COHEN
RUTHERFORD
+ KNIGHT P.C.
Certified Public Accountants

Audited Consolidated Financial Statements and Other Financial Information

Mercy Health Services, Inc. and Subsidiaries

June 30, 2011 and 2010

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Other Financial Information

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Report of Independent Auditors

The Board of Trustees
Mercy Health Services, Inc. and Subsidiaries
Baltimore, MD

We have audited the accompanying consolidated balance sheets of Mercy Health Services, Inc. and Subsidiaries as of June 30, 2011 and 2010, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Mercy Health Services, Inc. and Subsidiaries' management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Greenleaf Insurance Company, Ltd., a wholly-owned subsidiary, which statements reflect total assets of $45,364,088 and $37,752,778 as of June 30, 2011 and 2010, respectively, and total revenues of $13,177,419 and $12,480,954 for the years ended June 30, 2011 and 2010, respectively. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Greenleaf Insurance Company, Ltd., is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Mercy Health Services, Inc. and Subsidiaries' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements 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 Mercy Health Services, Inc. and Subsidiaries as of June 30, 2011 and 2010, and the results of their operations, changes in their net assets, and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Cohen, Rutherford + Knight, P.C.

August 31, 2011

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Mercy Health Services, Inc. and Subsidiaries
Consolidated Balance Sheets
(Dollars in thousands)

	June 30, 2011	June 30, 2010
ASSETS		
CURRENT ASSETS		
Cash, cash equivalents and short-term investments -- *Note A*	$ 86,759	$ 74,530
Current portion of funds held by trustee or authority -- *Note E*	13,643	12,045
Resident prepayments and security deposits	763	862
Patient accounts receivable, net -- *Note B*	36,234	38,389
Other amounts receivable, net	2,628	2,391
Current pledges receivable, net -- *Note C*	6,197	5,543
Inventory	6,919	5,649
Other current assets	3,774	2,000
TOTAL CURRENT ASSETS	156,917	141,409
PROPERTY AND EQUIPMENT, net -- *Note D*	542,973	484,570
INVESTMENTS AND OTHER ASSETS		
Funds held by trustee or authority, less current portion -- *Note E*	23,309	72,415
Board designated and donor restricted investments -- *Note F*	95,300	95,908
Restricted cash, cash equivalents and investments	41,220	47,463
Long-term investments	48,734	35,497
Long-term pledges receivable, net -- *Note C*	16,975	21,644
Investments in and advances to affiliates -- *Note G*	329	342
Reinsurance balances receivable or recoverable -- *Note I*	2,032	1,733
Other assets -- *Note H*	14,012	12,668
TOTAL ASSETS	$ 941,801	$ 913,648

See notes to the consolidated financial statements

Mercy Health Services, Inc. and Subsidiaries
Consolidated Balance Sheets - Continued
(Dollars in thousands)

	June 30, 2011	June 30, 2010
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current maturities of long-term debt -- *Note J*	$ 6,300	$ 5,315
Accounts payable and accrued expenses	70,507	64,477
Resident prepayments and security deposits	763	852
Construction retainage	780	10,467
TOTAL CURRENT LIABILITIES	78,350	81,111
Long-term debt -- *Note J*	454,193	456,011
Accrued interest	3,373	3,374
Provision for outstanding losses -- *Note I*	32,587	28,821
Post-retirement obligation -- *Note M*	6,819	5,538
Other long-term liabilities -- *Note W*	34,024	43,856
TOTAL LIABILITIES	609,346	618,711
NET ASSETS		
Unrestricted	294,588	252,398
Temporarily restricted -- *Note P*	35,689	40,361
Permanently restricted -- *Notes P and V*	2,178	2,178
TOTAL NET ASSETS	332,455	294,937
COMMITMENTS AND CONTINGENCIES -- *Notes R and U*		
TOTAL LIABILITIES AND NET ASSETS	$ 941,801	$ 913,648

See notes to the consolidated financial statements

Mercy Health Services, Inc. and Subsidiaries
Consolidated Statements of Operations
(Dollars in thousands)

	Year Ended June 30, 2011	2010
REVENUE		
Net patient service revenue -- *Notes B and S*	$ 538,391	$ 500,369
Other operating revenue	19,297	20,581
Net assets released from restriction used for operations	4,910	2,423
TOTAL REVENUE	562,598	523,373
EXPENSES -- *Note Q*		
Salaries and benefits	296,013	271,898
Medical and surgical supplies	44,982	39,953
Pharmacy supplies	25,671	25,006
Other expendable supplies	27,193	23,696
Professional fees	14,401	14,337
Insurance	9,738	9,989
Other purchased services	43,979	39,478
Interest expense	13,700	7,208
Repairs	9,838	8,447
Depreciation and amortization	30,404	25,225
Provision for bad debts	29,368	28,088
TOTAL EXPENSES	545,287	493,325
OPERATING INCOME	17,311	30,048
OTHER INCOME (EXPENSE)		
Investment income -- *Note F*	3,762	1,638
Net unrealized gains on trading securities -- *Note F*	7,320	2,835
Loss on early extinguishment of debt	0	(286)
Unrealized gain(loss) on interest rate swap	9,811	(6,235)
Equity in joint ventures -- *Note G*	540	565
Loss on asset disposal	(147)	(25)
New facility nonrecurring costs	(1,714)	0
Other	11	53
NET OTHER INCOME (EXPENSE)	19,583	(1,455)
EXCESS OF REVENUE OVER EXPENSES	36,894	28,593
Changes to post retirement plans obligations	200	1,991
Net assets released from restrictions for the purchase of property and equipment	5,096	5,755
INCREASE IN UNRESTRICTED NET ASSETS	$ 42,190	$ 36,339

See notes to the consolidated financial statements

Mercy Health Services, Inc. and Subsidiaries
Consolidated Statements of Changes in Net Assets
(Dollars in thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Net assets, June 30, 2009	$ 216,059	$ 43,019	$ 2,220	$ 261,298
Excess of revenue over expenses	28,593	0	0	28,593
Net assets released from restrictions for the purchase of property and equipment	5,755	(5,755)	0	0
Restricted gifts, bequests, and contributions	0	5,478	0	5,478
Changes to post retirement plans obligations -- *Notes M and N*	1,991	0	0	1,991
Fund transfers	0	42	(42)	0
Net assets released from restrictions used for operations	0	(2,423)	0	(2,423)
Change in net assets	36,339	(2,658)	(42)	33,639
Net assets, June 30, 2010	$ 252,398	$ 40,361	$ 2,178	$ 294,937
Excess of revenues over expenses	36,894	0	0	36,894
Net assets released from restrictions for the purchase of property and equipment	5,096	(5,096)	0	0
Restricted gifts, bequests, and contributions	0	5,334	0	5,334
Changes to post retirement plans obligations -- *Notes M and N*	200	0	0	200
Net assets released from restrictions used for operations	0	(4,910)	0	(4,910)
Change in net assets	42,190	(4,672)	0	37,518
Net assets, June 30, 2011	$ 294,588	$ 35,689	$ 2,178	$ 332,455

See notes to the consolidated financial statements

Mercy Health Services, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Dollars in thousands)

	Year Ended June 30, 2011	2010
OPERATING ACTIVITIES		
Change in net assets	$ 37,518	$ 33,639
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities		
Depreciation and amortization	30,404	25,225
Loss (gain) on interest rate swaps	(9,811)	6,235
Loss on sale of assets	147	25
Gain in equity of joint ventures	(540)	(565)
Realized and unrealized gains on board designated and donor restricted investments	(8,895)	(3,519)
Restricted gifts, bequests, contributions, and restricted investment income	(9,349)	(7,491)
Loss on early extinguishment of debt	0	286
Provision for bad debts	29,368	28,088
Decrease (increase) in:		
Patient accounts receivable, net	(27,213)	(26,600)
Other amounts receivable and investments in and advances to affiliates	(523)	999
Pledges receivable	4,015	2,013
Inventory	(1,270)	(406)
Other current assets	(1,764)	(1,089)
Increase (decrease) in:		
Accounts payable and accrued expenses	6,029	3,542
Provision for outstanding losses	3,766	95
Post-retirement obligation	1,281	(1,437)
Other long-term liabilities	(21)	(1,823)
NET CASH AND CASH EQUIVALENTS PROVIDED BY OPERATING ACTIVITIES	53,142	57,217
INVESTING ACTIVITIES		
Net decrease (increase) short-term investments	273	209
Net purchases of property and equipment	(97,691)	(146,484)
Net decrease (increase) in restricted cash, cash equivalents and investments	6,243	(2,665)
Net decrease in funds held by trustee or authority	47,508	112,887
Net decrease (increase) in board designated and donor restricted investments	9,503	(17,824)
Net increase in long term investments	(13,237)	(20,206)
Decrease (increase) in other assets	(1,823)	2,631
NET CASH AND CASH EQUIVALENTS USED IN INVESTING ACTIVITIES	(49,224)	(71,452)

(continued)

Mercy Health Services, Inc. and Subsidiaries
Consolidated Statements of Cash Flows - Continued
(Dollars in thousands)

	Year Ended June 30, 2011	2010
FINANCING ACTIVITIES		
Proceeds from restricted gifts, bequests, contributions, and restricted investment income	9,349	7,491
Debt retirement	(70,000)	0
Proceeds from long term debt	74,399	0
Repayment of long term debt	(5,311)	(5,296)
Deferred financing cost	147	0
NET CASH AND CASH EQUIVALENTS PROVIDED BY FINANCING ACTIVITIES	8,584	2,195
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	12,502	(12,040)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	73,003	85,043
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 85,505	$ 73,003

See notes to the consolidated financial statements

Mercy Health Services, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements
(Dollars in thousands)

Note A - Organization and Summary of Significant Accounting Policies

Organization, Basis of Presentation and Principles of Consolidation

Mercy Health Services, Inc. (MHS) was formed for the purpose of supporting, benefiting, or carrying out some or all of the purposes of Mercy Medical Center, Inc. (Medical Center or MMC), Stella Maris, Inc. (SMI), Maryland Family Care, Inc. (MFC), St. Paul Place Specialists, Inc. (SPPS), Mercy Health Foundation (MHF) and Maryland Specialty Services, LLC (MSS). MHS is the sole member of the Medical Center, SMI, MFC, SPPS, MHF and MSS. MHS prepares its consolidated financial statements on the accrual basis of accounting. The accompanying financial statements include MHS, MMC, SMI, MFC, SPPS, MHF and MSS. All material intercompany balances and transactions have been eliminated.

