

**NORTHWEST PHYSICIANS NETWORK, LLC  
AND SUBSIDIARY**

**INDEPENDENT AUDITOR'S REPORT  
and  
CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2008 AND 2007**

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Members  
Northwest Physicians Network, LLC and Subsidiary

We have audited the accompanying consolidated balance sheet of Northwest Physicians Network, LLC and subsidiary as of December 31, 2008 and 2007, and the related consolidated statements of operations and members' equity and cash flows for the years then ended. These financial statements are the responsibility of Northwest Physicians Network, LLC's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Northwest Physicians Network, LLC and subsidiary 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.



Tacoma, Washington  
April 20, 2009

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**CONSOLIDATED BALANCE SHEET**

**ASSETS**

	DECEMBER 31,	
	2008	2007
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,283,846	\$ 4,293,362
Certificates of deposit	1,511,563	1,927,978
Security reserves	1,915,236	6,221,147
Stop-loss receivables	127,239	176,175
Settlements receivable	44,369	135,074
Maternity case rate receivable	831,898	340,675
Other receivables	808,302	176,072
Note receivable - current	89,241	--
Prepaid expenses	114,145	74,066
Total current assets	<u>6,725,839</u>	<u>13,344,549</u>
<b>PROPERTY AND EQUIPMENT, net</b>	<u>304,252</u>	<u>408,752</u>
<b>OTHER ASSETS</b>		
Investment in PSHP	1,707,307	1,903,280
Deposits	269,697	19,697
Note receivable, net of current portion	94,659	--
Software license fees	18,750	54,610
Total other assets	<u>2,090,413</u>	<u>1,977,587</u>
	<u>\$ 9,120,504</u>	<u>\$ 15,730,888</u>

**LIABILITIES AND MEMBERS' EQUITY**

<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 77,956	\$ 83,978
Accrued expenses	628,086	537,635
Medical claims payable	4,084,364	7,028,128
Current portion of capital lease obligation	15,213	17,952
Settlements payable - current	279,317	935,673
	<u>5,084,936</u>	<u>8,603,366</u>
<b>OTHER LIABILITIES</b>		
Capital lease obligations - net of current portion	31,158	42,570
Settlements payable - noncurrent	154,942	164,792
	186,100	207,362
<b>MEMBERS' EQUITY</b>	<u>3,849,468</u>	<u>6,920,160</u>
	<u>\$ 9,120,504</u>	<u>\$ 15,730,888</u>

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**CONSOLIDATED STATEMENT OF OPERATIONS AND MEMBERS' EQUITY**

	YEAR ENDED DECEMBER 31,	
	2008	2007
<b>REVENUES</b>		
Prepaid plan revenue	\$ 27,850,602	\$ 39,396,561
Administrative fees	4,933,127	4,765,353
BMD revenue	207,278	291,451
Consulting revenue	153,701	153,116
Settlement income	97,580	77,054
Membership fees	25,250	11,500
	<u>33,267,538</u>	<u>44,695,035</u>
<b>COST OF SERVICES</b>		
Claims expense	26,976,047	33,785,398
Capitated payments	1,226,291	1,252,044
Stop-loss insurance premiums	475,185	590,363
Settlements expense	81,940	737,330
	<u>28,759,463</u>	<u>36,365,135</u>
<b>GROSS MARGIN</b>	4,508,075	8,329,900
<b>GENERAL AND ADMINISTRATIVE EXPENSES</b>	6,022,071	5,663,227
<b>OPERATING INCOME (LOSS)</b>	(1,513,996)	2,666,673
<b>OTHER INCOME</b>		
Interest income	238,534	533,044
Other income	81,215	93,346
Loss on investment in PSHP	(195,973)	(796,720)
	<u>(1,390,220)</u>	<u>2,496,343</u>
<b>NET INCOME (LOSS)</b>	(1,390,220)	2,496,343
<b>MEMBERS' EQUITY, beginning of period</b>	6,920,160	5,448,211
Contributed capital	45,150	9,450
Unit subscription receivables	(6,150)	(4,650)
Distributions	(1,719,472)	(1,029,194)
	<u>(1,719,472)</u>	<u>(1,029,194)</u>
<b>MEMBERS' EQUITY, end of period</b>	<u>\$ 3,849,468</u>	<u>\$ 6,920,160</u>

