West Penn Allegheny Health System

Management Discussion and Analysis

For the First Quarter Ended September 30, 2008

West Penn Allegheny Health System

Allegheny General Hospital ◈ Alle-Kiski Medical Center ◈ Canonsburg General Hospital ◈ The Western Pennsylvania Hospital
Allegheny Medical Practice Network ◈ Allegheny Specialty Practice Network ◈ Allegheny Singer Research Institute ◈ West Penn Corporate Medical Services
The Western Pennsylvania Hospital Foundation ◈ Forbes Health Foundation

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1. MANAGEMENT'S DISCUSSION OF RESULTS FOR THE QUARTER ENDED SEPTEMBER 30, 2008

Introduction

Organization of West Penn Allegheny Health System and the Obligated Group

This Quarterly Report is produced to comply with the $752,370,000 Allegheny County Hospital Development Authority Health System Revenue Bonds (West Penn Allegheny Health System), Series 2007A, Continuing Disclosure Agreement. The following CUSIP numbers are covered by this Quarterly Report:

01728AG67	01728AF92
01728AG75	01728AG83
01728AG34	01728AG42
01728AG26	01728AG59

West Penn Allegheny Health System

West Penn Allegheny Health System, Inc. is a Pennsylvania nonprofit corporation that, together with other entities under its direct or indirect control, forms a regional health system operating six hospital campuses and other health care facilities and delivering the services of health care professionals, including over 1,000 employed physicians, to residents of Western Pennsylvania. In the fiscal year ended June 30, 2008, the hospital affiliates of the Parent recorded over 180,000 emergency visits, discharged nearly 78,000 inpatients and delivered nearly 5,000 newborns. From these patient care activities, the Parent recorded on consolidated basis total net patient service revenue of more than $1.45 billion. At June 30, 2008, the Parent's consolidated total assets were approximately $1.29 billion, its total liabilities were approximately $1.25 billion and its net assets were approximately $37 million.

The Obligated Group currently includes West Penn Allegheny Health System, Inc. (WPAHS)* and the following hospitals, physician practice networks, and foundations and research organizations:

Hospitals
- Allegheny General Hospital (AGH)* which includes the AGH Suburban Campus
- The Western Pennsylvania Hospital (WPH)* which includes West Penn Campus (WPC) and Forbes Regional Campus (FRC)
- Alle-Kiski Medical Center (AKMC)
- Canonsburg General Hospital and Subsidiary (CGH)

Physician Practice Networks
- Allegheny Specialty Practice Network (ASPN)
- Allegheny Medical Practice Network (AMPN)
- West Penn Corporate Medical Services, Inc. (WPCMS) (which, together with AMPN, is part of the Primary Care Network (PCN))
- West Penn Physician Practice Network (WPPPN), a subsidiary of WPH
- West Penn Specialty MSO, Inc., a subsidiary of WPH
- West Penn Allegheny Oncology Network (WPAON), a subsidiary of WPH

Foundations and Research Organizations
- The Western Pennsylvania Hospital Foundation (WPHF)
- Forbes Health Foundation (FHF)
- Suburban Health Foundation, (SHF) a subsidiary of AGH
- Allegheny-Singer Research Institute (ASRI)

* These corporations merged on December 31, 2007

WEST PENN ALLEGHENY HEALTH SYSTEM

CONSOLIDATED STATEMENT OF OPERATIONS

(Dollars in thousands)

	For the three months ended September 30, 2008 and 2007	
	First Quarter	
	Fiscal 2009	Fiscal 2008
Patient service revenue	$ 386,343	$ 363,169
Other revenue	14,055	12,584
Net assets released	1,066	870
Total revenues, gains and other support	401,464	376,623
Salaries, wages, and benefits	229,079	214,522
Patient care supplies	73,883	70,839
Professional fees and purchased services	35,503	26,714
General and administrative	39,305	34,767
Provision for bad debts	13,187	10,880
Depreciation and amortization	17,810	14,951
Interest	10,066	9,852
Total expenses	418,833	382,525
Operating loss	**$ (17,369)**	**$ (5,902)**
Investment income	1,030	7,073
Gifts and donations	374	345
(Excess of expenses over revenues) / Excess of revenues over expenses	**$ (15,965)**	**$ 1,516**

Operating Results

For the three months ended September 30, 2008, the System incurred an excess of expenses over revenue of $16.0 million. This is compared to an excess of revenue over expenses of $1.5 million for the same period in fiscal year 2008. The comparability of fiscal 2009 and fiscal 2008 are affected by several factors. The first is the balance sheet revenue recognition methodology adopted in the fourth quarter of fiscal 2008 as a more conservative accounting method. Second, consulting costs related to operational restructuring are expensed in fiscal 2009, but the benefits of such will not be realized until future periods. Third, the System adopted FAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities”, on July 1, 2008. The adoption of this accounting pronouncement requires unrealized gains and losses on investments to be recorded on the statement of operations (previously recorded directly to fund balance).

The System is in the midst of a restructuring initiative. Under the leadership of President and CEO Dr. Christopher T. Olivia, a majority of the System’s executive team has been recruited within the past six months and consists of leaders in various disciplines experienced in restructuring health systems. The goal of the restructuring initiative is to become a profitable, distinctive, physician-driven, employee supported integrated health system.

Overall inpatient acute discharge volume increased 2.9% across the System when comparing the three months ended September 30, 2008 to the same period of fiscal year 2008. Increases were noted in the specialties of internal medicine, obstetrics/gynecology, neonatology, oncology, nephrology, and neurosciences. A decrease was noted in cardiology due to increased competition from community hospitals as well as environmental factors reducing the need for inpatient treatment. A decrease in general surgery was noted due to physician departures at WPC.

Patient service revenue was $23.2 million, or 6.4% greater than the same period of fiscal year 2008. This increase was due to the above mentioned 2.9% growth in volume, a 1.1% increase in the all payor case mix index, and contracted higher rates for commercial and governmental payors. This growth in revenue is in spite of the more conservative balance sheet methodology being used in the first quarter of fiscal 2009.

A comparison of expense categories as a percentage of total revenue for the three months ended September 30, 2008 and 2007 is as follows:

	Three Months Ended September 30,	
	2008	2007
Salaries, wages, and benefits	57.1 %	57.0 %
Patient care supplies	18.4	18.8
Professional fees and purchased services	8.8	7.1
General and administrative	9.8	9.3
Provisions for bad debts	3.3	2.9
Depreciation and amortization	4.4	4.0
Interest	2.5	2.7
Total	104.3 %	101.8 %

Each expense category is relatively comparable for the periods shown above, with the exception of professional fees and purchased services. Professional fees and purchased services contain significant external consulting costs for the three months ended September 30, 2008. The external consultants are primarily assisting management with implementing operational turnaround strategies. The implementation of these turnaround strategies is anticipated to have a positive impact on operating results in future periods.

Investment income decreased to $1.0 million from $7.0 million for the three months ended September 30, 2008 and 2007, respectively. This was due to unrealized losses on investment securities due to adverse market conditions offsetting interest and dividend income. Unrealized losses on investment securities were not included in investment income in fiscal 2008.

Liquidity and Capital Position

As of September 30, 2008, day's cash on hand as defined in the Master Trust Indenture (MTI) was 50.9 days. Of the amounts included in the calculation, approximately 30% are subject to daily market value fluctuations, with approximately 10% invested in equities and 20% invested in fixed income securities and funds.

Capital spending in the three months ended September 30, 2008 was $10.5 million. The System has restrained approval of routine capital replacement, except those required for patient safety or code requirements. Strategic capital will be reviewed for return on investment prior to funding.

Pension contributions for the three months ended September 30, 2008 were $4.0 million. In accordance with Internal Revenue Service funding rules and in conjunction with special relief obtained under The Pension Protection Act of 2006, no additional funding is required to be made until April 15, 2010.

Volatility in the retirement plan investment portfolio may result in increased pension contributions in fiscal years beyond fiscal year 2010.

Debt repayments for the three months ended September 30, 2008 were $0.9 million. The Series 2007 bond issue required no principal repayments in fiscal year 2008 and 2009.

