



**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Consolidated Financial Statements
and Supplemental Information

December 31, 2010 and 2009

(With Independent Auditors' Report Thereon)

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Table of Contents

	Page(s)
Independent Auditors' Report	1
Consolidated financial statements:	
Balance Sheets	2 – 3
Statements of Operations and Changes in Net Assets	4
Statements of Cash Flows	5
Notes to consolidated financial statements	6 – 41
Supplemental Information	
Consolidating Balance Sheets	42 – 43
Consolidating Statement of Operations and Changes in Net Assets	44 – 45



KPMG LLP
Suite 900
801 Second Avenue
Seattle, WA 98104

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, 2010 and 2009, and the related consolidated statements of operations and changes in net assets and cash flows for the years 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.

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 2010 and 2009 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Group as of December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The additional consolidating information listed on pages 42 – 45 is presented for the purpose of additional analysis of the basic consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies, and is not a required part of the basic consolidated financial statements. This additional information is the responsibility of the Group's management. Such information has been subjected to the auditing procedures applied in our audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic consolidated financial statements taken as a whole.

KPMG LLP

April 7, 2011

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Consolidated Balance Sheets

December 31, 2010 and 2009

(in thousands)

Assets	2010	2009
Current assets:		
Cash and cash equivalents	\$ 80,147	\$ 149,605
Short-term marketable securities	91,000	65,136
Accounts receivable – net	125,740	104,807
Inventories	23,063	22,268
Assets held for sale	—	20,528
Other	28,512	25,150
	348,462	387,494
Total current assets		
Long-term marketable securities	843,721	751,913
Funds held by trustee	8,848	14,428
Land, buildings, and equipment:		
Land	26,811	22,180
Buildings and improvements	579,977	496,618
Equipment	424,052	388,422
Construction in progress	3,896	24,818
	1,034,736	932,038
Total land, buildings, and equipment		
Less accumulated depreciation	(613,708)	(514,169)
	421,028	417,869
Land, buildings, and equipment – net		
Other assets	32,901	32,987
	\$ 1,654,960	\$ 1,604,691
Total	\$ 1,654,960	\$ 1,604,691

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Consolidated Balance Sheets

December 31, 2010 and 2009

(in thousands)

Liabilities and Net Assets	2010	2009
Current liabilities:		
Accounts payable	\$ 78,290	\$ 73,612
External delivery services payable	231,667	200,216
Accrued employee compensation	56,353	43,997
Accrued taxes and interest	14,372	13,277
Unearned premiums and deposits	51,818	39,135
Short-term borrowings	40,977	—
Current portion of long-term debt	4,655	6,154
Current portion of reserve for self-insurance	17,335	10,725
Current portion of retiree medical benefits	4,635	16,836
Total current liabilities	500,102	403,952
Noncurrent liabilities:		
Long-term debt	144,748	187,713
Self-insurance	41,505	51,059
Retiree medical benefits	41,631	47,917
Pension	72,651	62,100
Other	34,935	37,202
Total noncurrent liabilities	335,470	385,991
Total liabilities	835,572	789,943
Commitments and contingencies (note 10)		
Net assets:		
Unrestricted	806,696	802,957
Temporarily restricted	5,026	4,227
Permanently restricted	7,666	7,564
Total net assets	819,388	814,748
Total	\$ 1,654,960	\$ 1,604,691

See accompanying notes to consolidated financial statements.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2010 and 2009

(in thousands)

	2010	2009
Revenues:		
Premiums	\$ 2,883,510	\$ 2,737,072
Clinical services	223,456	193,230
Other	89,976	70,618
	3,196,942	3,000,920
Expenses:		
External delivery services	1,694,863	1,595,801
Employee compensation	590,959	556,666
Other expenses	350,094	300,081
Group Health Permanente expense	295,945	279,519
Medical and operating supplies	263,512	250,324
Depreciation	56,534	50,287
	3,251,907	3,032,678
Operating loss	(54,965)	(31,758)
Nonoperating income (expense):		
Investment income	50,154	69,554
Interest expense	(8,182)	(13,149)
	41,972	56,405
(Deficit) excess of revenues over expenses	(12,993)	24,647
Change in net unrealized investment gains and losses	18,750	10,814
Change in defined benefit pension and other postretirement plans	(1,834)	41,754
Other	(184)	338
	3,739	77,553
Change in temporarily restricted net assets	799	2,404
Change in permanently restricted net assets	102	52
	4,640	80,009
Net assets:		
Beginning of year	814,748	734,739
End of period	\$ 819,388	\$ 814,748

See accompanying notes to consolidated financial statements.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended December 31, 2010 and 2009

(in thousands)

	2010	2009
Cash flows from operating activities:		
Change in net assets	\$ 4,640	\$ 80,009
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation	56,534	50,287
Provision for self-insurance	16,633	2,467
Change in realized and unrealized investments gains and losses	(42,559)	(52,679)
Change in fair value of interest rate swap	300	5,235
Recognized other-than-temporary impairment losses	3	243
Cumulative effect adjustment	—	(738)
Change in deferred gain on sale – leaseback	2,917	2,917
Other	2,121	1,179
Cash provided by operating assets and liabilities:		
Accounts receivable – net	(20,933)	(15,306)
Inventories	(795)	628
Other current assets	(3,725)	(2,158)
Other assets	(1,700)	(2,060)
Accounts payable	2,157	(1,940)
External delivery services payable	31,451	29,423
Accrued employee compensation	12,356	(3,733)
Self-insurance	(19,577)	(16,707)
Accrued taxes and interest	1,095	191
Unearned premiums and deposits	9,766	13,351
Pension	10,551	(44,886)
Retiree medical benefits	(18,487)	(5,030)
Other noncurrent liabilities	(3,307)	(3,789)
Net cash provided by operating activities	39,441	36,904
Cash flows from investing activities:		
Payments for land, buildings, and equipment	(36,655)	(59,524)
Proceeds from disposal of land, buildings, and equipment	82	48
Proceeds from sale of marketable securities	755,903	873,637
Purchases of marketable securities	(831,032)	(878,151)
Distribution from equity investments	1,594	1,850
Sales of other equity investments – net	—	100
Funds held by trustee	5,570	(6,022)
Net cash used in investing activities	(104,538)	(68,062)
Cash flows from financing activities:		
Repayment of long-term debt	(45,154)	(5,675)
Net short-term borrowings	40,977	—
Other	(184)	(180)
Net cash used in financing activities	(4,361)	(5,855)
Net decrease in cash and cash equivalents	(69,458)	(37,013)
Cash and cash equivalents :		
Beginning of year	149,605	186,618
End of period	\$ 80,147	\$ 149,605
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ 8,241	\$ 8,523
Income taxes	4,288	2,008

See accompanying notes to consolidated financial statements.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(1) Organization

The accompanying consolidated financial statements include the accounts of Group Health Cooperative (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 (the Auxiliary), and KPS's wholly owned subsidiary, Northwest Credentials Verification Service LLC (NCVS), (collectively, the Group).

GHC is a Washington nonprofit corporation registered as a health maintenance organization headquartered in Seattle, Washington. GHC 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 headquartered in Seattle, Washington. GHO provides 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 GHC 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 GHC to the community. The Foundation's operations are largely a function of the level of donations it receives.

The Auxiliary is an unincorporated association. It is organized for the purpose of promoting and advancing the welfare of GHC through fund-raising in order to provide services and gifts to the medical centers, specialty centers, and health-related programs of GHC 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. NCVS decided to discontinue operations at December 31, 2010 and transferred certain customer contracts to a qualified credentials verification organization. The discontinuance of NCVS did not have a material impact on the Group's consolidated financial statements.

