HIGHLINE MEDICAL SERVICES ORGANIZATION

Financial Statements
December 31, 2008 and 2007

and

Independent Auditor's Report

HAGEN, KURTH,

PERMAN & CO., P.S.

Highline Medical Services Organization
Financial Statements
Years Ended December 31, 2008 and 2007

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HAGEN, KURTH,
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Independent Auditor's Report

To the Board of Directors
Highline Medical Services Organization:

We have audited the accompanying balance sheets of Highline Medical Services Organization, a Washington not-for-profit corporation, as of December 31, 2008 and 2007, and the related statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of HMSO's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 financial statements referred to above present fairly, in all material respects, the financial position of Highline Medical Services Organization as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Hagen, Kurth, Perman & Co., P.S.

Seattle, Washington
April 28, 2009

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Highline Medical Services Organization
Balance Sheets
December 31, 2008 and 2007

		2008	2007
Assets			
Current Assets:			
Cash	$	4,466,219	3,641,853
Restricted cash - Molina Healthy Options		1,179,415	1,108,138
Investments		3,802,332	6,554,890
Receivable from contracting payor		774,245	414,553
Reinsurance receivables		1,097,069	1,534,297
Other receivables		289,334	411,888
Prepaid expenses		84,414	44,279
Refundable federal income tax		471,609	839,212
Total current assets		12,164,637	14,549,110
Office equipment, net of accumulated depreciation of $433,564 and $393,327, respectively		107,953	94,529
Investment in Puget Sound Health Partners, Inc.		1,304,000	1,803,280
Total assets	$	13,576,590	16,446,919
Liabilities and Retained Earnings			
Current Liabilities:			
Accounts payable	$	143,562	42,575
Medical claims payable		5,345,274	6,167,110
Payables to providers		1,511,455	3,050,000
Net deferred income tax liability		365,195	336,344
Current portion of note payable to Highline Medical Center		-	82,775
Accrued expenses		176,730	194,699
Total current liabilities		7,542,216	9,873,503
Note payable to Highline Medical Center, net of current portion		-	844,892
Net deferred income tax liability		36,326	31,336
Total liabilities		7,578,542	10,749,731
Retained earnings		5,998,048	5,697,188
Total liabilities and retained earnings	$	13,576,590	16,446,919

The accompanying notes are an integral part of the financial statements.

Highline Medical Services Organization
Statements of Income and Retained Earnings
Years Ended December 31, 2008 and 2007

		2008	2007
Revenue:			
Premium and administrative revenue	$	41,715,906	43,823,901
Reinsurance recoveries		1,097,069	1,785,626
Total revenue		42,812,975	45,609,527
Expenses:			
Medical claims from providers		36,194,903	37,631,857
Administrative expenses		2,296,611	2,196,266
Reinsurance		1,662,931	1,765,066
Distributions to providers		1,514,914	3,344,957
Total expenses		41,669,359	44,938,146
Operating income		1,143,616	671,381
Other income (expense):			
Interest income		275,153	591,536
Interest expense		(9,545)	(41,808)
Share of loss on investment in Puget Sound Health Partners, Inc.		(186,935)	(796,720)
Write down of investment in Puget Sound Health Partners, Inc.		(412,345)	-
Other income (expense)		(41,851)	5,198
Other income (expense), net		(375,523)	(241,794)
Income before provision for income taxes		768,093	429,587
Provision for income taxes:			
Current income tax expense		433,392	395,174
Deferred income tax expense		33,841	24,026
Total income taxes		467,233	419,200
Net income		300,860	10,387
Retained earnings at beginning of year		5,697,188	5,686,801
Retained earnings at end of year	$	5,998,048	5,697,188

The accompanying notes are an integral part of the financial statements.

Highline Medical Services Organization
Statements of Cash Flows
Years Ended December 31, 2008 and 2007

