



GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Consolidated Financial Statements as of and for
the Years Ended December 31, 2008 and 2007
Federal OMB Circular A-133 Reports for the Year
Ended December 31, 2008

(With Independent Auditors' Report Thereon)

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

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Independent Auditors' Report

The Board of Trustees
Group Health Cooperative and Subsidiaries
Seattle, Washington:

We have audited the accompanying consolidated balance sheets of Group Health Cooperative and subsidiaries (the Group) as of December 31, 2008, and the related consolidated statements of operations and changes in net assets and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The accompanying consolidated financial statements of Group Health Cooperative as of December 31, 2007, were audited by other auditors whose report thereon dated March 23, 2008, expressed an unqualified opinion on those statements.

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 Group'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 2008 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Group as of December 31, 2008, and the results of its operations and its cash flows for the years then ended in conformity with U. S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2009 on our consideration of the Group's internal control over financial reporting and on 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

KPMG LLP

March 25, 2009

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Consolidated Balance Sheets

December 31, 2008 and 2007

(In thousands)

Assets	<u>2008</u>	<u>2007</u>
Current assets:		
Cash and cash equivalents	\$ 186,618	\$ 81,139
Restricted cash	—	58
Short-term marketable securities	110,998	243,498
Accounts receivable – net	89,501	90,763
Inventories	22,896	21,488
Funds held by trustee – current portion	586	18,114
Other	43,157	22,965
Total current assets	<u>453,756</u>	<u>478,025</u>
Long-term marketable securities	648,370	696,710
Funds held by trustee – net of current portion	<u>8,848</u>	<u>8,848</u>
Land, buildings, and equipment:		
Land	22,152	18,468
Buildings and improvements	480,163	415,520
Equipment	379,266	402,146
Construction in progress	16,880	111,155
Total land, buildings, and equipment	<u>898,461</u>	<u>947,289</u>
Less accumulated depreciation	<u>(489,880)</u>	<u>(551,589)</u>
Land, buildings, and equipment – net	<u>408,581</u>	<u>395,700</u>
Other assets	<u>38,230</u>	<u>75,494</u>
Total	<u>\$ 1,557,785</u>	<u>\$ 1,654,777</u>

See accompanying notes to consolidated financial statements.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Consolidated Balance Sheets

December 31, 2008 and 2007

(In thousands)

Liabilities and Net Assets	<u>2008</u>	<u>2007</u>
Current liabilities:		
Accounts payable	\$ 75,470	\$ 103,720
External delivery services payable	170,793	152,716
Accrued employee compensation	47,730	50,639
Accrued taxes and interest	13,086	10,563
Unearned dues and deposits	22,867	24,096
Current portion of reserve for self-insurance	8,601	19,913
Current portion of retiree medical benefits	4,616	12,324
Current portion of long-term debt	5,872	5,626
Total current liabilities	<u>349,035</u>	<u>379,597</u>
Noncurrent liabilities:		
Long-term debt	193,863	199,730
Self-insurance	67,423	67,098
Retiree medical benefits	65,167	67,886
Pension	106,986	—
Other	40,572	43,631
Total noncurrent liabilities	<u>474,011</u>	<u>378,345</u>
Total liabilities	<u>823,046</u>	<u>757,942</u>
Commitments and contingencies (note 9)		
Net assets:		
Unrestricted	725,404	884,621
Temporarily restricted	1,823	4,835
Permanently restricted	7,512	7,379
Total net assets	<u>734,739</u>	<u>896,835</u>
Total	<u>\$ 1,557,785</u>	<u>\$ 1,654,777</u>

**GROUP HEALTH COOPERATIVE
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Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2008 and 2007

(In thousands)

	2008	2007
Revenues:		
Premiums	\$ 2,522,262	\$ 2,378,062
Clinical services	184,873	176,143
Other	62,629	53,396
	<u>2,769,764</u>	<u>2,607,601</u>
Total operating revenues		
Expenses:		
External delivery services	1,351,857	1,226,635
Employee compensation	530,573	549,052
Other expenses	280,594	278,971
Group Health Permanente expense	256,643	245,017
Medical and operating supplies	246,348	239,311
Depreciation	51,082	48,560
	<u>2,717,097</u>	<u>2,587,546</u>
Total operating expenses		
Operating income	<u>52,667</u>	<u>20,055</u>
Nonoperating income (expense):		
Investment income (loss)	(59,560)	57,700
Interest expense	(1,756)	(5,821)
	<u>(61,316)</u>	<u>51,879</u>
Total other income (expense)		
(Deficit) excess of revenues over expenses	<u>\$ (8,649)</u>	<u>\$ 71,934</u>

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2008 and 2007

(In thousands)

	<u>2008</u>	<u>2007</u>
(Deficit) excess of revenues over expenses	\$ (8,649)	\$ 71,934
Change in net unrealized investment gains and losses	(5,581)	4,980
Change in defined benefit pension and other postretirement plans	(144,835)	45,921
Other	<u>(152)</u>	<u>(155)</u>
Change in unrestricted net assets	(159,217)	122,680
Change in temporarily restricted net assets	(3,012)	(799)
Change in permanently restricted net assets	<u>133</u>	<u>69</u>
Change in net assets	(162,096)	121,950
Net assets:		
Beginning of year	<u>896,835</u>	<u>774,885</u>
End of year	<u>\$ 734,739</u>	<u>\$ 896,835</u>

**GROUP HEALTH COOPERATIVE
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Consolidated Statements of Cash Flows
Years ended December 31, 2008 and 2007

(In thousands)

	2008		2007
Cash flows from operating activities:			
Change in net assets	\$ (162,096)	\$	121,950
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation	51,082		48,560
Provision for self-insurance	2,524		16,531
Allowance for bad debt	6,716		5,385
Change in net unrealized investment gains and losses	5,581		(4,980)
Recognized other-than-temporary impairment losses	103,304		—
Other	7,977		(2,307)
Cash provided by (used in) operating assets and liabilities:			
Accounts receivable – net	(5,454)		(12,615)
Inventories	(1,408)		2,788
Other current assets	336		1,375
Other assets	(6,437)		(8,304)
Accounts payable	(23,535)		(29,542)
External delivery services payable	18,077		19,289
Accrued employee compensation	(2,909)		14,946
Accrued taxes and interest	2,523		(3,202)
Unearned dues and deposits	1,688		9,708
Pension	136,988		(30,503)
Other noncurrent liabilities	(27,596)		(22,743)
Net cash provided by operating activities	107,361		126,336
Cash flows from investing activities:			
Payments for land, buildings, and equipment	(89,343)		(127,310)
Proceeds from disposal of land, buildings, and equipment	353		5,812
Proceeds from sale of marketable securities	1,065,441		3,055,214
Purchases of marketable securities	(998,707)		(3,490,006)
Purchases of other equity investments – net	—		(100)
Distribution from equity investments	8,337		—
Funds held by trustee	17,623		55,418
Net cash provided by (used in) investing activities	3,704		(500,972)
Cash flows from financing activities:			
Repayment of debt	(5,434)		(5,875)
Other	(152)		(155)
Net cash used in financing activities	(5,586)		(6,030)
Net increase (decrease) in cash and cash equivalents	105,479		(380,666)
Cash and cash equivalents:			
Beginning of year	81,139		461,805
End of year	\$ 186,618	\$	81,139
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	\$ 9,014	\$	10,754
Income taxes	25		333

See accompanying notes to consolidated financial statements.

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(1) Organization

The accompanying consolidated financial statements include the accounts of Group Health Cooperative (the Cooperative or GHC), GHC's wholly owned subsidiary, Group Health Options, Inc. (GHO), and controlled affiliates, KPS Health Plans (KPS), Group Health Foundation (the Foundation), Auxiliary of Group Health Cooperative (Auxiliary), and KPS's wholly owned subsidiary, Northwest Credentials Verification Service LLC (NCVS), (collectively, the Group).

The Cooperative is a Washington nonprofit corporation registered as a health maintenance organization headquartered in Seattle, Washington. The Cooperative offers comprehensive, coordinated health care to an enrolled membership for a fixed prepaid fee through its owned and leased facilities, employed providers, and contracted providers, in addition to providing certain health care services on a fee-for-service basis to both enrollees and nonenrollees.

GHO is a Washington for-profit corporation registered and operating as a health care services contractor providing health care coverage products that feature increased customer choice, including a point of service plan benefit. It is also registered in Idaho as a Disability, Including Managed Care Carrier, operating in two counties.

The Foundation is a Washington nonprofit corporation. It is organized exclusively to benefit, perform the functions of, and carry out the purposes of the Cooperative and other affiliated tax-exempt organizations. It supports research, health careers, training, health education, GHC programs, and other projects that promote high quality health care. Grants are awarded to qualified health-related community organizations, extending the internal resources of the Cooperative to the community. The Foundation's operations are largely a function of the level of grants and donations it receives.

The Auxiliary is an unincorporated association. It is organized for the purpose of promoting and advancing the welfare of GHC through fundraising in order to provide services and gifts to the medical centers, specialty centers, and health-related programs of the Cooperative and its patients.

KPS is a Washington taxable nonprofit corporation registered and operating as a health care service contractor headquartered in Bremerton, Washington. KPS provides health care services through contracts with participating physicians and hospitals.