*See accompanying notes.*

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

	YEAR ENDED DECEMBER 31,	
	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$ (1,390,220)	\$ 2,496,343
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	138,309	151,033
Loss on disposal of equipment	1,871	15
Loss on investment with affiliate	195,973	796,720
Loss on disposal of software license fees	16,309	--
Changes in assets and liabilities		
Stop-loss receivables	48,936	98,221
Settlements receivable	90,705	(15,132)
Risk pool receivable	--	14,282
Maternity case rate receivable	(491,223)	90,604
Other receivables	(632,230)	(178,715)
Prepaid expenses	(40,079)	(7,566)
Accounts payable	(6,022)	(131,411)
Accrued expenses	190,451	167,817
Medical claims payable	(2,943,764)	(704,906)
Settlements payable	(666,206)	(15,297)
Net cash from operating activities	<u>(5,487,190)</u>	<u>2,762,008</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of certificates of deposit	(1,031,250)	(500,000)
Proceeds from certificates of deposit	1,447,665	452,722
Note receivable issued	(250,000)	--
Payments from notes receivable	66,100	--
Deposits	(250,000)	(500)
Investment in PSHP	(100,000)	(2,600,000)
(Increase) decrease in security reserves	4,305,911	(189,246)
Purchase of equipment	(16,129)	(171,439)
Net cash from investing activities	<u>4,172,297</u>	<u>(3,008,463)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Principal payments on capital lease obligations	(14,151)	(8,804)
Additions to capital lease obligations	--	63,868
Member contributions	39,000	4,800
Member distributions	(1,719,472)	(1,029,194)
Net cash from financing activities	<u>(1,694,623)</u>	<u>(969,330)</u>
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>		
	(3,009,516)	(1,215,785)
CASH AND CASH EQUIVALENTS, beginning of period	<u>4,293,362</u>	<u>5,509,147</u>
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 1,283,846</u>	<u>\$ 4,293,362</u>

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 1 – Description of Operations**

Northwest Physicians Network, LLC, a Washington Limited Liability Company, (“NPN”) is an independent physician association. NPN, as an agent of approximately 320 physicians in the Tacoma area, provides utilization, case management, credentialing, claims processing, chronic illness management, and contract negotiation services.

NPN, doing business as Benefit MD, functions as a distributor for the NPN’s non-managed care services, as well as selected services of other strategic partners. BMD is designed to be a market leader in offering several solutions to prospective employer groups, whether they are fully-insured or self-funded, and is relevant to provider groups, as well as hospitals and medical centers.

My Office Partners, LLC, a wholly-owned subsidiary of NPN, was organized to provide a broad range of practice management services to independent physicians. All related party transactions have been eliminated.

**Note 2 – Summary of Significant Accounting Policies**

**Basis of Presentation** – NPN maintains its financial records using the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when an obligation is incurred.

**Principles of Consolidation** – The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant intercompany accounts and transactions have been eliminated.

**Revenue Recognition** –

Prepaid Plan Revenue: NPN, as an agent for the physicians, contracts with health maintenance organizations (“HMO’s”) to arrange for health care services to HMO enrollees. Under various contracts NPN, on behalf of the physicians, receives a per-enrollee amount (capitated payment) each month covering contracted medical services which may be provided to HMO enrollees. Capitation payments are recognized as revenue during the period in which NPN, as an agent for the physicians, is obligated to provide processing services to HMO enrollees. Liabilities for medical services provided to enrollees by service providers are accrued in the month services are rendered to enrollees based, in part, on estimates, including an accrual for services provided, but not reported, to NPN.

HMO contracts contain either shared-risk or full-risk provisions, whereby the members of NPN share in the savings and losses from health care services provided to HMO enrollees. Estimated settlements of the savings and losses are accrued based upon the performance under the risk-sharing contract and adjusted in future periods as final settlements are determined.

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 2 – Summary of Significant Accounting Policies (continued)**

Administrative fee revenue is calculated to cover general and administrative expenses in excess of revenue derived from nonplan sources.

**Cash and Cash Equivalents** – Management considers cash and cash equivalents to include cash in the bank, on hand, or short-term investments in highly liquid instruments such as money market accounts and commercial paper purchased with an original maturity of three months or less from the date of purchase, excluding cash and cash equivalents held as security reserves.

**Security Reserves** – Security Reserves consist of cash and cash equivalents held in restricted accounts for contractual insolvency requirements. The reserves are to cover future payment of medical claims or contract withholds and settlements (Note 5).

**Accounts Receivable** – Accounts receivable consist primarily of contract fees receivable, reinsurance receivables, and delegated credentialing fees receivable. The Company does not require collateral or other security to support accounts receivable. Interest does not accrue on past due accounts. Management has determined that no allowance is deemed necessary.