		2008	2007
Cash flows from operating activities:			
Net income	$	300,860	10,387
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation expense		40,237	26,549
Deferred income taxes		33,841	24,026
Share of loss on investment in Puget Sound Health Partners, Inc.		186,935	796,720
Write down of investment in Puget Sound Health Partners, Inc.		412,345	-
Cash provided by (used in) operations by changes in operating assets and liabilities:			
Restricted cash		(71,277)	(56,061)
Net receivable from contracting payor		(359,692)	60,361
Reinsurance receivables		437,228	(837,453)
Prepaid expenses and other receivables		82,419	(277,013)
Refundable federal income tax		367,603	(839,212)
Accounts payable		100,987	9,633
Medical claims payable		(821,836)	1,317,421
Payables to providers		(1,538,545)	2,050,000
Federal income tax payable		-	(195,614)
Accrued expenses		(17,969)	7,420
Net cash provided by (used in) operating activities		(846,864)	2,097,164
Cash flows from investing activities:			
Purchase of office equipment		(53,661)	(65,541)
Redemptions (purchases) of short-term investments		2,752,558	(1,403,594)
Investment in Puget Sound Health Partners, Inc.		(100,000)	(2,600,000)
Net cash provided by (used in) investing activities		2,598,897	(4,069,135)
Cash flows from financing activities:			
Proceeds on note payable to Highline Medical Center		-	1,000,000
Payments on note payable to Highline Medical Center		(927,667)	(72,333)
Net cash provided by (used in) financing activities		(927,667)	927,667
Net change in cash		824,366	(1,044,304)
Cash at beginning of year		3,641,853	4,686,157
Cash at end of year	$	4,466,219	3,641,853

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash paid for interest was $9,545 and $41,808 for the years ended December 31, 2008 and 2007, respectively. Cash paid for income taxes was $555,000 and $1,430,000 for the years ended December 31, 2008 and 2007, respectively.

The accompanying notes are an integral part of the financial statements.

1. ORGANIZATION

Highline Medical Services Organization (HMSO) was formed to provide for the delivery of healthcare services on a capitated managed care basis. Contractual operations commenced October 1, 1993. HMSO is a not-for-profit organization under Washington State law but is taxable for federal income tax purposes.

Members of HMSO include Highline Medical Center (HMC), primary care providers and specialty care providers. HMSO contracts with these healthcare providers to deliver healthcare services to enrollees on a capitated, managed care basis under agreements with contracting payors, with HMSO acting as the designated contractor and agent for these providers. A significant amount of all medical claims of HMSO are paid to its members. HMSO is responsible for processing claims related to all of the current risk contracts. HMSO is directed by an executive board composed of representatives from each of the providers.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

b. Restricted cash – Molina Healthy Options

Restricted cash, which is invested in an interest bearing account, represents amounts set aside under the terms of an agreement with Molina Healthcare of Washington (Molina), a contracting payor. The restricted cash for Molina Healthy Options is funded by withholding monthly payments, as outlined in the agreement, to maintain a balance equal to 70% of one month's capitation payment, as calculated on a quarterly average. The funds will be released to HMSO upon termination of the Molina contract and HMSO satisfying certain criteria, as outlined in the contract. The contract with Molina is renewed annually.

c. Investments

Investments consist of short-term investments with maturities of six months or less as of December 31, 2008. HMSO intends to hold the investments until maturity. The investments represent corporate bonds and commercial paper and are stated at amortized cost.

The Board of Directors has designated funds of $1,180,000 and $800,000 as of December 31, 2008 and 2007, respectively, of the investment funds to be restricted from use pending Board approval. Of the designated balance, $150,000 has been designated as an operating reserve and $30,000 is a reserve fund equal to 10% of two months of premiums paid under the Molina Medicare Options Agreement.

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)

c. Investments, (Continued)

During 2008, HMSO negotiated a new contract with Pacificare of Washington (Pacificare), for the Secure Horizons Medicare product, which will begin January 1, 2009. As part of this contract, the agreement requires $1,000,000 be invested in an interest bearing account to be set aside under the terms of the agreement. As of December 31, 2008, the terms of the agreement were not complete, but in anticipation of the reserve, the Board of Directors designated the funds be segregated.

In accordance with a 2003 agreement with Pacificare of Washington, a contracting payor, HMSO agreed to establish a fund in the amount of $650,000. Subsequent to December 31, 2007, the contract with Pacificare was terminated, and the designation removed.

d. Credit risk

HMSO maintains its cash, restricted cash, and investments in bank deposit and investment accounts, which at times may not be federally insured. HMSO has not experienced any losses on such accounts. HMSO believes it is not exposed to any significant credit risk on cash, restricted cash, and investments.

e. Receivable from contracting payor

HMSO has risk contracts with all of its contracting payors. Based on these contracts, HMSO is entitled to monthly capitation payments from these contracting payors. HMSO also has an obligation to pay claims made by its members. The receivable from contracting payor represents the amounts due to HMSO as a result of any unsettled item with one of its contracting payors.

f. Reinsurance receivables

HMSO purchases reinsurance benefits to cover claims which exceed reinsurance levels on an individual subscriber basis. Reinsurance receivables represent claims, paid in excess of the stop-loss amounts, which are to be recovered by HMSO.

g. Investment in Puget Sound Health Partners

In 2007, HMSO acquired a one-third equity interest in Puget Sound Health Partners, Inc., (PSHP) for $2,700,000. HMSO accounts for the investment under the equity method of accounting.

h. Medical claims payable

Medical claims payable represents a provision for services provided for which payment had not been made. This includes claims received but not yet paid, claims incurred but not yet billed by providers, and an estimate for claims incurred but not yet reported.