NCVS, a Washington limited liability company, performs primary source credentials verification of health care providers requesting new or continued participation with KPS, and contracts nationally with health plans, hospitals, and other organizations to provide credentials verification services.

(2) Summary of Significant Accounting Policies

(a) *Principles of consolidation*

The consolidated financial statements include those of GHC, all of its wholly owned subsidiaries and controlled affiliates. All significant intercompany accounts and transactions have been eliminated in these consolidated financial statements.

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December 31, 2008 and 2007

The Group has prepared the accompanying consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP).

(b) *Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. Significant estimates and assumptions are used in the recording of external delivery services payable, asset valuation, allowances for uncollectible accounts, self-insurance reserves, and the evaluation of contingencies and litigation. Changes in these estimates and assumptions may have a material impact on the financial statements.

(c) *Cash and Cash Equivalents*

Cash and cash equivalents consist of liquid investments with original maturities of three months or less at the date of purchase and are carried at cost, which approximates fair value.

(d) *Marketable Securities*

Marketable securities are readily convertible to cash and are carried at fair value in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and SFAS No. 124, *Accounting for Certain Investments Held by Not for Profit Organizations*. The Group considers securities with maturities greater than 3 months and less than one year at the date of purchase to be short-term investments. All marketable securities are classified as available-for-sale securities and reported at fair value. The change in unrealized gains and losses is recorded as a separate component of net assets for GHC, GHO, KPS, and NCVS. The Foundation records the change in unrealized gains and losses to investment income in the statements of operations and changes in net assets. The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity or, in the case of mortgage-backed securities, over the estimated life of the security. The discount or premium is amortized using the effective yield method. Such amortization and accretion is included in investment income. Gains or losses on sale are calculated using the first-in first-out (FIFO) basis.

(e) *Other-Than-Temporary Impairment*

A decline in the market value of any available-for-sale security below cost that is deemed to be other-than-temporary results in an impairment to reduce the carrying amount to market value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, the Group considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, forecasted performance of the investee, and the general market condition in the geographic area or industry in which the investee operates.

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(f) *Accounts Receivable*

Accounts receivable are primarily comprised of enrollee dues, receivables for noncovered health care services, copays and deductibles, and receivables for fee-for-service clinical services provided to nonenrollees. The Group records a reduction in the related dues revenues for an estimate of amounts related to retroactive enrollment changes. Provisions for contractual adjustments are recorded on an accrual basis and are deducted from gross revenues. Bad debts related to services provided are recorded as expenses in the consolidated statements of operations. The allowance for uncollectible accounts was \$9,541,000 and \$8,647,000 as of December 31, 2008 and 2007, respectively.

(g) *Inventories*

Inventories consist of pharmaceuticals, medical, and operating supplies and are stated at the lower of weighted average cost or market.

(h) *Funds Held by Trustee*

Funds held by trustee are assets restricted as to use pursuant to terms and conditions of the revenue bonds (see note 4). The current portion represents funds held for bond principal and interest payable within the next 12 months. In 2007, the current portion included an amount for a project construction fund, which held the original Series 2006 revenue bond proceeds. This project construction fund was maintained until mid-2008 when the construction of the medical specialty center located in Bellevue, Washington was completed. The Cooperative requested reimbursement from the bond trustee as costs were incurred.

The Series 2006 revenue bonds require a debt service reserve fund in the amount of \$8,848,000 for the benefit of the bond owners which shall be maintained as long as any Series 2006 bonds remain outstanding. This debt service reserve fund is included within the long-term portion of funds held by trustee on the consolidated balance sheets as of December 31, 2008 and 2007.

In February 2009, the 1991 revenue bonds experienced a rating downgrade which triggered the establishment of a cash reserve requirement of \$5,476,000. Further rating downgrades will not result in additional cash reserves.

(i) *Charitable Gift Annuities*

As of December 31, 2008 and 2007, the Foundation had a charitable gift annuities liability of \$1,260,000 and \$1,161,000, respectively, which includes a 10% reserve as required by state law and is recorded as a component of other noncurrent liabilities in the accompanying consolidated balance sheets.

(j) *Land, Buildings, and Equipment*

Land, buildings and improvements, and equipment are recorded at cost. Depreciation is computed using the straight line method over the estimated useful lives of the assets or, for leasehold improvements, over the term of the related lease, whichever is shorter. When assets are sold or retired, their cost and related accumulated depreciation are removed from the accounts and any related gain or loss is reflected in operations. The estimated useful lives of buildings, improvements,

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and leasehold improvements are 5 to 40 years, and the estimated useful life of equipment is 2 to 20 years.

(k) Construction in Progress

Construction in progress (CIP) projects include costs incurred while preparing assets for their intended use. CIP projects typically consist of major computer system installations, the construction or remodel of buildings, or the installation of major equipment.

(l) Long-Lived Assets

In accounting for its long-lived assets, the Group makes estimates about the expected useful lives of the assets, the expected residual values of the assets, and the potential for impairment based on the fair value of the assets and the cash flows they generate. Factors indicating potential impairment include, but are not limited to, significant decreases in the market value of the long-lived assets, a significant change in the long-lived assets' condition, and operating cash flow losses associated with the use of the long-lived asset.

There is inherent risk in estimating the future cash flows used in the impairment test. If cash flows do not materialize as estimated, there is a risk the impairment charges recognized to date may be inaccurate, or further impairment charges may be necessary in the future.

In 2003, the Cooperative announced its intention to cease operations in 2008 of its Eastside Campus located in Redmond, Washington which housed an inpatient hospital facility, a specialty center and primary care clinic, and to consider the sale of the Campus at that time. This action is part of the Cooperative's overall strategic plan for the Eastside Campus. It included relocating the primary care center to downtown Redmond and building a new specialty center in Bellevue, adjacent to the Overlake Hospital Medical Center, a not-for-profit regional medical center, where Group Health enrollees can receive hospital care. In February 2008, Group Health carried out its plan and placed the Campus for sale. As a result, the assets of this facility of \$20,528,000 are classified as held for sale which are reported as other current assets in the consolidated balance sheets.

Management periodically performs an evaluation of the recoverability of the book value of the Eastside Campus assets. No impairment loss was incurred in 2008 or 2007.

(m) Self-Insurance

The Group is partially self-insured for professional liability and industrial accident claims and fully self-insured for unemployment benefits. Professional liability and industrial accident claims liabilities are determined using case-based estimates for reported claims and actuarial estimates for incurred but not reported claims. These estimates are based on historical information along with certain assumptions about future events. Changes in assumptions related to expected claims development as well as changes in actual experience could cause these estimates to change. At December 31, 2008 and 2007, the estimated liability for professional liability claims was \$67,324,000 and \$77,798,000 respectively. Due to favorable claims development experience, a reduction to the professional claims liability occurred in 2008. The professional liability expense was a credit of \$2,411,000 and an expense of \$11,901,000 for the years ended December 31, 2008 and

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2007, respectively. At December 31, 2008 and 2007, the estimated liability for industrial accident claims was \$7,629,000 and \$8,387,000 respectively.

(n) Reinsurance

The Group limits certain exposure to claims loss by ceding reinsurance to other insurance companies. GHC maintains reinsurance on a claims-made basis for professional liability and industrial accident claims. Retention levels are \$10,000,000 per claim with a \$50,000,000 annual aggregate in 2008 and 2007. KPS purchases reinsurance to limit its exposure on all of its insured contracts except the Federal Employees Health Benefit Plan and Medicare Supplemental products. A retention level of \$500,000 per claim with a coinsurance level of 10% was held in 2008 and 2007 by KPS.

Reinsurance contracts do not relieve the Group from its obligations to claimants. Failure of reinsurers to honor their obligations could result in losses to the Group. The Group had recorded prepaid reinsurance premiums of \$1,444,000 and \$1,487,000 of December 31, 2008 and 2007, respectively, and reinsurance receivables of \$68,000 and \$0 as of December 31, 2008 and 2007, respectively.

(o) Derivatives

In certain instances, the Group enters into derivative instruments to hedge specific assets and liabilities. Prior to entering into a derivative contract designated as a hedge, the relationship between the hedging instruments and the hedged items, as well as its risk management objective and strategy, are formally documented. On the date the Group enters into a derivative contract utilized as a hedge, the derivative instrument is designated as either a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (known as a "fair value" hedge) or a hedge of the variability in expected future cash flows associated with an existing recognized asset or liability or a forecasted transaction (known as a "cash flow" hedge).

In a cash flow hedge, the effective portion of the changes in the fair value of the hedging derivative is recorded in net assets and is subsequently reclassified into earnings during the same period in which the hedged item affects earnings. The change in fair value of any ineffective portion of the hedging derivative is recognized immediately in earnings.

To qualify for hedge accounting treatment, the derivatives and related hedged items must be designated as a hedge. Both at the inception of the hedge and on an ongoing basis, the Group assesses whether the hedging relationship is expected to be highly effective in offsetting changes in fair value or cash flows of hedged items. If it is determined that the derivative instrument is not highly effective as a hedge, hedge accounting treatment is discontinued.

(p) Revenues

Revenues are derived principally from prepaid health care premiums and fee-for-service clinical service billings. Premiums received in advance of the coverage period are deferred, and revenues are recognized in the period in which services are covered. Group contracts cover employee groups and are entered into with employers or union trusts. Clinical service revenues are generated through the

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provision of certain medical and pharmacy services not fully covered under existing benefit policies and from services provided to nonenrollees who receive care at GHC's facilities.

