsurance receivable		20,908	18,261
Intangible asset-pension (note 7)		—	21,362
Goodwill		7,629	8,158
Other		51,345	63,146
Total other assets	$	189,480	223,253

The Health System participates in various joint ventures for the purpose of furthering its healthcare mission. These joint venture agreements exist in all geographical locations in which the Health System operates. The primary purposes of the ventures are to provide outpatient services such as laboratory, outpatient surgery, and medical imaging. Two of these joint ventures, located in Anchorage, Alaska, and Mission Hills, California are controlled by the Health System and consequently are consolidated in the financial statements of the Health System. All other joint ventures are accounted for under the equity method of accounting. The equity in earnings from these joint ventures totaled $24,687,000 and $24,500,000 for the years ended December 31, 2007 and 2006, respectively, which is included in other operating revenues in the accompanying consolidated statements of operations.

(6) Long-term Debt

Long-term debt at December 31, 2007 and 2006 consists of the following:

		2007	2006
		(In thousands of dollars)	
Master trust debt:			
Series 1985, AIDEA Revenue Bonds (Sisters of Providence)	$	2,660	3,390
Series 1995, WHCFA Revenue Bonds (Sisters of Providence)		—	6,285
Series 1996, CHFFA Revenue Bonds (Sisters of Providence)		19,045	24,165
Series 1997, Direct Obligation Notes (Sisters of Providence)		13,710	23,355
Series 1998, CHFFA Revenue Bonds (Little Company of Mary)		60,640	62,540
Series 1999, WHCFA Revenue Bonds (Sisters of Providence)		—	9,360
Series 2001A, B, and C, CHFFA Revenue Bonds (Providence Health System)		157,400	157,400
Series 2001A, WHCFA Revenue Bonds (Providence Health System)		105,200	105,200
Series 2001B, WHCFA Revenue Bonds (Providence Health System)		14,475	24,925
Series 2002, MFFA Revenue Bonds (Providence Services)		—	22,270
Series 2003C, AIDEA Revenue Bonds (Providence Health System)		18,550	18,550
Series 2003H, AIDEA Revenue Bonds (Providence Health System)		36,000	36,000
Series 2003, HFACC Revenue Bonds (Providence Health System)		213,475	213,475
Series 2004, HFAMC Revenue Bonds (Providence Health System)		98,700	100,000
Series 2005, Direct Obligation Notes (Providence Health System)		57,415	58,735
Series 2006A, WHCFA Revenue Bonds (Providence Health & Services)		210,555	212,165

		2007	2006
		(In thousands of dollars)	
Series 2006B, MFFA Revenue Bonds (Providence Health & Services)	$	68,430	68,430
Series 2006C, WHCFA Revenue Bonds (Providence Health & Services)		69,425	69,425
Series 2006D, WHCFA Revenue Bonds (Providence Health & Services)		69,275	69,275
Series 2006E, WHCFA Revenue Bonds (Providence Health & Services)		26,350	26,350
Series 2006F, Direct Obligation Notes (Providence Health & Services)		53,250	64,500
Series 2006G, Direct Obligation Notes (Providence Health & Services)		60,575	60,575
Series 2006H, AIDEA Revenue Bonds (Providence Health & Services)		54,355	54,355
Series 2006I, Direct Obligation Notes (Providence Health & Services)		53,600	53,600
US Bank credit facility		—	2,040
Master trust debt at par value		1,463,085	1,546,365
Premiums and discounts, net		7,676	8,409
Master trust debt, net of premiums and discounts		1,470,761	1,554,774
Mortgages, capital leases, lines of credit, and other		45,029	39,130
Loans from unconsolidated affiliates		2,424	2,424
Total long-term debt		1,518,214	1,596,328
Less current portion		33,240	36,769
Long-term debt, net of current portion	$	1,484,974	1,559,559