1. **Mercy Medical Center, Inc.**

   The Medical Center provides inpatient, outpatient, and emergency care services primarily for the citizens of the Baltimore metropolitan area. In addition, the following entities are wholly owned subsidiaries of the Medical Center:

Name of Subsidiary	Tax Status
Mercy Transitional Care Services, Inc (MTC) *Provider of subacute services*	Tax exempt
Greenleaf Insurance Company, Ltd. (GIC) *Provider of self-insured general and malpractice coverage to MHS*	Foreign subsidiary

2. **Stella Maris, Inc.**

   SMI is the sole member of the Stella Maris Operating Corporation, as well as the Cardinal Sheehan Center, Incorporated (CSC). SMI provides sub-acute, hospice, long-term care and adult day care to patients in the central Maryland service area, within its 412-bed long-term care facility.

   CSC is engaged in maintaining and providing care and housing of aged and infirmed persons. CSC owns St. Elizabeth Hall, a 200-unit apartment complex for the elderly.

Note A - Organization and Summary of Significant Accounting Policies - Continued

3. **Maryland FamilyCare, Inc.**

   MFC provides primary care physician services within the Baltimore area.

4. **St. Paul Place Specialists, Inc.**

   SPPS provides specialty physician services within the Baltimore area.

5. **Mercy Health Foundation, Inc.**

   MHF was formed to coordinate and strengthen the fundraising function on behalf of MHS.

6. **Maryland Specialty Services, LLC**

   MSS provides vascular services to patients within the Baltimore area.

Income Taxes

MHS, MMC, SMI, MFC, SPPS, MHF, and MSS are not-for-profit organizations exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code, and are therefore not subject to federal income tax under current income tax regulations. Taxable subsidiaries of MHS account for income taxes in accordance with the Financial Accounting Standards Board's (FASB) guidance on accounting for income taxes. Deferred income taxes are recognized for the tax consequences in future years for differences between the tax basis of assets and liabilities and their financial reporting amounts at each year end. MHS subsidiaries otherwise exempt from federal and state taxation are nonetheless subject to taxation at corporate tax rates at both the federal and state level on their unrelated business income.

Current accounting standards define the threshold for recognizing uncertain income tax return positions in the financial statements as "more likely than not" that the position is sustainable, based on its technical merits, and also provide guidance on the measurement, classification and disclosure of tax return positions in the financial statements. Management believes there is no impact on MHS's accompanying consolidated financial statements related to uncertain income tax positions.

Unrestricted, Temporarily Restricted, and Permanently Restricted Net Assets

Unrestricted net assets represent contributions, gifts, and grants which have no donor-imposed restrictions or which arise as a result of operations.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Unrestricted, Temporarily Restricted, and Permanently Restricted Net Assets - Continued

Temporarily restricted net assets are subject to donor-imposed stipulations that may or will be met either by satisfying a specific purpose and/or the passage of time. Permanently restricted net assets are subject to donor-imposed stipulations that they be maintained in perpetuity. Generally, the donors of these assets permit the use of all or part of the income earned on related investments for specific purposes (see *Notes P and V*).

Cash Equivalents and Short-Term Investments

MHS and certain of its subsidiaries invest in money market funds and U.S. Treasury Bills, which are highly liquid and have an original maturity of ninety days or less. These financial instruments are considered cash and cash equivalents and are recorded at cost, which approximates fair value. Short-term investments are highly liquid assets that have an original maturity between three months and one year.

Restricted Cash, Cash Equivalents, and Investments

Restricted cash, cash equivalents and investments represent funds required for interest rate swap collateral and that have been set aside to cover a portion of GIC's estimated outstanding claims and donor restricted funds from permanently and temporarily restricted net assets. At June 30, 2011, restricted cash, cash equivalents and investments of $10,450 was set aside for interest rate swap collateral and $30,770 was set aside to cover estimated outstanding claims and donor restricted funds. At June 30, 2010, restricted cash, cash equivalents and investments of $18,868 was set aside for interest rate swap collateral and $28,595 was set aside to cover estimated outstanding claims and donor restricted funds.

Reclassification

Certain prior year amounts have been classified to conform to the current year's presentation.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Investments

Investments include marketable equity securities with readily determinable fair values based on quoted market prices. Unrestricted investment income or losses are reported in the consolidated statements of operations as part of excess of revenues and gains over expenses and losses unless the income is restricted by donor or law. Investments received by gift or bequest are reported at fair value at the date of the donation. Investment income and changes in the fair value of temporarily restricted and permanently restricted investments are recorded as increases or decreases in unrestricted, temporarily restricted or permanently restricted net assets in accordance with the terms of the donor's original gift or bequest.

Investments also include investments in limited partnerships and other alternative investments, which are made in accordance with the investment policies of MHS and are monitored through quarterly performance reviews. The limited partnerships acquire, hold, invest, manage, dispose of, and otherwise deal in and with securities of all kinds and descriptions. Publicly traded securities are valued using generally accepted pricing services selected by the fund managers of the limited partnership. Securities not valued by such pricing services will be valued upon bid quotations obtained from independent dealers in the securities. In the absence of any independent quotations, securities will be valued by the fund managers on the basis of data obtained from the best available sources.

Although the various fund managers use their best judgment at estimating the fair value of the alternative investments, there are inherent limitations in any valuation technique. Therefore, the value is not necessarily indicative of the amount that could be realized in a current transaction. Future events will also affect the estimates of fair value, and the effect of such events on the estimates of the fair value could be material (see *Note K*).

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair 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 to unrestricted net assets and reported in the statement of operations as net assets released from restrictions.

Inventories

Inventories are stated at the lower of cost, determined by the first-in, first-out method, or market.

Note A - Organization and Summary of Significant Accounting Policies – Continued

Deferred Financing Costs

Costs incurred in obtaining and issuing the Maryland Health and Higher Educational Facilities Authority (MHHEFA) bonds have been capitalized. These expenses are being amortized over the term of the bonds using the straight-line method. Accumulated amortization amounted to $1,961 and $1,793 at June 30, 2011 and 2010, respectively.

Recent Pronouncements

In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-06, *Improving Disclosures about Fair Value Measurements.* ASU 2010-06 amends FASB Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements and Disclosures,* to require additional disclosures regarding fair value measurements. In addition to amendments already effective, entities will also be required to report purchases, sales, issuances, and settlement of Level 3 assets and liabilities on a gross basis, rather than net. This is effective for fiscal years beginning after December 15, 2010. As of June 30, 2011, management of MHS does not believe the adoption of this guidance will impact the consolidated financial statement amounts; however, additional disclosures may be required.

In August 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-23, *Measuring Charity Care for Disclosure.* ASU 2011-23 affects entities within the scope of Topic 954, *Health Care Entities* that provide charity care. ASU 2011-23 requires that cost be used as the measurement basis for charity care disclosures and that cost be identified as the direct and indirect costs of providing charity care. This update also requires disclosure of the method used to identify or determine such costs. This is effective for fiscal years beginning after December 15, 2011, and early adoption is permitted (MHS adopted this guidance during the year ended June 30, 2011). The amendments in this update should be applied retrospectively to all prior periods presented.

In August 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries.* ASU 2011-24 affects entities within the scope of Topic 954, *Health Care Entities.* ASU 2011-24 clarifies that a health care entity should not net insurance recoveries against a related claim liability and the amount of the claim liability should be determined without consideration of insurance recoveries. This is effective for fiscal years beginning after December 15, 2011 (early adoption permitted). A cumulative-effect adjustment should be recognized in opening retained earnings in the period of adoption if a difference exists between any liabilities and insurance receivables recorded as a result of applying the amendments in this update. Management of MHS does not believe the adoption of this update will have a significant impact on the consolidated financial statements because MHS already reports its malpractice claim liability on a gross basis (see *Notes I and* R).

Note A - Organization and Summary of Significant Accounting Policies – Continued

Recent Pronouncements - Continued

In July 2011, FASB issued ASU No. 2011-7, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities.* ASU 2011-7 affects entities within the scope of Topic 954, *Health Care Entities,* that recognize significant amounts of patient service revenue at the time services are rendered even though the entities do not assess a patient's ability to pay. ASU 2011-7 requires certain health care entities to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, those health care entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. ASU 2011-7 also requires disclosure of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowances for doubtful accounts. This is effective for fiscal years beginning after December 15, 2011 for public entities and for the first annual period ending after December 15, 2012 for non-public entities (early adoption permitted). Application for periods presented in the statement of operations would be retrospective; however, the disclosures required by the amendments would be prospective.

Subsequent Events

Management has evaluated subsequent events through August 31, 2011, the date that the financial statements were available to be issued.

Net Patient Service Revenues and Allowances

Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered. MMC charges are based on rates established by the State of Maryland Health Services Cost Review Commission; accordingly, revenue reflects actual charges to patients based on rates in effect during the period in which the services are rendered (see *Note S*). SMI, MFC and SPPS are paid for services based on negotiated contracts with commercial payers and fee schedules with Medicare and Medicaid.

Contractual adjustments represent the difference between amounts billed as patient service revenue and amounts allowed by third-party payers, and are accrued in the period in which the related services are rendered.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Charity Care

The Medical Center provides medically necessary services without charge, or at amounts less than its established rates, to patients who qualify for charity care under its financial assistance policy. Because the Medical Center does not pursue collection of those amounts determined to qualify as charity care, they are not reported as a component of net patient service revenue or patient accounts receivable.

The criteria for qualifying for charity care applied by the Medical Center include family income, net assets, and the size of the patient's bill relative to the patient's ability to pay. Discounts are provided to patients who are unable to pay based on a sliding scale that is applied for family incomes up to approximately 400% above the U.S. Department of Health and Human Services (HHS) Poverty Guidelines. Free care is provided to patients with family incomes up to approximately 200% above the HHS Poverty Guidelines.

Charity care will be provided to patients that qualify under the Medical Center's financial assistance policy at any time. Once the Medical Center determines that the patient qualifies for charity care, the Medical Center makes no further attempt to collect on the amount qualifying for charity care.

Certain other controlled subsidiaries of MHS also provide services without charge, or at amounts less than their established rates, to patients who qualify for charity care under their respective financial assistance policies.

Impairment of Long-Lived Assets

MHS accounts for long-lived assets in accordance with the FASB's guidance on accounting for impairment or disposal of long-lived assets. This requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell. Management believes that no asset impairment existed at June 30, 2011 and 2010.

Property and Equipment

Property and equipment are recorded at cost. Donated property and equipment are recorded at fair value at the date of the donation. Depreciation is provided on the straight-line method over the estimated useful lives of the assets, which is forty years for buildings and the parking center and ranges from three to ten years for machinery and equipment.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Resident Prepayment Deposits

SMI's private pay residents are required to make a non-interest bearing prepayment of two months' room and board at the time of admission. At the time of discharge or acceptance by Medical Assistance or similar government assistance programs, any prepayment remaining after application to the resident's outstanding bill will be refunded. At June 30, 2011 and 2010, resident prepayment deposits of approximately $763 and $862, respectively, were invested in short-term investments.