The Cooperative has a contract with the Centers for Medicare and Medicaid Services (CMS) to provide health care services to enrollees eligible for Medicare coverage. Under this arrangement, premiums from CMS are paid prospectively. The premium amounts vary by individual and are determined through a bidding process whereby GHC submits a bid for the projected costs of Medicare covered services. The amount of the premium is determined by the relationship of the submitted bid to the CMS county level benchmarks and is adjusted for the health risk of the enrollee. Supplemental dues are paid by individual enrollees or employer groups for benefits not covered under CMS premiums.

Other revenues consist mainly of grants awarded to the Center for Health Studies, a division of Group Health, and optical sales. Also included in other revenues are unconditional promises to donate cash and other assets to the Foundation, which are reported at fair value at the date the promise is received. The Foundation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires (when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and are reported as other revenue.

The table below presents the balances of the significant operating revenue types for the years ended December 31, 2008 and 2007 (in thousands):

	<u>2008</u>	<u>2007</u>
Premiums:		
Group dues	\$ 1,769,149	\$ 1,647,079
Medicare	647,409	632,152
Medicaid	34,159	32,678
Individual and family	71,545	66,153
Total premiums	<u>2,522,262</u>	<u>2,378,062</u>
Clinical services	184,873	176,143
Other revenue:		
Sales	13,639	14,823
Grants	31,861	27,040
Other	17,129	11,533
Total other	<u>62,629</u>	<u>53,396</u>
Total operating revenues	<u>\$ 2,769,764</u>	<u>\$ 2,607,601</u>

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(q) Premium Deficiencies

A premium deficiency reserve is recognized when the expected future claims payments and administrative costs of a grouping of existing contracts exceed the premiums to be collected for the remainder of a contract period. Deficiencies in one grouping of contracts are not offset by anticipated surpluses in other groupings. Reserves are regularly reviewed and adjusted as experience develops or new information becomes known. Such adjustments are included in current operations. No reserve was considered necessary at December 31, 2008 and 2007.

(r) External Delivery Services

External delivery services represent health care expenses incurred by the Cooperative, GHO, and KPS for care provided by contracted and noncontracted health care facilities and practitioners. The liability reflected on the consolidated balance sheets is determined using actuarial estimates. These estimates are based on historical information along with certain assumptions about future events. Changes in assumptions, as well as changes in actual experience, could materially impact these estimates.

(s) Group Health Permanente Expense

Group Health Permanente P.C., is an independent medical group with an exclusive contract to provide medical services at Group Health facilities providing primary, specialty, and inpatient care.

(t) Advertising

Advertising costs are expensed as incurred and are recorded within other expense in the statements of operations and changes in net assets. The Group recorded advertising expense of \$8,966,000 and \$7,886,000 for the years ended December 31, 2008 and 2007, respectively.

(u) Leases

Rent revenue and expense is recorded on a straight-line basis over the term of the respective leases. Lease incentives are amortized ratably over the lease term. (See note 9).

(v) Income Taxes

GHO, KPS, and NCVS are subject to federal income taxes. These companies file federal tax returns and are not subject to any state income tax filing requirements. GHC is exempt from federal income taxes under Section 501(a) of the Internal Revenue Code (the Code) as a charitable organization under Section 501(c)(3) of the Code, except for unrelated business income tax. The Foundation has received a determination letter from the Internal Revenue Service (IRS) that it is a tax exempt public foundation in accordance with Section 501(c)(3) and a public charity in accordance with Section 170(b)(1)(A)(vi) of the Code. The Auxiliary has received a determination letter from the IRS that it is a tax exempt organization in accordance with Sections 501(c)(3) and 509(a)(2) of the Code.

GHO and KPS recognize deferred income taxes for the tax consequences in future years of the differences between the tax basis of assets and liabilities and their financial reporting amounts at each year end based on enacted tax laws and statutory tax rates applicable to the periods in which the

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differences are expected to reverse. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities (including the impact of available carryback and carryforward periods), projected future taxable income, and tax-planning strategies in making this assessment. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. Interest and penalties, if any, are recognized as other expense in the period in which the interest would be accruing according to tax law or in the period the tax position is initially taken.

(w) Net Assets

Unrestricted net assets result from operations and unrestricted contributions received. Temporarily and permanently restricted net assets are accounted for within the Cooperative and the Foundation. Temporarily restricted net assets account for funds restricted by donors for specific purposes and are available to support the Cooperative and the Foundation in carrying out their missions. Permanently restricted net assets are contributions restricted by the donor to be invested in perpetuity. A portion of the income earned from permanently restricted net assets is disbursed to support the Foundation in carrying out its mission.

(x) Reclassifications

Certain reclassifications have been made to the 2007 consolidated financial statements to conform to the 2008 consolidated financial statement presentation.

(y) Accounting Changes

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* which establishes a framework for measuring fair value of assets and liabilities and expands disclosures about fair value measurements. The definition of fair value under SFAS 157 supersedes definitions in most other pronouncements to create consistency in financial reporting. This standard is effective for the 2008 fiscal year. The adoption of this standard required additional disclosures (see footnote 6) and did not have a material impact on the Group's consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109*. The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken on a tax return. This standard is effective for the 2007 fiscal year. The adoption of this standard did not have a material impact on the Group's consolidated financial statements.

(z) New Accounting Pronouncements

In January 2009, the FASB issued FASB Staff Position (FSP) EITF 99-20-1, *Amendments to the Impairment Guidance of EITF Issue No. 99-20*, which amends the impairment guidance to achieve more consistent determination of whether an other-than-temporary impairment (OTTI) has occurred.

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The FSP retains and emphasizes the objectives of OTTI assessment and the related disclosure requirements in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and other related guidance. This standard is effective for the Group's 2008 fiscal year. The adoption of this standard did not have a material impact on the Group's consolidated financial statements.

In May 2008, the FASB issued SFAS 163, *Accounting for Financial Guarantee Insurance Contracts – an interpretation of FASB Statement No. 60*, which requires an insurance enterprise to recognize a claim liability prior to an insured event when there is evidence that credit deterioration has occurred in an insured financial obligation. This standard is effective for the 2009 fiscal year. The Group is evaluating the impact the adoption of this standard will have on its future consolidated financial statements.

In May 2008, the FASB issued SFAS 162, *The Hierarchy of GAAP*, which identifies the source of accounting principles and the framework for selecting the principles used in the preparation of financial statements. Previously the hierarchy was set by the American Institute of Certified Public Accountants and was directed at auditors. The effective date for this standard will be 60 days after the U. S. Securities & Exchange Commission's (SEC) approval of a separate regulation. The adoption of this standard will not have a material impact on the Group's consolidated financial statements.

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FAS 133*, which expands the disclosures required under FAS 133. The intent of this standard is to provide a clear understanding of the use of derivative instruments and how they affect the entity's financial performance. This standard is effective for the 2009 fiscal year. The adoption of this standard will not have a material impact on the Group's consolidated financial statements.

In December 2007, the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51*, which establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This standard applies to all entities that prepare consolidated financial statements, except not for profit organizations. Not for profit organizations should continue to apply guidance in ARB No. 51, *Consolidated Financial Statements*, until the FASB issues interpretative guidance. This standard is effective for the 2009 fiscal year. The adoption of this standard will not have a material impact on the Group's consolidated financial statements.

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(3) Marketable Securities

Marketable securities as of December 31, 2008 and 2007, consist of the following (in thousands):

	2008				2007			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Debt:								
U.S. government securities \$	306,573	14,891	(158)	321,306	250,745	4,913	(90)	255,568
Commercial paper	17,434	48	—	17,482	—	—	—	—
Corporate debt securities	189,431	2,089	(4,691)	186,829	369,211	1,238	(1,293)	369,156
Mortgage backed securities	50,345	1	(2,182)	48,164	104,091	450	(41)	104,500
Collateralized mortgage obligations	35,805	169	(4,194)	31,780	31,085	274	(92)	31,267
Mutual funds:								
Fixed income	3,025	24	(63)	2,986	4,387	37	(20)	4,404
Equity	154,821	—	(4,132)	150,689	167,871	11,738	(4,779)	174,830
Other	135	—	(3)	132	219	264	—	483
Total	\$ 757,569	17,222	(15,423)	759,368	927,609	18,914	(6,315)	940,208

Contractual maturities of debt securities held as of December 31, 2008 include:

	Fair value				
	Within 1 year	After 1 year through 5 years	After 5 years through 10 years	After 10 years	Total fair value
Debt:					
U.S. government securities \$	20,205	43,453	72,871	184,777	321,306
Commercial paper	17,482	—	—	—	17,482
Corporate debt securities	72,449	66,654	35,034	12,692	186,829
Mortgage-backed securities	742	45,127	496	1,799	48,164
Collateral mortgage obligations	—	—	4,145	27,635	31,780

Securities not due at a single maturity date, such as mortgage-backed securities, are allocated in the table above by its final maturity date.