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)

i. Payables to providers

Through its contractual agreements with providers, HMSO has transferred the financial risk for delivery of healthcare services to the providers. On a periodic basis, HMSO's executive board reviews the results of HMSO's operations. The net income or deficit from operations for a period may, at the executive board's discretion, be recorded as a payable to or receivable from providers.

j. Premium and administrative revenue

Premium and administrative revenue represents capitation payments earned, based on monthly subscriber enrollment. Revenue per subscriber varies depending on the category of the subscriber's enrollment.

k. Depreciation

Depreciation on office equipment is provided over estimated useful lives ranging from three to seven years using the straight-line depreciation method.

l. Income taxes

HMSO uses the asset and liability method in providing income taxes on all transactions that have been recognized in the financial statements, in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. The asset and liability method provides that deferred taxes be adjusted to reflect the tax rates at which future taxable amounts will be settled or realized (currently 34%). The effects of tax rate changes on future deferred tax liabilities and deferred tax assets, as well as other changes in income tax laws, are recognized in net income or loss in the period such changes are enacted. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

In June 2006, the FASB released FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*. FIN 48 interprets the guidance in FASB Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*. When FIN 48 is implemented, reporting entities utilize different recognition thresholds and measurement requirements when compared to prior technical literature. On December 30, 2008, the FASB Staff issued FASB Staff Position FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*. As deferred by the guidance in FIN 48-3, HMSO is not required to implement the provisions of FIN 48 until fiscal years beginning after December 15, 2008. As such, HMSO has not implemented those provisions in the 2008 financial statements.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)

l. Income taxes, (Continued)

Since the provisions of FIN 48 have not been implemented in accounting for uncertain tax positions, HMSO continues to utilize its prior policy of accounting for these positions, following the guidance in SFAS No. 5, *Accounting for Contingencies.* Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable. Using that guidance, as of December 31, 2008, HMSO has no uncertain tax positions that qualify for either recognition or disclosure in the financial statements.

m. Fair value accounting

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements.* (FAS 157). FAS 157 1) establishes a single definition of fair value and a framework for measuring fair value, 2) sets out a fair value hierarchy to be used to classify the source of information used in fair value measurements, and 3) requires new disclosures of assets and liabilities measured at fair value. FAS 157 clarifies the principle that fair value measurements should be based on assumptions the marketplace would use when pricing an asset whenever practicable, rather than company-specific assumptions or historical cost. In February 2008, the FASB issued Staff Position (FSP) No. 157-2, which deferred the effective date of FAS 157 for one year relative to the presentation of nonfinancial assets and nonfinancial liabilities.

The three levels of the fair value hierarchy under FASB Statement No. 157 are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that HMSO has the ability to access.

Level 2 Inputs to the valuation methodology include:

- Quoted for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)

m. Fair value accounting, (Continued)

For the year ended December 31, 2008, HMSO has assets for which FAS 157 is applicable including short-term investments. HMSO has reflected valuation adjustments for the unrealized portion of the gains and losses related to these financial assets and liabilities. Realized gains and losses on these financial assets are recognized as incurred. The valuation adjustments have been made using Level 1 inputs, market pricing information and published exchange rates.

3. RELATED PARTY TRANSACTIONS

HMSO receives certain administrative services from HMC. At December 31, 2008 and 2007, HMSO recorded in accounts payable $2,052 and $7,813, respectively, for administrative expenses that HMC paid on behalf of HMSO. Amounts paid to HMC during 2008 and 2007 were $29,246 and $44,494, respectively.

HMSO provides certain administrative and financial services for HMC. At December 31, 2008 and 2007, HMSO recorded in accounts receivable $0 and $16,077, respectively, for service fees and expenses that HMSO paid on behalf of HMC. Amounts received from HMC during 2008 and 2007 were $6,000 and $38,375, respectively.