**Other Receivables** – CMS calculates the premiums the Company receives using risk scores assigned to its enrolled members. These risk scores are derived from the severity of illness evidenced by claims the Company receives from providers and other data, which are submitted to CMS. The Company recognized premium revenues and premium receivables from CMS for these risk score adjustments, in the amount of \$401,683 for the year ended December 31, 2008.

**Note Receivable** – NPN loaned \$250,000 to the Tacoma Ambulatory Surgical Center, LLC at an interest rate of 4.5%. The effective date of the note is February 15, 2008 with monthly installments beginning March 15, 2008, maturing February 15, 2011. The outstanding balance at December 31, 2008, was \$183,900.

**Property and Equipment** – Property and equipment are stated at cost. Improvements and replacements of property and equipment are capitalized. Maintenance and repairs are charged to current operations as incurred.

The cost of property and equipment are depreciated using the straight-line method over the estimated useful lives of the assets which range from three to seven years. Depreciation expense for the year ended December 31, 2008 and 2007, was \$118,758 and \$131,482, respectively.

**Investment in Puget Sound Health Partners, Inc.** – The Company has purchased common stock resulting in a one-third interest in Puget Sound Health Partners, Inc. (“PSHP”). The investment is accounted for using the equity method of accounting. (Note 8 and Note 14.)

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 2 – Summary of Significant Accounting Policies (continued)**

**Contracts with Third-party Payors** – Effective January 2008, NPN signed a contract amendment with Molina for which NPN is globally capitated for the Medicare Advantage Plan. For this amendment, NPN will receive a per member per month payment for NPN's administrative services. NPN will also be required to have a reserve of two months of claims expense.

In addition to receiving capitation from Molina, from which revenue will be used to fund cost of claims as well as NPN's overhead, NPN will also be paid an administrative fee for delegated claims processing.

**Reinsurance** – In the normal course of business, NPN, on behalf of the physicians, seeks to limit its exposure to loss on any single insured to recover a portion of benefits paid by ceding reinsurance to a third-party insurance company under excess coverage agreements. The policy requires monthly premium payments on a per HMO member per month basis. In return, the insurer assumes 100% of the risk for hospital and physician claims in excess of stop-loss limits. Reinsurance agreements do not relieve the members of NPN from their obligation to providers. Amounts recoverable from the reinsurance policy are estimated based upon experienced claims in a manner consistent with the policy terms. Reinsurance premiums are included as a component of cost of services. Recoveries under the policy are reported as a reduction of claims expense.

The terms of the policy include a \$1,000,000 maximum benefit per member per year ("PMPY"); a \$1,000,000 maximum benefit per member per lifetime; \$100,000 to \$125,000 deductible PMPY, depending on the carrier; and reimbursement of 90% of institutional and professional services. Claims expense is net of \$506,034 and \$185,150 for stop-loss reimbursements in 2008 and 2007, respectively.

**Medical Claims Payable** – Claims incurred represent capitation and noncapitation payments for services rendered during the year. The claims payable liability is based on experience statistics related to the nature and volume of work performed. Management periodically evaluates the estimated liability in order to maintain it at a level that is sufficient to absorb probable incurred, but not reported, claims. Management's evaluation of the adequacy of the estimate is based on an analysis of claims paid after the balance sheet date.

**Income Taxes** – NPN is treated as a partnership for federal income tax purposes and does not incur income taxes. Instead, its earnings and losses are included in the personal returns of its members and taxed depending on their personal tax situations. The financial statements do not reflect a provision for income taxes.

**Advertising Costs** – Advertising costs are charged to expense as incurred. Advertising expense was \$27,038 and \$71,796 in 2008 and 2007, respectively.

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 2 – Summary of Significant Accounting Policies (continued)**

**Use of Estimates** – The preparation of the 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 amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of stop-loss receivables, medical claims payable, and accrued settlements.

Actual results from estimates of accrued medical claims payable resulted in over reported income in 2007 and unreported income in 2006 of approximately \$48,000 and \$575,000, respectively.

Actual results from estimates of accrued settlements payable resulted in unreported income in 2007 and 2006 of approximately \$187,000 and \$134,000 respectively.

Actual results from estimates of accrued stop loss receivables resulted in unreported income in 2007 and 2006 of approximately \$405,000 and \$57,000, respectively.