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Investment income (loss) as of December 31, 2008 and 2007, consist of the following (in thousands):

	<u>2008</u>	<u>2007</u>
Interest	\$ 36,016	\$ 39,374
Realized gains on sale	8,340	3,379
Realized losses on sale	(5,840)	(2,722)
Dividends and capital gains	7,035	8,223
Amortization, accretion and other	(1,807)	9,446
Other-than-temporary impairments	(103,304)	—
Total investment income (loss)	<u>\$ (59,560)</u>	<u>\$ 57,700</u>

The following tables show the gross unrealized losses and fair value of the Group's investments with unrealized losses. These securities are deemed to be temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2008 and 2007 (in thousands):

<u>2008</u>	<u>Less than 12 months</u>		<u>12 months or greater</u>		<u>Total</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
Debt:						
U.S. government securities	\$ 6,765	(158)	—	—	6,765	(158)
Corporate debt securities	83,842	(3,712)	5,353	(979)	89,195	(4,691)
Mortgage backed securities	45,761	(2,063)	981	(119)	46,742	(2,182)
Collateralized mortgage obligations	15,921	(2,869)	4,514	(1,325)	20,435	(4,194)
Mutual funds:						
Fixed income	1,190	(50)	1,137	(13)	2,327	(63)
Equity	5,058	(2,399)	1,879	(1,733)	6,937	(4,132)
Other	—	—	3	(3)	3	(3)
Total	<u>\$ 158,537</u>	<u>(11,251)</u>	<u>13,867</u>	<u>(4,172)</u>	<u>172,404</u>	<u>(15,423)</u>

<u>2007</u>	<u>Less than 12 months</u>		<u>12 months or greater</u>		<u>Total</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
Debt:						
U.S. government securities	\$ 730	(25)	4,017	(65)	4,747	(90)
Corporate debt securities	118,588	(1,160)	8,611	(133)	127,199	(1,293)
Mortgage backed securities	6,480	(28)	1,439	(13)	7,919	(41)
Collateralized mortgage obligations	5,021	(32)	1,602	(60)	6,623	(92)
Mutual funds:						
Fixed income	—	—	1,581	(20)	1,581	(20)
Equity	48,205	(4,779)	—	—	48,205	(4,779)
Total	<u>\$ 179,024</u>	<u>(6,024)</u>	<u>17,250</u>	<u>(291)</u>	<u>196,274</u>	<u>(6,315)</u>

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The unrealized losses in the Group's investments were due primarily to the dramatic downturn in the credit markets during the latter part of 2008. Substantially all debt security positions are investment grade with 70% rated high quality, AA or higher, by Standard & Poor's rating agency. Securities with contractual payments are current and no payments were missed in 2008. The Group has the ability and intent to hold these investments until a recovery of market value, which may be maturity, and considers these investments to be temporarily impaired.

(4) Borrowing Arrangements

(a) Line of Credit

In 2008, the Cooperative determined it did not need its revolving line of credit which enabled it to draw up to \$50,000,000, and chose not to renew the agreement in May. There were no borrowings taken when it expired.

(b) Revenue Bonds

The revenue bonds were issued through the Washington Health Care Facilities Authority (the Authority). As security for the repayment of the bonds, the Cooperative has granted the Authority a security interest in its gross receivables and bond funds and liens against certain facilities and equipment. The loan agreements for the revenue bonds require, among other restrictions, that the Cooperative achieve certain minimum debt service coverage ratios. Management believes the Cooperative was in compliance with all debt covenants at December 31, 2008 and 2007.

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Long-term debt at December 31, 2008 and 2007, consists of the following (in thousands):

	Years of maturity	2008	2007
Revenue bonds:			
Series 2006, 4-1/2% to 5.0%, plus bond premium of \$1,856 and \$1,941 in 2008 and 2007, respectively	2022 – 2036	\$ 99,821	\$ 99,906
Series 2001, 3-1/2% to 5-3/8%, plus bond premium of \$1,241 and \$1,472 in 2008 and 2007, respectively	2007 – 2019	58,391	62,482
Series 1991, 6-1/4% to 6-3/4%, net of bond discount of \$1,097 and \$1,225 in 2008 and 2007, respectively	2007 – 2021	41,518	42,950
Other		5	18
Subtotal		199,735	205,356
Less current portion		(5,872)	(5,626)
Total long-term debt		\$ 193,863	\$ 199,730

Future annual principal payments on long-term debt for each of the next five years and thereafter at December 31, 2008, are as follows (in thousands):

Years ending December 31:		
2009	\$	5,680
2010		5,985
2011		6,050
2012		6,620
2013		6,970
Thereafter		166,430
Subtotal		197,735
Add unamortized premium and discount, net		2,000
Total	\$	199,735

Interest paid during 2008 and 2007 was \$9,014,000 and \$10,754,000, respectively. Interest expense was \$1,756,000 and \$5,821,000 during 2008 and 2007, respectively, and the amount of interest

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capitalized was \$1,904,000 and \$4,943,000 in 2008 and 2007, respectively. The effect of the interest rate swaps reduced interest by \$6,935,000 and \$601,000 in 2008 and 2007.

(5) Derivative Financial Instruments

The Cooperative is exposed to the effects of changing interest rates. This exposure is managed, in part, with the use of derivatives. The following is a summary of the Cooperative's risk management strategies and the effects of these strategies on the consolidated financial statements.

In January 2007, the Cooperative entered into an interest rate swap with Citigroup on the 2006 Series bonds as part of the effort to rebalance the mix of variable and fixed rate exposure. The swap entitles GHC to receive payments based on a fixed rate and pay a variable rate based on the Securities Industry and Financial Markets Association Municipal Swap Index (formerly known as the Bond Market Association Municipal Swap Index.) The terms include a provision to cap the market value of the swap at \$22,500,000, and a par termination option with a term to match the call provision of the 2006 Series bonds. The Cooperative has elected to account for the swap as a free standing derivative; therefore changes in the fair value are recorded in earnings. The notional amount of this derivative is \$75,000,000.

The Cooperative had a total return swap with Lehman Brothers considered to be a derivative financial instrument. The total return swap entitled the Cooperative to receive payments equal to the coupon rates on the 1991 Series bonds and pay a variable rate that is based on the Securities Industry and Financial Markets Association Municipal Swap Index. In September 2008, Lehman Brothers Holdings Inc., which is the guarantor of the counterparty, filed for bankruptcy. The counterparty, Lehman Brothers Holdings Inc. also filed for bankruptcy in October 2008. These events resulted in the termination of the swap agreement. The fair value of the interest rate swap which was charged to interest expense was not significant to the consolidated financial statements.

(6) Disclosure about Fair Value of Financial Instruments

Assets and liabilities that are recorded at fair value are required to be grouped in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The three levels are:

- Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets. At December 31, 2008, level 1 securities include primarily US. government and corporate bonds.
- Level 2 - Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. At December 31, 2008, level 2 securities include primarily U. S. government and corporate bonds, commercial paper, mortgage-backed securities, collateralized mortgage obligations and mutual funds.
- Level 3 – Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Group's estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of discounted cash flow models and similar techniques. At December 31, 2008, level 3 securities include primarily corporate bonds, interest rate swaps and other.

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Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Group maximizes the use of observable inputs and minimizes the use of unobservable inputs when developing fair value measurements. Fair value measurements for assets and liabilities where there is limited or no observable market data and, therefore, are based primarily upon estimates calculated by the Group, are based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the results cannot be determined with precision and may not be realized upon an actual settlement of the asset or liability. There may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, that could significantly affect the results of the current or future values.

Following is a description of valuation methods and assumptions used for assets recorded at fair value and for estimating fair value for financial instruments not recorded at fair value but required to be disclosed:

(a) Cash and cash equivalents

The carrying amounts, at cost, approximate fair value due to the short maturity of those instruments.

(b) Funds held by trustee

The carrying amount, at cost, of funds held by trustee approximates fair value due to the short maturity of those instruments.

(c) Long-term debt

Long-term debt is carried at amortized cost, however, accounting standards require the Group to disclose the fair value. The fair value of the Group's long-term debt is estimated based on the future cash flows at the discounted current rates available to the Group for debt of similar type and maturity which are level 2 inputs. Any call provisions that apply are taken into account when valuing the debt. The fair value of the long-term debt was \$165,715,000 and \$211,898,000 as of December 31, 2008 and 2007, respectively.

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(d) *Marketable securities and interest rate swap*

The table below presents the balances of assets measured at fair value on a recurring basis. There were zero liabilities required to be reported at fair value as of December 31, 2008 (in thousands):

	Fair value measurements at reporting date using			
	Fair value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Available for sale securities	\$ 759,368	217,016	534,263	8,089
Interest rate swap	5,486	—	—	5,486

The changes in Level 3 assets measured at fair value on a recurring basis are summarized as follows (in thousands):

	Fair value measurements using significant unobservable inputs (Level 3)		
	Available for sale securities	Interest rate swap	Total
Beginning balance as January 1, 2008	\$ 184	(130)	54
Purchases	8,133	—	8,133
Total gains or losses (realized/unrealized) included in changes in net assets	(228)	5,616	5,388
Ending balance at December 31, 2008	\$ 8,089	5,486	13,575
Net unrealized gains (losses) included in changes in net assets for the year relating to assets held at December 31, 2008	\$ (81)	—	(81)

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(7) Pension Plans

The Group contributes to two defined benefit plans (the Plans), a defined contribution plan, two 401(k) plans, a 403(b) plan, and several union negotiated plans that collectively cover substantially all of its employees. The Group's policy is to fund pension costs for the Plans based on actuarially determined funding requirements, thereby accumulating funds adequate to provide for all accrued benefits. Contributions for the defined contribution plan are based on a percentage of covered employees' salaries. Matching contributions to the 401(k) and 403(b) plans are based on a percentage of participants' contributions as set forth in the plan agreement. The total expense for the defined benefit plan was \$10,168,000 and \$14,293,000 in 2008 and 2007 respectively, and the total expense for the other plans was \$13,705,000 and \$11,799,000 in 2008 and 2007 respectively.