(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.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The Group has prepared the accompanying consolidated financial statements in accordance with U.S. generally accepted accounting principles (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 or remaining maturities of three months or less at the date of purchase and approximate fair value. Cash equivalents generally consist of money market funds.

The Group is potentially subject to a concentration of credit risk related to financial instruments such as funds held at high credit quality financial institutions and at times such balances with any one financial institution may exceed the Federal Deposit Insurance Corporation's (FDIC) insured limits. Beginning December 31, 2010 through December 31, 2012, the Dodd-Frank Wall Street Reform and Consumer Protection Act provides temporary unlimited coverage for noninterest-bearing transaction accounts, which is separate from and in addition to, coverage provided by the FDIC, which mitigates a portion of the Group's risk.

(d) *Marketable Securities*

Marketable securities are readily convertible to cash and are carried at fair value. The Group considers securities that will mature within one year as 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, and KPS. 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 are included in investment income. Gains or losses on sale are calculated using the first-in first-out (FIFO) method.

(e) *Other-Than-Temporary Impairment (OTTI)*

An investment is impaired if the fair value of the investment is less than its amortized cost, resulting in an unrealized loss position. Impaired securities are assessed to determine if the impairment is other-than-temporary. The Group evaluates investment securities for OTTI based on qualitative and quantitative factors. If the Group has the intent to sell, or it is more likely than not that it will be sold before recovery, OTTI is recorded in income equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. If the Group does not intend to sell or

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

it is more likely than not it will be required to sell the security before recovery, OTTI is separated into the amount representing the credit loss and the amount related to all other factors. The credit component of the OTTI is recognized in income and the noncredit component is recognized as a component of net assets.

The credit component of OTTI is determined by comparing the present value of projected future cash flows with the amortized cost basis of the fixed income security. The present value is calculated by discounting the projected future cash flows at the effective interest rate implicit in the fixed income maturity at the date of acquisition. For mortgage-backed and asset-backed securities, cash flow estimates are based on assumptions regarding the underlying collateral including prepayment speeds, type of underlying assets, geographic concentrations, default rates, recoveries, and changes in value. For all other debt securities, cash flow estimates are driven by assumptions regarding probability of default, including changes in credit ratings, and estimates regarding timing and amount of recoveries associated with a default. Unrealized losses caused by noncredit related factors related to fixed income securities, for which the Group expects to fully recover the amortized cost basis, continue to be recognized as a component of net assets.

(f) *Accounts Receivable*

Accounts receivable are primarily comprised of enrollee premiums, 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 premium 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.

(g) *Provision for Uncollectible Accounts and Retroactivity*

The Group provides an allowance for potential uncollectible accounts receivable whereby such receivables are reduced to their estimated net realizable value. The Group estimates this allowance based on the aging of accounts receivable, historical collection experience, enrollment retroactivity and other relevant factors. There are various factors that can impact the collection trends and the estimation process, such as changes in the economy, the increased burden of copays and deductibles to be made by enrollees and business practices related to collection efforts. The allowance for uncollectible accounts was \$12,622,000 and \$6,353,000 as of December 31, 2010 and 2009, respectively.

(h) *Inventories*

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

(i) *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 5).

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

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. The Series 1991 revenue bonds experienced a rating downgrade which triggered the establishment of a cash reserve requirement of \$5,476,000 in February 2009. In 2010, the Series 1991 revenue bonds were paid off, eliminating the need for the cash reserve.

(j) Charitable Gift Annuities

As of December 31, 2010 and 2009, the Foundation had a charitable gift annuities liability of \$1,224,000 and \$1,240,000, 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.

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

(l) 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. The Group capitalizes interest costs on borrowings incurred during construction or development of qualifying assets. Capitalized interest is added to the cost of the underlying assets and is depreciated or amortized over the useful lives of the assets.

(m) 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 assets.

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 2008, GHC closed its Eastside Campus, which housed an inpatient hospital facility, a specialty center, and primary care clinic. GHC relocated its primary care clinic to Redmond and its specialty

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

center to Bellevue, adjacent to Overlake Hospital Medical Center where GHC enrollees receive hospital care. Group Health placed the Eastside Campus for sale resulting in the assets of this facility being classified as held-for-sale. Group Health continues to actively market the facility; however, due to a combination of factors, including the impact of the economic downturn, the facility has not sold and the assets were reclassified as held-for-use in 2010. The reclassification of this asset resulted in additional depreciation expense of \$5,282,000 dating back to March 2008, when the asset was originally classified as held-for-sale.

Management periodically performs an evaluation of the book value of the Eastside Campus assets compared to fair value less cost to sell. No impairment loss was incurred in 2010 or 2009.

(n) 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, 2010 and 2009, the estimated liability for professional liability claims was \$50,962,000 and \$53,415,000, respectively. Prior to 2009, when preparing its estimate for professional claims liability, the Group had historically recorded a margin for risk of adverse deviation in excess of the expected ultimate losses and costs associated with settling claims. In 2009, the Group changed its method of estimating professional claims liability and is now recording at the best estimate of the ultimate losses and costs associated with settling claims. The effect of this correction was not material to the Group's consolidated financial statements. The reduction in the professional claims liability in 2009 was due primarily to the elimination of the margin for risk of adverse deviation, which resulted in a decrease of professional liability expense of approximately \$11,424,000 for the year ended December 31, 2009 relating to the prior years. The professional liability expense (credit) was \$11,930,000 and \$(2,954,000) for the years ended December 31, 2010 and 2009, respectively. At December 31, 2010 and 2009, the estimated liability for industrial accident claims was \$7,118,000 and \$6,885,000, respectively.

(o) 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 for professional liability are \$10,000,000 per claim with a \$50,000,000 annual aggregate in 2010 and 2009. Retention levels for industrial accident claims are \$450,000 in 2010 and 2009, per claim and in aggregate. 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 \$550,000 and \$500,000 per claim with a coinsurance level of 10% was held in 2010 and 2009, respectively, 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

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

prepaid reinsurance premiums of \$903,000 and \$1,161,000 as of December 31, 2010 and 2009, respectively, and reinsurance receivables of \$146,000 and \$97,000 as of December 31, 2010 and 2009, respectively.

(p) 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, is 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 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.

(q) Revenues

Revenues are derived principally from health care premiums and clinical service billings, net of charity care and contractual adjustments. 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 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.

GHC and GHO have 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 and GHO submit bids 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 premiums are paid by individual enrollees or employer groups for benefits not covered under CMS premiums.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Other revenues include grants awarded to the Group Health Research Institute, a division of Group Health, and optical sales. Also included in other revenues are self-funded administrative service fees generated by the Group and 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.

The table below presents the balances of the significant operating revenue types for the years ended December 31, 2010 and 2009 (in thousands):

	2010	2009
Premiums:		
Group	\$ 2,006,942	\$ 1,925,714
Medicare	686,876	669,334
Individual and family	148,919	104,936
Medicaid	40,773	37,088
Total premiums	2,883,510	2,737,072
Clinical services	223,456	193,230
Other revenue:		
Grants	42,520	37,500
Other	32,677	19,728
Sales	14,779	13,390
Total other	89,976	70,618
Total operating revenues	\$ 3,196,942	\$ 3,000,920

(r) 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. The Group considers anticipated investment income in determining if a premium deficiency exists. Reserves are regularly reviewed and adjusted as experience develops or new information becomes known. Such adjustments would be included in current operations. No reserve was considered necessary at December 31, 2010 and 2009.