Providence Health System – Washington; Providence Health System – Oregon (exclusive of Providence Plan Partners); Providence Health System – Southern California (exclusive of Medical Institute of Little Company of Mary, Lifecare Ventures, Inc., and TrinityCare Hospice); Providence Everett Medical Center, Everett, Washington; Providence Health Care; St. Mary Medical Center; St. Joseph Hospital Corporation, St. Patrick Hospital and Health Sciences Center, exclusive of related housing and foundations, are the members of an Obligated Group formed for issuing debt under a master trust indenture. Members of the Obligated Group are jointly and severally responsible for the debt of the other members of the Obligated Group. The master trust indenture and bond trust indentures for each debt issue require the Obligated Group to meet certain financial covenants. In June 2006, with the issuance of the Series 2006A, Series 2006B, Series 2006C, Series 2006D, Series 2006E, Series 2006F, and Series 2006G bonds, the members of the former Providence Services Obligated Group defeased their bonds, allowing them to become members of the Providence Health System Obligated Group.

Loans from unconsolidated affiliates outstanding at December 31, 2007 and 2006 are at various interest rates and have no stated repayment terms.

The Health System recorded a loss on refinancing of debt of $655,000 and $11,236,000 in 2007 and 2006, respectively, which was recorded in net nonoperating gains in the accompanying consolidated statements of operations.

Alaska Industrial Development and Export Authority (AIDEA) Variable Rate Demand Industrial Development Revenue Bonds, Series 1985

The Series 1985 bonds were issued in July 1985. The bonds are currently issued as variable rate bonds priced monthly. The interest rate in effect on December 31, 2007 was 3.5%. Annual principal payments range from $805,000 in 2008 up to $970,000 in 2010.

Washington Health Care Facilities Authority (WHCFA) Revenue Bonds, Refunding Series 1995

The Series 1995 bonds were issued in November 1995. The outstanding bonds bore interest rates ranging from 5.0% to 5.75% payable semiannually on April 1 and October 1. In June 2006, in conjunction with the issuance of the Series 2006E bonds, 71% of these outstanding bonds were legally defeased in the amount of $20,555,000. The remaining $6,285,000 were legally defeased in February 2007.

California Health Facilities Financing Authority (CHFFA) Health Facility Revenue Bonds, Series 1996

The Series 1996 bonds were issued in January 1996. The outstanding bonds bear interest rates ranging from 5.0% to 6.0% payable semiannually on April 1 and October 1. Annual principal payments range from $4,280,000 in 2008 to $1,045,000 in 2016.

Direct Obligation Notes, Series 1997

The Series 1997 bonds were issued in March 1997. The outstanding bonds bear an interest rate of 7.7% payable semiannually on April 1 and October 1. Annual principal payments range from $3,405,000 in 2008 to $750,000 in 2017.

California Health Facilities Financing Authority (CHFFA) Insured Revenue Bonds, Series 1998

The Series 1998 bonds were issued in October 1998. The outstanding bonds bear interest rates ranging from 4.0% to 5.0% payable semiannually on April 1 and October 1. Annual principal payments range from $1,990,000 in 2008 up to $3,825,000 in 2028.

Washington Health Care Facilities Authority (WHCFA) Revenue Bonds, Series 1999 (Providence Health System)

The Series 1999 bonds were issued in April 1999. The outstanding bonds bore interest rates ranging from 4.3% to 5.0% payable semiannually on April 1 and October 1. The remaining $9,360,000 of outstanding bonds were legally defeased in February 2007.

California Health Facilities Financing Authority (CHFFA) Insured Variable Rate Revenue Bonds, Series 2001A, B, and C

The Series 2001A, B, and C bonds were issued in July 2001. The Series 2001A bonds are currently issued as 28-day auction rate bonds. The Series 2001B and C bonds are currently issued as auction rate bonds priced daily. The interest rates in effect on December 31, 2007 were 3.8% for the Series 2001A bonds and 3.5% for the Series 2001B and C bonds (see note 13). Annual principal payments range from $5,025,000 beginning in 2011 up to $23,125,000 in 2021.

Washington Health Care Facilities Authority (WHCFA) Revenue Bonds, Series 2001A

The Series 2001A bonds were issued in June 2001. The outstanding bonds bear interest rates ranging from 4.6% to 5.625% payable semiannually on April 1 and October 1. Annual principal payments range from $7,565,000 beginning in 2011 up to $12,245,000 in 2021.