The average number of days in net accounts receivable was 35.0 at September 30, 2008. Accounts payable balances have been maintained at acceptable levels with all trade vendors.

Performance Improvement Project Update

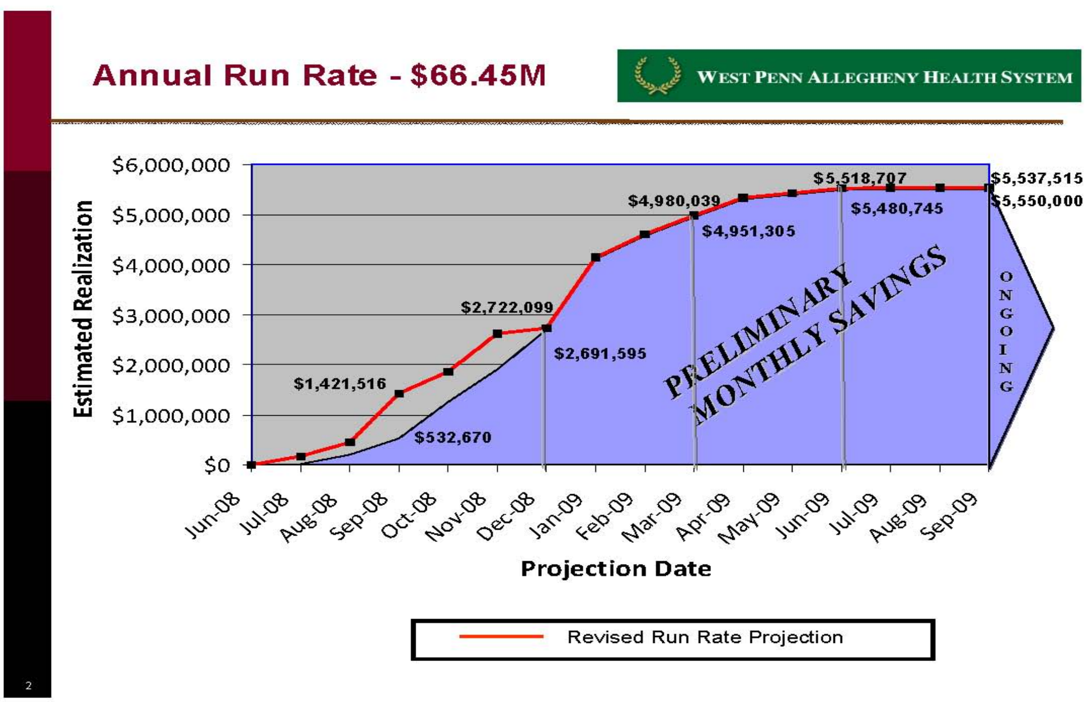
The System is continuing with the implementation of its performance improvement initiatives. As of mid-November 2008, in excess of $53 million of recurring project benefits have been implemented. These include $23 million of non-labor savings, $18 million of labor savings, and $12 million of revenue cycle improvements. The mid-point of the target rate of recurring benefits is $66 million.

The majority of the non-labor savings were in the area of employee benefits. A restructuring of the cash balance retirement plan to reduce the amount of benefits earned under the plan for non-union employees yielded the largest savings. Under this initiative, employees will continue to earn benefit credits for each service year attained, but at a lessor percentage of salary. Our analysis indicated that our overall retirement benefit would remain competitive with other healthcare providers in Western Pennsylvania after the restructuring.

Labor savings have been achieved through a reduction in workforce that was achieved through both attrition as well as elimination of positions. Approximately 300 FTEs have been eliminated to date.

The revenue cycle initiatives have been implemented in a number of areas, including improved self-pay management, strategic charge master pricing, managed care contracting, denials management, and improved clinical documentation.

The quantification of the monthly savings run rate is as follows:



Physician Recruitment and Program Growth Initiatives

Fifteen distinguished physicians in numerous medical and surgical specialties have joined The Western Pennsylvania Hospital. Among physicians recently joining West Penn are specialists in general surgery, plastic surgery, urology, hematology and oncology, medical oncology, endocrinology, critical care, internal medicine and sports medicine. At Allegheny General Hospital, 29 physicians have been added, including specialists in cardiothoracic surgery, emergency medicine, oncology, neurology, orthopaedic surgery, and transplant surgery. Forbes added surgeons and cardiologists, while Alle-Kiski continued its ambitious program to serve the primary care needs of the market through medical staff development. This active recruitment program continues, as the System demonstrates its commitment to physician economic alignment.

Programmatically, WPAHS has accelerated strategic business development across the system, implementing programs designed to generate growth through increased patient volumes and market share. In an effort to better serve post-acute care patients, the System executed a strategic partnership with RehabCare to improve case management and expand inpatient rehabilitation. Cardiac services were implemented across multiple sites in electrophysiology, heart failure and transplants, surgical critical care, and catheterization. Allegheny General Hospital opened a Center for Restorative Joint Surgery, expanding orthopaedic capacity in a dedicated inpatient facility. Alle-Kiski Medical Center has begun a renovation and expansion of its emergency department and established an endoscopy center. Western Pennsylvania/Forbes completed implementation of the Dardanell Heart and Vascular Center, reaching a milestone of 100 open heart surgeries after five months of operation, and created a Joint and Spine Center.

2. FINANCIAL STATEMENTS OR THE QUARTER ENDED SEPTEMBER 30, 2008

West Penn Allegheny Health System and Subsidiaries

Consolidated Financial Statements as of and
for the Three Months Ended September 30, 2008 and
Supplemental Schedules as of and for the
Three Months Ended September 30, 2008

WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES

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WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
AS OF SEPTEMBER 30, 2008
(Amounts in thousands)

ASSETS

CURRENT ASSETS:	
Cash and cash equivalents	$ 76,150
Short-term investments	1,411
Assets limited or restricted as to use	12,360
Receivables:	
Patient accounts — net of allowance for uncollectible accounts of $34,300	167,925
Other	12,508
Inventories	26,693
Prepaid expenses	12,680
Total current assets	309,727
ASSETS LIMITED OR RESTRICTED AS TO USE	460,866
PROPERTY AND EQUIPMENT — Net	419,884
OTHER ASSETS — Net	70,264
TOTAL	$ 1,260,741

WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET
AS OF SEPTEMBER 30, 2008
(Amounts in thousands)

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:	
Current portion of long-term debt	$ 3,824
Accounts payable	77,956
Accrued expenses	26,592
Accrued interest	14,908
Accrued salaries and vacation	54,145
Estimated third-party payor settlements	2,945
Current portion of deferred revenue	11,925
Current portion of self-insurance liabilities	2,543
Total current liabilities	194,838
DEFERRED REVENUE	41,127
SELF-INSURANCE LIABILITIES	52,599
LONG-TERM DEBT	824,680
ACCRUED PENSION OBLIGATION	130,217
OTHER NONCURRENT LIABILITIES	11,955
Total liabilities	1,255,416
COMMITMENTS AND CONTINGENCIES (Notes 8, 10, 11, and 14)	
NET ASSETS (DEFICIT):	
Unrestricted	(249,843)
Temporarily restricted	31,207
Permanently restricted	223,961
Total net assets	5,325
TOTAL	$ 1,260,741

WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008
(Amounts in thousands)

UNRESTRICTED REVENUES AND OTHER SUPPORT:	
Net patient service revenue	$ 386,343
Other revenue	14,055
Net assets released from restrictions	1,066
Total unrestricted revenues and other support	401,464
EXPENSES:	
Salaries, wages, and fringe benefits	229,079
Patient care supplies	73,883
Professional fees and purchased services	35,503
General and administrative	39,305
Provision for bad debts	13,187
Depreciation and amortization	17,810
Interest	10,066
Total expenses	418,833
OPERATING LOSS	(17,369)
Investment income	1,030
Gifts and donations	374
EXCESS OF EXPENSES OVER REVENUES	(15,965)
NET ASSETS RELEASED FOR PROPERTY ACQUISITIONS AND DONATED CAPITAL	933
CHANGE IN NET UNREALIZED GAINS (LOSSES) ON OTHER THAN TRADING SECURITIES	(5)
DECREASE IN UNRESTRICTED NET ASSETS	$ (15,037)

WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN NET ASSETS
FOR THE THREEMONTHS ENDED SEPTEMBER 30, 2008
(Amounts in thousands)

UNRESTRICTED NET ASSETS:	
Excess of expenses over revenues	$ (15,965)
Net assets released for property acquisitions and donated capital	933
Change in net unrealized gains (losses) on other than trading securities	(5)
Decrease in unrestricted net assets	(15,037)
TEMPORARILY RESTRICTED NET ASSETS:	
Contributions	1,233
Investment income	334
Net assets released from restrictions used for:	
Operations	(1,066)
Acquisition of equipment	(923)
Change in net unrealized gains (losses) on other than trading securities	(889)
Other transfers	8
Decrease in temporarily restricted net assets	(1,303)
PERMANENTLY RESTRICTED NET ASSETS:	
Investment loss	(920)
Change in net unrealized gains (losses) on other than trading securities	(15,424)
Transfers out of endowments/participating trust to investment income and operations	(1,825)
Decrease in permanently restricted net assets	(18,169)
DECREASE IN NET ASSETS	(34,509)
NET ASSETS — Beginning of period	39,834
NET ASSETS — End of period	$ 5,325

WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008
(Amounts in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES:	
Decrease in net assets	$ (34,509)
Adjustments to reconcile decrease in net assets to net cash used in operating activities:	
Depreciation and amortization	17,810
Non-cash (gains)/losses	3,435
Debt premium/discount amortization	(97)
Pension Contribution	(4,009)
Provision for bad debts	13,187
Change in net unrealized (gains) losses on other than trading securities	19,491
Restricted contributions and investment income	(647)
Unrestricted net realized losses	188
Increase (decrease) in cash from changes in:	
Receivables	(15,065)
Inventories	(133)
Other current assets and prepaid expenses	1,144
Accounts payable and accrued expenses	5,071
Estimated third-party payor settlements	472
Deferred revenue	(1,591)
Self-insurance liabilities	281
Other assets	566
Other liabilities	8,797
Net cash provided by operating activities	14,391
CASH FLOWS FROM INVESTING ACTIVITIES:	
Acquisition of property and equipment	(10,480)
Purchase of assets, limited use	(87,561)
Sales of assets limited or restricted as to use	80,712
Net cash used in investing activities	(17,329)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Repayments of long-term debt	(919)
Proceeds from restricted contributions and investment income	647
Net cash used in financing activities	(272)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(3,210)
CASH AND CASH EQUIVALENTS — Beginning of period	79,360
CASH AND CASH EQUIVALENTS — End of period	$ 76,150
SUPPLEMENTAL DISCLOSURE — Cash paid for interest — net of amounts capitalized of $110	$ 307

1. ORGANIZATION

West Penn Allegheny Health System and subsidiaries (WPAHS or the "System") is a Pennsylvania non-profit charitable corporation that provides routine and tertiary healthcare services.

The System consisted of the following entities, with WPAHS as the sole member of these entities:

West Penn Allegheny Health System (WPAHS)
Alle-Kiski Medical Center (AKMC)
Canonsburg General Hospital and Subsidiary (CGH)
West Penn Allegheny Foundation, LLC (WPAF)
The Western Pennsylvania Hospital Foundation (WPHF)
Forbes Health Foundation (FHF)
Allegheny Specialty Practice Network (ASPN)
Allegheny Singer Research Institute (ASRI)
Friendship Insurance Company, Ltd. (FIC)
Alle-Kiski Medical Center Trust (AKMC Trust)
Primary Care Network (PCN)

Effective December 31, 2007, WPAHS, Allegheny General Hospital and subsidiaries (AGH), and The Western Pennsylvania Hospital and subsidiaries (WPH) adopted resolutions approving the merger of these entities. WPH was the surviving entity and has changed its name to WPAHS, Inc. AGH and WPH operate as divisions of WPAHS, Inc.

Allegheny Medical Practice Network (AMPN) and West Penn Corporate Medical Services, Inc. (WPCMSI) comprise the PCN which operates under a joint management team.

WPAHS is the sole member of each of these entities. Each member of the Obligated Group (the "Obligated Group") is jointly and severally liable for the satisfaction of the outstanding bond debt of WPAHS (see Note 7). All members of the System with the exception of FIC, AKMC Trust, and WPAF are members of the Obligated Group.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in preparing the consolidated financial statements are summarized below:

Basis of Accounting — WPAHS maintains its accounts on the accrual basis of accounting.

Principles of Consolidation — The consolidated financial statements include the accounts of WPAHS, Inc., AKMC, AKMC Trust, CGH, FHF, ASRI, ASPN, WPHF, FIC, WPAF, and PCN. Joint venture investments, investments in limited partnerships, and investments with an ownership interest greater than 20% where control is not demonstrated are accounted for using the equity method.

All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates in the Preparation of Consolidated Financial Statements — The preparation of consolidated 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 the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Investment securities and pension obligations are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities and interest rates, it is at least reasonably possible that these changes in risks in the near term could materially affect the amounts reported in the accompanying consolidated balance sheet, statements of operations, and changes in net assets.

Net Patient Service Revenue — WPAHS has agreements with third-party payors that provide for payments to WPAHS at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services as they are rendered and includes estimated retroactive revenue adjustments due to future retrospective audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. A summary of the payment arrangements with major third-party payors follows:

Medicare **—** Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. WPAHS is reimbursed for services rendered at a tentative rate with a final settlement determined after submission of annual cost reports by WPAHS and audits thereof by the Medicare fiscal intermediary. WPAHS' classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by the utilization review committee. WPAHS entities' Medicare cost reports have been audited by the Medicare fiscal intermediary through the fiscal year ended June 30, 2007, for all hospitals and the final reports have been received for AKMC, CGH, and FRC.

Medical Assistance — Inpatient care and outpatient services rendered to Medical Assistance eligible patients are paid at prospectively determined rates. WPAHS' classification of patients under the Medical Assistance program and the appropriateness of their admission are subject to an independent review by the utilization review committee.

Blue Cross — Inpatient and outpatient services rendered to Blue Cross subscribers are reimbursed at prospectively determined rates.

WPAHS has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to WPAHS under these agreements includes prospectively determined rates and discounts from established charges.

During the three months ended September 30, 2008, net patient service revenue increased $512 due to prior-year retroactive adjustments on estimated third-party payor settlements in excess of amounts previously estimated.

Revenue from the Medicare and Medical Assistance programs accounted for approximately 40% and 8%, respectively, of WPAHS' net patient service revenue for the three months ended September 30, 2008. Laws and regulations governing the Medicare and Medical Assistance programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

WPAHS grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of net receivables from patients and third-party payors at September 30, 2008, is as follows:

Medicare	32 %
Medical Assistance	12
Blue Cross	16
Managed care	15
Other third-party payors	22
Patients	3
Total	100 %

Excess of Revenues Over Expenses — The consolidated statements of operations and changes in net assets include, in excess of revenues over expenses, the results of operations, including nonoperating activities. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, consistent with industry practice, include changes in unrealized gains (losses) on other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, pension liability adjustments not reflected in pension expense, the impact of accounting changes, and contributions of long-lived assets (including assets acquired using contributions which, by donor restriction, were to be used for the purposes of acquiring such assets).

Cash and Cash Equivalents — Cash and cash equivalents include highly liquid investments purchased with original maturities of three month or less. Cash equivalents are stated at fair value, which approximates cost.

Inventories — Inventories, consisting of drugs and medical supplies, are stated at the lower of cost (first-in, first-out) or market value.

Assets Limited or Restricted as to Use — Investments classified as assets limited or restricted as to use in the accompanying consolidated balance sheet primarily include assets held by trustees under indenture agreements, temporarily and permanently restricted assets, and designated assets set aside by the board of trustees for future capital improvements, over which the board retains control and may use for other purposes at its discretion. If applicable, amounts required to meet current liabilities have been included in current assets in the accompanying consolidated balance sheet at September 30, 2008.

Investment income or loss (including realized gains and losses on investments, interest, and dividends, and other than temporary impairment losses on investments) is included in the excess of revenues over expenses, unless this income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses.