Derivative Instruments

Current accounting standards require that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. MHS has entered into interest rate swap agreements to manage their interest rate risk (see *Notes J and K*). The interest rate swaps do not qualify for hedge accounting under the current accounting standards; therefore, management accounts for the derivative instruments as speculative derivative instruments with the change in the fair value reflected in the statements of operations as a component of other non-operating income. Net settlement payments are reported as a component of interest cost with the exception of the instruments used to support the plan of finance for the new clinical tower. These related settlements were capitalized as part of the project during the construction period.

Accounting Estimates

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

Excess of Revenue Over Expenses

The consolidated statements of operations include excess of revenue over expenses. Changes in unrestricted net assets which are excluded from excess of revenue over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, 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).

Activities that result in gains or losses unrelated to the primary operations of MHS are considered to be nonoperating.

(Dollars in thousands)

Note B – Patient Accounts Receivable, Allowances, and Charity Care

Patient accounts receivable consist of the following at June 30:

	2011	2010
Gross patient accounts receivable	$ 108,725	$ 105,511
Less:		
Allowance for doubtful accounts and contractual adjustments	(48,238)	(42,954)
Third party advances	(24,253)	(24,168)
	$ 36,234	$ 38,389

Approximately 33% and 36% of gross patient accounts receivable were due from Medicare and Medicaid at both June 30, 2011 and 2010, respectively.

The net cost of charity care provided by MHS totaled $14,544 and $13,492 for the years ended June 30, 2011 and 2010, respectively. The cost of charity care was calculated by applying the cost-to-charge ratio to the total amount of charges foregone for each of the controlled subsidiaries of MHS that provide charity care. The net cost of charity care was determined net of any patient-related revenue due to sliding scale payments or other patient-specific sources, and includes both direct and indirect cost of rendering care.

Additionally, MHS and certain of its controlled subsidiaries provide structured repayment plans to patients without collateral.

Medicare reimburses MTC and SMI under a prospective payment system (PPS) for skilled nursing facility services, under which facilities are paid a fixed fee for virtually all covered services. Under PPS, each patient's clinical status is evaluated and placed into a payment category. The patient's payment category dictates the amount that the provider will receive to care for the patient on a daily basis. The per diem rate covers (i) all routine inpatient costs currently paid under Medicare Part A; (ii) certain ancillary and other items and services previously covered separately under Medicare Part B on a "pass-through" basis; and (iii) certain capital costs.

(Dollars in thousands)

Note C - Pledges Receivable, Net

At June 30, 2011, pledges receivable were $24,879 less an allowance for uncollectible pledges of $800 and a discount of $907. Such amounts have been discounted at 1.78%. The payment terms of the pledges receivable less the uncollectible pledges at June 30, 2011 are as follows:

2011	$	6,197
2012		5,132
2013		2,741
2014		2,600
2015		1,984
Thereafter		4,518
		23,172
Less current portion		6,197
Long-term portion	$	16,975

Note D - Property and Equipment

Property and equipment, at cost, consists of the following at June 30:

		2011		2010
Buildings and improvements	$	523,292	$	247,994
Machinery and equipment		193,197		168,813
Construction-in-progress		13,612		255,900
Parking center		41,214		41,214
Land		10,772		10,772
		782,087		724,693
Accumulated depreciation		(239,114)		(240,123)
	$	542,973	$	484,570

MMC entered into a construction management contract with Whiting Turner for the construction of the new clinical tower. As of June 30, 2011, MMC had a remaining commitment of $8,023 on this contract.

(Dollars in thousands)

Note E - Funds Held by Trustee or Authority

Funds held by trustee or authority, which consist primarily of cash and government obligations (at fair value), are limited as to use as follows at June 30:

	2011	2010
Project fund	$ 0	$ 71,466
Debt service fund	13,643	6,257
Debt service reserve	21,641	5,151
Reserve for replacements and residual receipts	1,668	1,585
	36,952	84,459
Less current portion	13,643	12,044
Long-term portion	$ 23,309	$ 72,415

Note F - Board Designated and Donor Restricted Investments

Board designated investments are set aside by the board of trustees for costs relating to the building program, replacement or improvement of existing assets, or to cover the cost of services rendered as charity care and other programs. All board designated investments are unrestricted, as the board at its discretion may undesignate the use of such funds. Donor restricted investments have been limited by donors to a specific purpose.

Board designated and donor restricted investments consist of the following at June 30:

	2011	2010
Equity	$ 53,339	$ 24,486
Fixed income	26,675	18,884
Cash	13,552	48,491
Alternatives	1,734	4,047
	$ 95,300	$ 95,908

Each of the alternative investments owned by MHS represents less than one-half of one percent of each respective alternative investment fund as of June 30, 2011 and 2010.

(Dollars in thousands)

Note F - Board Designated and Donor Restricted Investments - Continued

The investments above have been allocated, by source, as follows at June 30:

	2011	2010
Board designated	$ 82,783	$ 82,735
Donor restricted (temporary)	12,517	13,173
	$ 95,300	$ 95,908

Permanently restricted donor investments at June 30, 2011 and 2010 of $2,178 are reported as restricted cash.

Earnings on investments are as follows for the years ended June 30:

	2011	2010
Unrestricted:		
Interest and dividends	$ 2,187	$ 954
Net realized gains	1,575	684
Unrealized gains on trading securities	7,320	2,835
	$ 11,082	$ 4,473

Note G - Investments In and Advances to Affiliates

Investments in and advances to affiliates include investments in joint ventures in which the Medical Center has ownership interests of 50%. Investments in which the ownership interest is less than 20% are carried at cost, and investments in which the ownership interest is at least 20% and less than 51% are generally carried on the equity method.

(Dollars in thousands)

Note G - Investments In and Advances to Affiliates - Continued

MHS has investments totaling $329 at June 30, 2011 and 2010, in the following joint ventures:

		Percentage of ownership		Investment	
Joint venture	Business purpose	2011	2010	2011	2010
Premier Purchasing Partners, Inc.	Capital balance in group purchasing organization	n/a	n/a	$ 329	$ 329
Mercy Ridge, Inc.	Continuing care retirement community	50%	50%	0	0
				$ 329	$ 329

MHS recorded non-operating income of $540 and $565 related to the operations of the investments in joint ventures for the years ended June 30, 2011 and 2010, respectively.

Note H - Other Assets

Other assets consist of the following at June 30:

	2011	2010
Deferred compensation plan assets (see *Note L*)	$ 6,648	$ 5,908
Amortizable assets, net	5,613	5,292
Health insurance prepayment	810	810
Notes receivable	476	201
Other investments	465	457
	$ 14,012	$ 12,668

Note I - Reinsurance Receivable/Recoverable and Provision for Outstanding Losses

GIC management based the provision for losses at June 30, 2011 on a report dated July 2011 prepared by GIC's independent actuaries, Complete Actuarial Solutions Co. of Bethesda, Maryland. In their report, the actuaries estimate outstanding losses at an expected confidence level, on an undiscounted basis, to be $29,740 and $26,749 net of reinsurance as of June 30, 2011 and 2010, respectively. At June 30, 2011 and 2010, GIC had $30,555 and $27,088, respectively, as its provision for outstanding losses net of reinsurance after factoring in actual losses paid to June 30th. The estimates provided by the actuaries are based on the historical data of the program blended together with relevant insurance industry loss development statistics.

Note I - Reinsurance Receivable/Recoverable and Provision for Outstanding Losses - Continued

In the opinion of the GIC management, the provision for outstanding losses relating to losses reported and losses incurred but not reported at the consolidated balance sheet dates is adequate to cover the expected ultimate liability of GIC. However, due to the nature of the insurance risks assumed, these provisions are necessarily estimates, and could vary from the amounts ultimately paid.

Consistent with most companies with similar insurance operations, GIC's provision for outstanding losses is ultimately based on management's reasonable expectations of future events. It is reasonably possible that the expectations associated with these amounts could change in the near term (i.e., within one year) and that the effect of such changes could be material to the consolidated financial statements.

GIC's estimated provision for outstanding losses exceeds GIC's retention limits by $2,032 and $1,733 for the years ended June 30, 2011 and 2010, respectively. These losses are 100% reinsured with reinsurers, and accordingly are recorded as reinsurance balances recoverable in the consolidated balance sheets.

In the event that GIC's reinsurers are unable to meet their obligations under the reinsurance agreements, GIC would still be liable to pay all losses under the insurance policies it issues, but would only receive reimbursement to the extent the reinsurers could meet their above mentioned obligations. GIC considers that all amounts included in reinsurance balances receivable and recoverable in the consolidated balance sheets will be collected in full from the reinsurers.

Mercy Health Services, Inc. and Subsidiaries
Notes to Consolidated Financial Statements - Continued
(Dollars in thousands)

Note J-Long - Term Debt

Long-term debt consists of the following at June 30:

	2011	2010
MHEEFA Revenue Bonds, Mercy Medical Center Issue, Series A 2007, interest rate ranging from 4% to 5.50%, due July 1, 2042	$ 152,500	$ 153,400
MHEEFA Revenue Bonds, Mercy Medical center Issue, Series B, C, D 2007, variable interest rate (0.08% and 0.22% at June 30, 2011 and 2010, respectively), due July 1, 2042	50,000	120,000
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2001; interest rate 5.625%; due July 1, 2031	49,480	49,480
MHEEFA Revenue Bonds, Mercy Medical Center Issue, Series 2011, variable interest rate ranging from 3.00% to 6.25%, due July 1, 2031	40,770	0
MHEEFA Revenue Bonds, Mercy Medical Center Issue, Series 2011B, interest rate (1.67% at June 30, 2011), due July 1, 2037	34,890	0
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2006; interest rate 5.69%; due July 1, 2036	33,910	34,470
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2008 (converted); interest rate 3.99%; due July 1, 2022	30,000	30,000
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 2007 B, C (converted); interest rate 3.80%; due July 1, 2024	30,000	30,000
MHHEFA Revenue Bonds, Mercy Medical Center Issue, Series 1996; interest rate ranging from 4.55% to 6.50%; due July 1, 2026	21,015	21,845
MHHEFA Revenue Bonds, Stella Maris Issue, Series 1997; variable interest rate (0.28% and 0.29% at June 30, 2011 and 2010, respectively); due 2021	14,255	15,210
interest rate (0.09% and 0.31% at June 30, 2011 and 2010, respectively); due July 1, 2011	1,985	3,770
HUD mortgage loan; interest rate 6.88%; due 2020	4,736	4,995
Other	225	264
Total long-term debt	463,766	463,434
Less:		
Unamortized discount	3,273	2,108
Current portion	6,300	5,315
Long -term portion	$ 454,193	$ 456,011

(Dollars in thousands)

Note J - Long-Term Debt - Continued

Principal payments on long-term debt are as follows for the years ended June 30:

2012	$	6,300
2013		8,638
2014		8,786
2015		9,154
2016		9,503
Thereafter		421,385
	$	463,766

Mercy Medical Center Issue, Series 2007 (A, B, C, and D) Bonds and Series 2007 B, C (Converted)

In October 2007, Maryland Health and Higher Educational Facilities Authority ("MHHEFA") authorized the issuance, sale and delivery of its $305,000 Revenue Bonds, Mercy Medical Center Issue, Series 2007 (A, B, C and D). The proceeds were loaned by MHEEFA to MMC to finance the construction of a new replacement hospital facility. The proceeds were also used to refinance the MHHEFA Pooled Loan Revenue Bond.