Washington Health Care Facilities Authority (WHCFA) Revenue Bonds, Series 2001B

The Series 2001B bonds were issued in June 2001. The bonds are currently issued as 28-day auction rate bonds. The interest rate in effect on December 31, 2007 was 3.6% (see note 13). Annual principal payments range from $3,125,000 in 2008 up to $5,850,000 in 2010.

Montana Facility Finance Authority (MFFA) Revenue Bonds, Series 2002

The Series 2002 bonds were issued in July 2002. The bonds bore an interest rate ranging from 3.0% to 5.0% payable semiannually on June 1 and December 1. In June 2006, in conjunction with the issuance of the Series 2006B bonds, 67% of these outstanding bonds were legally defeased in the amount of $46,360,000. The remaining $22,270,000 were defeased in April 2007 (see note 1).

Alaska Industrial Development and Export Authority (AIDEA) Revenue Bonds, Series 2003C

The Series 2003C bonds were issued in May 2003. The outstanding bonds bear an interest rate of 5.0% payable semiannually on April 1 and October 1. Annual principal payments range from $9,050,000 beginning in 2009 up to $9,500,000 in 2010.

Alaska Industrial Development and Export Authority (AIDEA) Revenue Bonds, Series 2003H

The Series 2003H bonds were issued in September 2003. The outstanding bonds bear interest rates ranging from 4.625% to 5.25% payable semiannually on April 1 and October 1. Annual principal payments range from $8,200,000 in 2008 to $4,600,000 in 2015.

Hospital Facility Authority of Clackamas County, Oregon (HFACC) Revenue Bonds, Series 2003D, E, F, and G

The Series 2003D, E, F, and G bonds were issued in May 2003. The Series 2003D and Series 2003E bonds are currently issued as auction rate bonds priced weekly. The Series 2003F and Series 2003G bonds are currently issued as 28-day auction rate bonds. The interest rates in effect on December 31, 2007 were 4.2% for the Series 2003D, Series 2003E, and Series 2003F bonds, and 5.9% for the Series 2003G bonds (see note 13). Annual principal payments range from $1,150,000 in 2008 up to $18,175,000 in 2033.

Hospital Facilities Authority of Multnomah County, Oregon (HFAMC) Revenue Bonds, Series 2004

The Series 2004 bonds were issued in July 2004. The outstanding bonds bear interest rates ranging from 3.0% to 5.5% payable semiannually on April 1 and October 1. Annual principal payments range from $900,000 in 2008 up to $9,185,000 in 2024.

Direct Obligation Notes, Series 2005

The Series 2005 bonds were issued in July 2005. The outstanding bonds bear interest rates ranging from 4.54% to 5.39% payable semiannually on April 1 and October 1. Annual principal payments range from $1,380,000 in 2008 up to $4,160,000 in 2030.

Washington Health Care Facilities Authority (WHCFA) Revenue Bonds, Series 2006A

The Series 2006A bonds were issued in June 2006. The outstanding bonds bear interest rates ranging from 4.5% to 5.0% payable semiannually on April 1 and October 1. Annual principal payments range from $1,495,000 in 2027 up to $57,415,000 in 2036. In April 2006, $1,610,000 of these outstanding bonds were legally defeased.

Montana Facility Finance Authority (MFFA) Revenue Bonds, Series 2006B

The Series 2006B bonds were issued in June 2006. The outstanding bonds bear interest rates ranging from 4.0% to 5.0% payable semiannually on April 1 and October 1. Annual principal payments range from $3,255,000 beginning in 2012 up to $6,240,000 in 2026.

Washington Health Care Facilities Authority (WHCFA) Revenue Bonds, Series 2006C

The Series 2006C bonds were issued in June 2006. The outstanding bonds are currently issued as 28-day auction rate bonds. The interest rate in effect on December 31, 2007 was 4.8% (see note 13). Annual principal payments range from $6,700,000 beginning in 2025 up to $8,825,000 in 2033.