(s) Charity Care

Charity care represents medically necessary health care services that are provided to patients who have demonstrated an inability to pay. Only the portion of a patient's account that meets GHC's established criteria is recognized as charity care. The charges associated with charity care provided

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

by GHC were \$2,023,000 and \$2,422,000 for the years ended December 31, 2010 and 2009, respectively.

(t) External Delivery Services

External delivery services represent health care expenses incurred by GHC, 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.

(u) Group Health Permanente Expense

Group Health Permanente P.C. is an independent medical group with an exclusive contract to provide medical services at GHC facilities providing primary, specialty, and inpatient care. GHC's net liability to Group Health Permanente was \$24,435,000 and \$31,208,000 as of December 31, 2010 and 2009, respectively, and is a component of accounts payable in the accompanying consolidated balance sheets.

(v) Advertising

Advertising costs are expensed as incurred and are recorded within other expenses in the statements of operations and changes in net assets. The Group recorded advertising expense of \$7,851,000 and \$8,639,000 for the years ended December 31, 2010 and 2009, respectively.

(w) 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 10).

(x) 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, KPS, and NCVS 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 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.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

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.

(y) Net Assets

Unrestricted net assets result from operations and unrestricted contributions income. Temporarily and permanently restricted net assets are accounted for within the Foundation. Temporarily restricted net assets account for funds restricted by donors for specific purposes and also unappropriated earnings on permanent endowments and are available to support the Foundation in carrying out its missions.

Temporarily restricted net assets are available for the following purposes as of December 31, 2010 and 2009 (in thousands):

	2010	2009
Health care services	\$ 3,186	\$ 2,917
Health education	1,075	767
Health care research and development	700	456
Other	65	87
Total temporarily restricted net assets	\$ 5,026	\$ 4,227

When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets. Permanently restricted net assets as of December 31, 2010 and 2009 are contributions restricted by the donor to be invested in perpetuity.

The change in temporarily restricted net assets is comprised of \$1,060,000 and \$944,000 of contributions, \$1,292,000 and \$951,000 of release from restrictions, and investment income of \$1,031,000 and \$2,043,000, and other of zero and \$368,000 for the years ended December 31, 2010 and 2009, respectively.

(z) Reclassifications

Certain reclassifications have been made to the 2009 consolidated financial statements to conform to the 2010 consolidated financial statement presentation.

(aa) New Accounting Pronouncements

In August 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-24, *Health Care Entities – Presentation of Insurance Claims and Related Insurance Recoveries*, which clarifies that insurance recoveries should not be netted against a related

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

claim liability. The claim liability amount should be calculated without consideration of insurance recoveries. This standard is effective for the 2011 fiscal year. The adoption of this standard will not have a material impact on the Group's consolidated financial statements.

In August 2010, the FASB issued ASU No. 2010-23, *Health Care Entities – Measuring Charity Care for Disclosure*, which requires a standardized process be used by health care entities that provide charity care to determine the measurement basis. Cost will be used as the measurement basis for disclosure purposes and should be broken down between direct and indirect costs for providing charity care. This standard is effective for the 2011 fiscal year. The adoption of this standard will not have a material impact on the Group's consolidated financial statements.

In April 2010, the FASB issued ASU No. 2010-17, *Revenue Recognition — Milestone Method*, which provides guidance in applying the milestone method of revenue recognition to research or development arrangements. Under this guidance management may recognize revenue contingent upon the achievement of a milestone in its entirety, in the period in which the milestone is achieved, only if the milestone meets all the criteria within the guidance to be considered substantive. This standard is effective for the 2011 fiscal year. The adoption of this standard will not have a material impact on the Group's consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-07, *Not-for-Profit Entities – Mergers and Acquisitions*, which provides guidance on how a not-for-profit entity should account for mergers and acquisitions. This standard is effective for the 2010 fiscal year. The adoption of this standard did not have a material impact on the Group's consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures, Improving Disclosures about Fair Value Measurements*, which requires new disclosures that increase the transparency in financial reporting. This standard is effective for the 2010 fiscal year. The adoption of this standard did not have a material impact on the Group's consolidated financial statements.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(3) Marketable Securities

Marketable securities as of December 31, 2010 and 2009 consist of the following (in thousands):

	2010			
	<u>Amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Fair value</u>
Debt:				
U.S. government securities	\$ 122,159	\$ 2,623	\$ (2,091)	\$ 122,691
Municipals	18,945	156	(333)	18,768
Commercial paper	4,251	—	(11)	4,240
International government	19,502	229	(10)	19,721
Corporate debt securities	305,621	11,426	(1,050)	315,997
Mortgage-backed securities	142,659	2,366	(1,109)	143,916
Asset-backed securities	8,760	45	(12)	8,793
Collateralized mortgage obligations	58,387	1,772	(336)	59,823
Domestic equity securities:				
Mutual funds:				
Large blend	70,176	8,640	(253)	78,563
Large value	50,558	4,463	—	55,021
Medium growth	14,950	3,330	—	18,280
Small blend	4,956	805	—	5,761
Small value	18,686	1,642	(11)	20,317
U.S. Treasury	5,218	30	(5)	5,243
Other	5,837	302	(35)	6,104
Foreign equity securities:				
Mutual funds:				
Large blend	38,961	3,838	(550)	42,249
Large value	8,529	338	(99)	8,768
Other	454	—	(3)	451
Other	15	—	—	15
Total	<u>\$ 898,624</u>	<u>\$ 42,005</u>	<u>\$ (5,908)</u>	<u>\$ 934,721</u>

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

	2009			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Debt:				
U.S. government securities	\$ 304,301	\$ 6,497	\$ (2,108)	\$ 308,690
Commercial paper	7,750	2	—	7,752
Corporate debt securities	243,324	7,550	(1,003)	249,871
Asset-backed securities	8,835	113	(229)	8,719
Collateralized mortgage obligations	51,061	878	(921)	51,018
Domestic equity securities:				
Mutual funds:				
Large blend	91,411	3,178	(524)	94,065
Large value	30,525	1,253	(146)	31,632
Medium growth	16,000	641	—	16,641
Small blend	4,062	280	—	4,342
Other	6,401	244	(261)	6,384
Foreign equity securities:				
Mutual funds:				
Large blend	30,986	1,272	(764)	31,494
Large value	6,509	51	(132)	6,428
Other	15	—	(2)	13
Total	\$ 801,180	\$ 21,959	\$ (6,090)	\$ 817,049

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Contractual maturities of debt securities held as of December 31, 2010 include the following (in thousands):

	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	\$ 9,108	\$ 52,106	\$ 54,871	\$ 6,606	\$ 122,691
Municipals	1,200	2,593	6,353	8,622	18,768
Commercial paper	3,591	500	149	—	4,240
International government	8,449	10,813	—	459	19,721
Corporate debt securities	68,902	147,815	86,757	12,523	315,997
Mortgage-backed securities	144	83,627	59,750	395	143,916
Asset-backed securities	2,048	2,515	3,611	619	8,793
Collateralized mortgage obligations	8,424	39,293	10,799	1,307	59,823
Total	<u>\$ 101,866</u>	<u>\$ 339,262</u>	<u>\$ 222,290</u>	<u>\$ 30,531</u>	<u>\$ 693,949</u>

Securities not due at a single maturity date are reflected in the table above by its final maturity date.