On April 1, 2010, $30,000 of the Revenue Bonds Series 2007 B and C was converted to Bank Qualified Revenue Bonds held by a commercial bank. The 2007 B and C (converted) Bonds refinanced $18,080 of the $50,000 2007 Series B and $11,920 of the $50,000 2007 Series C. Principal repayment on the converted bonds series begins July 1, 2012 and is paid annually through the termination date. The termination date is July 1, 2024. The converted bonds will be subject to mandatory purchase by MMC on April 1, 2020 at their par value, unless the bank and MMC agree to an extension. Interest accrues at a fixed rate of 3.87%. The monthly interest payments are made directly to the bank. During 2011, the remaining $70,000 of the Series 2007 B and C Revenue Bonds were refunded with proceeds from the issuance of two separate Revenue Bond issues; MMC Issue, Series 2011 and MMC Issue Series 2011B.

Principal repayment of the MMC issue Series 2007 Bonds began July 1, 2008 and is scheduled to be paid annually through July 1, 2042. On the Series 2007 A Bonds ($155,000 Revenue Bonds), interest accrues at a fixed rate ranging from 4.0% to 5.50%. The Series 2007 A Bonds are net of an original issue discount of $875, which is being amortized over the life of the bonds using the straight line method. The Series 2007A Bonds require a debt service reserve fund. The balance of the debt service reserve fund at June 30, 2011 is $12,557. Interest is payable semi-annually on January 1st and July 1st.

Note J - Long-Term Debt – Continued

Mercy Medical Center Issue, Series 2007 (A, B, C, and D) Bonds and Series 2007 B, C (Converted) - Continued

The $50,000 Series 2007 D Bonds accrue interest at a variable rate based on the prevailing interest rate in effect as determined by the Remarketing Agent on each Calculation Date. The variable rate of interest is set to be the lower of the Maximum Rate as defined by the Indenture and the minimum rate that would enable the Remarketing Agent to sell all of the bonds. The Series 2007 D Bonds are net of an original issue discount of $225, which is being amortized over the life of the bonds using the straight line method. Payment on the Series 2007 D Bonds is secured by a $50,000 irrevocable letter of credit from Wachovia Bank. An annual letter of credit fee equal to 0.38% is payable quarterly by MMC. The Wachovia letter of credit expires November 8, 2013.

To lower the cost of capital of the hospital replacement project, MMC entered into two interest rate swap agreements. In August 2007, a fixed spread basis swap was entered into with a notional amount of $210,000. Pursuant to the swap agreement, MMC pays the counter party a fixed interest rate equal to the USD-SIFMA Municipal Swap Index and receives interest at a variable rate equal to the sum of 67% of the USD-LIBOR-BBA and 0.54%. The interest rate swap agreement terminates on August 20, 2037. The interest rate swap does not qualify for hedge accounting under generally accepted accounting principles. At June 30, 2011 and 2010, the fair value of the interest rate swap was ($6,697) and ($12,493), respectively, and is included in other long-term liabilities in the accompanying consolidated balance sheets. For the years ended June 30, 2011 and 2010, an unrealized gain (loss) on interest rate swap totaling $5,796 and ($46), respectively, is reflected in the accompanying consolidated statements of operations.

During October 2007, MMC entered into a fixed payer swap with a notional amount of $65,000. Pursuant to the swap agreement, MMC pays the counter party a fixed rate of 4.093% and receives a variable rate equal to the USD-SIFMA Municipal Swap Index. The interest rate swap agreement terminates on July 1, 2042. At June 30, 2011 and 2010, the fair value of the interest rate swap was ($7,339) and ($8,732), respectively, and is included in other long-term liabilities in the accompanying consolidated balance sheets. An unrealized gain (loss) on interest rate swap totaling $1,393 and ($4,091) is reflected in the accompanying consolidated statements of operations for the fiscal years ended June 30, 2011 and 2010, respectively. The interest rate swap does not qualify for hedge accounting under generally accepted accounting principles.

Note J - Long-Term Debt – Continued

Mercy Medical Center Issue, Series 2001 Bonds

In November 2001, MHHEFA authorized the issuance, sale and delivery of its $49,480 Revenue Bonds, Mercy Medical Center Issue, Series 2001, the proceeds of which were loaned by MHEEFA to MMC, and together with fundraising receipts from MHS' capital campaign and amounts generated from MMC's operations, were used to finance and refinance the costs of the 2001 Additional Facilities. The 2001 Additional Facilities include expansion, renovation and equipping of certain hospital facilities, including construction of an ambulatory services building, acquisition of a parking garage and construction of an additional parking garage.

The Series 2001 Bonds are net of an original issue discount of $1,220, which is being amortized over the life of the bonds using the straight line method. The Series 2001 Bonds require a debt service reserve fund. The balance of the debt service reserve fund at June 30, 2011 is $5,058. The Series 2001 Bonds will be subject to redemption prior to maturity beginning on July 1, 2011, at the principal amount thereof plus accrued interest to the redemption date. Interest is payable semi-annually on January 1st and July 1st. Principal repayment of these bonds begins on July 1, 2023 and is paid annually through July 1, 2031.

On December 1, 2004, the Medical Center entered into a fixed spread basis swap agreement in order to reduce the cost of capital by removing the tax risk to bond holders and transferring the risk to the Medical Center. The fixed spread basis swap matures on December 1, 2024 and the exchanges of cash flows with the counter party began March 1, 2005. The notional amount of the swap is $50,000. Pursuant to the swap agreement, the Medical Center pays the counter party a variable rate equal to the USD-SIFMA Municipal Swap Index and receives interest at a variable rate equal to the sum of 67% of USD-LIBOR-BBA and 0.60%. The interest rate swap does not qualify for hedge accounting under generally accepted accounting principles.

At June 30, 2011 and 2010, the fair value of the interest rate swap was $262 and ($688), respectively and is included in other long-term liabilities in the accompanying consolidated balance sheets. An unrealized gain on interest rate swap totaling $950 and $391 is reflected in the accompanying consolidated statements of operations for the fiscal years ended June 30, 2011 and 2010, respectively.

Mercy Medical Center Issue, Series 2008 Bonds and Series 2008 (Converted)

In July 2008, MHHEFA authorized the issuance, sale and delivery of its $35,325 Revenue Bonds, Mercy Medical Center Issue, Series 2008, the proceeds of which were loaned by the MHHEFA to MMC in order to refund the MMC, Series 2003 Bonds. On December 16, 2009, $30,000 of the Series 2008 Bonds was converted to Bank Qualified Revenue Bonds with a fixed interest rate period of approximately twelve years. The bank at its discretion has the right to call the converted bonds at the seventh and tenth year anniversary. Principal repayment of the converted bonds begins July 1, 2011 and is paid annually through July 1, 2022. Interest accrues at a fixed rate of 3.9932%.

Note J - Long-Term Debt – Continued

Mercy Medical Center Issue, Series 2008 Bonds and Series 2008 (Converted) - Continued

The monthly interest payments are made directly to the bank. Principal repayment of the Series 2008 Bonds began on July 1, 2009 and will be fully paid on July 1, 2011. Interest accrues at a variable rate based on the prevailing interest rate in effect as determined by the remarketing agent on each calculation date. The variable rate of interest is set to be the lower of the Maximum Rate as defined by the Indenture and the minimum rate that would enable the remarketing agent to sell all of the Bonds at a price equal to the principal amount thereof, plus accrued interest.

Payments on the bonds are secured by an irrevocable letter of credit provided by M&T Bank in the amount of $1,985 and $3,770 at June 30, 2011 and 2010, respectively. The annual letter of credit fee equals 0.6% through July 4, 2010 and thereafter 0.8% of the letter of credit amount. The fee is payable quarterly by MMC. The letter of credit expires July 16, 2011.

Mercy Medical Center Issue, Series 2011 Bonds

In February 2011, MHHEFA authorized the issuance, sale and delivery of its $40,770 Revenue Bonds, Mercy Medical Center Issue, Series 2011. The proceeds were loaned by MHEEFA to MMC to refund $35,110 aggregate principal amount of the MMC Issue, Series 2007 B and C Bonds. The bonds are net of an original issue discount of $881, which is being amortized over the life of the bonds using the straight line method. The bonds require a debt service reserve fund. The balance of the debt service reserve fund at June 30, 2011 is $4,026.

Principal repayment of the MMC Issue, Series 2011 Bonds begins July 1, 2012 and is scheduled to be paid annually through July 1, 2031. Interest accrues at a rate varying from 3.0% to 6.25%. The interest is payable semi-annually on January 1st and July 1st.

Mercy Medical Center Issue, Series 2011B Bonds

In June 2011, MHHEFA authorized the issuance, sale and delivery of its $34,890 Revenue Bonds, Mercy Medical Center Issue, Series 2011 B. The proceeds were loaned by MHEEFA to MMC to refund $34,890 aggregate principal amount of the MMC Issue, Series 2007 B and C Bonds. The bonds were issued as non-bank qualified revenue bonds and directly purchased by a commercial bank. The direct bank purchase terminates on June 9, 2021 at which time the bonds will be subject to a mandatory purchase at their par value by MMC unless the bank and MMC agree to an extension.

The bonds bear interest at a variable rate equal to 69% of 30 day LIBOR and 1.5%, plus 0.45%. Interest is paid monthly. Principal repayment of the Series 2011B Bonds begins July 1, 2032 and is scheduled to be paid annually through July 1, 2037.

Note J - Long-Term Debt – Continued

Mercy Medical Center Issue, Series 2006 Bonds

In August 2006, MHHEFA authorized the issuance, sale and delivery of $35,000 of Mercy Medical Center Series 2006 Revenue Bonds. The proceeds were loaned by MHEEFA to MMC in order to finance the construction of a new parking garage as well as the financing of certain routine capital expenditures.

Principal repayment of these bonds began on July 1, 2009 and is paid annually through July 1, 2036. Interest is paid semiannually on January 1st and July 1st. Interest accrues at a fixed rate of 5.69%.