Washington Health Care Facilities Authority (WHCFA) Revenue Bonds, Series 2006D

The Series 2006D bonds were issued in June 2006. The outstanding bonds are currently issued as 28-day auction rate bonds. The interest rate in effect on December 31, 2007 was 5.09% (see note 13). Annual principal payments range from $6,625,000 beginning in 2025 up to $8,875,000 in 2033.

Washington Health Care Facilities Authority (WHCFA) Revenue Bonds, Series 2006E

The Series 2006E bonds were issued in June 2006. The outstanding bonds are currently issued as 35-day auction rate bonds. The interest rate in effect on December 31, 2007 was 4.7% (see note 13). Annual principal payments range from $2,550,000 beginning in 2025 up to $3,350,000 in 2033.

Direct Obligation Variable Rate Notes, Series 2006F

The Series 2006F bonds were issued in June 2006. The outstanding bonds are currently issued as 28-day auction rate bonds. The interest rate in effect on December 31, 2007 was 7.25% (see note 13). Annual principal payments range from $2,075,000 in 2008 up to $5,325,000 through 2036. In February 2007, 17% of these outstanding bonds were legally defeased in the amount of $11,250,000.

Direct Obligation Variable Rate Notes, Series 2006G

The Series 2006G bonds were issued in June 2006. The outstanding bonds are currently issued as 28-day auction rate bonds. The interest rate in effect on December 31, 2007 was 6.8% (see note 13). Annual principal payments range from $3,100,000 in 2008 up to $5,350,000 in 2036.

Alaska Industrial Development and Export Authority (AIDEA) Revenue Bonds, Series 2006H

The Series 2006H bonds were issued in November 2006. The outstanding bonds bear an interest rate of 5.0% payable semiannually on April 1 and October 1. Annual principal payments range from $2,545,000 beginning in 2022 up to $4,905,000 in 2036.

Direct Obligation Variable Rate Notes, Series 2006I

The Series 2006I bonds were issued in November 2006. The outstanding bonds are currently issued as 28-day auction rate bonds. The interest rate in effect on December 31, 2007 was 7.1% (see note 13). Annual principal payments range from $2,525,000 beginning in 2022 up to $4,900,000 in 2036.

Long-term debt maturities for the next five years and thereafter are as follows:

	Master trust	Other	Total
	(In thousands of dollars)		
2008	$ 28,335	4,905	33,240
2009	29,545	5,004	34,549
2010	31,235	4,567	35,802
2011	37,035	3,484	40,519
2012	37,600	2,598	40,198
Thereafter	1,299,335	24,471	1,323,806
	$ 1,463,085	45,029	1,508,114

Leases

The Health System leases various medical and office equipment and buildings under operating leases. Future minimum lease commitments under noncancelable operating leases for the next five years and thereafter are as follows (in thousands of dollars):

2008	$ 35,215
2009	32,554
2010	23,718
2011	21,019
2012	12,987
Thereafter	27,725
	$ 153,218

Rental expense was $57,250,000 and $54,330,000 for the years ended December 31, 2007 and 2006, respectively, and is included in other expenses in the accompanying consolidated statements of operations.

(Continued)

(7) Retirement Plans

The Health System has a noncontributory cash balance plan covering substantially all employees called the Providence Health System Cash Balance Retirement Plan (the Cash Balance Plan). The plan benefits are based on defined average compensation and years of service. The vesting period is five years. The Health System's funding policy is based on the actuarially determined cost method, and includes normal service cost and prior service costs amortized over a 20-year period. The Cash Balance Plan meets the definition of a defined benefit plan under SFAS No. 87 (SFAS 87), *Employers' Accounting for Pensions*. Under the Cash Balance Plan, each employee carries an individual account balance. The Health System makes a defined, annual contribution and provides a defined interest credit to each employee's account.

The Health System also has a defined benefit plan called the Providence Services Pension Plan (the PSP Plan). Effective on January 1, 2007, the Cash Balance Plan was amended. As of this date, the PSP Plan was merged into the Cash Balance Plan and was renamed the Providence Health & Services Cash Balance Retirement Plan. Certain plan benefits were modified at that time which primarily impact new entrants into the plan after December 31, 2007.