The Group records investment income net of related expenses and consists of the following as of December 31, 2010 and 2009 (in thousands):

	2010	2009
Interest	\$ 29,135	\$ 28,889
Realized gains on sale	20,180	42,037
Realized losses on sale	(1,072)	(3,063)
Dividends and capital gains	7,734	2,496
Amortization, accretion, and other	(5,820)	(562)
OTTI	(3)	(243)
Total investment income	<u>\$ 50,154</u>	<u>\$ 69,554</u>

Upon adoption of Accounting Standards Codification (ASC) Section 320-10-65, *Recognition and Presentation of Other-Than-Temporary Impairments*, in 2009, the Group recorded a cumulative effect adjustment of \$738,000 as of the beginning of the period of adoption to reclassify the noncredit component of previously recognized OTTI and is reflected within other changes in unrestricted net assets in the consolidated statements of operations and changes in net assets.

The Group evaluates investment securities for OTTI losses based on qualitative and quantitative factors. The amount of the credit component of OTTI losses on fixed income securities recognized in income was \$3,000 and \$243,000 in 2010 and 2009, respectively. The portion of the OTTI losses from

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

noncredit-related factors was zero and \$79,000 in 2010 and 2009, respectively, and was recognized as a component of the changes in net unrealized investment gains and losses.

The following tables show the gross unrealized losses and fair value of the Group's investments with unrealized losses. These securities are aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2010 and 2009 (in thousands):

2010	Less than 12 months		12 months or greater		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Debt:						
U.S. government securities	\$ 56,815	\$ (2,091)	\$ —	\$ —	\$ 56,815	\$ (2,091)
Municipals	9,222	(333)	—	—	9,222	(333)
Commercial paper	3,741	(11)	—	—	3,741	(11)
International government	6,589	(10)	—	—	6,589	(10)
Corporate debt securities	91,990	(1,023)	823	(27)	92,813	(1,050)
Mortgage-backed securities	64,360	(1,109)	—	—	64,360	(1,109)
Asset-backed securities	3,444	(6)	176	(6)	3,620	(12)
Collateralized mortgage obligations	10,907	(333)	105	(3)	11,012	(336)
Domestic equity securities:						
Mutual funds:						
Large blend	4	—	814	(253)	818	(253)
Small value	—	—	190	(11)	190	(11)
U.S. Treasury	190	(5)	—	—	190	(5)
Other	136	(3)	144	(32)	280	(35)
Foreign equity securities:						
Mutual funds:						
Large blend	507	(158)	987	(392)	1,494	(550)
Large value	3,904	(99)	—	—	3,904	(99)
Other	430	(3)	—	—	430	(3)
Total	\$ 252,239	\$ (5,184)	\$ 3,239	\$ (724)	\$ 255,478	\$ (5,908)

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

2009	Less than 12 months		12 months or greater		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Debt:						
U.S. government securities	\$ 121,650	\$ (1,864)	\$ 2,331	\$ (244)	\$ 123,981	\$ (2,108)
Corporate debt securities	57,153	(787)	3,566	(216)	60,719	(1,003)
Asset-backed securities	796	(200)	359	(29)	1,155	(229)
Collateralized mortgage obligations	14,558	(135)	8,995	(786)	23,553	(921)
Domestic equity securities:						
Mutual funds:						
Large blend	4,956	(48)	2,090	(476)	7,046	(524)
Large value	8,968	(35)	296	(111)	9,264	(146)
Other	367	(6)	2,166	(255)	2,533	(261)
Foreign equity securities:						
Mutual funds:						
Large blend	2,713	(26)	1,408	(738)	4,121	(764)
Large value	3,871	(132)	—	—	3,871	(132)
Other	—	—	4	(2)	4	(2)
Total	\$ 215,032	\$ (3,233)	\$ 21,215	\$ (2,857)	\$ 236,247	\$ (6,090)

The unrealized losses in the Group's investments in 2010 were due primarily to changes in interest rates. Substantially all debt security positions are investment grade and rated high quality, AA, or higher by Standard & Poor's rating agency. Securities with contractual payments are current and no payments were missed in 2010. 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) External Delivery Services Payable

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

	2010	2009
Balances at January 1	\$ 200,216	\$ 170,793
Incurred related to:		
Current year	1,698,294	1,596,520
Prior years	(3,431)	(719)
Total incurred	1,694,863	1,595,801
Paid related to:		
Current year	1,492,643	1,420,028
Prior years	170,769	146,350
Total paid	1,663,412	1,566,378
Balances at December 31	\$ 231,667	\$ 200,216

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

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.

(5) Borrowing Arrangements

GHC issued new borrowings to refinance certain indebtedness and for its general corporate purposes in April 2010. The Series 2010 taxable commercial paper notes were offered as part of a commercial paper financing program under which notes may be issued from time to time up to the aggregate face amount of \$75,000,000. The notes may be sold at a discount from the par amount to reflect an interest component to the maturity date. The maturity date of the notes will be 1 to 270 days and are not subject to redemption prior to the maturity date. The notes are secured by GHC's gross receivables, certain equipment, and a lien on certain real property. The issued notes outstanding are included within short-term borrowings on the consolidated balance sheets.

Revenue bonds were issued through the Washington Health Care Facilities Authority (the Authority). As security for the repayment of the bonds, GHC has granted the Authority a security interest in its gross receivables, bond funds, and liens against certain facilities and equipment. The loan agreements for the revenue bonds require, among other restrictions, that GHC achieve certain minimum debt service coverage ratios. Management believes GHC was in compliance with all debt covenants at December 31, 2010 and 2009.

In May 2010, GHC redeemed the Series 1991 revenue bonds at the outstanding aggregate amount of \$40,950,000. There was no call premium associated with the early redemption. Approximately \$862,000 of deferred financing costs associated with the Series 1991 bonds were expensed upon redemption and are included as a component of interest expense in the consolidated statements of operations.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Long-term debt at December 31, 2010 and 2009 consists of the following (in thousands):

	Years of maturity	2010	2009
Revenue bonds:			
Series 1991, 6-1/4% to 6-3/4%, net of bond discount of \$975 in 2009	2009 – 2021	\$ —	\$ 39,976
Series 2001, 4.00% to 5-3/8%, plus bond premium of \$812 and \$1,011 in 2010 and 2009, respectively	2009 – 2019	49,748	54,151
Series 2006, 4-1/2% to 5.00%, plus bond premium of \$1,686 and \$1,771 in 2010 and 2009, respectively	2022 – 2036	99,651	99,736
Other		4	4
Subtotal		149,403	193,867
Less current portion		(4,655)	(6,154)
Total long-term debt		\$ 144,748	\$ 187,713

Future annual principal payments on long-term debt for each of the next five years and thereafter at December 31, 2010 are as follows (in thousands):

Years ending December 31:		
2011	\$	4,374
2012		4,590
2013		4,815
2014		5,075
2015		5,400
Thereafter		122,650
Subtotal		146,904
Add unamortized premium and discount, net		2,499
Total	\$	149,403

Interest paid during 2010 and 2009 was \$8,241,000 and \$8,523,000, respectively. Interest expense was \$8,182,000 and \$13,149,000 during 2010 and 2009, respectively, and the amount of interest capitalized was \$147,000 and \$410,000 in 2010 and 2009, respectively. The effect of the interest rate swap decreased interest expense by \$2,539,000 and increased interest expense by \$2,465,000 in 2010 and 2009, respectively.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(6) Derivative Financial Instruments

GHC is exposed to the effects of changing interest rates. This exposure is managed, in part, with the use of derivatives. In January 2007, GHC 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. 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. GHC 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.

(7) 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 observability of the inputs 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, 2010, Level 1 securities include primarily U.S. government bonds and mutual funds.
- 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, 2010, Level 2 securities include primarily U.S. government and international government bonds, municipal bonds, commercial paper, corporate bonds, asset-backed and mortgage-backed securities, and collateralized mortgage obligations.
- 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, 2010, Level 3 instruments include primarily a guaranteed interest contract, an interest rate swap, and real estate.