For each of the investment categories above, WPAHS continually monitors investment performance and the potential need for the recording of impairments. The WPAHS impairment policy requires securities that are significantly below cost for at least the last six months, for which cost is considered unrecoverable, be deemed other-than-temporarily impaired. Additionally, individual securities are evaluated when indicators of impairment (e.g., bankruptcy) exist regardless of the amount and duration of the unrealized loss.

The System has recorded beneficial interests from perpetual trusts held by third parties and the related unrestricted trust income in the consolidated balance sheet and statement of operations. The System has the irrevocable right to receive the income earned on the trust assets in perpetuity but will never receive the underlying assets.

Temporarily and Permanently Restricted Net Assets — Temporarily restricted net assets are those whose use has been limited by donors for a specific purpose or time period. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity, except as provided by the provisions of Section 8113 of the Pennsylvania Probate, Estate, and Fiduciary Code (see Note 4). Temporarily restricted net assets released from restriction, as their specific purpose or time period has been met during the reporting period, are reflected in the consolidated statement of operations and statement of changes in assets.

Property and Equipment — Property and equipment acquisitions are recorded at cost, less an allowance for depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the related assets, which are as follows:

Description of Assets	Life
Buildings and building improvements	10–40 years
Equipment	3–30 years
Leasehold improvements	5–25 years
Land improvements	10–20 years

Other Assets — Deferred financing costs are being amortized over the respective terms of the related bond issues on a straight-line basis, which approximates the effective interest method. Other assets, excluding the prefunded insurance deductible, including noncompete arrangements and signing bonuses, are amortized over the life of the respective arrangement.

Long-Lived Assets — WPAHS reviews long-lived assets and certain identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable.

Donor Restricted Gifts — Unconditional promises to give cash and other assets to WPAHS are reported at fair market value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair market value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statement of operations as net assets released from restrictions. Donor-restricted contributions, whose restrictions are met within the same year as received, are reported as unrestricted contributions in the accompanying consolidated financial statements.

Deferred Revenue — In December 2006, WPAHS entered into a long-term contract whereby System facilities and providers will provide healthcare services to members of the contract at discounted amounts, for a period of 10 years. The System received $35,000 in connection with these agreements, which has been reflected as deferred revenue in the consolidated financial statements and is being amortized on a straight-line basis over the life of the related contracts, consistent with the earnings process. At September 30, 2008, $29,167 received from the agreements is included in deferred revenue in the consolidated balance sheet.

The System records deferred revenue as non-governmental grant monies are received. Revenue is subsequently recognized as grant proceeds are expended. During the three months ended September 30, 2008, grant proceeds expended of $4,771, were recognized as other revenue. The System also records as deferred revenue, governmental grant monies received for the acquisition of property and equipment. The amount deferred is amortized over the estimated useful life of the assets acquired. At September 30, 2008, $15,770, of grant funds are included in deferred revenue within the accompanying consolidated balance sheet.

During the years ended June 30, 1997 and 1996, AGH sold certain nonclinical assets, which are being leased back by AGH over 20 years. These transactions resulted in gains, which have been deferred and will be amortized into income over the lease terms. The annual amortization is included in other revenue in the consolidated statement of operations. Unamortized gains of $6,950 are included in deferred revenue at September 30, 2008.

Income Taxes — WPAHS and all member entities, with the exception of WPCMSI, WPAF, AND FIC are not-for-profit corporations that have been recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code (IRC). WPCMSI is a taxable corporation. WPAF is a single member limited liability corporation. FIC is registered under the laws of the Cayman Islands.

Other Revenue — Other revenue is derived from services other than providing healthcare services to patients. Included in other revenue are grants, rent, cafeteria, tuition, sponsored project and contribution revenue, contract revenue, and sale leaseback gain amortization.

Asset Retirement Obligations — WPAHS accounts for asset retirement obligations in accordance with the Financial Accounting Standards Board (FASB) issued Interpretation ("FIN") No. 47, *Accounting for Conditional Asset Retirement Obligations — an Interpretation of FASB Statement No. 143.* FIN No. 47 clarifies an entity is required to recognize a liability and capitalized costs for the fair value of a conditional asset retirement obligation (ARO) when incurred if the fair value of the liability can be reasonably estimated or when the entity has sufficient information to reasonably estimate the fair value of the ARO. FIN No. 47 requires an ARO liability be recognized at its net present value, with a corresponding increase to the carrying amount of the long-lived asset to which the ARO relates. The ARO liability is accreted through periodic charges to interest expense. The initially capitalized ARO long-lived asset cost is depreciated over the useful life of the related long-lived asset.

In the normal course of operations, WPAHS performs repairs and maintenance on its buildings. Additionally, WPAHS is involved in ongoing construction and renovation projects. WPAHS has identified costs that may be incurred for asbestos abatement, which would be legally required, if exposed as a result of such construction and renovation projects.

WPAHS has an ARO liability to recognize the costs associated with future asbestos removal. This represents the present value of the expected future cash flows based on various potential settlement possibilities, including normal repairs and maintenance and currently known renovation plans between 2008 and 2048, which represents management's estimated time period for removal. The liability was $2,708 at September 30, 2008. WPAHS has recorded no costs for the three months ended September 30, 2008, relating to asbestos removal. The ARO liability has been discounted using a rate of 8.95% as of the date of adoption.

The significant assumptions and estimates used in the calculation of the AROs are based on the facts and circumstances known at that time of estimation.

Changes in demand, availability of capital, competition, economic conditions, technology advancements, and state regulations can significantly affect the estimated settlement date. To date, management has not performed a comprehensive engineering study surrounding this obligation. Differences between estimated future costs and actual costs could be significant.

Valuation of Investments — Debt and equity securities are recorded at fair value. Beneficial interests in perpetual trusts are recorded at the present value of the estimated future cash receipts from the trusts, which approximates the fair value of the assets in the trust.

Adoption of New Accounting Pronouncement — In September 2006, the FASB issued FASB Statement No. 158, *Employer's Accounting for Defined Benefit Pension and* other *Postretirement Plans — an amendment of FASB Statements No 87, 88, 106, and 132(R)*. FASB Statement No. 158 requires a company who sponsors a postretirement benefit plan to fully recognize, as an asset or liability, the overfunded or underfunded status of the benefit plan, and to recognize changes in that funded status in the year they occur, through changes in unrestricted net assets. Additionally, it requires a company to measure the funded status of the plan as of the date of its year-end. The recognition provisions were adopted by the System for the year ended June 30, 2007, and the measurement provision of this statement will be adopted by the System for the year ended June 30, 2009.

Recently Issued Accounting Pronouncements — In September 2006, the FASB issued FASB No. 157, *Fair Value Measurements.* FASB Statement No. 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This pronouncement applies to other existing accounting pronouncements that require or permit fair value measurements. The pronouncement does not require any new fair value measurements. FASB Statement No. 157 will be effective for financial statements issued for the fiscal year beginning July 1, 2008.

In February 2007, the FASB issued FASB Statement No. 159, *The fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115.* FASB Statement No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. FASB Statement No. 159 will be effective for financial statements issued for the fiscal year beginning July 1, 2008.

The System adopted Statements 157 and 159 on July 1, 2008. The basis of investments for accounting purposes was increased by $3,321 of previously unrealized gains on the date of adoption. During the three months ended September 30, 2008 WPAHS has recorded $3,435 to the Statement of Operations for the change in fair market value since adoption.

3. UNCOMPENSATED CARE AND COMMUNITY SERVICE BENEFITS

To enhance the health status of the communities in which it operates and consistent with its tax-exempt status, WPAHS provides needed health care services to individuals regardless of their ability to pay for all or part of the services rendered. These services include both inpatient and outpatient services, as well as maintaining six emergency rooms that are available 24 hours a day, including a level I regional resource trauma center, and many primary care and specialty care practices that provide services to the community without regard to the ability to pay for services rendered.

WPAHS maintains a written charity care policy that defines the levels of household income that would qualify for various levels of charity care. Patients can qualify for charity care with household incomes of up to four times the federal poverty guidelines. WPAHS does not pursue collection of amounts, which qualify as charity care in accordance with the policy. Charges foregone for services and supplies provided for those individuals who applied for and qualified under the charity care policy amounted to

$3,507 for the three months ended September 30, 2008. These amounts are recorded as a reduction in net patient service revenue in the consolidated statement of operations. Patients are required to apply for the charity care discount, but often do not complete the necessary paperwork to determine if they qualify. As a result, there is an unquantifiable amount of uncompensated services that would potentially be considered charity care under the policy, but rather are ultimately reflected in bad debt expense.