The Health System also sponsors the Providence Health & Services Matching Plan (the Matching Plan). The plan is a money purchase pension plan, which provides for the Health System to make matching contributions to the plan based on employee contributions to the Providence Health & Services Tax Deferred Annuity Plan. The Matching Plan contribution vesting period is five years.

The Health System's contributions to these pension plans for the years ended December 31, 2007 and 2006 were $117,800,000 and $85,976,000, respectively.

As discussed in note 2, effective December 31, 2007, the Health System adopted SFAS 158. SFAS 158 requires companies to recognize the funded status of defined benefit pension and other postretirement plans as a net asset or liability on its balance sheet. The adoption of SFAS 158 caused a reduction in assets of $21,362,000 and an increase in liabilities of $74,942,000, for a total reduction in net assets of $96,304,000. All future adjustments to the funded status of the plan will be recognized as increases or decreases to net assets in the corresponding accounting period.

The following disclosures cover both the Cash Balance Plan and the PSP Plan as of and for the years ended December 31, 2007 and 2006. The measurement dates for the defined benefit plans are September 30, 2007 and 2006, respectively. A rollforward of the change in benefit obligation and change in the fair value of plan assets for the defined benefit plans is as follows:

		2007	2006
		(In thousands of dollars)	
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	$	1,516,309	1,472,501
Service cost		92,475	92,928
Interest cost		85,174	78,555
Plan amendments		42,016	220
Actuarial gain		(24,400)	(37,360)
Benefits paid		(93,303)	(90,535)
Projected benefit obligation at end of year	$	1,618,271	1,516,309
Change in fair value of plan assets:			
Fair value of plan assets at beginning of year	$	1,199,371	1,107,192
Actual return on plan assets		173,228	102,142
Employer contributions		78,348	80,572
Benefits paid		(93,303)	(90,535)
Fair value of plan assets at end of year	$	1,357,644	1,199,371
Funded status	$	(260,627)	(316,938)
Fourth quarter contributions		21,349	19,407
Adjusted funded status		(239,278)	(297,531)
Unrecognized net actuarial loss		58,151	138,242
Accrued additional minimum pension liability		—	36,574
Unrecognized prior service cost		48,820	14,741
Net amount recognized	$	(132,307)	(107,974)
Amounts recognized in the balance sheet consist of:			
Noncurrent assets		—	21,362
Current liabilities		(13,322)	—
Noncurrent liabilities		(225,956)	(165,910)
Accumulated other comprehensive income		106,971	36,574
Net amount recognized	$	(132,307)	(107,974)
Weighted average assumptions:			
Discount rate		6.35%	5.85%
Rate of increase in compensation levels		3.65 – 4.00	3.50 – 4.00
Long-term rate of return on assets		8.00	8.00

(Continued)

Prepaid pension costs are included in other long-term assets, and pension liabilities are included in current and other long-term liabilities on the Health System's consolidated balance sheets. Net periodic pension cost for the defined benefit plans for 2007 and 2006 is included in employee benefits in the accompanying consolidated statements of operations and includes the following components:

		2007	2006
		(In thousands of dollars)	
Components of net periodic pension cost:			
Service cost	$	95,285	95,172
Interest cost		85,174	78,555
Expected return on plan assets		(88,845)	(83,102)
Amortization of prior service cost		7,872	4,401
Recognized net actuarial loss		5,137	17,930
Net periodic pension cost	$	104,623	112,956

The accumulated benefit obligation was $1,464,622,000 and $1,376,965,000 at December 31, 2007 and 2006, respectively.

The Health System's pension plans' weighted average asset allocations at December 31, 2007 and 2006 by asset category are as follows:

	2007	2006
Asset category:		
Debt securities	20%	17%
Equity securities	70	68
Other	10	15
Total	100%	100%

The expected long-term rate of return on plan assets is the expected average rate of return on the funds invested currently and on funds to be invested in the future in order to provide for the benefits included in the projected benefit obligation. The Health System used 8% in calculating the 2007 and 2006 expense amounts. This assumption is based on capital market assumptions and the plan's target asset allocation.