Simultaneously with the issuance of the bonds, MMC entered into an interest rate swap agreement with a counter party with a notional amount of $35,000 to convert the fixed rate structure to a variable rate. Under this agreement, MMC will receive a fixed interest rate of 5.14% and pay to the counter party the USD-SIFMA Municipal Swap Index. The interest rate swap agreement terminates on August 3, 2016. The interest rate swap does not qualify for hedge accounting under generally accepted accounting principles. The value of this contract is based on two components: (i) the accrued but unpaid periodic cash flows and (ii) the termination value as defined in the agreement. By definition, the termination value is equal to the bond amount multiplied by the difference between highest price in the marketplace and the bonds base price (100%). The bonds are currently callable at par (100%) and the call price would be the highest price in the marketplace on the valuation date. This is due to the fact that MHS would be economically inclined to call the bonds at par versus paying any termination payment on the swap and the bonds are carried on MHS' books at par. With MHS prepared to call the bonds at par, the market price should immediately converge on the call price. Additionally, MHS has the right to optionally terminate the contract. The counter party does not have the right to optionally terminate the agreement. The counter party can only terminate the agreement prior to its stated maturity if an event of default or an additional termination event exists. Therefore, as of June 30, 2011 and 2010, the fair value of the swap was zero.

In anticipation of the transaction, MMC entered into a forward interest rate swap agreement on June 28, 2006 with a notional amount of $35,000 in order to convert the variable swap rate to a fixed rate. Pursuant to the swap agreement, MMC pays the counter party a fixed interest rate of 3.976% and receives a variable rate equal to 67% of the USD-LIBOR-BBA. The interest rate swap agreement terminates on July 1, 2036. The interest rate swap does not qualify for hedge accounting under generally accepted accounting principles. At June 30, 2011 and 2010, the fair value of the interest rate swap was ($5,964) and ($7,179), respectively and is included in other long-term assets (liabilities) in the accompanying consolidated balance sheets. An unrealized gain (loss) on interest rate swap totaling $1,215 and ($1,667) is reflected in the accompanying statements of operations for the fiscal years ended June 30, 2011 and 2010, respectively.

Note J - Long-Term Debt – Continued

Mercy Medical Center Issues, Series 1996

In May 1996, MHHEFA authorized the issuance, sale and delivery of its $30,000 Revenue Bonds, Mercy Medical Center Issue, Series 1996, the proceeds of which were loaned by the Authority to MMC in order to finance and refinance the costs of the 1996 project. The 1996 project consisted of the construction, acquisition, renovation, and equipping of certain hospital facilities including certain inpatient upgrades, ambulatory care facilities, operating rooms, building infrastructure, and administrative and support service facilities.

The Series 1996 Bonds are net of original issue discounts of $302, which are being amortized over the life of the bonds using the straight line method. Interest is payable semi-annually on January 1st and July 1st. Principal repayment of these bonds began on July 1, 2004 and is paid annually through July 1, 2022.

In 2006, MMC entered into an agreement with a third party to run a tender process for the entire balance of the callable Series 1996 Bonds that totaled $19,700. MMC gave investors the choice of accepting a 1% incremental premium over the existing call premium in exchange for tendering their bonds. Any investor not tendering their bonds had their bonds redeemed at the applicable redemption price. Through the execution of a traditional bond agreement, the third party agreed to purchase the bonds from those investors who tendered their bonds.

Prior to the mailing of notice of redemption for the bonds, MMC was obligated to deposit the redemption price of the bonds with the Bonds Trustee. On June 23, 2006, MMC entered into a Notes Purchase Agreement (the "Note") with Merrill Lynch, Pierce, Fenner & Smith (Merrill Lynch). MMC borrowed $20,094 for the purpose of funding the principal ($19,700) and premium component of the redemption price ($394) of the Mercy Medical Center Issue Series 1996 Bonds. In August 2006, $18,195 of the Bonds was purchased by the third party and the Note was fully repaid. The remaining $1,505 of bonds were called and retired. A tender premium of $546 has been included in the outstanding debt and was repaid August 1, 2008.

To convert the underlying fixed rate structure to a variable rate, simultaneously with the purchase of the bonds, MMC entered into two interest rate swap agreements with a counter party with notional amounts of $13,840 and $4,355. The two interest rate swap agreements with the counterparty were amended on August 1, 2008. Pursuant to the amended swap agreements, the counter party pays to MMC a fixed interest rate of 5.75% and 5.625% and receives a variable rate equal to the USD-SIFMA Municipal Swap Index and 1.25%. The interest rate swap agreements terminate on July 25, 2011. The interest rate swaps do not qualify for hedge accounting under generally accepted accounting principles. The value of this contract is based on two components: (i) the accrued but unpaid periodic cash flows and (ii) the termination value as defined in the agreement. By definition, the termination value is equal to the bond amount multiplied by the difference between highest price in the marketplace and the bonds base price (100%).

Note J - Long-Term Debt – Continued

Mercy Medical Center Issues, Series 1996 - Continued

The bonds are currently callable at par (100%) and the call price would be the highest price in the marketplace on the valuation date. This is due to the fact that MHS would be economically inclined to call the bonds at par versus paying any termination payment on the swap and the bonds are carried on MHS' books at par. With MHS prepared to call the bonds at par, the market price should immediately converge on the call price. Additionally, MHS has the right to optionally terminate the contract. The counter party does not have the right to optionally terminate the agreement. The counter party can only terminate the agreement prior to its stated maturity if an event of default or an additional termination event exists. Therefore, as of June 30, 2011 and 2010, the fair value of the swap was zero.

On July 25, 2011, the two interest rate swap agreements connected to Mercy Medical Center Series 1996 bonds were amended. Pursuant to the amended swap agreements, the counterparty pays to MMC a fixed interest rate of 5.75% and 5.625% and receives a variable rate equal to the sum of the USD-SIFMA Municipal Swap Index and 1.55%. The interest rate swap agreements are scheduled to terminate July 25, 2014.

On June 28, 2006, to convert the structure back to a fixed rate, MMC entered into a forward rate swap agreement with a notional amount of $18,741. Pursuant to the swap agreement, MMC pays the counter party a fixed interest rate of 4.031% and receives a variable rate of 67% of the USD-LIBOR-BBA. The interest rate swap agreement terminates on July 1, 2026. The interest rate swap does not qualify for hedge accounting under generally accepted accounting principles. At June 30, 2011 and 2010, the fair value of the interest rate swap was ($3,051) and ($3,509), respectively and is included in other long-term assets (liabilities) in the accompanying consolidated balance sheets. An unrealized gain (loss) on interest rate swap totaling $458 and ($824) is reflected in the accompanying consolidated statements of operations for the fiscal years ended June 30, 2011 and 2010, respectively.

Note J - Long-Term Debt - Continued

Stella Maris Issue, Series 1997 Bonds

The Series 1997 Bonds were issued to finance the acquisition by SMI of Stella Maris Operating Corporation and CSC; to advance refund certain nursing home revenue bonds previously issued by MHHEFA, Stella Maris Issue, Series 1991 and to refinance certain outstanding indebtedness of the acquired corporations.

Principal repayment of these bonds began on July 1, 2001 and is paid annually through July 1, 2021. All bonds are subject to redemption prior to maturity beginning March 1, 2001. Interest is accrued at a variable rate based on the prevailing interest rate in effect as determined by the Remarketing Agent on each Calculation Date. Interest on the bonds is payable monthly.

Under the provisions of the bond agreement, SMI has granted to MHHEFA a security interest in all of its real property and the assignment of its leases. In addition, payments on the bonds are secured by an irrevocable letter of credit provided by M&T Bank. An annual letter of credit fee, equal to 0.9% of the letter of credit amount, is payable quarterly by SMI. The letter of credit expires June 30, 2015.

Under the terms of the bond indenture, SMI is required to maintain certain deposits with a trustee. The bond indenture agreement also requires SMI to satisfy certain measures of financial performance as long as the bonds are outstanding. As of June 30, 2011 and 2010, SMI was in compliance with the financial covenant requirements of the bond indenture.

HUD Mortgage Loan

The mortgage loan from the U.S. Department of Housing and Urban Development (HUD) was used by CSC to construct St. Elizabeth Hall. The note bears interest at 6.875% per annum and the loan is payable in monthly installments of $43, including interest, with the final payment due November 1, 2020. Concurrent with these monthly mortgage payments, St. Elizabeth Hall is required by the mortgage agreement to make monthly payments of $2 to a reserve fund for the replacement of property and equipment. These payments are required until the mortgage matures and are included in Board designated and donor restricted investments. All disbursements from this fund are contingent upon HUD's prior approval.

Note J - Long-Term Debt – Continued

HUD Mortgage Loan - Continued

In July 1997, CSC received authorization from HUD to suspend its monthly principal and interest payments of $43 through December 2005. In January 2006, CSC resumed making mortgage payments in accordance with the terms of the original agreement with HUD. During this deferral period, all revenue of St. Elizabeth Hall in excess of actual operating expenses, including but not limited to payments to the replacement reserve fund, were required to be segregated and deposited into a separate account for future payments of principal and interest on the mortgage.

The liability of CSC under the mortgage note is limited to the underlying value of the real estate collateral plus other amounts deposited with the lender.

Construction Loan

The 1989 bank term loan was incurred to pay construction costs associated with a physician office building. The loan is collateralized by a first lien mortgage on various real properties. Monthly principal and interest payments are $39 and the interest rate is floating, with various rate options. The loan was paid in full during the year ended June 30, 2010.

Line-of-Credit

The Medical Center has a $20,000 operating line of credit with M&T Bank, and no amounts were outstanding at June 30, 2011 and 2010.

The Medical Center has a $1,000 operating line of credit for leases, and no amounts were outstanding at June 30, 2011 and 2010.

Mercy Health Services has a $15,000 line of credit for equipment and construction with PNC Bank, and no amounts were outstanding at June 30, 2011.

Note K - Fair Value of Financial Instruments

The following methods and assumptions were used by MHS in estimating the fair value of its financial instruments:

Cash and cash equivalents, patient receivables, other receivables, accounts payable and accrued expenses, due to third party payers and construction retainage: The carrying amounts reported in the consolidated balance sheets approximate fair value.

Short-term investments, funds held by trustee or authority and board designated and donor restricted investments: Fair values, which are the amounts reported in the consolidated balance sheets, are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

Long-term debt: Fair values of revenue bonds and other debt are based on current traded values. At June 30, 2011 and 2010, the fair value of long-term debt was approximately $439,802 and $450,611, respectively.

Current accounting standards define 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, and establish a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels of inputs that may be used to measure fair value are:

Level 1: Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities that are traded in an active exchange market, as well as U.S. Treasury securities.