In January 2007, HMSO borrowed $1,000,000 from HMC. Monthly principal and interest payments of $10,607 commenced in February 2007. The term was ten years and the interest rate was 5%. The note was unsecured with no guarantees and no prepayment penalty. During 2007, HMSO made principal payments of $72,333 and interest payments of $41,808. In March 2008, HMSO paid the note in full including interest of $9,545.

4. INVESTMENT IN PUGET SOUND HEALTH PARTNERS, INC.

Investment in PSHP is accounted for under the equity method. Under this method, the investment is carried at cost and adjusted for the Organization's proportionate share of undistributed earnings and losses. During 2008, HMSO requested their stock in PSHP be redeemed. The transaction is pending approval by the Office of the Insurance Commissioner of the State of Washington. The sale price of the stock is expected to be $1,304,000. As a result, a write down of $412,345 has been recorded in the statement of income for the year ended December 31, 2008.

Following is selected financial information of PSHP as of and for the year ended December 31, 2008:

Total assets	$	6,993,793
Total liabilities		1,844,757
Net loss		560,799

5. INVESTMENTS

Costs and fair value of investments at December 31 are as follows:

		2008	2007
Amortized cost	$	3,802,332	6,554,890
Gross unrealized losses		(9,204)	(1,685)
Fair value	$	3,793,128	6,553,205

6. OPERATING LEASES

HMSO leases office space under an operating lease agreement that expired December 31, 2008 with the option to extend the lease for an additional two years. During 2008, HMSO exercised its option to extend the lease for two years. Future minimum lease payments total $94,080 for 2009 and $96,320 for 2010.

Total rent expense charged to operations was $89,600 and $59,149 for the years ended December 31, 2008 and 2007, respectively.

7. INCOME TAXES

HMSO is a not-for-profit organization under Washington State law but is taxable for federal income tax purposes. HMSO provides for deferred income taxes resulting from temporary differences that arise from recording certain transactions (principally treatment of medical claims payable, payables to providers, and restricted cash) in different years for income tax reporting purposes than for financial reporting purposes.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31 are presented below:

		2008	2007
Current deferred income tax asset (liability):			
Restricted cash, difference in amount deductible for tax - Molina	$	(401,001)	(376,767)
Medical claims payable, differences in amount deductible for tax		35,806	40,423
Net current deferred income tax liability	$	(365,195)	(336,344)
Non-current deferred income tax asset (liability):			
Office equipment, difference in depreciation	$	(36,326)	(31,336)
Loss on investment in PSHP		474,640	270,885
		438,314	239,549
Less valuation allowance		474,640	270,885
Net non-current deferred income tax liability	$	(36,326)	(31,336)

(Continued)

7. INCOME TAXES, (Continued)

The provision for income taxes is different from that which would be obtained by applying the statutory income tax rate of 34% to income or loss before income taxes. The items causing this difference for the years ended December 31 are as follows:

		2008	2007
Expected tax on income before income taxes	$	261,151	146,059
Expenses nondeductible for tax		2,327	2,256
Loss on investment in PSHP nondeductible for tax		203,755	270,885
Total provision for income taxes	$	467,233	419,200

8. CONCENTRATIONS

At December 31, 2008 and 2007, receivable from one contracting payor (Molina) represented 94% and 100%, respectively, of the net receivable from contracting payor. For the years ended December 31, 2008 and 2007, premium revenue from two contracting payors represented 100% of total revenue.

9. EMPLOYEE BENEFIT PLAN

Effective July 2005, HMSO offers a defined contribution 401(k) plan to all full-time employees who have completed one year of service as defined by the plan. Employees may contribute up to 85% of their eligible compensation to the plan, subject to limitations of section 401(k) of the Internal Revenue Code. Effective April 1, 2008, HMSO added a provision to allow employees to contribute to a Roth 401(k). HMSO's matching contribution was $64,227 and $64,394 for the years ended December 31, 2008 and 2007, respectively.

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April 29, 2009

Ms. Karen Lee, President
Highline Medical Services Organization
19600 International Blvd., Suite 201
SeaTac, WA 98188

Dear Karen:

Enclosed are twenty bound financial statements of Highline Medical Services Organization with the independent auditor's report thereon for the years ended December 31, 2008 and 2007.

If the financial statements are reproduced, they should be reproduced in their entirety. Also, please forward to us, for our review prior to publication, any document that will contain reproductions of the financial statements.

If you have any questions, please call me.

Sincerely,

HAGEN, KURTH, PERMAN & CO., P.S.

Jennifer Rinker

Jennifer A. Rinker, C.P.A.

JAR: kks

CELEBRATING
30 YEARS
OF
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