The asset category other includes plan investments in two hedge funds with an estimated fair value of $104,573,000 and $47,536,000 as of the plan measurement dates of September 30, 2007 and 2006, respectively. The fair value of these alternative investments were estimated by management using information provided by the fund managers. Because these investments are not readily marketable, their estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for such investments existed.

The Health System continues to monitor the expected long-term rate of return. If changes in those parameters cause 8.0% to be outside of a reasonable range of expected returns or if actual plan returns, over an extended period of time, suggest that general market assumptions are not representative of expected plan results, the Health System will revise this estimate.

The following pension benefit payments reflect expected future service. Payments expected to be paid over the next 10 years are as follows (in thousands of dollars):

2008	$	132,119
2009		133,435
2010		151,549
2011		159,424
2012 – 2017		1,169,462
	$	1,745,989

The Health System expects to contribute approximately $108,890,000 to the defined benefit pension plans in 2008.

Total expense for all of the Health System's retirement programs for the years ended December 31, 2007 and 2006 was $138,423,000 and $118,049,000, respectively, and are included in employee benefits in the accompanying consolidated statements of operations.

(8) Fair Value of Financial Instruments

The fair value of board-designated cash and investments, funds held for long-term purposes, and funds held by trustee, which are the amounts reported in the consolidated balance sheets, are estimated based on quoted market prices. For long-term debt, the fair value is estimated based on quoted market prices, when available, or on the discounted value of the future cash flows using current rates for debt with the same remaining maturities, considering the existing call premium and protection. The carrying value and fair value of long-term debt, including accrued interest, was $1,521,879,000 and $1,530,277,000, respectively, as of December 31, 2007, and $1,599,098,000 and $1,631,635,000, respectively, as of December 31, 2006.

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

(9) Commitments

The Health System has committed to several construction projects and other purchase commitments with an estimated cost of $379,761,000 remaining to be spent as of December 31, 2007.

(10) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at December 31, 2007 and 2006:

		2007	2006
		(In thousands of dollars)	
Program support	$	68,643	68,953
Low income housing		30,399	29,815
Capital acquisition and other		71,915	63,692
Total temporarily restricted net assets	$	170,957	162,460

The Health System's fundraising foundations have obtained contributions to support the various programs offered by the Health System. Many of these contributions remain temporarily restricted as of December 31, 2007 and 2006 because the time or purpose restrictions stipulated by the donor have not been met. Total fundraising expenses were $8,950,000 and $8,564,000 for the years ended December 31, 2007 and 2006, respectively. Generally, program support consists of items that will defray the cost of operating certain patient care activities of the Health System.

Other operating revenues included $28,202,000 and $31,917,000 of assets released from restriction for the years ended December 31, 2007 and 2006, respectively.

Income from permanently restricted net assets is restricted primarily for program support.

(11) Litigation and Contingencies

The healthcare industry is subject to numerous laws and regulations from federal, state, and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. Government monitoring and enforcement activity continues with respect to investigations and allegations concerning possible violations by healthcare providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of patient services previously billed. Institutions within the Health System are subject to similar regulatory reviews.

Management is aware of certain asserted and unasserted legal claims and regulatory matters arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Health System's future financial position or results of operations.

(Continued)

(12) Functional Expenses

The Health System provides healthcare services to residents within its geographic service areas. Expenses related to providing these services for the years ended December 31, 2007 and 2006 are as follows:

		2007	2006
		(In thousands of dollars)	
Healthcare expenses	$	4,562,187	4,149,653
Purchased healthcare expenses		539,346	492,461
General and administrative expenses		941,343	911,759
Total operating expenses	$	6,042,876	5,553,873

(13) Subsequent Event

The Health System has approximately $720,000,000 of auction rate bonds as of December 31, 2007 which are included in long-term debt in the accompanying consolidated balance sheets. Variable interest rates, determined through the auctions, have increased in 2008 and until there is some relief from the illiquid market conditions in the debt markets, the Health System expects to incur higher interest expense. During February 2008, the Health System experienced certain failed auctions subjecting the organization to higher interest costs related to this category of debt for the auction reset period. As a result of these failed auctions, the interest rate upon reset is determined based upon formulas that are a factor of LIBOR or a stated ceiling. The maximum rate calculations vary by issuance and could go as high as 15% for tax-exempt issuances and 21% for taxable issuances. Management is pursuing various alternatives to refinance or retire these auction rate bonds.