Level 2: Observable input other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in 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 2 assets and liabilities include debt securities with quoted market prices that are traded less frequently than exchange-traded instruments. This category generally includes certain U.S. government and agency mortgage-backed debt securities, corporate-debt securities, and alternative investments.

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. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes certain private debt and equity instruments and alternative investments.

Note K - Fair Value of Financial Instruments - Continued

The following discussion describes the valuation methodologies used for financial assets measured at fair value. The techniques utilized in estimating the fair values are affected by the assumptions used, including discount rates and estimates of the amount and timing of future cash flows. Care should be exercised in deriving conclusions about the business, value, or financial position of MHS based on the fair value information of financial assets presented below.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset, including estimates of the timing, amount of expected future cash flows, and the credit standing of the issuer. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial asset. Furthermore, the disclosed fair values do not reflect any premium or discount that could result from offering for sale at one time an entire holding of a particular financial asset. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

Fair values of equity securities and fixed maturity securities have been determined by MHS from observable market quotations, when available. Private placement securities and other equity securities where a public quotation is not available are valued by using broker quotes. Cash equivalents comprise short-term fixed maturity securities and carrying amounts approximate fair values, which have been determined from public quotations, when available.

Money markets and certificates of deposit comprise short-term fixed maturity securities. Because of the nature of these assets, carrying amounts approximate fair values, which have been determined from public quotations, when available.

MHS holds alternative investments that are not traded on national exchanges or over-the-counter markets. MHS is provided information on a net asset value per share for these investments that has been calculated by the funds of funds' managers (who are investment advisors registered with the Securities and Exchange Commission (SEC)) based on information provided by the managers of underlying funds.

Fair value of the interest rate swaps represent, or are derived from, mid-market values. Mid-market prices and inputs may not be observable, and instead valuations may be derived from proprietary or other pricing models based on certain assumptions regarding past, present and future market conditions. Some inputs may be theoretical, not empirical, and require subjective assumptions and judgments. Valuations may be based on assumptions as to the volatility of the underlying security, basket or index, interest rates, exchange rates, dividend yields, correlations between these or other factors, the impact of these factors upon the value of the security (including the embedded options), as well as issuer funding rates and credit spreads (actual or approximated) or additional relevant factors.

(Dollars in thousands)

Note K - Fair Value of Financial Instruments - Continued

The following table presents MHS' fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2011.

Assets	Level 1	Level 2	Level 3	Total Fair Value
Board designated and donor restricted investments:				
Cash and cash equivalents				
Cash	$ 41	$ 0	$ 0	$ 41
Money market funds	0	7,359	0	7,359
Equity securities				
Mutual funds				
International large cap core	15,723	0	0	15,723
Emerging markets	3,027	0	0	3,027
Domestic mutual fund	6,471	0	0	6,471
Common stocks				
Healthcare	3,345	0	0	3,345
Utilities	287	0	0	287
Financials	2,781	0	0	2,781
Consumer staples	1,385	0	0	1,385
Consumer discretionary	2,846	0	0	2,846
Materials	769	0	0	769
Energy	1,615	0	0	1,615
Information technology	7,399	0	0	7,399
Industrials	3,434	0	0	3,434
Telecommunication service	46	0	0	46
Foreign stocks/American deposit receipt	3,248	0	0	3,248
Investment in partnership	143	0	0	143
Fixed maturity				
US treasury notes	6,396	0	0	6,396
US government and agencies				
U.S. treasury bonds	0	233	0	233
Government agency bonds	0	210	0	210
Government agency mortgage backed securities	0	262	0	262
Government agency pools	0	4,886	0	4,886
Corporate bonds				
Strip and zero coupon	0	85	0	85
Asset backed securities	0	2,258	0	2,258
Financial	0	2,559	0	2,559
Industrial	0	2,749	0	2,749
International (other global corp bonds)	0	796	0	796
Bond fund	0	7,430	0	7,430
Municipal bonds	0	3,947	0	3,947
Alternative	0	0	3,570	3,570
Total board designated and donor restricted investments	58,956	32,774	3,570	95,300

(Dollars in thousands)

Note K - Fair Value of Financial Instruments - Continued

Assets	Level 1	Level 2	Level 3	Total Fair Value
Restricted funds				
Cash	$ 2,522	$ 0	$ 0	$ 2,522
Equity				
Mutual fund				
Fixed maturity exchange traded	2,000	0	0	2,000
Exchange traded	2,243	0	0	2,243
International exchange traded	825	0	0	825
Real estate exchange traded	1,510	0	0	1,510
Commodity exchange traded	1,517	0	0	1,517
Fixed maturity				
U.S. treasury notes	15,056	0	0	15,056
U.S. government and agencies				
Government agency pools	0	9,086	0	9,086
Corporate and foreign bonds	0	1,817	0	1,817
Municipal bonds	0	4,644	0	4,644
Total restricted funds	25,673	15,547	0	41,220
Cash and cash equivalents				
Cash	64,307	0	0	64,307
Money market fund	0	20,998	0	20,998
Treasury bill	200	0	0	200
Total cash and cash equivalents	64,507	20,998	0	85,505
Short term investments				
Certificate of deposit	0	1,254	0	1,254
Total short term investments	0	1,254	0	1,254
Total cash, cash equivalents and short term investments	64,507	22,252	0	86,759
Long term investments				
Equity				
Fixed maturity exchange traded	2,695	0	0	2,695
Fixed maturity				
U.S. treasury notes	18,971	0	0	18,971
U.S. government and agencies				
U.S. treasury bonds	0	69	0	69
Government agency bonds	0	2,339	0	2,339
Government agency mortgage backed securities	0	3,791	0	3,791
Government agency pools	0	8,100	0	8,100
Corporate Bonds				
Financial	0	3,144	0	3,144
Industrial	0	5,531	0	5,531
International (other global corp bonds)	0	1,614	0	1,614
Mortgage backed securities	0	0	0	0
Municipal bonds	0	2,480	0	2,480
Total long term investments	21,666	27,068	0	48,734

Mercy Health Services, Inc. and Subsidiaries
Notes to Consolidated Financial Statements - Continued
(Dollars in thousands)

Note K - Fair Value of Financial Instruments - Continued

Assets	Level 1	Level 2	Level 3	Total Fair Value
Funds held by trustee (current)				
Money market	$ 12,863	$ 0	$ 0	$ 12,863
Fixed maturity				
Government agency notes	0	780	0	780
Total funds held by trustee (current)	12,863	780	0	13,643
Funds held by trustee (non-current)				
Money market	3,795	0	0	3,795
Fixed maturity				
U.S. government and agencies	0	19,154	0	19,154
Certificate of deposit	0	360	0	360
Funds held by trustee (non-current)	3,795	19,514	0	23,309
Total funds held by trustee	16,658	20,294	0	36,952
Total assets fair value	$ 187,460	$ 117,935	$ 3,570	$ 308,965
Liabilities				
Interest rate swap	$ 0	$ 0	$ 22,789	$ 22,789
Total liabilities at fair value	$ 0	$ 0	$ 22,789	$ 22,789

Mercy Health Services, Inc. and Subsidiaries
Notes to Consolidated Financial Statements - Continued
(Dollars in thousands)

Note K - Fair Value of Financial Instruments - Continued

The following table presents MHS' fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2010.

Assets	Level 1	Level 2	Level 3	Total Fair Value
Board designated and donor restricted investments:				
Equity	$ 23,825	$ 661	$ 0	$ 24,486
Equity alternatives	0	0	760	760
Fixed maturity	1,110	38,949	0	40,059
Fixed maturity alternatives	0	0	6,308	6,308
Cash and cash equivalents	0	24,295	0	24,295
Total board designated and donor restricted investments:	24,935	63,905	7,068	95,908
Restricted funds				
Equity	6,779	0	0	6,779
Fixed maturity	26,626	11,535	0	38,161
Cash and cash equivalents	2,523	0	0	2,523
Total Restricted funds	35,928	11,535	0	47,463
Cash and cash equivalents				
Cash	67,444	0	0	67,444
Money market fund	0	5,559	0	5,559
Total cash equivalents	67,444	5,559	0	73,003
Short-term investments:				
Certificate of deposit	0	1,527	0	1,527
Total short-term investments:	0	1,527	0	1,527
Total cash, cash equivalents and short term investments	67,444	7,086	0	74,530
Long-term investments:				
Equity	1,964	0	0	1,964
Fixed maturity	15,696	17,837	0	33,533
Total long-term investments:	17,660	17,837	0	35,497
Funds held by trustee:				
Equity alternatives	0	0	48,645	48,645
Fixed maturity	0	17,630	0	17,630
Cash and cash equivalents	18,185	0	0	18,185
Total funds held by trustee	18,185	17,630	48,645	84,460
Total assets fair value	$ 164,152	$ 117,993	$ 55,713	$ 337,858
Liabilities				
Interest rate swap	$ 0	$ 0	$ 32,600	$ 32,600
Total liabilities at fair value	$ 0	$ 0	$ 32,600	$ 32,600

Note K - Fair Value of Financial Instruments - Continued

During fiscal year 2011, MHS transferred $20,000 from level 2 fixed maturity and money market fund securities to level 1 equity securities in accordance with MHS investment committee decision to reallocate the portfolio.

Included in alternative investments as of June 31, 2011 are three classes of hedge funds of funds with fair values of $1,799 (Fund A), $1,732 (Fund B) and $39 (Fund C). Fund A is redeemable semiannually with one hundred twenty days notice (receipt of proceeds in seven to fifteen days of notice), Fund C is redeemable monthly with ninety days notice (receipt of proceeds twenty days following month end), and Fund B is redeemable at the manager's discretion (receipt of proceeds in seven to fifteen days of notice). Included in alternative investments as of June 31, 2010 are four classes of funds of funds with fair values of $2,648 (Fund A), $3,798 (Fund B), $377 (Fund C) and $245 (Fund D). Fund A is redeemable semiannually with one hundred twenty days notice (receipt of proceeds in seven to fifteen days of notice), Fund C is redeemable monthly with ninety days notice (receipt of proceeds twenty days following month end), Fund B is redeemable at the manager's discretion (receipt of proceeds in seven to fifteen days of notice), and Fund D is redeemable annually on December 31 if notice is provided on or before the prior September 15 (receipt of proceeds required 75% within sixty days of year end, but generally are 90% within thirty days of year end and the remaining 10% upon completion of annual audit the following June). There are no unfunded commitments for any of the hedge fund of funds for either 2011 or 2010.