Actual results from estimates of accrued settlements receivable resulted in unreported income of approximately \$242,000 and \$94,000, in 2007 and 2006, respectively.

The total change related to significant estimates has been appropriately included as adjustments to cost of services during 2008 and 2007 of approximately \$508,000 and \$684,000, respectively.

**Reclassification** – Certain accounts were classified in the prior year for consistency and comparison purposes with the current year presentation. Such reclassifications have no effect on previously reported net income.

**Note 3 – Recently Issued Pronouncements**

**Statement of Financial Accounting Standards No. 157** – Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (“FAS 157”). SFAS No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 has been applied prospectively as of the beginning of the year.

The carrying value of cash and cash equivalents, accounts payable, and accrued liabilities approximates fair value because of the short maturity of these instruments.

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 3 – Recently Issued Pronouncements (continued)**

SFAS No. 157 defines fair value as 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. SFAS No. 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

*Level 1* – Quoted prices in active markets for identical assets or liabilities

*Level 2* – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

*Level 3* – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities

Fair value measurements at December 31, 2008, are as follows:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Certificates of Deposit	\$ --	\$ 1,511,563	\$ --

**FASB Interpretation No. 48** – In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes (“FIN 48”)*. FIN 48 clarifies the accounting for income taxes by prescribing a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined in FIN 48 as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement.

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 3 – Recently Issued Pronouncements (continued)**

FIN 48 was originally effective for fiscal years beginning after December 15, 2006. In February 2008, the FASB issued Staff Position (“FSP”) FIN 48-2, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, which delayed by one year the effective date of FIN No. 48 for certain nonpublic enterprises. In December 2008, the FASB issued Staff Position FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, which again delayed by one year the effective date of FIN 48 for certain nonpublic enterprises.

The Company has elected to defer the application of FIN 48 to years beginning after December 15, 2008, in accordance with FSP FIN 48-3. The Company is continuing to evaluate the impact FIN 48 will have on its financial statements.

**Note 4 – Certificates of Deposit**

Certificates of deposit are recorded at cost which approximates fair value. Certificates of deposit held at financial institutions at December 31, 2008 and 2007, are as follows:

	2008	2007
Certificate matured April 2008	\$ --	\$ 482,063
Certificate matures June 2009 and earns interest at an annual rate of 2.62%	200,000	400,000
Certificate matured May 2008	--	500,000
Certificate matures April 2009 and earns interest at an annual rate of 3.20%	280,313	545,915
Certificate matures May 2009 and earns interest at an annual rate of 4.65%	278,200	--
Certificate matures January 2009 and earns interest at an annual rate of 1.98%	244,546	--
Certificate matures February 2009 and earns interest at an annual rate of 3.35%	254,252	--
Certificate matures March 2009 and earns interest at an annual rate of 3.35%	254,252	--
	\$ 1,511,563	\$ 1,927,978

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 5 – Security Reserves**

Security reserves have been established as a condition of NPN's current agreement with Molina. Security reserves are recorded at cost which approximates fair value.

For the Molina reserve, NPN is required to accumulate and maintain a balance equal to \$150 per Molina member. Molina has a secured interest in the reserve to satisfy the Network's claims and capitation obligations for the Molina contract. As of December 31, 2008 and 2007, NPN, on behalf of its members, has satisfied the reserve requirement.

The reserves are invested in either Certificates of Deposit or preferred money market accounts. The investments earn interest at a variable rate. NPN has rights to all accruing interest, totaling \$93,730 and \$249,789 in 2008 and 2007, respectively.

**Note 6 – Property and Equipment, Net**

	<u>2008</u>	<u>2007</u>
Computer equipment	\$ 152,973	\$ 154,289
Software	253,762	253,762
Furniture and furnishings	365,430	361,126
Tenant improvements	<u>132,333</u>	<u>129,370</u>
	904,498	898,547
Less accumulated depreciation	<u>600,246</u>	<u>489,795</u>
Property and equipment, net	<u>\$ 304,252</u>	<u>\$ 408,752</u>

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 7 – Capital Lease Obligations**

The Company is obligated under various capital leases for certain equipment at December 31, 2008. The leases expire at various times between 2010 and 2013. The gross amount of fixed assets recorded under capital leases at December 31, 2008 and 2007 approximated \$72,000, respectively. Accumulated amortization relating to equipment recorded under capital leases totaled \$27,799 and \$12,504 at December 31, 2008 and 2007, respectively. Assets under capital leases are amortized over the life of the lease.