PROVIDENCE HEALTH & SERVICES

Consolidating Schedule – Balance Sheet Information

December 31, 2007 (with consolidated totals for 2006)

(In thousands of dollars)

Assets	Alaska Region	Washington/ Montana Region	Oregon Region	Providence Plan Partners	Southern California Region	System Office, Eliminations, and Other	2007 Total Health System	2006 Total Health System
Current assets:								
Cash and cash equivalents	$ 43,363	214,726	39,704	23,353	11,690	26,554	359,390	410,937
Assets held under securities lending	—	—	—	—	—	257,001	257,001	159,169
Accounts receivable, net	88,470	281,529	229,053	—	178,297	(25,434)	751,915	714,824
Premiums receivable	—	—	1,060	5,263	—	—	6,323	4,862
Other receivables, net, including affiliate	7,663	27,086	49,042	11,188	33,799	(8,120)	120,658	112,400
Supplies inventory	13,981	42,473	15,345	—	15,098	195	87,092	80,297
Other current assets	2,156	25,114	9,259	267	4,552	10,247	51,595	53,474
Current portion of assets whose use is limited	82	321	1,578	—	358	69,064	71,403	67,619
Total current assets	155,715	591,249	345,041	40,071	243,794	329,507	1,705,377	1,603,582
Assets whose use is limited:								
Board-designated cash and investments	212,811	516,591	823,966	421,566	180,541	33,988	2,189,463	2,115,003
Funds held for long-term purposes	1,871	496	505	—	—	4,788	7,660	27,572
Gift annuities and trusts	955	6,520	23,163	—	7,655	6,911	45,204	41,672
Funds held by trustee	—	60,880	14,724	—	—	270,695	346,299	322,731
Assets whose use is limited, net	215,637	584,487	862,358	421,566	188,196	316,382	2,588,626	2,506,978
Property, plant, and equipment, net	442,216	1,031,937	1,060,140	3,260	569,753	182,129	3,289,435	2,929,823
Other assets	50,479	118,220	17,840	—	66,488	(63,547)	189,480	223,253
Total assets	$ 864,047	2,325,893	2,285,379	464,897	1,068,231	764,471	7,772,918	7,263,636
Liabilities and Net Assets								
Current liabilities:								
Current portion of long-term debt	$ 11,569	6,215	2,909	—	8,786	3,761	33,240	36,769
Accounts payable	31,690	105,719	80,244	815	51,194	6,861	276,523	275,762
Accrued compensation	28,441	88,193	81,799	—	38,886	18,995	256,314	246,300
Payable to contractual agencies	4,642	33,855	26,320	2,568	12,592	—	79,977	91,756
Unearned premiums/deferred revenue	805	1,856	10,694	11,461	3,528	3,342	31,686	30,384
Liability for unpaid medical claims	—	1	—	63,698	3,257	(25,445)	41,511	42,153
Liability for risk-sharing	—	—	50	12,915	861	—	13,826	18,056
Liabilities under securities lending	—	—	—	—	—	257,001	257,001	159,169
Current portion of self-insurance liability	—	—	—	—	—	68,934	68,934	64,667
Other, including accrued interest and affiliate	2,625	22,132	9,282	14,045	5,045	(1,006)	52,123	48,120
Total current liabilities	79,772	257,971	211,298	105,502	124,149	332,443	1,111,135	1,013,136
Long-term debt, net of current portion	203,648	684,383	327,316	—	269,781	(154)	1,484,974	1,559,559
Gift annuity obligations, trusts, and other	19,066	27,032	18,669	776	17,940	420,768	504,251	465,063
Total liabilities	302,486	969,386	557,283	106,278	411,870	753,057	3,100,360	3,037,758
Net assets:								
Unrestricted	557,284	1,320,810	1,649,683	358,619	601,466	(40,891)	4,446,971	4,012,733
Temporarily restricted	4,277	25,058	54,799	—	41,087	45,736	170,957	162,460
Permanently restricted	—	10,639	23,614	—	13,808	6,569	54,630	50,685
Total net assets	561,561	1,356,507	1,728,096	358,619	656,361	11,414	4,672,558	4,225,878
Total liabilities and net assets	$ 864,047	2,325,893	2,285,379	464,897	1,068,231	764,471	7,772,918	7,263,636