WPAHS offers a 50% uninsured discount on charges for most services performed for individuals without insurance, regardless of income levels. Total discounts offered during the three months ended September 30, 2008, amounted to $7,737. These amounts are recorded as a reduction in net patient service revenue in the consolidated statement of operations.

Total uncompensated care, including bad debts, uninsured discounts, and charity care was $24,431 for the three months ended September 30, 2008.

In addition to uncompensated care, WPAHS provides free and below cost services and programs for the benefit of the community. The cost of these programs is included in salaries, wages, and fringe benefits; patient care supplies; professional fees and purchased services; and other expense lines in the consolidated financial statements.

Services are also provided to beneficiaries of government sponsored programs, including state Medical Assistance and indigent care programs. Reimbursement from these programs is often less than the cost of providing these services.

4. ASSETS LIMITED OR RESTRICTED AS TO USE

Assets limited or restricted as to use at September 30, 2008, consists of the following components:

Unrestricted:	
Designated by board of trustees for:	
Capital improvements	$ 36,182
Self-insurance	3,361
Foundation	32,002
Other	7,217
Capital project funds	78,333
Debt service	60,963
Total unrestricted	218,058
Temporarily restricted	31,207
Permanently restricted	223,961
Total assets limited or restricted as to use and beneficial interest in perpetual trust	473,226
Less current portion	12,360
Assets limited or restricted as to use, including beneficial interests in perpetual trusts — net of current portion	$ 460,866

Assets limited or restricted as to use by investment type at September 30, 2008, consist of the following:

Cash and short-term investments	$ 36,103
Guaranteed investment contracts	76,922
Government and corporate obligations	204,733
Marketable equity securities	145,671
Collective funds and other	9,797
Assets limited or restricted as to use	$473,226

Investment income for the three months ended September 30, 2008, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted
Net realized losses on investments	$ (188)	$ (7)	$ (2,129)
Dividends and interest — net of trustee fees	4,653	341	1,209
Non-cash investment gains/(losses)	(3,435)	-	-
	$ 1,030	$ 334	$ (920)

During May 2000, the Orphan's Court of Pennsylvania permitted the election of a fixed investment income distribution under the provisions of Section 8113 (the "Election") of the Pennsylvania Probate, Estate, and Fiduciary Code for certain trust accounts, which name applicable WPAHS entities as the sole beneficiary. Under the provisions of the Election, the trustees annually determine and distribute income to the beneficiary at a fixed percentage of the value of the individual trusts. The calculations are based upon the three-year average market value of the respective trusts, and require the trustees to select a percentage, which is consistent with the long-term preservation of the real value of the principal of the trust, but in no event shall the percentage be less than 2% nor more than 7% per year. Distributions from these trusts are included in investment income in the accompanying consolidated statement of operations and totaled $1,712 for the three months ended September 30, 2008. Under the provisions of the Election, there is no settlement with the trustee should the trustee be permitted to revoke the Election. As such, the excess distributions are also reflected as a reduction in the permanent net assets of WPAHS.

5. PROPERTY AND EQUIPMENT

Property and equipment at September 30, 2008, consist of the following:

Buildings and building improvements	$ 790,208
Equipment	661,883
Leasehold improvements	33,376
Total depreciable assets	1,485,467
Less accumulated depreciation and amortization	1,114,202
Net depreciable assets	371,265
Land and land improvements	28,837
Construction in progress	19,782
Property and equipment — net	$ 419,884

WPAHS capitalizes interest on certain assets that require a period of time to prepare for their intended use. The amount capitalized is based on the weighted-average outstanding borrowing rate of WPAHS' indebtedness exclusive of earnings on the capital project funds. During the three months ended September 30, 2008, WPAHS capitalized $110 of related interest costs. Depreciation expense was $17,225 for the three month period ended September 30, 2008.

6. OTHER ASSETS

Other assets at September 30, 2008, consist of the following:

Prefunded insurance deductible	$ 23,792
Deferred bond financing costs — net of accumulated amortization of $1,112	16,133
Intangibles — net of accumulated amortization of $11,059	8,179
Investment in CHA RRG	13,894
Other	8,266
Total	$ 70,264

7. LONG-TERM DEBT

Long-term debt as of September 30, 2008, consists of the following:

Allegheny County Hospital Development Authority (ACHDA) — Series 2007 A with maturity dates through November 15, 2040, and interest rates ranging from 5.000% to 5.375%, including a net unamortized premium of $5,857 at September 30, 2008	$ 758,227
Floating Rate Restructuring Certificates (FRRC) — payable based on attainment of defined income levels, noninterest-bearing through June 30, 2003, with a variable interest rate of the three-month London InterBank Offered Rate (LIBOR) plus 0.25% (4.303% at September 30, 2008) thereafter until maturity on June 30, 2030	37,084
Series 2006 B Health Facilities Revenue Notes — payable in monthly principal and interest payments through October 2015, with interest rates ranging from 4.55% to 4.61%	22,750
Series 2006 A Health Facilities Revenue Notes — payable in monthly principal and interest payments through December 2016, at a fixed interest rate of 5.25% for all payments	4,047
McKeesport Industrial Development Authority	2,921
Mortgage loans	3,475
Total	828,504
Less current portion	3,824
Total long-term debt	$ 824,680

In June 2007, the System issued $752,400 of Allegheny County Hospital Development Authority Health System Revenue Bonds (West Penn Allegheny Health System Series 2007 A, the “Series 2007 A bonds”). Proceeds of the Series 2007 A bonds were used to advance refund the outstanding Allegheny County Hospital Development Authority Series 2000 A and B bond issues and to current refund the Dauphin County General Authority Series 1992 A and B Hospital Revenue Bonds, the Pennsylvania Higher Education Facility Authority Series 1991 A Revenue Bonds, the Monroeville Hospital Authority Series 1992 and 1995 Revenue Bonds, and partially refund an outstanding loan from Highmark.

The Series 2007 A bonds are a liability of the Obligated Group. Each member of the Obligated Group is jointly and severally liable for payment of this obligation.

The Series 2007 A bonds are subject to mandatory redemption on November 15, 2017, November 15, 2028, and November 15, 2040, based on the mandatory sinking fund dates as disclosed in the official statement. They are subject to redemption prior to their respective stated maturity dates, in part, or by lot, on variable dates as disclosed on the official statement at the discretion of WPAHS and the ACHDA. Under the Master Trust Indenture (MIT), interest is payable to the bondholders semiannually on each May 15 and November 15.

The Series 2007 A bonds are secured by (i) first mortgage liens on certain real property, (ii) security interests in certain equipment and other tangible and intangible personal property of the Obligated Group, and (iii) gross revenues of the Obligated Group. Debt service reserve accounts in the amount of $63,706 at September 30, 2008, exist for the Series 2007 A bonds, which must be maintained at required reserve levels.

Under the MTI, the Obligated Group has covenants including, but not limited to, a long-term debt service coverage ratio of 1.0 and days cash on hand of 20 (both measured annually at June 30). As of June 30, 2008, WPAHS was in compliance with these covenants.

In December 2006, WPAF entered into two note agreements with the issuance of Series 2006 B Notes in the amount of $24,000 and Series 2006 A Note in the amount of $4,950 to purchase four new helicopters and hospital beds, respectively (see Note 8). The notes are collateralized by the acquired beds and helicopters.

The McKeesport Industrial Development Authority note is payable in monthly principal and interest payments through January 2010 at a fixed interest rate of 5.12% and is secured by an interest in capital equipment owned by WPAF. The loan agreement requires WPAF to maintain a liquidity level of 20% of the outstanding balance.

WPAF maintains three mortgage loans related to the purchase of a professional office building. Each of these has variable interest which will be reset in June 2011, June 2016, and June 2021. At September 30, 2008, the portion related to taxable usage has a rate of 7.53%. The portion related to tax-exempt usage has a rate of 5.43%. The portion related to the building improvements has a rate of 7.4%. The payments through June 2009 are primarily interest only with final principal and interest payment being due in May 2006.