Future minimum lease payments for capital leases for years ending December 31 are:

2009	\$	15,213
2010		15,213
2011		12,801
2012		11,553
2013		891
		<hr/>
Total Future Minimum Lease Payments		55,671
Less Amount representing interest		9,300
		<hr/>
Present Value of Future Minimum Lease Payments		46,371
Less Current Portion		15,213
		<hr/>
Long-Term Portion	\$	31,158
		<hr/> <hr/>

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 8 – Investment in Puget Sound Health Partners, Inc.**

The Company has invested in Puget Sound Health Partners, Inc. (“PSHP”) a total of 270,000 shares and a historical cost of \$2,700,000. PSHP was organized to contract directly with the Centers for Medicare and Medicaid so as to provide Medicare Advantage health plans to Medicare beneficiaries in King, Pierce, and Thurston Counties. PSHP has the authority to issue 1,200,000 shares of Class A Common Stock at \$10 per share. (Note 14.)

The following is summarized unaudited financial information for Puget Sound Health Partners, Inc. at December 31, 2008:

Balance Sheet

Current assets:	
Cash and cash equivalents	\$ 611,061
Restricted cash	4,016,727
Accounts receivable from members	296,231
Prepays and other receivables	281,476
	<hr/>
Total current assets	5,205,495
Deposits and other receivables	24,621
Federal income tax recoverable	1,514,566
Fixed assets net of accumulated depreciation	249,111
Total assets	<hr/> <u>\$ 6,993,793</u>
Current liabilities	
Accounts payable	\$ 288,150
Due to parent	77,343
Salaries and benefits payable	93,575
Medical claims payable	1,008,304
Remittances not allocated	42,803
Liabilities for CMS prospective payments	238,907
Current portion of capital leases	36,707
	<hr/>
Total current liabilities	1,785,789
Long-term liabilities:	
Capital lease obligation, excluding current portion	21,147
Federal tax liability	8,781
Other liabilities	1,925
	<hr/>
Total long-term liabilities	31,853
Total liabilities	<hr/> <u>1,817,642</u>

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 8 – Investment in Puget Sound Health Partners, Inc. (continued)**

Shareholders' equity:	
Common stock	8,100,000
Results of operations	(2,978,079)
Total shareholders' equity	<u>5,121,921</u>
Total liabilities and shareholders' equity	<u>\$ 6,939,563</u>

Statement of Income and Shareholders' Equity

Medical premium revenue	\$ 39,135,173
Pharmacy premium revenue	4,414,275
Investment income	103,975
Healthcare costs	(33,590,245)
Pharmacy costs	(3,690,864)
Operating expenses	(7,261,384)
Federal income tax recovery	301,156
Net loss	<u>\$ (587,914)</u>
Company's 1/3 interest:	
Equity at December 31, 2008	\$ 1,707,307
Share of net loss for the year ended December 31, 2008	\$ (195,971)

**Note 9 – Significant Concentrations of Credit Risk**

NPN periodically has cash deposits in a bank in excess of federal deposit insurance limitations.

**Note 10 – Pension Plan**

NPN maintains a 401(k) defined contribution pension plan for all eligible employees. Employees are eligible to participate in the plan upon attaining the age of 21 years and six months of active service. Contributions, including matching employee contributions or other discretionary contributions, amounted to \$157,171 and \$78,802 for the years ended December 31, 2008 and 2007, respectively.

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 11 – Contracts with payors**

NPN derived 87.3% and 99.9% of its revenue from two insurance contracts in 2008 and 2007, respectively. Receivables totaling \$876,267 and \$475,749 as of December 31, 2008 and 2007, are due from one of these contracted carriers. A contract with a carrier who comprised approximately 60% of NPN's revenue in 2007 was not renewed for the calendar year 2008. NPN continued to process the claims run-out for those members under the contract, which continued through calendar year 2008. The Security Reserve Account (SRA), established as a condition to the agreement with the carrier, contained funds sufficient to meet the IBNR liability expenses, the majority of which was paid out in the first quarter of 2008.

**Note 12 – Commitments and Contingencies**

**Industry Regulations** – The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditations, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity continues with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Companies are in compliance with fraud and abuse, as well as other applicable government laws and regulations. While no regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions known or unasserted at this time.

**Operating Leases** – NPN entered into an agreement to lease office space with terms expiring in December 2012, with the option to extend the lease an additional five years. Monthly lease payments are \$10,202 with annual increases each subsequent year. In 2006, NPN entered into an agreement to lease additional office space, with terms expiring in December 2012. Monthly lease payments are \$7,350 with annual increases each subsequent year.