On January 15, 2009, KPS amended its defined benefit pension plan to freeze benefits, effective March 1, 2009. As a result, each active participant's pension benefit will be determined based on the participant's compensation and duration of employment as of March 1, 2009. The most significant financial effect is that no new benefits will be accrued after the date of the freeze.

The actuarial cost method used in determining the net periodic pension cost is the projected unit credit cost method. At December 31, 2008 and 2007, net periodic pension expense related to the Group's participation in the Plans for 2008 and 2007 included the following components (in thousands):

	<u>2008</u>	<u>2007</u>
Service cost	\$ 21,172	\$ 21,744
Interest cost on projected benefits	25,075	22,957
Expected return on Plan assets	(36,421)	(33,562)
Actuarial loss	(74)	940
Net periodic pension cost	<u>\$ 9,752</u>	<u>\$ 12,079</u>
Discount rate (preretirement)	6.30% – 6.60%	5.80% – 6.00%
Discount rate (postretirement)	5.50 – 6.60	5.00 – 6.00
Rate of increase in compensation levels	4.39 – 5.00	4.39 – 5.00
Expected return on Plan assets	8.00 – 8.50	8.00 – 8.50

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The Plans' funded status as of December 31, 2008 and 2007, is as follows (in thousands):

	<u>2008</u>	<u>2007</u>
Projected benefit obligation – end of year	\$ 435,363	\$ 406,079
Change in Plan assets:		
Fair value of Plan assets – beginning of year	\$ 436,081	\$ 402,329
Actual return on Plan assets	(109,858)	30,901
Employer contributions	21,898	20,750
Employee contributions	79	76
Benefits paid	(19,823)	(17,975)
Fair value of Plan assets – end of year	<u>328,377</u>	<u>436,081</u>
Funded status	\$ <u>(106,986)</u>	\$ <u>30,002</u>
Accumulated benefit obligation – end of year	\$ 391,871	\$ 361,610
Discount rate (preretirement)	6.00% – 6.20%	6.30% – 6.60%
Discount rate (postretirement)	6.00	5.50 – 6.60
Rate of increase in compensation levels	4.39 – 5.00	4.39 – 5.00

The funded status is recorded as a component of other noncurrent liabilities as of December 31, 2008 and 2007 in the consolidated balance sheets.

Certain of the Group's employees are covered by union sponsored, collectively bargained, multi-employer defined benefit plans. Contributions are determined in accordance with the provisions of negotiated labor contracts.

(a) Investment policies and strategies

The Group has adopted investment policies for its defined benefit plans that incorporates a strategic, long-term asset allocation mix designed to best meet its long-term pension obligations. Plan fiduciaries set the investment policies and strategies for the pension trust. This includes the following:

- Selecting investment managers
- Setting long-term and short-term target asset allocations
- Periodic review of the target asset allocations, and, if necessary, to make adjustments based on changing economic and market conditions
- Monitoring the actual asset allocations, and, when necessary, rebalancing to the current target allocation.

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As of December 31, 2008 and 2007, the following table summarizes the target allocation range defined in the investment policies compared to the actual allocations of the Group's plan assets:

	2008		2007	
	Target allocation	Actual allocation	Target allocation	Actual allocation
Equity securities	60% – 70%	55%	60% – 70%	62% – 64%
Debt securities	25 – 40	43	25 – 40	35 – 36
Cash equivalents	0 – 5	2	0 – 5	3
Other investments	0 – 5	—	0 – 5	—

The investment policy emphasizes the following key objectives:

- Maintain a diversified portfolio among various asset classes and investment managers
- Invest in a prudent manner for the exclusive benefit of plan participants
- Preserve the funded status of the plan
- Balance between acceptable level of risk and maximizing returns
- Maintain adequate control over administrative costs
- Maintain adequate liquidity to meet expected benefit payments.

(b) *Expected long-term rate of return on assets*

The Group uses a “building block” approach to determine the expected rate of return on plan assets assumption for the Retirement Income Credit Plan.

This approach analyzes historical long-term rates of return for various investment categories, as measured by appropriate indexes. The rates of return on these indexes are then weighted based upon the percentage of plan assets in each applicable category to determine a composite expected return. The Group reviews its expected rate of return assumption annually. However, this is considered to be a long-term assumption and hence not anticipated to change annually, unless there are significant changes in economic and market conditions.

The assumed long-term return on Plan assets used for 2008 was 8.5%

There are no required employer contributions expected to be made to the Plans in 2009.

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Expected amounts to be recognized as components of 2009 net periodic pension cost are (in thousands):

Service cost	\$	22,328
Interest cost on projected benefits		26,095
Expected return on Plan assets		(27,672)
Amortization of net loss		16,973
		37,724
Net periodic pension cost	\$	37,724

The benefits expected to be paid in each of the next five years, and in the aggregate for the five fiscal years thereafter, as of December 31, 2008, are as follows (in thousands):

Years ending December 31:		
2009	\$	28,578
2010		30,208
2011		32,137
2012		34,918
2013		35,234
2014 – 2018		202,183
		363,258
Total	\$	363,258

(8) Retiree Medical Plans

The Cooperative provides certain medical benefits for eligible retired employees. Employees become eligible for these benefits upon retirement and attainment of a specified age and upon completion of a certain number of years of service.

At December 31, 2008 and 2007, net periodic postretirement benefit cost is comprised of the following components (in thousands):

		2008		2007
Service cost	\$	868	\$	1,546
Interest cost on accumulated benefit obligation		4,173		5,007
Amortization of unrecognized prior service cost		(299)		(544)
Amortization of unrecognized transition obligation over 20 years		477		2,000
		5,219		8,009
Net periodic postretirement benefit cost	\$	5,219	\$	8,009

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The Cooperative's accumulated postretirement benefit obligation (APBO) is unfunded. The APBO is included in the components of the retiree medical benefits liability on the consolidated balance sheets at December 31, 2008 and 2007, and is comprised of the following components (in thousands):

	<u>2008</u>	<u>2007</u>
Accumulated postretirement benefit obligation – end of year	\$ 69,781	\$ 80,210
Change in Plan assets:		
Employer contributions	\$ 4,295	\$ 4,554
Benefits paid	(4,295)	(4,554)

Future benefit costs were estimated assuming medical costs would increase at a 7.0% annual rate. A 1.0% increase in this annual trend rate would have increased the APBO at December 31, 2008, by \$6,908,000 and the sum of service cost and interest cost for 2008 by \$591,000. A 1.0% decrease in this annual trend rate would have decreased the APBO at December 31, 2008 by \$5,931,000 and the sum of service cost and interest cost for 2008 by \$501,000.

The weighted average discount rate used in determining the APBO was 6.20% in 2008 and 6.30% in 2007. The assumptions used to determine the APBO are measured at year end. The weighted average discount rate used in determining the net periodic postretirement benefit cost was 6.20% in 2008 and 6.30% in 2007, and is based on beginning of year assumptions.

Expected amounts to be recognized as components of 2009 net periodic postretirement benefit cost are (in thousands):

Service cost	\$ 927
Interest cost on projected benefits	4,183
Amortization of prior service credit	(299)
Amortization of transition obligation	477
Net periodic postretirement benefit cost	\$ <u>5,288</u>

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The Cooperative funds the plan as benefit payments are required. The expected benefit payments to be paid, and contributions to be made, in each of the next five years, and in the aggregate for the five fiscal years thereafter, as of December 31, 2008, are as follows (in thousands):

Years ending December 31:		
2009	\$	4,616
2010		4,914
2011		5,172
2012		5,374
2013		5,538
2014 – 2018		29,327
Total	\$	54,941

In 2007, the Cooperative opted to discontinue its contribution to the premiums for staff retiring on or after December 31, 2007. These changes resulted in the phase out of the benefit for the Cooperative's nonunion active employees. A portion of the accumulated benefit obligation totaling \$7,448,000 was paid out in the first quarter of 2008.

(9) Commitments and Contingencies

(a) Leases

The Group has various operating leases for land, buildings, and equipment. Total rent expense was \$19,955,000 and \$18,614,000 on these leases in 2008 and 2007, respectively. Total sublease rental revenue was \$2,341,000 and \$1,162,000 in 2008 and 2007, respectively. Future minimum rental payments and future minimum sublease rental receipts under noncancelable operating lease and sublease agreements as of December 31, 2008, are as follows (in thousands):

		Minimum sublease rental receipts		Minimum rental payments
Years ending December 31:				
2009	\$	2,453	\$	20,310
2010		2,291		19,990
2011		2,077		19,844
2012		1,815		16,225
2013		1,730		15,399
Thereafter		1,880		47,384
Total	\$	12,246	\$	139,152

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The Cooperative entered into a sale-leaseback transaction in 2006 involving the sale of its administrative main building located in Tukwila, Washington, and then entered into a 10-year operating lease with the purchaser. The gain on sale was deferred and is being amortized over 120 months with the amortization recorded in other expense in the consolidated statements of operations and changes in net assets. The deferred gain is a component of other noncurrent liabilities in the consolidated balance sheets in the amount of \$19,205,000 and \$22,122,000 as of December 31, 2008 and 2007, respectively.