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, 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.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

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

(a) *Assets and Liabilities*

The carrying amounts reported in the balance sheets for cash and cash equivalents, accounts receivable – net, accounts payable, external delivery services payable, accrued employee compensation, accrued taxes and interest, and short-term borrowings approximate fair value.

(b) *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 based on quoted market prices in markets that are not active, which are Level 2 inputs. The fair value of the long-term debt was \$149,434,000 and \$190,246,000 as of December 31, 2010 and 2009, respectively.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(c) Marketable Securities, Funds Held by Trustee, and Interest Rate Swap

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 and 2009 (in thousands):

	Fair value measurements at December 31, 2010 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				
Debt:				
U.S. government securities	\$ 122,691	\$ 86,145	\$ 36,546	\$ —
Municipals	18,768	—	18,768	—
Commercial paper	4,240	—	4,240	—
International government	19,721	—	19,721	—
Corporate debt securities	315,997	—	315,997	—
Mortgage-backed securities	143,916	—	143,916	—
Asset-backed securities	8,793	—	8,793	—
Collateralized mortgage obligations	59,823	—	59,823	—
Domestic Equity Securities				
Mutual Funds:				
Large blend	78,563	78,563	—	—
Large value	55,021	55,021	—	—
Medium growth	18,280	18,280	—	—
Small blend	5,761	5,761	—	—
Small value	20,317	20,317	—	—
US Treasury	5,243	5,243	—	—
Other	6,104	6,104	—	—
Foreign Equity Securities				
Mutual Funds:				
Large blend	42,249	42,249	—	—
Large value	8,768	8,768	—	—
Other	451	451	—	—
Other	15	6	—	9
Total available-for-sale securities	<u>\$ 934,721</u>	<u>\$ 326,908</u>	<u>\$ 607,804</u>	<u>\$ 9</u>
Funds held by trustee				
Guaranteed income contract	\$ 8,848	\$ —	\$ —	\$ 8,848
Total funds held by trustee	<u>\$ 8,848</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 8,848</u>
Interest rate swap	\$ (49)	\$ —	\$ —	\$ (49)

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

	Fair value measurements at December 31, 2009 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				
Debt:				
U.S. government securities	\$ 308,690	\$ 120,744	\$ 187,946	\$ —
Commercial paper	7,752	—	7,752	—
Corporate debt securities	249,871	—	249,871	—
Asset-backed securities	8,719	—	8,719	—
Collateralized mortgage obligations	51,018	—	51,018	—
Domestic Equity Securities				
Mutual Funds:				
Large blend	91,344	91,344	—	—
Large value	34,352	34,352	—	—
Medium growth	16,641	16,641	—	—
Small blend	4,341	4,341	—	—
Other	6,386	6,386	—	—
Foreign Equity Securities				
Mutual Funds:				
Large blend	31,494	31,494	—	—
Large value	6,428	6,428	—	—
Other	13	4	—	9
Total available-for-sale securities	<u>\$ 817,049</u>	<u>\$ 311,734</u>	<u>\$ 505,306</u>	<u>\$ 9</u>
Funds held by trustee:				
Money markets	\$ 5,943	\$ 5,943	\$ —	\$ —
Guaranteed income contract	8,848	—	—	8,848
Total funds held by trustee	<u>\$ 14,791</u>	<u>\$ 5,943</u>	<u>\$ —</u>	<u>\$ 8,848</u>
Interest rate swap	\$ 251	\$ —	\$ —	\$ 251

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The changes in Level 3 assets and liabilities 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	Funds held by trustee	Interest rate swap	Total
Beginning balance at January 1, 2009	\$ 8,089	\$ 8,848	\$ 5,486	\$ 22,423
Sales	(8,077)	—	—	(8,077)
Total losses (realized/ unrealized) included in changes in net assets	(3)	—	(5,235)	(5,238)
Ending balance at December 31, 2009	9	8,848	251	9,108
Total losses (unrealized) included in changes in net assets	—	—	(300)	(300)
Ending balance at December 31, 2010	\$ 9	\$ 8,848	\$ (49)	\$ 8,808

There were no significant transfers between assets with inputs with quoted prices in active markets for identical assets (Level 1) and assets with inputs with significant other observable inputs (Level 2) during the years ended December 31, 2010 and 2009.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(8) 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 plans was \$25,497,000 and \$35,567,000 in 2010 and 2009, respectively, and the total expense for the other plans was \$23,920,000 and \$17,137,000 in 2010 and 2009, respectively.

In 2009, KPS amended its defined benefit pension plan to freeze benefits, effective March 1, 2009. As a result, each active participant's pension benefit was 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 are being accrued after the date of freeze.

For the defined benefit plans, the actuarial cost method used in determining the net periodic pension cost is the projected unit credit cost method. At December 31, 2010 and 2009, net periodic pension expense related to the Group's participation in the Plans for 2010 and 2009 included the following components (in thousands):

	<u>2010</u>	<u>2009</u>
Service cost	\$ 20,715	\$ 19,383
Interest cost on projected benefits	27,734	25,810
Expected return on plan assets	(34,414)	(27,040)
Amortization of net loss	11,462	17,184
Actuarial loss	—	230
	<u>\$ 25,497</u>	<u>\$ 35,567</u>
Discount rate (preretirement)	5.90% – 6.00%	6.00% – 6.20%
Discount rate (postretirement)	5.90 – 6.00	6.00
Rate of increase in compensation levels	5.00	4.39 – 5.00
Expected return on plan assets	7.25 – 8.50	8.00 – 8.50

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The Plans' funded status and amounts included in unrestricted net assets to be recognized as a component of net periodic pension cost as of December 31, 2010 and 2009 are shown in the following table (in thousands):

	2010	2009
Change in projected benefit obligation:		
Projected benefit obligation – beginning of year	\$ 486,504	\$ 435,363
Service cost	20,715	19,383
Interest cost	27,734	25,811
Plan amendments/curtailment	—	(3,007)
Actuarial loss	35,321	17,015
Employee contributions	1,998	930
Benefits paid	(17,744)	(8,991)
Projected benefit obligation – end of year	554,528	486,504
Change in plan assets:		
Fair value of plan assets – beginning of year	424,404	328,377
Actual return on plan assets	50,844	73,213
Employer contributions	22,375	30,875
Employee contributions	1,998	930
Benefits paid	(17,744)	(8,991)
Fair value of plan assets – end of year	481,877	424,404
Funded status	\$ (72,651)	\$ (62,100)
Amounts recognized in unrestricted net assets consist of:		
Net actuarial loss	\$ 134,278	\$ 126,848
Accumulated benefit obligation – end of year	516,617	447,278
Discount rate (preretirement)	5.40% – 5.50%	5.90% – 6.00%
Discount rate (postretirement)	5.50 – 5.60	5.90 – 6.00
Rate of increase in compensation levels	0.00 – 4.00	0.00 – 5.00

The funded status is recorded as a component of noncurrent liabilities as of December 31, 2010 and 2009 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 incorporate a strategic, long-term asset allocation mix designed to best meet its long-term pension obligations. Plan

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

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.

As of December 31, 2010 and 2009, the following table summarizes the target allocation range defined in the investment policies compared to the actual allocations of the Group's plan assets:

	2010		2009	
	Target allocation	Actual allocation	Target allocation	Actual allocation
Equity securities	30% – 60%	58%	60% – 70%	56%
Debt securities	20 – 50	36	30 – 40	40
Cash equivalents	0 – 5	1	0 – 5	4
Other investments	0 – 10	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 Plans. 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.