See accompanying independent auditors' report.

PROVIDENCE HEALTH & SERVICES

Consolidating Schedule – Statement of Operations Information

December 31, 2007 (with consolidated totals for 2006)

(In thousands of dollars)

	Alaska Region	Washington/ Montana Region	Oregon Region	Providence Plan Partners	Southern California Region	System Office, Eliminations, and Other	2007 Total Health System	2006 Total Health System
Operating revenues:								
Net patient service revenues	$ 605,969	2,071,956	1,653,701	—	996,143	(235,040)	5,092,729	4,637,229
Premium revenues	—	18,613	39,289	855,002	—	—	912,904	854,120
Other revenues	26,468	178,986	138,646	21,397	27,889	(50,982)	342,404	329,944
Total operating revenues	632,437	2,269,555	1,831,636	876,399	1,024,032	(286,022)	6,348,037	5,821,293
Operating expenses:								
Salaries and wages	222,820	910,336	802,885	420	393,869	82,755	2,413,085	2,232,082
Employee benefits	58,477	227,251	180,912	18	130,118	24,339	621,115	594,909
Purchased healthcare	—	1	14,191	748,361	16,622	(239,824)	539,351	492,461
Professional fees	10,186	72,499	60,742	2,686	28,290	11,873	186,276	169,355
Supplies	88,226	379,624	257,192	603	142,490	1,774	869,909	816,892
Depreciation	38,405	95,375	89,915	1,459	49,802	17,412	292,368	262,805
Interest and amortization	6,733	32,343	8,886	18	7,414	7,490	62,884	52,160
Bad debts	57,116	78,713	39,830	16	50,617	286	226,578	174,201
Provider tax	—	—	10,664	—	—	—	10,664	8,649
Purchased services and other	106,308	360,833	246,095	83,936	162,882	(139,408)	820,646	750,359
Total operating expenses	588,271	2,156,975	1,711,312	837,517	982,104	(233,303)	6,042,876	5,553,873
Excess (deficit) of revenues over expenses from operations	44,166	112,580	120,324	38,882	41,928	(52,719)	305,161	267,420
Net nonoperating gains, principally investment income and gains	26,409	54,300	173,186	20,481	28,366	46,679	349,421	189,723
Excess (deficit) of revenues over expenses	70,575	166,880	293,510	59,363	70,294	(6,040)	654,582	457,143
Net assets released from restriction and other	6,061	(295)	9,322	—	7,524	(1,046)	21,566	18,540
Change in accrued additional minimum pension liability	—	—	—	—	—	25,925	25,925	52,493
Implementation of SFAS 158	—	—	—	—	—	(96,304)	(96,304)	—
Interdivision transfers	(7,254)	(19,973)	(15,275)	(400)	(10,232)	53,134	—	—
Change in net unrealized gains (losses) on investments	(687)	8,008	24,165	3,514	1,394	6,462	42,856	10,708
Reclassification of investment portfolio to trading	(8,609)	(28,569)	(133,720)	(2,024)	(16,114)	(25,351)	(214,387)	—
Discontinued operations – Benefis Healthcare	—	—	—	—	—	—	—	(190,521)
Increase (decrease) in unrestricted net assets	$ 60,086	126,051	178,002	60,453	52,866	(43,220)	434,238	348,363

See accompanying independent auditors' report.