(b) Labor

Approximately 58% of the Cooperative's employees are covered under collective bargaining agreements. These employees provide nursing and other technical services to the Cooperative. Bargaining disputes could adversely affect the Cooperative.

(c) Litigation

The Group is involved in litigation and regulatory investigations arising in the normal course of business. After consultation with legal counsel, management estimates accruals, if any, that are necessary related to these matters. Management believes the recorded amounts are adequate and the ultimate outcome of the matters will not have a material adverse effect on the Group's consolidated financial position or results of operations.

(d) Guarantees

In December 2005, GHC signed a joint venture agreement with City Investors V LLC, a real estate development company controlled by the Vulcan Corporation, to form Westlake Terry LLC. GHC has a 50% ownership interest in Westlake Terry LLC in the amount of \$5,944,000 and \$13,691,000 as of December 31, 2008 and 2007, respectively. Under the agreement, the joint venture developed two adjacent buildings totaling 319,000 square feet located in Seattle, Washington, with GHC a major tenant of the new facility with a 10 year operating lease agreement. GHC, GHO, and the Foundation moved their administrative headquarters to this site in August 2007.

In May 2006, GHC and City Investors V LLC entered into loan guarantees with Westlake Terry, LLC's lenders, relating to its construction and long-term financing. In May 2008, the construction guarantees were eliminated. Management believes the likelihood of performance on the remaining guarantees to be remote and, therefore, has not recorded a related liability.

GHC's guaranty to the lender is now fully nonrecourse, absent fraud or default under certain loan obligations, in which event GHC and City Investors V LLC remain jointly and severally liable for repayment of the loan in full, until the loan has been satisfied.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(10) External Delivery Services Payable

Activity in the external delivery services payable for unpaid claims and claim adjustment expenses is summarized as follows (in thousands):

	<u>2008</u>	<u>2007</u>
Balances at January 1	\$ 152,716	\$ 133,427
Incurred related to:		
Current year	1,378,503	1,226,012
Prior years	(26,646)	623
Total incurred	<u>1,351,857</u>	<u>1,226,635</u>
Paid related to:		
Current year	1,226,582	1,090,943
Prior years	107,198	116,403
Total paid	<u>1,333,780</u>	<u>1,207,346</u>
Balances at December 31	<u>\$ 170,793</u>	<u>\$ 152,716</u>

Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately adjudicated and paid. Liabilities at any year-end are continually reviewed and re-estimated as information regarding actual claims payments becomes known. This information is compared to the originally established year-end liability. Negative amounts reported for incurred related to prior years result from claims being adjudicated and paid for amounts less than originally estimated.

(11) Federal Income Taxes

GHO, KPS, and NCVS are the entities of the Group subject to federal income taxes. Federal income tax expense (benefit) was \$798,000 and \$(1,098,000) in 2008 and 2007, respectively, and is included in other expenses in the statements of operations and changes in net assets. At December 31, 2008 and 2007, deferred tax assets totaled \$9,824,000 and \$5,885,000, respectively, and are included within other current assets and noncurrent assets in the consolidated balance sheets. Deferred tax assets primarily relate to the tax effects of temporary differences associated with pension liabilities, buildings and improvements, other than temporary impairments, and net operating loss carryforwards. At December 31, 2008 and 2007, the Group had a valuation allowance of \$5,186,000 and \$0, respectively recorded against the deferred tax assets, resulting in net deferred tax assets of \$4,638,000. At December 31, 2008 and 2007, deferred tax liabilities totaled \$0 and \$1,190,000, respectively and are recorded as a component of accrued taxes and interest in the accompanying consolidated balance sheets. At December 31, 2008, the Group has net operating loss carryforwards for federal income tax purposes of \$9,210,000 which expire between 2018 through 2024.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(12) Subsequent Event

Subsequent to December 31, 2008, there has been continued instability in the financial markets and certain markets have declined significantly between January 1, 2009 and March 23, 2009. Management is monitoring market conditions and the related unrealized losses on investments. Due to the volatility of the U. S. economy and the financial markets as of the date of this report, there is uncertainty regarding the long-term impact market conditions will have on the Group's investment portfolio.



KPMG LLP
Suite 900
801 Second Avenue
Seattle, WA 98104

**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
Group Health Cooperative and Subsidiaries:

We have audited the financial statements of Group Health Cooperative and Subsidiaries (the Group) as of and for the year ended December 31, 2008, and have issued our report thereon dated March 25, 2009. 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 Group'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 Group's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Group'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. However, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and that are described in the accompanying schedule of findings and questioned costs as findings 08-01 and 08-02. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Group'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*.

We noted certain matters that we reported to management of the Group in a separate letter dated March 25, 2009.

The Group's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Group's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Trustees, others within the entity, 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.

KPMG LLP

March 25, 2009



KPMG LLP
Suite 900
801 Second Avenue
Seattle, WA 98104

**Independent Auditors' 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
Group Health Cooperative and Subsidiaries
Seattle, Washington:

Compliance

We have audited the compliance of Group Health Cooperative and Subsidiaries (the Group) 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 December 31, 2008. The Group's major federal programs are identified in the summary of auditor's 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 Group's management. Our responsibility is to express an opinion on the Group'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 Group's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provided a reasonable basis for our opinion. Our audit does not provide a legal determination on the Group's compliance with those requirements.

In our opinion, the Group complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2008.

Internal Control over Compliance

The management of the Group is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grant agreements applicable to federal programs. In planning and performing our audit, we considered the Group's internal control over compliance with 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 Group'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 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 consolidated financial statements of the Group as of and for the year ended December 31, 2008, and have issued our report thereon dated March 25, 2009. Our audit was performed for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic consolidated financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Trustees, management, others within the entity, 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.

KPMG LLP

March 25, 2009

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Schedule of Expenditures of Federal Awards

Year ended December 31, 2008

<u>Federal agency/subdivision</u>	<u>CFDA number or contract number</u>	<u>Pass-through identifying number</u>	<u>Expenditures</u>
Research and development cluster:			
Department of Defense	12.420		\$ 75,976
Pass-through funds from:			
University of Washington	12.800	FA7014-08-2-0002	4,036
			<u>80,012</u>
Department of Veterans Affairs FSC	Agency 64 VA-246-P-0146		<u>51,560</u>
			<u>51,560</u>
Department of Veterans Affairs:			
Pass-through funds from:			
Department of Veterans Affairs MC	64.RD	Agency 64 SHP 08-137	2,337
			<u>2,337</u>
Agency for Healthcare Research and Quality	93.226		282,573
Pass-through funds from:			
Harvard Pilgrim Health Care, Inc.	93.226	1U18HS016955-01	23,114
Harvard Pilgrim Health Care, Inc.	93.226	5U18HS016955	22,334
University of Washington	93.226	1R01HS014764-02	(50,257)
University of Washington	93.226	1R21HS017657-01	14,033
University of Washington	93.226	5R01HS014764-02	228,065
			<u>519,863</u>
Agency for Healthcare Research and Quality	Agency 93 HHSP233200800234A		30,962
Pass-through funds from:			
Harvard Pilgrim Health Care, Inc.	Agency 93 HHSA290200500331-TO4-WA1	HHSA290200500331-TO4-WA1	27,426
Harvard Pilgrim Health Care, Inc.	Agency 93 HHSA290200500331TO5	HHSA290200500331TO5	46,827
RAND	Agency 93 HHSA2902006000171	HHSA2902006000171	119,078
			<u>224,294</u>
Agency for Healthcare Research and Quality:			
Pass-through funds from:			
Harvard Pilgrim Health Care, Inc.	93.266	5U18HS010391-07	(119)
University of Washington	93.266	5U18HS016658-02	5,367
			<u>5,248</u>
Centers for Disease Control and Prevention	93.135		5,936
Pass-through funds from:			
University of Washington	93.135	5U48DP000050-04	52,869
University of Washington	93.135	5U48DP000050-05	2,022
Center For Health Training	93.260	6FPTPA100014-27	82,819
Southeast Alaska Regional Health Consortium	93.283	5U58DP024463-04	33,499
Southeast Alaska Regional Health Consortium	93.283	5U58DP024663-04	11,862
Public Health Seattle & King	93.283	5U58CCU02330-05	128,306
University of Washington	93.283	5U90TP024247-04	40,891
University of Washington	93.283	5U90TP024247-05	5,426
Children's Hospital and Regional Medical Center	93.945	5U01DP000244-03	2,900
Children's Hospital and Regional Medical Center	93.945	5U01DP000244-04	1,339
America's Health Insurance Plan	Agency 93 200-2002-00732	200-2002-00732	1,192,482
			<u>1,560,352</u>
Department of Health and Human Services:			
Pass-through funds from:			
MDRC	Agency 93 233-01-0012	233-01-0012	18,474
			<u>18,474</u>
Food and Drug Administration	Agency 93 HHSF223200831324P		41,267
Pass-through funds from:			
Harvard Pilgrim Health Care, Inc.	Agency 93 HHSF223200510012C	HHSF223200510012C	669
Harvard Pilgrim Health Care, Inc.	Agency 93 HHSF223200510012C-COA6	HHSF223200510012C-COA6	4,414
Harvard Pilgrim Health Care, Inc.	Agency 93 HHSF223200510012C-COA7	HHSF223200510012C-COA7	783
			<u>47,134</u>
Health Services and Services Admin			
Pass-through funds from:			
University of Washington	93.249	D20HP00007-09-00	2,043
University of Washington	93.249	D20HP00007-08	8,606
			<u>10,649</u>
National Institutes of Health	93.172		1,252,317
			<u>1,252,317</u>