The Series 2006 B Health Facilities Revenue Notes ("Series 2006 B Notes"), and the Series 2006 A Health Facilities Revenue Note ("Series 2006 A Note"), the McKeesport Industrial Development Authority obligation, the Mortgage loan, are solely the obligation of WPAF.

In 2000, certain creditors of AGH and its affiliates restructured approximately $114,300 of indebtedness by exchanging such indebtedness for approximately $76,900 in cash and approximately $37,100 in principal amount of FRRCs. Initially, no interest accrued on the FRRCs. Beginning July 1, 2003, the FRRCs bear interest at the three-month LIBOR plus 0.25%. Payment of interest is contingent upon achieving and maintaining specified liquidity levels. Management believes the probability of future interest payments to be remote and has, therefore, not recorded interest to date.

Subject to the FRRC Cap, if applicable, the FRRCs are entitled to receive an annual single payment of 25% (30% if unenhanced indebtedness of any other member of the Obligated Group is rated "A" or better) of the adjusted net operating income of the Obligated Group as defined in the FRRC indenture, calculated as of each June 30 commencing June 30, 2004. Payments are also contingent upon achieving and maintaining specified liquidity levels. No payments have ever been due under the FRRCs.

Scheduled principal repayments and sinking fund requirements on all long-term debt for each of the next five years and thereafter as of September 30, 2008, are as follows:

	Total Obligated Group	WPAF	Total Consolidated Group
Nine months ending June 30, 2009	$ -	$ 2,834	$ 2,834
Year ending June 30, 2010	9,885	3,081	12,966
Year ending June 30, 2011	10,390	1,868	12,258
Year ending June 30, 2012	10,925	1,963	12,888
Year ending June 30, 2013	11,485	2,061	13,546
Thereafter	746,769	21,386	768,155
	$ 789,454	$ 33,193	$ 822,647

8. COMMITMENTS

Rental expense consists of amounts paid to lease property for physician offices, a network of ambulatory locations, parking garages, and administrative offices. In addition, WPAHS leases clinical, administrative, and helicopter equipment. Equipment leases involve both noncancelable operating leases, as well as ordinary month-to-month rentals for items that are used as the need arises based on the volume or mix of procedures and, therefore, are not practical to purchase. The components of rental expense for the three months ended September 30, 2008, are as follows:

Property rentals	$ 6,368
Equipment rentals	4,701
Total	$ 11,069

The future minimum lease payments under noncancelable operating leases entered into as of September 30, 2008, are as follows:

Nine months ending June 30, 2009	$ 30,829
Year ending June 30, 2010	35,025
Year ending June 30, 2011	26,087
Year ending June 30, 2012	18,299
Year ending June 30, 2013	14,117
Thereafter	52,863
Total minimum payments	$ 177,220

WPAHS has committed approximately $31,800 to replace the clinical information system at most of the WPAHS hospitals, of which $25,611 has been expended at September 30, 2008. The implementation of this system is expected to be completed in 2010.

Approximately 14% of employees are covered by collective bargaining agreements. There are five bargaining units which have expiration dates ranging from January 2009 through April 2010.

WPAHS has employment agreements with physicians, specialists, and others. These agreements are for periods up to 10 years and require services to be performed.

WPAHS has one helicopter lease expiring in 2012. Under this lease, AGH bears a contractual residual risk amount at the end of the lease. AGH estimates that the fair value of the helicopter at the end of the lease will exceed the contractual residual risk amount. As such, no liability is recorded at September 30, 2008.

9. INCOME TAXES

No provision for income taxes has been recognized in the accompanying consolidated financial statements as WPCMSI has incurred net operating losses in most years prior to fiscal 2009, which are available to offset current and future taxes payable. A valuation allowance of approximately $19,000 has been established to fully reserve for cumulative net operating losses of approximately $48,000, which expires between 2009 and 2029, as future earnings are not estimated to be sufficient to realize the asset before the net operating loss carry forward expires.

10. INSURANCE

Workers' Compensation — Prior to various dates during 1999, WPAHS was self-insured for workers' compensation claims. From 1999 through October 14, 2004, WPAHS purchased occurrence based commercial insurance for workers' compensation claims. The coverage was for $250 per claim at AKMC, CGH, Forbes Regional Campus ("FRC"), and Suburban Campus and $350 per claim at AGH and WPH. From October 15, 2004, WPAHS is self-insured for workers' compensation claims and has purchased excess insurance coverage of $350 per claim for all of its hospitals. During the three months ended September 30, 2008 WPAHS's workers' compensation expense was $816.

General and Professional Liability — Historically, the entities that are now part of WPAHS established self-insurance programs for professional and general liability through offshore captive insurance companies.

From 1999 through 2001, AGH, FRH, AKMC, and CGH (the "Allegheny Entities") purchased commercial professional and general liability insurance ($400 per claim for 1999 and 2000; $500 per claim for 2001). The primary professional liability and Mcare coverage were set at state mandated limits. For 2001, the professional liability insurance premium was retrospectively rated and the initial paid-in premium of $6,000 may increase up to a maximum premium of $9,000 depending upon actual loss experience. In addition to the initial paid-in premium of approximately $6,000, to date, WPAHS has received one refund of approximately $500 and made payments totaling approximately $3,000. The total retrospective premium calculation as of January 1, 2008, was $9,231; including $8,331 of incurred losses, $600 of premium charges, and $300 of insurance charges. However, as noted WPAHS' payment is capped at $9,000.

In 2001, for AGH only, there was $1,000/$2,000 retention between the Mcare coverage (MCare Coverage was $800 per claim for 1999 and 2000 and & 700 per claim for 2001) and first excess policy. Additional commercial excess policies existed for 1999, 2000, and 2001. The 1999 and 2000 excess policies extended coverage to the physicians employed by the Allegheny Entities.

Additional commercial excess policies existed for 1999, 2000, and 2001. The 1999 and 2000 excess policies extended coverage to the physicians.

For years 1999 through 2001, WPH and SGH purchased commercial professional and general liability insurance with the same limits as the Allegheny Entities. Primary coverage was purchased through PHICO Insurance Company. In 2002, PHICO was placed in liquidation resulting in the potential for: (i) gap insurance risk between the amounts provided by the Pennsylvania Insurance Guaranty Fund and the Pennsylvania Catastrophe Fund attachment point, and (ii) rights of recovery by the Pennsylvania Insurance Guaranty Fund against entities with net assets in excess of $50,000. Any exposure related to the gap or rights of recovery are recorded in the self insurance liabilities on the consolidated balance sheet. Additional commercial excess coverage existed for these years.

In 2002, WPAHS reestablished its self-insurance program through FIC, an offshore captive insurance company domiciled in the Cayman Islands. The primary professional liability and Mcare coverage were set at state mandated limits ($500 per claim), through a reinsurance relationship funded by a commercial insurer. There was a retention layer between the Mcare coverage and the first excess policy of $2,000 per claim at FRH, AKMC, SGH, and CGH; and $3,000 per claim at AGH and WPH. Additional excess policies were obtained through commercial insurers.

Beginning in 2003, WPAHS has been insured through the Community Health Alliance Reciprocal Risk Retention Group ("CHA RRG"), a Vermont domiciled risk retention group. The primary professional liability and Mcare coverage were set at state mandated limits ($500 per claim). The primary layer is subject to a $250 per claim deductible, which is pre-funded to the CHA RRG. A pre-funded insurance deductible asset and an offsetting self-insurance liability have been recorded in the accompanying consolidated balance sheet for $23,792 as of September 30, 2008, to reflect the amount of deductible payments that have been made to CHA RRG, but have not yet been paid-out to settle claims. Any portion of this pre-funded deductible that is not ultimately used to settle claims will be returned to WPAHS. There was a $5,200 aggregate retention for all entities between the Mcare and first excess layers. CHA RRG provided two excess layers: first excess $5,200/$10,400, second excess $5,000/$5,000. WPAHS also purchased commercial insurance over the CHA RRG excess layers. All parties participating in CHA RRG made a minimum three-year participation commitment. Subsequent year changes to the above are as follows:

- 2004 — The retention dropped to $5,000 aggregate; the CHA RRG excess layers changed to: first excess $1,000/$3,000; second excess $9,000/$9,000.
- 2005 — The CHA RRG second excess changed to $9,000/$18,000.
- 2006 — A third layer of CHA RRG excess of $10,000/$10,000 was added. This layer is reinsured through a commercial carrier.
- 2007 — The primary layer general liability aggregate was increased from $1,000 to $3,000 for this policy year.
- 2008 – The professional liability coverage was increased by adding $5,000 to the 5th layer of insurance. The 5th layer previously provided general liability coverage only.