There are no required employer contributions expected to be made to the Plans in 2011.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Expected amounts to be recognized as components of 2011 net periodic pension cost are as follows (in thousands):

Service cost	\$	22,972
Interest cost on projected benefits		28,886
Expected return on plan assets		(40,610)
Amortization of net loss		10,684
		21,932
Net periodic pension cost	\$	21,932

The estimated net loss amount will be amortized from unrestricted net assets into net periodic benefit cost.

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, 2010 are as follows (in thousands):

Years ending December 31:		
2011	\$	39,102
2012		41,831
2013		40,611
2014		42,221
2015		43,241
2016 – 2020		226,118
		433,124
Total	\$	433,124

(c) Fair Value of Pension Assets

The Group's pension assets are reported at fair value and are required to be grouped in three levels, based on the markets in which they are traded and the observability of the inputs 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, 2010, Level 1 securities include primarily common stocks, corporate bonds, and mutual funds.
- 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, 2010, Level 2 securities include primarily commingled trusts, limited liability corporations, and trust index 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.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Valuation techniques include use of discounted cash flow models and similar techniques. At December 31, 2010, Level 3 securities include commingled trusts and a limited partnership.

The table below presents the balances of plan assets measured at fair value on a recurring basis as of December 31, 2010 and 2009 (in thousands):

	Fair value measurements at December 31, 2010 using			
	Fair value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Plan assets				
Cash and cash equivalents	\$ 10,288	\$ 10,285	\$ 3	\$ —
Commingled trusts	121,128	—	110,935	10,193
Common stocks	210,839	210,839	—	—
Corporate debt securities	68,495	68,495	—	—
Limited partnership	20,687	—	—	20,687
Limited liability corporation	20,495	—	20,495	—
Trust index fund	10,920	—	10,920	—
Mutual Funds:				
Domestic equities				
Large blend	8,632	8,632	—	—
Long-term bond	4,099	4,099	—	—
Intermediate-term bond	4,149	4,149	—	—
Foreign equities				
Large blend	2,145	2,145	—	—
Total plan assets	<u>\$ 481,877</u>	<u>\$ 308,644</u>	<u>\$ 142,353</u>	<u>\$ 30,880</u>

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Fair value measurements at December 31, 2009 using				
	Fair value	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Plan assets				
Commingled bond funds	\$ 108,641	\$ 108,641	\$ —	\$ —
Commingled trust	31,740	—	—	31,740
Common collective trust	63,029	—	19,850	43,179
Common stocks	115,317	115,317	—	—
Corporate debt securities	12,155	12,155	—	—
Limited partnership	36,459	—	—	36,459
Mutual funds:				
Domestic equities				
Large blend	31,562	31,562	—	—
Long-term bond	3,845	3,845	—	—
Intermediate-term bond	3,849	3,849	—	—
Small growth	15,027	15,027	—	—
Other	7	7	—	—
Foreign equities				
Large blend	1,841	1,841	—	—
Real estate investment trusts	932	932	—	—
Total plan assets	\$ 424,404	\$ 293,176	\$ 19,850	\$ 111,378

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

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

	Fair value measurements using significant unobservable inputs (Level 3)			
	Commingled trust	Common collective trust	Limited partnership	Total
Beginning balance at January 1, 2009	\$ 24,688	\$ 36,617	\$ 29,202	\$ 90,507
Purchases, sales, and settlements	555	2,329	1,198	4,082
Total gains (realized/ unrealized)	<u>6,497</u>	<u>4,233</u>	<u>6,059</u>	<u>16,789</u>
Ending balance at December 31, 2009	31,740	43,179	36,459	111,378
Purchases, sales, and settlements	(21,694)	(44,715)	20,000	(46,409)
Level transfers	—	(288)	(36,459)	(36,747)
Total gains (realized/ unrealized)	<u>147</u>	<u>1,824</u>	<u>687</u>	<u>2,658</u>
Ending balance at December 31, 2010	<u>\$ 10,193</u>	<u>\$ —</u>	<u>\$ 20,687</u>	<u>\$ 30,880</u>
Net unrealized gains relating to assets held at December 31, 2009	\$ 15,356	\$ 4,233	\$ 7,993	\$ 27,582
Net unrealized gains relating to assets held at December 31, 2010	\$ 147	\$ —	\$ 687	\$ 834

There were no significant transfers between assets with inputs with quoted prices in active markets for identical assets (Level 1) and assets with inputs with significant other observable inputs (Level 2) during the years ended December 31, 2010 and 2009.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(d) Pension Net Asset Valuation

Alternative investments held in the Plans that are reported at net asset value as a practical expedient for fair value are presented by major category (in thousands):

	<u>Fair value</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
		Daily, Semi-monthly,	
Commingled trust (a)	\$ 121,128	Monthly	1 – 15 days
Limited partnership (b)	20,687	Quarterly	15 days
Limited liability corporation (c)	20,495	Monthly	15 days
Trust index fund (d)	10,920	Monthly	10 days
Total	<u>\$ 173,230</u>		

- a. This category is comprised of five different fund strategies: 1) An index fund that invests in treasury inflation protected securities. 2) An index fund that invests in U.S. investment grade bonds. 3) An index fund that invests in non-U.S. global equities. 4) An actively managed fund that invests in non-U.S. developed markets equities (Europe, Australia, Asia and Far East) employing a long-term value approach to stock selection. 5) An actively managed fund that invests in emerging market local debt employing a long-term strategy focused on income and capital appreciation.
- b. This category is comprised of an actively managed fund that invests in noninvestment grade bonds employing a long-term strategy focused on income and capital appreciation.
- c. This category is comprised of an actively managed fund that invests in noninvestment grade bonds employing an intermediate-term strategy focused on income and capital appreciation.
- d. This category is comprised of an index fund that invests in commodity futures.

At December 31, 2010 and 2009, the Plans have no outstanding funding commitments.

(9) Retiree Medical Plans

GHC provides certain medical benefits for eligible retired employees. Employees became eligible for these benefits upon retirement, attainment of a specified age, and upon completion of a certain number of years of service.

In 2009, GHC completed the curtailment of this benefit. The contribution to the premiums for collective bargaining active employees retiring on or after December 31, 2009 was discontinued. This resulted in the final phase out of the benefit. In 2008, the phase out of the benefit occurred for the nonunion active employees.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

At December 31, 2010 and 2009, net periodic postretirement benefit cost is comprised of the following components (in thousands):

	<u>2010</u>	<u>2009</u>
Service cost	\$ —	\$ 663
Interest cost on accumulated benefit obligation	2,311	4,451
Amortization of unrecognized prior service cost	—	(299)
Amortization of transition obligation	—	477
Net periodic postretirement benefit cost	<u>\$ 2,311</u>	<u>\$ 5,292</u>

Amounts recognized in unrestricted net assets consisted of net actuarial losses of \$1,991,000 and \$7,587,000 at December 31, 2010 and 2009, respectively.

GHC'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, 2010 and 2009, and comprises the following components (in thousands):

	<u>2010</u>	<u>2009</u>
Change in accumulated postretirement benefit obligation:		
Accumulated postretirement benefit obligation – beginning of year	\$ 64,753	\$ 69,783
Service cost	—	661
Interest cost	2,311	4,451
Plan amendments/curtailment	(11,483)	(14,305)
Actuarial loss (gain)	(4,993)	9,296
Benefits paid	<u>(4,322)</u>	<u>(5,133)</u>
Accumulated postretirement benefit obligation – end of year	<u>\$ 46,266</u>	<u>\$ 64,753</u>
Change in plan assets:		
Employer contributions	\$ 4,322	\$ 5,133
Benefits paid	<u>(4,322)</u>	<u>(5,133)</u>

Future benefit costs were estimated assuming medical costs would increase at a 6.90% annual rate. A 1.00% increase in this annual trend rate would have increased the APBO at December 31, 2010, by \$3,489,000 and the sum of service cost and interest cost for 2010 by \$183,000. A 1.00% decrease in this annual trend rate would have decreased the APBO at December 31, 2010 by \$3,076,000 and the sum of service cost and interest cost for 2010 by \$164,000.