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Schedule of Expenditures of Federal Awards

Year ended December 31, 2008

<u>Federal agency/subdivision</u>	<u>CFDA number or contract number</u>	<u>Pass-through identifying number</u>	<u>Expenditures</u>
National Institutes of Health	93.123		\$ 1,754,542
Pass-through funds from:			
Sloan Kettering Institute	93.123	1R21AT004189-0141	1,693
			<u>1,756,234</u>
National Institutes of Health	93.242		2,926,313
Pass-through funds from:			
University of Washington	93.242	5R01MH041739-20	808,426
University of Washington	93.242	5R01MH072736-03	19,815
University of Washington	93.242	5R01MH072736-04	10,835
University of Washington	93.242	5R01MH067587-03	7,141
			<u>3,772,532</u>
National Institutes of Health	93.279		749,322
Pass-through funds from:			
Univ of California San Francisco	93.279	5U01DA020830-04	5,548
Univ of California San Francisco	93.279	5U01DA020830-03	24,867
University of Washington	93.279	1R21DA018695-01A2	22,073
			<u>801,809</u>
National Institutes of Health	93.393		3,855,554
Pass-through funds from:			
Boston Medical Center	93.393	2R01CA093772-01	15,813
Center For Health Research	93.393	1R01CA114204-01A1	28,408
Center For Health Research	93.393	5R01CA114204-02	35,559
Fred Hutchinson Cancer Res Ctr	93.393	5R01CA097325-05	60,000
Fred Hutchinson Cancer Res Ctr	93.393	5R01CA098415-05	22,881
Fred Hutchinson Cancer Res Ctr	93.393	5U01CA088160-08	6,580
Fred Hutchinson Cancer Res Ctr	93.393	5R01CA097271-04	379
Fred Hutchinson Cancer Res Ctr	93.393	5R01CA097325-04	69,858
Fred Hutchinson Cancer Res Ctr	93.393	5R01CA098415-04	20,753
Kaiser Permanente Division Of Research	93.393	1P20CA137219-01	13,677
Sloan Kettering Institute	93.393	5R01CA079572-09	57,298
Sloan Kettering Institute	93.393	5R01CA079572-08	104,858
SRI International	93.393	5R01CA71358-05A1	128,879
The University Of Vermont	93.393	3U01CA070013-14S2	4,871
Univ of California San Fran	93.393	1R21CA131698-01	1,044
Univ of Missouri-Columbia	93.393	1R01CA134196-01	7,798
Univ of Tx Md Anderson Ca Ctr	93.393	5R01CA098380-05	9,103
University of Washington	93.393	5R01CA107623-06	197,439
Wake Forest University	93.393	1R01CA121303-01	7,232
			<u>4,647,984</u>
National Institutes of Health			
Pass-through funds from:			
University of Washington	93.397	5U54CA116847-03	6,668
			<u>6,668</u>
National Institutes of Health			
Pass-through funds from:			
Univ of California San Fran	93.398	1K24CA125036-01	598
			<u>598</u>
National Institutes of Health	93.399		5,148,247
Pass-through funds from:			
Boston Medical Center	93.399	5R01CA093772-04	2,483
Dana Farber Cancer Institute	93.399	7U01CA093332	30,164
University of Illinois Chicago	93.399	5P50DA019706-09	(10,474)
University of Michigan	93.399	5P50CA101451-05	438,332
University of Nebraska Med Ctr	93.399	5U01CA111294-02	5,643
University of Wisconsin	93.399	5P50DA019706-10	10,281
			<u>5,624,676</u>
National Institutes of Health	93.837		181,309
Pass-through funds from:			
Black Hills Center-AI Health	93.837	5U01HL087422-02	19,217
Black Hills Center-AI Health	93.837	5U01HL087422-03	11,364
Childrens Hospital Med Center	93.837	7R01HL079402-04	2,673
Kaiser Permanente Division Of Research	93.837	1U19HL091179-01	31,215
Kaiser Permanente Division Of Research	93.837	5U19HL0911179-02	23,593

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Schedule of Expenditures of Federal Awards

Year ended December 31, 2008

<u>Federal agency/subdivision</u>	<u>CFDA number or contract number</u>	<u>Pass-through identifying number</u>	<u>Expenditures</u>
University of Washington	93.837	1R01HL085251-01	\$ 150,460
University of Washington	93.837	1R01HL088456-01	82,974
University of Washington	93.837	1R01HL091244-01	432
University of Washington	93.837	5R01HL068639-04	39,473
University of Washington	93.837	5R01HL085251-02	119,794
University of Washington	93.837	5R01HL068986-04	4,031
			<hr/> 666,535
National Institutes of Health	93.864		30,187
Pass-through funds from:			
Fred Hutchinson Cancer Research Center	93.864	5R01HD040398-05	1,033
			<hr/> 31,220
National Institutes of Health	93.865		677,097
Pass-through funds from:			
Fred Hutchinson Cancer Research Center	93.865	5R01HD044813-04	19,737
			<hr/> 696,834
National Institutes of Health	93.866		1,479,204
Pass-through funds from:			
Pennsylvania State University	93.866	5R37AG024102-03	13,102
Sea Inst Of Biomed Research	93.866	5R01AG024180-03	104,816
Sea Inst Of Biomed Research	93.866	1R01AG024180-01A2	(49)
Sea Inst Of Biomed Research	93.866	R01AG02418001A2	133,068
University of Washington	93.866	1R01AG031126-01A1	26,646
University of Washington	93.866	5K23AG028980-03	16,519
University of Washington	93.866	5R37AG024102-04	8,341
University of Washington	93.866	5R01NS045254-03	10,790
University of Washington	93.866	R01AG11380	8,826
			<hr/> 1,801,263
National Institutes of Health			
Pass-through funds from:			
Jaeb Center For Health Res	93.867	5U10EY12358	90
			<hr/> 90
National Institutes of Health	Agency 93 HHSN272200800004C		1,377,906
National Institutes of Health	Agency 93 HHSN268200425216C		192,852
National Institutes of Health	Agency 93 HHSN272200800269P		34,186
National Institutes of Health	Agency 93 2653-MQ-612311		(346)
Pass-through funds from:			
Booz Allen Hamilton, Inc.	Agency 93 HHSN27620008003880	HHSN27620008003880	25,512
Booz Allen Hamilton, Inc.	Agency 93 1435-04-04-CT-73980	1435-04-04-CT-73980	6,915
University of Washington	Agency 93 N01-HC-95159	N01-HC-95159	24,537
			<hr/> 1,661,562
National Institutes of Health:			
Pass-through funds from:			
University of Washington	93.113	5P42ES004696-21	43,604
University of Washington	93.113	5P42ES004696-20	24,295
University of Washington	93.113	5K23MH069814-03	54,277
University of Washington	93.113	5R01HL079402-02	61,582
University of Washington	93.113	5R01HL073410-03	119,717
University of Washington	93.113	1R01DK071101-01A2	38,453
University of Washington	93.113	1R01DK076608-01A1	39,032
University of Washington	93.849	5P01DK053369-10	77,344
			<hr/> 458,304
National Institutes of Health	93.684		68,577
			<hr/> 68,577
National Institutes of Health			
Pass-through funds from:			
University of Washington	93.833	5R01AF023801-04	9,812
University of Washington	93.833	R01AF023801	16,722
			<hr/> 26,534

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Schedule of Expenditures of Federal Awards

Year ended December 31, 2008

<u>Federal agency/subdivision</u>	<u>CFDA number or contract number</u>	<u>Pass-through identifying number</u>	<u>Expenditures</u>
National Institutes of Health	93.866	5T32AG027677-02	\$ 40,342
Pass-through funds from:			
Fred Hutchinson Cancer Res Ctr	93.389	5R01CA098858-04	2,244
University of Washington	93.389	1UL1RR025014-01	302,344
University of Washington	93.389	3UL1RR025014-02S1	5,787
University of Washington	93.389	5UL1RR025014-02	179,018
			<u>529,735</u>
Total research and development cluster			<u>26,323,395</u>
Other awards:			
Department of Health and Human Services			
Pass-through funds from:			
Washington State Hospital Association	93.889	U3RHS05968 and U3RHS05968	2,611
Total other awards			<u>2,611</u>
Total federal awards			<u>\$ 26,326,006</u>

See accompanying notes to schedule of expenditures of federal awards.

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Notes to the Schedule of Expenditures of Federal Awards

Year ended December 31, 2008

(1) Basis of Accounting

The accompanying schedule of expenditures of federal awards has been prepared from the Group's accounting records and is presented on the accrual basis of accounting.

(2) Major Program

The research and development grants are determined to be a cluster of grants. A cluster of grants means a grouping of closely related grants that share common compliance requirements. A cluster of grants shall be considered as one program for determining major programs, as described in §520, Major Program Determination, of the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement*.