WPAHS has a 20% voting interest in CHA RRG. The interest is accounted for using the equity method.

WPAHS provides for the costs associated with general and professional liability claims based on actuarially determined projected settlements, which include estimates for claims incurred but not reported. There exists, however, inherent risks in the areas of general and professional liability insurance that stem from, among other things, coverage availability and the financial viability of the underlying insurance carrier.

During the three months ended September 30, 2008, WPAHS's general and professional liability expense was $6,784.

11. PENSION PLANS

Defined Benefit Plans — WPAHS maintains the Retirement Plan for the Employees of West Penn Allegheny Health System, a defined benefit cash balance pension plan. Under this cash balance plan, pension accruals are determined using a defined percentage of an employee's current compensation based upon the employee's age and years of service. Each employee's individual retirement benefit is defined within the plan's obligation as notational cash balance retirement accounts and is credited with interest based upon a defined interest rate.

WPAHS' investment policy is to provide for the benefit obligations earned by employees during their career at WPAHS. Plan assets are invested to generate earnings over an extended time period to help fund the cost of benefits under the plan while controlling investment fees.

WPAHS' funding policy is to contribute such amounts, as necessary, on an actuarial basis to provide the plan with assets sufficient to meet benefits to be paid to retirees or their beneficiaries, and to satisfy minimum funding requirements of Employee Retirement Income Security Act of 1974, and the IRC. The plan has been deemed by the Pension Protection Act of 2006 (PPA) to be a Pension Benefit Guarantee Corporation settlement plan, which exempts WPAHS from the accelerated funding rules of the PPA until 2014. Plan assets are invested primarily in corporate common stocks, fixed income obligations of the United States government and corporations, and interests in mutual funds.

WPAHS' pension plan weighted-average asset allocation at March 31, 2008 by asset category is as follows:

	Actual	Target Ranges
Plan assets:		
Domestic equity securities and funds	27 %	20-50 %
Tactical asset allocation fund	15	10-30
Debt securities and funds	25	15-35
International equity securities and funds	18	10-25
Alternative investment fund of funds	9	0-15
Real estate investment trusts	3	0-10
Cash, cash equivalents, and others	3	-
Total	100%	

WPAHS maintains no significant concentrations of a single investment in plan assets.

The funded status at the measurement date of April 1, 2008, and amounts recognized in the consolidated financial statements at September 30, 2008, relating to employee retirement benefits are as follows:

Projected benefit obligation	$ 621,344
Fair value of plan assets	490,719
Projected benefit obligation in excess of fair value of plan assets	$ 130,625
Accrued pension obligation at September 30, 2008	$ 130,217
Weighted-average assumptions used to determine benefit obligations:	
Discount rate	6.10 %
Rate of compensation increase	3 - 8 % Graded

Components of net periodic benefit costs:	
Service cost	$ 7,599
Interest cost	9,002
Expected return on plan assets	(9,697)
Recognized actuarial gain	(220)
Amortization of prior service cost	2,918
Net periodic cost for the three months ended September 30, 2008	$ 9,602
Benefits paid for the three months ended September 30, 2008	$ 9,023
Weighted-average assumptions used to determine net cost:	
Discount rate	6.10 %
Expected return on plan assets	8.50 %
Rate of compensation increase	3 - 8% Graded

The System is required to abide by the minimum funding requirements of Section 412 of the IRC. Based on most recent actuarial estimates, the System has no required funding during the 12 months ending September 30, 2009. The System contributed approximately $4,000 for the three months ended September 30, 2008.

The long-term expected rate of return on pension investments is developed by independent estimates of forward looking rates of return by investment category, multiplied by the target investment allocation mix.

The following benefit payments, which reflect future service, as appropriate, are expected to be paid by WPAHS:

	Total Pension Benefits
Nine months ending June 30, 2009	$ 54,074
Year ending June 30, 2010	35,052
Year ending June 30, 2011	33,461
Year ending June 30, 2012	39,148
Year ending June 30, 2013	41,959
Years ending June 30, 2014–2018	271,030

Adoption of FASB Statement No. 158 — In September 2006, the FASB issued FASB Statement No. 158. FASB Statement No. 158 requires a company who sponsors a postretirement benefit plan to fully recognize, as an asset or liability, the over funded or under funded status of the benefit plan, and to recognize changes in that funded status in the year they occur, through changes in unrestricted net assets. Additionally, it requires an employer to measure the funded status of the plan as of the date of its year-end. The recognition provisions of FASB Statement No. 158 were required to be adopted by the System for the fiscal year ended June 30, 2007, and the measurement provision of this statement is required to be adopted by the System for the fiscal year ended June 30, 2009. Based on the funded status of WPAHS' defined benefit plan at April 1, 2007, measurement date, WPAHS was required to increase its net liabilities for pension by $63,840, which was recorded as a decrease in the System's unrestricted fund balance at June 30, 2007.

The net actuarial loss and prior service cost (credit) not yet recognized into net periodic pension cost was $163,843 and ($89), respectively at June 30, 2008. The estimated excess of expenses over revenues and prior service cost (credit) that will be amortized from unrestricted deficit into net periodic pension cost in 2009 is $10,793 of which $2,698 has been amortized through September 30, 2008.

Defined Contribution Plans — WPAHS sponsors a defined contribution savings plan, which is available to substantially all WPAHS employees in order to provide additional security during retirement by creating an incentive for employees to make regular contributions on their own behalf. As of July 1, 2007, all employees of WPCMSI were integrated into WPAHS and were eligible to participate in the WPAHS defined contribution savings plan. Under this plan and as determined on an individual employee basis, WPAHS contributed an amount equal to 50% of an employee's contribution up to 2.5% of such employee's salary in a given year. An additional matching contribution was made based on years of vesting service. Such expense related to these plans was based on actual contributions made.

WPAHS' expense associated with its matching contributions to these savings plans was $1,311 for the three months ended September 30, 2008.

12. FUNCTIONAL EXPENSES

WPAHS provides general healthcare services. Expenses related to such services for the nine month period ended September 30, 2008, are as follows:

Health care services	$ 362,802
General	51,630
Research	3,996
Fund raising and other	405
Total	$ 418,833

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used in estimating the fair value of WPAHS's financial instruments:

Cash and Cash Equivalents — The carrying value reported in the consolidated balance sheet for cash and cash equivalents approximates their fair value.

Marketable Securities, Short-Term Investments, and Assets Limited or Restricted as to Use — Fair values, which are the amounts reported in the consolidated balance sheet, are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

Accounts Payable and Other Accrued Liabilities — The carrying value reported in the consolidated balance sheet for these obligations approximates their fair value. The carrying and fair values of the self insurance liabilities are actuarially determined.

Long-Term Debt — Fair value of WPAHS' revenue bonds and notes are based on current traded value. The fair value and carrying amounts of the bonds and notes were $600,164 and $758,227, respectively, at September 30, 2008. WPAHS has determined that it is not practical, as applicable, to estimate the fair value of the FRRC's without incurring excessive costs as quoted market prices are not available. The fair value of the mortgage loan approximates its carrying value as it is a resettable rate debt. The fair value of the 2006 A and B Healthcare Facilities Revenue Notes and the McKeesport Industrial Development Authority debt approximates its carrying value based on rates available on similar debt instruments.

14. LEGAL MATTERS

In August 2008, the United States Securities and Exchange Commission (SEC) notified WPAHS that it had initiated an informal inquiry into the $73 million balance sheet adjustments in fiscal 2008 announced on July 28, 2008. WPAHS is, on a voluntary basis, fully cooperating with the SEC's inquiry.