(Dollars in thousands)

Note K - Fair Value of Financial Instruments - Continued

The following table is a rollforward of the consolidated statements of financial position amounts for financial instruments classified by MHS within level 3 of the valuation hierarchy defined above:

	Investments	Interest rate swaps
Fair value June 30, 2009	$ 151,080	$ (26,365)
Realized and unrealized (losses) gains, net	6,160	(6,235)
Purchases, issuances, and settlements, net	(101,527)	0
Fair value June 30, 2010	55,713	(32,600)
Realized and unrealized (losses) gains, net	1,169	9,811
Purchases, issuances, and settlements, net	(53,312)	0
Fair value June 30, 2011	$ 3,570	$ (22,789)

Note L - Pension and Profit Sharing Plans

MHS has a qualified 401(k) plan covering substantially all employees of the Medical Center and SMI who have completed at least one year of service and are at least twenty-one years of age. MHS makes an annual contribution on behalf of all eligible employees based on either the employee's contributions to the 401(k) plan or their annual compensation. MHS will match, on a dollar for dollar basis (based on age and years of service thresholds) the amount contributed by the employee, not to exceed 6% of the employee's salary. MHS' contributions to the 401(k) plan for all participants employed prior to April 1, 1997 for Medical Center employees or July 1, 1997 for SMI employees, vest at a rate of 25% annually and completely vested on April 1, 2001 for Medical Center employees and July 1, 2001 for SMI employees. MHS' contributions for all participants employed on or after April 1, 1997 for Medical Center employees or July 1, 1997 for SMI employees vest after four years of service, with no vesting prior to four years of service. Contributions under this plan totaled approximately $3,793 and $3,310 for the years ended June 30, 2011 and 2010, respectively.

The Medical Center has a nonqualified deferred compensation plan for certain executives and physicians. The deferred compensation plan provides for severance and supplemental retirement benefits as defined in the plan. Compensation expense related to the deferred compensation plan was $1,129 and $517 for the years ended June 30, 2011 and 2010, respectively. Total deferred compensation obligations of $6,648 and $5,908 are included in other long-term liabilities in the consolidated balance sheets at June 30, 2011 and 2010, respectively (See *Note W*).

(Dollars in thousands)

Note L - Pension and Profit Sharing Plans – Continued

The fair values of deferred compensation plan assets as of June 30, 2011 by asset category are as follows (see *Note H and K*):

Assets	Level 1	Level 2	Level 3	Total Fair Value
Equity				
Mutual funds				
International large cap core	$ 530	$ 0	$ 0	$ 530
Emerging markets	72	0	0	72
Domestic mutual fund-equity income	4,811	0	0	4,811
Fixed maturity				
Bond fund	0	1,235	0	1,235
Total assets fair value	$ 5,413	$ 1,235	$ 0	$ 6,648

There were no significant transfers between level 1 and level 2 fair value investments for the year ended June 30, 2011.

The fair values of deferred compensation plan assets as of June 30, 2010 by asset category are as follows:

Assets	Level 1	Level 2	Level 3	Total Fair Value
Equity	$ 4,762	$ 1,146	$ 0	$ 5,908
Total assets fair value	$ 4,762	$ 1,146	$ 0	$ 5,908

(Dollars in thousands)

Note M - Post-Retirement Benefit Plan

MHS has an unfunded contributory health and medical post-retirement benefit plan available to all eligible employees who meet certain age and length of service requirements. The plan provides for health and medical benefits including primary care physician and specialist visits, hospitalization and emergency care, prescription drugs, vision care, and Medicare supplemental coverage.

The following table sets forth the components of the MHS obligation at June 30:

	2011	2010
Change in Benefit Obligation		
Benefit obligation at beginning of year	$ 5,702	$ 7,145
Service cost	253	148
Interest cost	342	271
Actuarial loss (gain)	957	(1,732)
Benefit paid	(219)	(130)
Benefit obligation at end of year	7,035	5,702
Change in Plan Assets		
Employer contribution	219	130
Plan participant's contribution	377	396
Medicare Part D reimbursement	87	93
Benefits paid	(683)	(619)
Fair value of plan assets at end of year	0	0
Fund status	(7,035)	(5,702)
Unrecognized actuarial loss	0	0
Accrued post-retirement benefit cost	(7,035)	(5,702)
Less current portion, included in accounts payable and accrued expenses	(216)	(164)
Total accrued post-retirement benefit cost, long-term portion	$ (6,819)	$ (5,538)

(Dollars in thousands)

Note M - Post-Retirement Benefit Plan – Continued

Net periodic post-retirement benefit cost included the following for the years ended June 30:

	2011	2010
Service cost - benefits attributed to service during the period	$ 253	$ 148
Interest cost on accumulated post-retirement benefit obligation	342	271
Net post-retirement benefit cost	$ 595	$ 419

The weighted average discount rate used in determining the accumulated post-retirement benefit obligation (APBO) for the plan was 5.25% and 5.0% for the years ended June 30, 2011 and 2010, respectively. For measurement purposes, the health care cost trend rates used in determining the APBO for the plan was 7.5% and 8.0% in 2011 and 2010, respectively. Increasing the health care cost trend rates by 1% would increase the APBO by $1,225 and aggregate service and interest cost by $140 at June 30, 2011.

Note N - Retirement Annuity Plan

MHS had a pension plan that was terminated on April 1, 1997 and established a retirement annuity plan under which certain participants of the terminated plan were entitled to annuity payments. Participants to the plan include (a) the retirees and beneficiaries entitled to benefits from the terminated plan on April 1, 1997 and (b) other participants with benefits worth more than $4 that elected an annuity. All benefits are vested and based on the frozen accrued benefits at April 1, 1997.

(Dollars in thousands)

Note N - Retirement Annuity Plan – Continued

The measurement dates for fiscal years 2011 and 2010 were June 30, 2011 and June 30, 2010, respectively. The following table sets forth the funded status of the retirement annuity plan and amounts recognized in accompanying consolidated financial statements:

	2011	2010
Change in Benefit Obligation		
Benefit obligation at beginning of year	$ 10,869	$ 11,030
Interest cost	511	620
Actuarial loss	35	597
Benefit paid	(1,358)	(1,378)
Benefit obligation at end of year	10,057	10,869
Change in Plan Assets		
Fair value of plan assets at beginning of year	6,965	7,073
Actuarial return on plan assets	1,320	1,270
Benefits paid	(1,358)	(1,378)
Fair value of plan assets at end of year	6,927	6,965
Fund status	(3,130)	(3,904)
Unrecognized actuarial loss (gain)	0	0
Accrued benefit cost	$ (3,130)	$ (3,904)

The discount rate was 5.25% and 5.0% for 2011 and 2010, respectively. The expected rate of return on plan assets was 6.50% for 2011 and 2010. The accompanying consolidated net pension cost was $150 in 2011 and $206 in 2010.

MHS' expected rate of return is evaluated annually and is based on the current interest rate environment, rate of inflation, allocation of the plan assets among various investment options and other market conditions.

(Dollars in thousands)

Note N - Retirement Annuity Plan - Continued

The fair value of the plan assets as of June 30, 2011 was $6,927. The weighted-average asset allocations in the plan as of June 30, 2011 and 2010, by asset category were as follows:

	June 30,	
	2011	**2010**
Asset Category		
Equity securities	56%	48%
Fixed income alternatives	13%	18%
Fixed income bond fund	20%	0%
Cash and cash equivalents	8%	30%
Equity alternatives	3%	4%
Total	100%	100%

MHS' asset allocation guidelines at June 30, 2011 are as follows:

	Ranges	**Target Allocation**
TOTAL EQUITY	30-65%	50%
Domestic equity	30-65%	40%
International equity	0-15%	10%
EQUITY ALTERNATIVES	0-50%	0%
FIXED INCOME ALTERNATIVES	0-40%	35%
CASH	5-25%	15%

(Dollars in thousands)

Note N - Retirement Annuity Plan - Continued

The fair values of plan assets as of June 30, 2011 by asset category are as follows:

Assets	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Cash	$ 0	$ 4	$ 0	$ 4
Money market funds	0	546	0	546
Equity alternative	0	0	208	208
Fixed maturity alternative	0	0	870	870
Fixed maturity				
Bond fund	0	1,397	0	1,397
Equity securities				
Mutual funds				
International large cap core	556	0	0	556
Emerging markets	366	0	0	366
Domestic fund	122	0	0	122
Common stocks				
Healthcare	377	0	0	377
Utilities	26	0	0	26
Financials	309	0	0	309
Consumer staples	186	0	0	186
Consumer discretionary	281	0	0	281
Materials	90	0	0	90
Energy	160	0	0	160
Information technology	698	0	0	698
Industrials	357	0	0	357
Telecommunication service	0	0	0	0
Real estate investment trusts	25	0	0	25
Foreign stocks/American deposit receipt	349	0	0	349
Total assets fair value	$ 3,902	$ 1,947	$ 1,078	$ 6,927

There were no significant transfers between level 1 and level 2 fair value investments for the year ended June 30, 2011.

(Dollars in thousands)

Note N - Retirement Annuity Plan - Continued

The fair values of plan assets as of June 30, 2010 by asset category are as follows:

Assets	Level 1	Level 2	Level 3	Total Fair Value
Equity	$ 3,135	$ 0	$ 0	$ 3,135
Equity alternatives	0	0	302	302
Fixed maturity alternatives	0	0	1,257	1,257
Cash and cash equivalents	82	2,189	0	2,271
Total assets fair value	$ 3,217	$ 2,189	$ 1,559	$ 6,965

Included in alternative investments as of June 31, 2011 are hedge funds of funds with fair values of $1,079. The funds are redeemable semiannually with no prior required redemption notice. Included in alternative investments as of June 31, 2010 are hedge funds of funds with fair values of $1,559. The funds are redeemable semiannually with no required redemption notice. There are no unfunded commitments for any of the hedge fund of funds for either 2011 or 2010.

(Dollars in thousands)

Note N - Retirement Annuity Plan - Continued

The following table is a rollforward of the fair value amounts for financial instruments classified by the plan within level 3 of the valuation hierarchy above:

	Alternative Investments
Fair value June 30, 2009	$ 2,531
Realized and unrealized (losses) gains, net	151
Purchases, issuances, and settlements, net	(1,123)
Fair value June 30, 2010	1,559
Realized and unrealized (losses) gains, net	146
Purchases, issuances, and settlements, net	(627)
Fair value June 30, 2011	$ 1,078

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

	Pension Benefits
2012	$ 1,285
2013	1,226
2014	1,159
2015	1,092
2016	1,020
Years 2016 - 2020	4,025

Note O - Supplemental Cash Flow Information

Cash payments for interest, net of amounts capitalized and swap payments, were $13,601 in 2011 and $7,130 in 2010. Capitalized interest related to construction activities includes interest payments to creditors on bonds, net payments/receipts to counterparties on interest rate swap arrangements, and income received on trustee-held funds, totaling $8,294 for 2011 and $4,373 for 2010.