(3) Health Resources and Services Administration – Noncash Subaward

In the year ended December 31, 2008, GHC participated in a subcontract from the Washington State Department of Health in the performance of a federal Health Resources and Services Administration Grant (CFDA 93.889). There was \$2,111 of noncash property purchased and delivered by the Washington State Hospital Association (WSHA) on GHC's behalf during the year ended December 31, 2008. This noncash property purchased by WSHA on GHC's behalf is equipment that is to be used in disaster response including chemical, biological, radiological, nuclear, or explosive events. This activity is included on the schedule of expenditures of federal awards under CFDA 93.889.

(4) Subrecipient Awards

GHC, GHO, KPS, Auxiliary, NCVS, and the Foundation passed through federal awards to subrecipients for:

CFDA # or contract #	Program	Subrecipient	Amount
12.420	A Population-Based Randomized Trial to Assess the Effect of Short-Term Cessation of HRT on Mammography Assessments and Breast Density	University of Washington	\$ 13,538
93.172	Development and use of network Infrastructure for High Throughput GWA Studies	Fred Hutchinson Cancer Research Center University of Washington	91,597 289,144
93.172	Development and use of network Infrastructure for High Throughput GWA Studies Supplement	University of Washington	17,174

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Notes to the Schedule of Expenditures of Federal Awards

Year ended December 31, 2008

CFDA # or contract #	Program	Subrecipient	Amount
93.172	Cancer Research Network Across Healthcare Systems	Harvard Pilgrim Health Care Henry Ford Health System Kaiser Foundation Research Institute	\$ 6,118 143,867 45,568
93.213	Evaluating the Efficacy of Acupuncture for Chronic Low Back Pain	Cancer Research and Biostatistics University of Washington Kaiser Foundation Research Institute Oregon Health & Science	15,389 (4,273) 74,411 5,151
93.242	Social Role Disability and Mental-Physical Co-Morbidity	Harvard Medical School University of Washington	92,910 14,950
93.242	Depression-Diabetes Care Disparities, Adverse Outcomes	University of Washington	89,000
93.242	Epidemiology and Treatment of Comorbid Obesity and Depression	Regents of the University of Minnesota	(2,628)
93.242	Transition From Prison to Community: A Pilot Intervention of Adherence Support	University of Wisconsin at Madison	117,581
93.242	Prevention Needs HIV+ persons awaiting release from prison	University of Wisconsin at Madison	11,325
93.242	Patient Portal to support treatment adherence	Kaiser Foundation Research Institute	63,672
93.242	Patient-Centered Interventions for Mood Disorders	Depression and Bipolar Support University of Washington	12,963 28,161
93.279	Long-Term Opioid Management of Chronic Pain: Trends and Risks	Kaiser Foundation Research Institute University of Washington	347,757 64,174
93.389	Institutional and Clinical Translational Science Award	University of Minnesota	23,629
93.393	Proactive Cessation Intervention with Biomarker Feedback	Free and Clear, Inc.	2,023

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Notes to the Schedule of Expenditures of Federal Awards

Year ended December 31, 2008

CFDA # or contract #	Program	Subrecipient	Amount
93.393	Multi-Center Study of Pancreatic Cancer Etiology	Fred Hutchinson Cancer Research Center Kaiser Foundation Research Institute University of Washington	\$ 76,681 508,904 128,542
93.393	Statistical Coordinating Center for the Breast Cancer Surveillance Consortium	Cancer Research and Biostatistics University of New Mexico	43,635 5,459
93.393	Design and Inference for Hybrid Ecological Studies	University of Washington	2,524
93.393	Systems of Support (SOS) to Increase Colon Cancer Screening and Support	Fred Hutchinson Cancer Research Center Kaiser Foundation Research Institute	37,569 13,176
93.393	Statistical coordinating center for the BSCS – Admin Supplement Medicare Data	University of New Mexico	3,567
93.399	Cancer Research Network Across Healthcare Systems	Geisinger Clinic Harvard Pilgrim Health Care, Inc. Healthpartners Research Henry Ford Health System Kaiser Foundation Research Institute Loveland Clinic Foundation Marshfield Clinic University of Massachusetts Dartmouth College Beth Israel Deaconess	14,975 358,181 147,432 307,857 2,774,038 79,635 146,311 319,686 27,858 131,582
93.864	Entopic Pregnancy: Assessing Long-Term Trends in Rates and Risk Factors	University of Washington	19,177
93.865	Oral Contraceptive Use and Bone Density in Young Women	Fred Hutchinson Cancer Research Center University of Washington	20,718 19,549
93.866	HRT Decision Making in the Post-WHI Era	University of Washington	386
93.866	Alzheimer’s Disease Patient Registry	University of Washington Evergreen Healthcare	527,151 40,092

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Notes to the Schedule of Expenditures of Federal Awards

Year ended December 31, 2008

CFDA # or contract #	Program	Subrecipient	Amount
93.866	MCI, Insulin, and Cholesterol in a Community Sample	University of Washington Evergreen Healthcare	\$ 144,803 9,830
93.866	Oral Contraceptive Use and Fractures Around The Menopause Transition	Fred Hutchinson Cancer Research Center University of Washington	1,847 1,537
93.RD	Re-engineering the Clinical Research Enterprise Feasibility	Harvard Pilgrim Health Care, Inc. Health Partners Research Foundation Henry Ford Health System Kaiser Foundation Research Institute Lovelace Clinic University of Massachusetts	16,687 8,003 11,557 14,542 33,069 4,506
93.RD	Integrating Chronic Care and Business Strategies in the Safety Net	California Health Care Safety Net Institute	14,262
93.RD	Vaccine Treatment and Evaluation Units	Children's Hospital & Regional Medical Center University of Washington	58,419 586,409
			\$ <u>8,223,357</u>

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Schedule of Findings and Questioned Costs

Year ended December 31, 2008

Part I – Summary of Auditors’ Results

Financial Statements

Type of auditor’s report issued: Unqualified

Internal control over financial reporting:

- Material weaknesses identified? _____ Yes X No
- Significant deficiencies identified that are not considered to be material weaknesses X Yes _____ None Reported
- Noncompliance material to financial statements noted? _____ Yes X No

Federal Awards

Internal control over major programs:

- Material weaknesses identified? _____ Yes X No
- Significant deficiencies identified that are not considered to be material weaknesses _____ Yes X None Reported

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

Any audit findings disclosed that are required to be reported in accordance with

Circular A-133 (section 0.510(a))? _____ Yes X No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
Cluster	Research and Development

Dollar threshold used to distinguish between Type A and Type B programs: \$789,780

Auditee qualified as low-risk auditee? X Yes _____ No

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Schedule of Findings and Questioned Costs

Year ended December 31, 2008

Part II – Financial Statement Findings Section

Finding 08-01:

Criteria

Management is responsible for preparing their financial statements in accordance with Generally Accepted Accounting Principals (GAAP).

Statement of Condition

As part of the fiscal year 2008 audit, KPMG noted that Group Health Cooperative did not consider certain aspects of the applicable accounting literature for equity and fixed income securities.

Questioned Costs

None noted.

Cause and Effect

During our audit procedures over the activities of the Cooperative for the period ended December 31, 2008, KPMG noted that certain aspects of the applicable accounting literature for equity and fixed income securities related to other-than-temporary-impairments were not considered, which resulted in audit adjustments being proposed by KPMG and recorded by the Cooperative.

Recommendation

We recommend the Group refine its policy for evaluating other-than-temporary investments to consider all applicable accounting literature for both equity and fixed income securities. Given the continuing volatile market conditions, we recommend that impaired investments be analyzed at least quarterly to provide timely and accurate financial information.

Views of Responsible Officials

The Group's written other-than-temporary impairment (OTTI) accounting policy was finalized in December 2008 and was intended to assist in determining when a security is OTTI. The Financial Accounting Standards Board (FASB) doesn't provide clear guidance on how to determine OTTI, which makes it a challenging and gray area to work in. The Group sought assistance from other sources when considering how to establish the OTTI accounting policy.

The Group has the ability and intent to hold its investments until a recovery of market value, which has a bearing on whether the security should be OTTI, but did not have strong enough evidence supporting the recovery timeframe that was recommended.

The Group agrees with the recommendation and will refine its OTTI accounting policy.

GROUP HEALTH COOPERATIVE AND SUBSIDIARIES

Schedule of Findings and Questioned Costs

Year ended December 31, 2008

Finding 08-02:

Criteria

Management is responsible for ensuring proper communications between accounting/finance personnel and other departments within the Cooperative in order to ascertain that all transactions that the Cooperative is party to are properly reflected in the financial statements.

Statement of Condition

During the close of our audit procedures, KPMG was informed of a potential assessed financial penalty related to performance under a health plan contract. This matter and its financial impact were not promptly communicated to the finance personnel.

Questioned Costs

None noted.

Cause and Effect

Management identified an issue related to a potential penalty to be assessed on the Cooperative related to a customer service clause with a health plan contract. This information was not promptly communicated to the GHC accounting department.

Recommendation

KPMG recommends management implement a process for ensuring proper communication between the accounting, legal, and other operational departments to ensure that all material transactions that have a potential financial statement impact are identified and reported to the accounting department in a timely manner.

Views of Responsible Officials

Management agrees with the recommendation. The accounting department will work to strengthen the understanding of our legal and operational departments about the type and timing of when financial information should be communicated.

Part III – Federal Award Findings and Questioned Costs Section

No matters reported.