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 12 – Commitments and Contingencies (continued)**

NPN also holds various lease agreements for office equipment with terms expiring through December 2010. Monthly lease payments for office equipment total \$8,292. Total lease expense was \$281,641 and \$313,858 for the years ended December 31, 2008 and 2007.

Future minimum lease payments on these leases for the years ending December 31 are as follows:

2009	\$ 239,336
2010	246,305
2011	251,071
2012	<u>255,000</u>
	<u>\$ 991,712</u>

**Note 13 – Related-Party Transactions**

**Consulting Expenses** – The Company entered into a consulting agreement with a related party. Fees paid related to the consulting agreement totaled approximately \$287,000 and \$123,000 for the year ended December 31, 2008 and 2007, respectively.

**Income from PSHP** – Beginning January 2008, NPN contracted with PSHP through which NPN is globally capitated for PSHP's Medicare Advantage Plan members. Total capitation revenue from PSHP at December 31, 2008, was approximately \$8,231,000. In addition to receiving capitation from PSHP, from which revenue will be used to fund cost of claims as well as NPN's overhead, NPN is also paid an administrative fee for delegated claims processing duties for NPN's membership. Total administrative fee revenue as of December 31, 2008, was approximately \$1,606,204.

NPN has entered into a delegation agreement with PSHP for which NPN will ensure the credentialing of all the contracted providers for PSHP. NPN is also paid an administrative fee for the credentialing performed. At December 31, 2008, NPN had approximately \$84,000 in accounts receivable for the PSHP credentialing income.

**Note 14 – Supplemental Cash Flow Information**

Noncash financing transactions consist of:

- Subscription receivables issued for the purchase of member units totaling \$6,150 and \$4,650 in 2008 and 2007, respectively.
- The final stock purchase in PSHP was accrued in 2007, due February 1, 2008, per the subscription agreement, totaling \$100,000.

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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**Note 15 – Subsequent Events**

In November 2008, NPN entered into an agreement to purchase 135,000 PSHP shares currently held by another organization. At the conclusion of this transaction, NPN would own one-half of the shares issued and outstanding of PSHP. The total purchase of these shares will range from \$310,000 to a maximum of \$820,000; however, the final price is dependent on the actual number of lives enrolled in PSHP through the organization currently holding the shares for the 2009 calendar year. An initial payment of \$250,000 was paid during December 2008 and placed with an escrow agent pending approval by the regulatory agencies, at which time the funds will be released from escrow and shares distributed to NPN, and is included in deposits on the balance sheet. Further payments against the purchase price for the stock will be paid monthly based on the number of lives enrolled in PSHP by the organization.

The agreement specified the regulatory agency approval is to be obtained on or before December 31, 2008; however, as of the report date, approval was not concluded.

In February 2009, NPN made an additional capital contribution to PSHP of \$500,000.

**SUPPLEMENTAL INFORMATION**

**INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTAL INFORMATION**

To the Board of Directors and Members  
Northwest Physicians Network, LLC and Subsidiary

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplemental information for the years ended December 31, 2008 and 2007, on page 19 is presented for purposes of additional analysis of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

*Moss Adams LLP*

Tacoma, Washington  
April 20, 2009

**NORTHWEST PHYSICIANS NETWORK, LLC**  
**SCHEDULE OF GENERAL AND ADMINISTRATIVE EXPENSES**

	YEAR ENDED	
	DECEMBER 31,	
	2008	2007
Salaries, benefits, and payroll taxes	\$ 3,910,482	\$ 3,438,132
Consulting	591,822	256,670
Lease	281,641	313,858
Repairs and maintenance	207,079	111,304
Printing, postage, and supplies	143,343	117,421
Depreciation and amortization	138,309	151,033
Business taxes	106,162	192,696
Accounting	94,402	94,727
Insurance	75,584	66,779
Legal	71,615	86,114
Meetings	56,462	43,029
Contributions	54,903	11,625
Travel	44,096	58,081
Miscellaneous	43,915	89,965
Telephone	43,073	42,660
Dues and licenses	34,054	26,623
Professional development	31,708	40,369
Purchased services	27,106	29,326
Advertising	27,038	71,796
Board fees	25,419	102,707
Credentialing fees	16,394	15,175
Meals and entertainment	14,567	16,942
Business development	(17,103)	286,195
	<u>\$ 6,022,071</u>	<u>\$ 5,663,227</u>