In January 2006, the United States Department of Justice ("DOJ") sent a letter to WPAHS asserting that each of AKMC, AGH, WPH, FRH, and CGH had erroneously billed certain Medicare claims during years 2001–2004, resulting in overpayments to WPAHS hospitals. Following an internal review of the data, System representatives met with representatives of the U.S. Attorney's Office and presented information regarding our audit results and the System's compliance program generally. This matter has been paid and settled outside of the False Claims Act in fiscal 2008 for $1,061, which represents the amount of the overpayment plus interest in the aggregate. No penalties were assessed.

WPAHS is additionally subject to various legal proceedings and claims consistent with an organization of its size arising in the ordinary course of its business and not yet adjudicated.

In the opinion of management, after consultation with legal counsel, the ultimate outcome of the lawsuits and claims discussed above are unlikely to have a material adverse effect on the consolidated balance sheet, results of operations, or cash flows of WPAHS.

* * * * * *

SUPPLEMENTAL SCHEDULES

WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET INFORMATION
AS OF SEPTEMBER 30, 2008
(Amounts in thousands)

ASSETS	Total Obligated	Total Non-Obligated	Eliminations	Total Consolidated
CURRENT ASSETS				
Cash and cash equivalents	$ 74,668	$ 1,482	$ -	$ 76,150
Short-term investments	1,411	-	1,411	1,411
Assets limited or restricted as to use	11,506	853	1	12,360
Receivables:				
Patient accounts, less allowance for uncollectible accounts of $34,300	167,925	-	-	167,925
Other	12,022	308	178	12,508
Inventories	26,693	-	-	26,693
Prepaid expenses	12,627	3	50	12,680
Total current assets	306,852	2,646	229	309,727
ASSETS LIMITED OR RESTRICTED AS TO USI	457,895	2,971	-	460,866
PROPERTY AND EQUIPMENT—Net		35,793	(1)	35,792
OTHER ASSETS—Net	70,587	2,297	(2,620)	70,264
TOTAL	$ 835,334	$ 43,707	$ (2,392)	$ 876,649

WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATING BALANCE SHEET INFORMATION
AS OF SEPTEMBER 30, 2008
(Amounts in thousands)

LIABILITIES AND NET ASSETS	Total Obligated	Total Non-	Eliminations	Total Consolidated
CURRENT LIABILITIES:				
Current portion of long-term debt	$ -	$ 3,824	$ -	$ 3,824
Accounts payable	77,596	360	-	77,956
Accrued expenses	26,592	-	-	26,592
Accrued interest	14,808	100	-	14,908
Accrued salaries and vacation	54,145	-	-	54,145
Estimated third-party payor settlements	2,945	-	-	2,945
Current portion of deferred revenue	11,875	-	50	11,925
Current portion of self-insurance liabilities	2,543	-	-	2,543
Current portion of notes payable to affiliates	-	-	-	-
Due to affiliate—net	-	(178)	178	-
Total current liabilities	190,504	4,106	228	194,838
DEFERRED REVENUE	41,127	-	-	41,127
SELF-INSURANCE LIABILITIES	51,129	1,471	(1)	52,599
LONG-TERM DEBT	795,311	29,369	-	824,680
ACCRUED PENSION OBLIGATION	130,217	-	-	130,217
OTHER NONCURRENT LIABILITIES	8,640	3,314	1	11,955
Total liabilities		38,260	228	1,255,416
NET ASSETS (DEFICIT):				
Unrestricted	(252,191)	4,969	(2,621)	(249,843)
Temporarily restrictec	30,728	478	1	31,207
Permanently restricted	223,961	-	-	223,961
Total net assets (deficit)	2,498	5,447	(2,620)	5,325
TOTAL	$ 2,498	$ 43,707	$ (2,392)	$ 1,260,741

WEST PENN ALLEGHENY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATING STATEMENT OF OPERATIONS INFORMATION
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008
(Amounts in thousands)

	Total Obligated	Total Non-	Eliminations	Total Consolidate
UNRESTRICTED REVENUES, GAINS, AND OTHER SUPPORT				
Net patient service revenue	$ 386,343	$ -	$ -	$ 386,343
Other revenue	14,042	1,294	(1,281)	14,055
Net assets released from restriction used for operations	1,049	17	-	1,066
Total unrestricted revenues, gains, and other support	401,434	1,311	(1,281)	401,464
EXPENSES:				
Salaries, wages, and fringe benefits	229,079	-	-	229,079
Patient care supplies	73,883	-	-	73,883
Professional fees and purchased services	35,503	-	-	35,503
General and administrative	40,570	17	(1,282)	39,305
Depreciation and amortization	16,892	918	-	17,810
Interest	9,597	468	1	10,066
Provision for bad debts	13,187	-	-	13,187
Total expenses	418,711	1,403	(1,281)	418,833
OPERATING INCOME (LOSS)	$ (17,277)	$ (92)	$ -	$ (17,369)
Investment income (loss	1,015	15	-	1,030
Gifts and donations	374	-	-	374
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES	$ (15,888)	$ (77)	$ -	$ (15,965)

3. COMPARATIVE STATISTICAL SUMMARY FOR THE QUARTERS ENDED SEPTEMBER 30, 2004 - 2008

West Penn Allegheny Health System
Health System Totals
Statistics and Volumes

	Three Months Ended September 30,				
	2004	2005	2006	2007	2008
Discharges					
Acute	19,926	19,395	19,199	19,106	19,659
Rehab	399	281	251	276	279
Hospice	81	107	105	99	117
Patient Days (based on census/excludes newborns)					
Acute	101,024	97,242	98,738	97,702	97,280
Rehab	4,940	3,558	3,114	3,210	3,172
Hospice	611	736	731	856	971
Staffed Beds					
Acute	1,690	1,717	1,692	1,633	1,648
Rehab	101	101	61	61	61
Hospice	12	12	12	12	12
Occupancy Rate					
Acute	65.0%	61.6%	63.4%	65.0%	64.2%
Rehab	53.2%	38.3%	55.5%	57.2%	56.5%
Hospice	55.3%	66.7%	66.2%	77.5%	88.0%
Length-of-Stay (based on discharges)					
Acute	5.07	5.01	4.95	4.96	4.79
Rehab	12.38	12.66	12.22	11.84	11.17
Hospice	7.54	6.88	6.96	8.65	8.30
Births	1,203	1,235	1,176	1,264	1,344
Emergency Visits					
Inpatient	10,980	10,388	10,427	10,688	11,290
Outpatient	35,644	36,712	37,683	38,507	39,596
Operating Room Cases					
Inpatient	6,642	6,234	5,946	5,993	5,999
Outpatient	9,277	8,863	8,679	8,877	8,363
Transplants					
Heart	-	-	4	5	5
Kidney	20	17	33	21	21
Bone Marrow	19	19	20	19	14
Liver	-	-	-	-	2

4. DAYS CASH-ON-HAND AND DEBT SERVICE COVERAGE RATIO CALCULATION AS OF SEPTEMBER 30, 2008

WPAHS
DAYS CASH ON HAND
as of September 30, 2008
(dollars in thousands)

Days Cash on Hand:	
Series 2007A Project Fund	$ 76,922
Cash & Cash Equivalents	74,668
Board designated (funded depreciation)	68,183
Short term investments	1,411
Due (to)/from temporarily restricted	1,205
Subtotal	**$ 222,389**
Total operating expenses	418,711
Less: Depreciation and Amortization	(16,892)
Operating expenses less Depr. And Amort.	**$ 401,819**
Days in fiscal period	92
Operating expenses per day (Subtotal)	$ 4,368
DAYS CASH ON HAND	**50.9**

WPAHS
ANNUAL DEBT SERVICE COVERAGE RATIO
as of September 30, 2008
(dollars in thousands)

Annual Debt Service Coverage Ratio:	
Excess of expenses of revenues	($ 15,888)
Plus: depreciation and amortization	16,892
Plus: interest expense	9,597
Plus: non-cash investment gains and losses	3,435
Subtotal	**14,036**
Debt service requirement	$ 39,198
x 25% of year	9,799
RATIO	**1.43**