The weighted average discount rate used in determining the APBO was 4.70% in 2010 and 5.30% in 2009. 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 5.30% in 2010 and 6.20% in 2009, and is based on beginning of year assumptions.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

Expected amounts to be recognized as components of 2011 net periodic postretirement benefit cost are interest cost on projected benefits of \$2,057,000.

GHC 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, 2010, are as follows (in thousands):

Years ending December 31:		
2011	\$	4,280
2012		4,205
2013		4,112
2014		4,020
2015		3,925
2016 – 2020		17,777
Total	\$	<u>38,319</u>

(10) Commitments and Contingencies

(a) Leases

The Group has various operating leases for land, buildings, and equipment. Total rent expense was \$20,008,000 and \$19,204,000 on these leases in 2010 and 2009, respectively. Total sublease rental revenue was \$2,504,000 and \$2,406,000 in 2010 and 2009, respectively. Future minimum rental payments and future minimum sublease rental receipts under noncancelable operating lease and sublease agreements as of December 31, 2010 are as follows (in thousands):

Years ending December 31:	<u>Minimum sublease rental receipts</u>	<u>Minimum rental payments</u>
2011	\$ 2,910	\$ 20,680
2012	2,773	19,554
2013	2,607	18,493
2014	1,309	16,150
2015	1,014	14,186
Thereafter	1,527	20,656
Total	\$ <u>12,140</u>	\$ <u>109,719</u>

GHC 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

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

net assets. The deferred gain is a component of unearned premiums and deposits and other noncurrent liabilities in the consolidated balance sheets in the amount of \$16,288,000 and \$19,205,000 as of December 31, 2010 and 2009, respectively.

(b) Labor

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

(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) Government Contracts

The Group's Medicare business primarily consists of products covered under Medicare Advantage and Medicare Part D Prescription Drug Plan contracts with the federal government. CMS performs coding audits to validate the supporting documentation maintained by health plans and their care providers. These coding audits may result in retrospective payment adjustments to health plans.

(e) 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 \$4,227,000 and \$4,711,000 as of December 31, 2010 and 2009, 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 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.

(f) Contingencies

GHC contracts with the Office of Personnel Management (OPM) as a community-rated carrier under the Federal Employee Health Benefits Program (FEHBP). During 2009, a regularly scheduled audit

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

was conducted by the Office of Inspector General (OIG) on behalf of OPM. In October 2010, GHC received the final audit report that had been submitted by the OIG to OPM in September 2010. The final audit report contained findings and recommendations that included an assertion of defective pricing for the contract year 2007 in the amount of approximately \$31,000,000 plus interest. Currently, the OPM has not made a final decision regarding this matter. The decision date by the OPM is not known. Management strongly disagrees with the OIG's assertion as management believes it is contrary to applicable laws, regulations, and OPM's instructions and believes that no amount is owed to OPM for this matter. Management expects this matter to be resolved without a material effect on the Group's consolidated financial statements.

(11) Federal Income Taxes

The components of income tax expense (benefit) for GHO, KPS, and NCVS related to continuing operations and the change in unrestricted net assets for the years ended December 31, 2010 and 2009 are summarized as follows (in thousands):

	2010	2009
Federal income tax expense (benefit) on operations	\$ 3,245	\$ (937)
Federal income tax (benefit) included in the change in unrestricted net assets	(216)	(1,283)
Federal income tax expense (benefit)	\$ 3,029	\$ (2,220)

Federal income tax expense on operations is recognized as a component of other expenses in the consolidated statements of operations and changes in net assets. Federal income tax benefit included in the change in unrestricted net assets is recognized as a component of changes in net unrealized investment gains and losses and the change in defined benefit pension and other postretirement plans in the consolidated statements of operations and changes in net assets.

The deferred tax asset is recorded within other current assets and noncurrent assets and the deferred tax liability is recorded as a component of accrued taxes and interest and in other noncurrent liabilities in the accompanying consolidated balance sheets in the following amounts (in thousands):

	2010	2009
Deferred tax asset	\$ 10,843	\$ 9,484
Deferred tax liability	(1,089)	(987)
Valuation allowance	(4,917)	(5,128)
Net deferred tax asset	\$ 4,837	\$ 3,369

Deferred tax assets primarily relate to the tax effects of temporary differences associated with pension liabilities, buildings and improvements, and net operating loss carryforwards. The deferred tax liability results primarily from temporary differences in unrealized investment gains and pension and

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

postretirement accruals. A valuation allowance has been provided for the net deferred tax asset as management believes it is more likely than not that the entire amount will not be realized.

At December 31, 2010, the Group has net operating loss carryforwards for federal income tax purposes of \$15,883,000, which expire between 2019 through 2030.

(12) Endowments

Endowment funds held at the Foundation consist of approximately 40 individual funds established for a variety of purposes and are all donor-restricted. The change in net assets associated with the endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. Donor-restricted endowment assets were \$10,497,000 and \$9,707,000 at December 31, 2010 and 2009, respectively, and are recorded in restricted net assets.

The State of Washington Uniform Prudent Management of Institutional Funds Act of 2009 (the Act) requires the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result, the Foundation classifies as permanently restricted net assets, the original value of gifts donated to the permanent endowment funds, the original value of subsequent gifts to the permanent endowment fund, and accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation was added to the fund.

The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation in a manner consistent with the standard of prudence prescribed by the Act, unless otherwise stipulated by the donor. In accordance with the Act, the Foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- The duration and preservation of the endowment funds
- The purposes of the Foundation and the endowment funds
- General economic conditions
- The possible effect of inflation or deflation
- The expected total return from income and the appreciation of investments
- Other resources of GHC and the Foundation
- The investment policy of the Foundation.

The Foundation has adopted spending and investment policies for endowment assets that are consistent with the provisions of the Act.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The Foundation policy limits spending in any calendar year at 5% of the fair market value of the endowments' three-year moving average. The Foundation may in any year choose to spend less than 5%. The Foundation may also choose to charge up to 1% of the endowment market value as an annual management fee. Total annual spending, including both management fee and spending allocations, cannot exceed the 5% limit. Newly received and named endowment funds are invested for one year before disbursements are made.

Under the investment policy, a diversified asset allocation is used consisting of equity securities and cash equivalents.

(13) Subsequent Events

Subsequent events are events or transactions that occur after the consolidated balance sheet date but before financial statements are issued that provide additional evidence about conditions that existed at the date of the balance sheet. The Group has evaluated subsequent events for recognition or disclosure through April 7, 2011, the date these consolidated financial statements were issued.

As a result of federal health care reform legislation enacted in 2010, substantial changes are anticipated in the United States health care system. Such legislation includes numerous provisions affecting the delivery of health care services, the financing of health care costs, reimbursement of health care providers, and the legal obligations of health insurers, providers, and employers. These provisions are currently slated to take effect at specified times over approximately the next decade. This federal health care reform legislation does not affect the 2010 consolidated financial statements.

SUPPLEMENTAL INFORMATION

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Supplemental Consolidating Balance Sheet

December 31, 2010

(In thousands)

<u>Assets</u>	<u>GHC & Auxiliary Consolidated</u>	<u>GHO</u>	<u>Foundation</u>	<u>KPS & NCVS Consolidated</u>	<u>Eliminations</u>	<u>Total</u>
Current assets:						
Cash and cash equivalents	\$ 58,070	\$ 7,981	\$ 518	\$ 13,578	\$ —	\$ 80,147
Short-term marketable securities	75,020	12,653	—	3,327	—	91,000
Accounts receivable – net	99,383	11,267	5	17,588	(2,503)	125,740
Receivable from affiliate	41	9,233	338	—	(9,612)	—
Inventories	23,063	—	—	—	—	23,063
Other	23,699	3,756	—	1,057	—	28,512
Total current assets	<u>279,276</u>	<u>44,890</u>	<u>861</u>	<u>35,550</u>	<u>(12,115)</u>	<u>348,462</u>
Long-term marketable securities	684,913	139,331	15,925	3,552	—	843,721
Funds held by trustee	8,848	—	—	—	—	8,848
Land, buildings, and equipment:						
Land	26,598	—	—	213	—	26,811
Buildings and improvements	572,482	—	—	7,495	—	579,977
Equipment	415,593	—	—	8,459	—	424,052
Construction in progress	3,896	—	—	—	—	3,896
Total land, buildings, and equipment	<u>1,018,569</u>	<u>—</u>	<u>—</u>	<u>16,167</u>	<u>—</u>	<u>1,034,736</u>
Less accumulated depreciation	<u>(598,273)</u>	<u>—</u>	<u>—</u>	<u>(15,435)</u>	<u>—</u>	<u>(613,708)</u>
Land, buildings, and equipment – net	420,296	—	—	732	—	421,028
Other assets	165,843	1,358	2,296	5,528	(142,124)	32,901
Total	<u>\$ 1,559,176</u>	<u>\$ 185,579</u>	<u>\$ 19,082</u>	<u>\$ 45,362</u>	<u>\$ (154,239)</u>	<u>\$ 1,654,960</u>

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Supplemental Consolidating Balance Sheet

December 31, 2010

(In thousands)

<u>Liabilities and Net Assets</u>	<u>GHC & Auxiliary Consolidated</u>	<u>GHO</u>	<u>Foundation</u>	<u>KPS & NCVS Consolidated</u>	<u>Eliminations</u>	<u>Total</u>
Current liabilities:						
Accounts payable	\$ 64,892	\$ 2,774	\$ 269	\$ 10,355	\$ —	\$ 78,290
External delivery services payable	178,872	36,162	—	18,346	(1,713)	231,667
Accrued employee compensation	55,361	86	—	906	—	56,353
Accrued taxes and interest	6,998	7,164	—	210	—	14,372
Unearned premiums and deposits	23,785	25,720	—	2,313	—	51,818
Short-term borrowings	40,977	—	—	—	—	40,977
Current portion of long-term debt	4,651	—	—	4	—	4,655
Current portion of reserve for self-insurance	17,335	—	—	—	—	17,335
Current portion of retiree medical benefits	4,635	—	—	—	—	4,635
Liability to affiliate	9,572	—	663	42	(10,277)	—
Total current liabilities	<u>407,078</u>	<u>71,906</u>	<u>932</u>	<u>32,176</u>	<u>(11,990)</u>	<u>500,102</u>
Noncurrent liabilities:						
Long-term debt	144,748	—	—	—	—	144,748
Self-insurance	41,505	—	—	—	—	41,505
Retiree medical benefits	41,631	—	—	—	—	41,631
Pension	71,643	—	—	1,008	—	72,651
Other	33,183	—	1,350	527	(125)	34,935
Total noncurrent liabilities	<u>332,710</u>	<u>—</u>	<u>1,350</u>	<u>1,535</u>	<u>(125)</u>	<u>335,470</u>
Total liabilities	<u>739,788</u>	<u>71,906</u>	<u>2,282</u>	<u>33,711</u>	<u>(12,115)</u>	<u>835,572</u>
Commitments and contingencies (note 10)						
Net assets:						
Unrestricted	806,666	113,673	4,078	11,651	(129,372)	806,696
Temporarily restricted	5,026	—	5,026	—	(5,026)	5,026
Permanently restricted	7,696	—	7,696	—	(7,726)	7,666
Total net assets	<u>819,388</u>	<u>113,673</u>	<u>16,800</u>	<u>11,651</u>	<u>(142,124)</u>	<u>819,388</u>
Total	<u>\$ 1,559,176</u>	<u>\$ 185,579</u>	<u>\$ 19,082</u>	<u>\$ 45,362</u>	<u>\$ (154,239)</u>	<u>\$ 1,654,960</u>

See accompanying independent auditors' report.

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Supplemental Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2010

(In thousands)

	GHC & Auxiliary Consolidated	GHO	Foundation	KPS & NCVS Consolidated	Eliminations	Total
Revenues:						
Premium revenue	\$ 1,878,744	\$ 862,265	\$ —	\$ 149,394	\$ (6,893)	\$ 2,883,510
Clinical services	240,350	—	—	—	(16,894)	223,456
Other	641,973	6,521	5,796	9,013	(573,327)	89,976
Total operating revenues	2,761,067	868,786	5,796	158,407	(597,114)	3,196,942
Expenses:						
External delivery services	1,332,586	737,136	—	140,875	(515,734)	1,694,863
Employee compensation	588,446	625	73	10,749	(8,934)	590,959
Other expenses	284,710	123,693	4,963	9,163	(72,435)	350,094
Group Health Permanent expense	295,945	—	—	—	—	295,945
Medical and operating supplies	263,383	33	26	81	(11)	263,512
Depreciation	56,301	—	—	233	—	56,534
Total operating expenses	2,821,371	861,487	5,062	161,101	(597,114)	3,251,907
Operating income (loss)	(60,304)	7,299	734	(2,694)	—	(54,965)
Nonoperating income (expense):						
Investment income (loss)	55,422	2,861	714	2,133	(10,976)	50,154
Interest expense	(8,111)	(58)	—	(13)	—	(8,182)
Total other income (expense)	47,311	2,803	714	2,120	(10,976)	41,972
(Deficit) excess of revenues over expenses	\$ (12,993)	\$ 10,102	\$ 1,448	\$ (574)	\$ (10,976)	\$ (12,993)

**GROUP HEALTH COOPERATIVE
AND SUBSIDIARIES**

Supplemental Consolidating Statement of Operations and Changes in Net Assets

Year ended December 31, 2010

(In thousands)

	GHC & Auxiliary Consolidated	GHO	Foundation	KPS & NCVS Consolidated	Eliminations	Total
(Deficit) excess of revenues over expenses	\$ (12,993)	\$ 10,102	\$ 1,448	\$ (574)	\$ (10,976)	\$ (12,993)
Change in net unrealized investment gains and losses	18,750	434	—	(1,283)	849	18,750
Change in defined benefit pension and other post retirement plans	(1,834)	—	—	(628)	628	(1,834)
Capital contributions	—	30,000	—	—	(30,000)	—
Other	(184)	—	—	—	—	(184)
Change in unrestricted net assets	3,739	40,536	1,448	(2,485)	(39,499)	3,739
Change in temporarily restricted net assets	799	—	799	—	(799)	799
Change in permanently restricted net assets	102	—	102	—	(102)	102
Change in net assets	4,640	40,536	2,349	(2,485)	(40,400)	4,640
Net assets:						
Beginning of year	814,748	73,137	14,451	14,136	(101,724)	814,748
End of period	\$ 819,388	\$ 113,673	\$ 16,800	\$ 11,651	\$ (142,124)	\$ 819,388

See accompanying independent auditors' report.