(Dollars in thousands)

Note P - Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following health care services at June 30:

	2011	2010
Capital improvements	$ 22,551	$ 26,984
Departmental expenses	6,121	5,199
Pastoral care	4,763	4,763
Indigent care	1,090	1,430
Research programs	860	1,752
Education programs	215	173
Other	89	60
	$ 35,689	$ 40,361

Permanently restricted net assets consist of the following at June 30:

	2011	2010
SMI Hospice Endowment	$ 1,055	$ 1,055
Weinberg Endowment	1,000	1,000
Dr. Goodman Endowment	123	123
	$ 2,178	$ 2,178

Note Q - Functional Expenses

MHS and its subsidiaries provide general health care services to patients within their geographic location. Expenses related to providing these services are as follows for the years ended June 30:

	2011	2010
Health care services	$ 412,236	$ 359,455
Administrative and support services	133,051	133,870
	$ 545,287	$ 493,325

Note R - Commitments and Contingent Liabilities

Litigation

MHS has outstanding litigation involving claims brought against it in the normal course of business. Litigation in the normal course of business, as well as responses to claims and investigations described below, can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings and government investigations are difficult to predict. Attorneys for MHS are representing MHS in all of these matters. Management is currently unable to estimate, with reasonable certainty, the possible loss, or range of loss, if any, for such lawsuits and investigations. Management of MHS is unable to determine the amount of any possible settlements for such lawsuits and investigations, but is of the opinion that all of the lawsuits are covered by applicable MHS insurance.

MHS is subject to asserted and unasserted claims (in addition to litigation) encountered in the ordinary course of business. As a result of the current level of governmental and public concerns with health care fraud and abuse, management recognizes that additional investigative activity could occur in the future. In the opinion of management and after consultation with legal counsel, management believes it has established adequate accrued reserves related to all known matters. The outcome of any potential investigative, regulatory or prosecutorial activity that may occur in the future cannot be predicted with certainty, however, and any associated potential future losses resulting from such activity could have a material adverse effect on the future financial position, results of operations and liquidity of MHS.

Self-Insurance Programs

As discussed in *Notes A* and *I*, Greenleaf Insurance Company, Ltd. (GIC) provides general and professional liability coverage to MHS. Such coverage provides both primary and excess liability coverage. GIC retains the risk related to the primary policy and reinsures the whole of the excess policies. Insurance policy limits vary by year; however, management believes such amounts are appropriate to cover any general and professional liabilities losses, if any.

(Dollars in thousands)

Note R - Commitments and Contingent Liabilities - Continued

GIC provided coverage up to the following primary limits for the periods ending June 30:

	2011	2010
Healthcare Professional Liability	$5,000 per occurrence	$5,000 per occurrence
	$16,500 aggregate	$15,000 aggregate
Managed Care Organization Liability	$5,000 per occurrence	$5,000 per occurrence
	$16,500 aggregate	$15,000 aggregate
Commercial General Liability	$5,000 per occurrence	$5,000 per occurrence
	$16,500 aggregate	$15,000 aggregate

GIC also provides an excess policy to MHS and its subsidiaries for $75,000 per occurrence and $75,000 in the aggregate that is reinsured with a commercial insurance company.

In management's opinion, the assets of GIC are sufficient to meet its obligations as of June 30, 2011. If the financial condition of GIC were to materially deteriorate in the future, and GIC was unable to pay its claim obligations, the responsibility to pay those claims would return to MHS.

MHS and certain of its subsidiaries are self-insured against employee medical claims. Plan expenses include claims incurred and provisions for unreported claims. However, the program has an annual aggregate stop loss provision per employee.

MHS and certain of its subsidiaries are self-insured against workers compensation claims and have surety bonds of $2,200 (for claims arising after June 2004) as collateral for such claims. For claims that occurred between December 18, 2002 and June 2004, the surety coverage is limited to $1,950. For claims that occurred prior to December 18, 2002, the surety coverage is limited to $1,400.

MHS and certain of its subsidiaries are self-insured against unemployment claims and have surety bonds of $1,475 for the Medical Center and $350 for SMI. The amounts change each October 1st as dictated by the Maryland Department of Licensing and Regulation.

(Dollars in thousands)

Note R - Commitments and Contingent Liabilities - Continued

Lease Commitments

The Medical Center and MFC have entered into separate long term leases for commercial space. The leases contain escalation clauses and charges for other costs related to the leased space. Future minimum payments for these leases for each of the years ended June 30 are as follows:

2012	$	3,791
2013		3,479
2014		3,278
2015		3,162
2016		2,657
Thereafter		11,710
	$	28,077

MHS and certain of its subsidiaries have other office space leases. Rent expense for the years ended June 30, 2011 and 2010 was $4,243 and $3,622, respectively.

The Medical Center and MFC have entered into separate long term operating leases for equipment. The leases contain escalation clauses and charges for other costs related to the leased space. Future minimum payments for these leases for each of the years ended June 30 are as follows:

2012	$	1,492
2013		1,063
2014		883
2015		883
2016		883
Thereafter		516
	$	5,720

MHS and certain of its subsidiaries have other operating leases for equipment. Equipment lease expense for the years ended June 30, 2011 and 2010 was $2,314 and $2,258, respectively.

Note S - Maryland Health Services Cost Review Commission

The Medical Center's charges are subject to review and approval by the State of Maryland Health Services Cost Review Commission (the Commission). Management has made the required filings with the Commission and believes the Medical Center to be in compliance with the Commission's requirements.

The Commission established an uncompensated care fund whereby all hospitals are required to contribute 0.75% of revenues to this fund to help provide for the cost associated with uncompensated care for certain Maryland hospitals above the State average. In December 2008, the Commission modified this mechanism to finance uncompensated care statewide. The policy implemented 100% pooling and all Maryland hospitals have the same percentage of uncompensated care in rates. High uncompensated care hospitals receive funds and low uncompensated care hospitals pay into the fund. The Medical Center had net receipts of $370 and $1,561 for 2011 and 2010, respectively.

Effective April 1, 1999, the Medical Center entered into a charge per case (CPC) agreement with the Commission for inpatient services. This reimbursement system provides for periodic (usually annual) updates for inflation, case mix, hospitals' relative charge position, and other factors. On July 1, 2010, the Medical Center entered into a charge per visit (CPV) agreement with the Commission for outpatient services. This outpatient reimbursement system is designed to be similar to the inpatient system providing periodic (usually annual) updates for inflation, case mix, and other factors.

The CPC methodology was in place for the fiscal year ended June 30, 2010. The CPV methodology was in place for the fiscal year ended June 30, 2011.

Note T - Housing Assistance Payment Contract

The U.S. Federal Housing Administration (FHA) has contracted with CSC under Section 8 of Title II of the Housing and Community Development Act of 1974 to make housing assistance payments to CSC on behalf of certified tenants. For fiscal year 2011 and 2010, the maximum contract commitment was $1,066 and $1,055 per year, respectively. During the years ended June 30, 2011 and 2010, CSC received housing assistance payments of $558 and $374, respectively, which are included in patient service revenue. The contract had automatic annual renewals through March 2011 and has been renewed for automatic renewals through March 2012.

Note U - Certain Risks and Uncertainties

Regulation and Reimbursement

MHS provides health care services primarily through an acute care hospital in Baltimore City and a long-term care facility in Baltimore County, Maryland.

MHS and other healthcare providers in Maryland are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the Federal Medicare and State Medicaid programs;
- Regulation of hospital rates by the State of Maryland Health Services Cost Review Commission;
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes; and
- Lawsuits alleging malpractice and related claims.

Such inherent risks require the use of certain management estimates in the preparation of MHS' consolidated financial statements and it is reasonably possible that a change in such estimates may occur.

The Medicare and state Medicaid reimbursement programs represent a substantial portion of MHS' revenues and MHS' operations are subject to a variety of other Federal, state and local regulatory requirements. Failure to maintain required regulatory approvals and licenses and/or changes in such regulatory requirements could have a significant adverse effect on MHS. Changes in Federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on MHS.

Note U - Certain Risks and Uncertainties - Continued

Investments

MHS and certain of its subsidiaries have funds on deposit with financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation.

Certain alternative investments held in the MHS portfolio are exposed to potential risks in excess of the risks associated with the other investments in the MHS portfolio. These include, but are not limited to, the following potential risks:

- limited or no liquidity (including "side pocket" arrangements),
- derivative financial instruments that expose the investment funds to market risk (if the market value of the contract is higher or lower than the contract price at the maturity date) and credit risk (arising from the potential inability of counterparties to perform under the terms of the contracts),
- investment in non-marketable securities that are valued without the benefit of an active secondary market,
- substantially less regulation, and
- no current income production.

During September 2008, certain large U.S. financial institutions failed, primarily as a result of holdings in troubled subprime loans or assets collateralized with such distressed loans. These institutional failures, and the negative economic conditions that contributed to these failures, generated substantial volatility in global financial markets and substantial uncertainty regarding access to capital and the continued viability of many other financial institutions. These conditions create uncertainty regarding the MHS's future ability to access capital and the cost of such capital. The resulting impact on the future financial position, results of operations and cash flows of MHS could be material.

Note V – Endowment

In August 2008, the FASB issued FASB ASC 958-205, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* which, among other things, provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent management. of Institutional Act of 2006 (UPMIFA) and additional disclosures about an organization's endowment funds. In 2008, the State of Maryland adopted UPMIFA.

The MHS endowments consist of three individual funds established for a variety of purposes. The endowments include both donor-restricted endowment funds and funds designated by the board of trustees to function as endowments. As required by generally accepted accounting principles, net assets associated with endowment funds, including funds designated by the board of trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

The board of trustees of MHS has interpreted the Maryland State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, MHS classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts donated to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by SPMIFA. In accordance with SPMIFA, MHS considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

(1) The duration and preservation of the fund
(2) The purposes of the organization and the donor-restricted endowment fund
(3) General economic conditions
(4) The possible effect of inflation and deflation
(5) The expected total return from income and the appreciation of investments
(6) Other resources of the organization
(7) The investment policies of the organization

(Dollars in thousands)

Note V – Endowment - Continued

MHS has adopted an investment policy for endowment assets that attempts to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that must be held in perpetuity.

To satisfy its long term rate-of-return objectives, MHS relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). MHS targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

At June 30, 2011, the endowment net asset composition by type of fund consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted funds	$ 0	$ (44)	$ 2,178	$ 2,134
Total funds	$ 0	$ (44)	$ 2,178	$ 2,134

At June 30, 2010, the endowment net asset composition by type of fund consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted funds	$ 0	$ (435)	$ 2,178	$ 1,743
Total funds	$ 0	$ (435)	$ 2,178	$ 1,743

Mercy Health Services, Inc. and Subsidiaries
Notes to Consolidated Financial Statements - Continued
(Dollars in thousands)

Note V – Endowment - Continued

Changes in endowment net assets for the fiscal year ended June 30, 2011, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 0	$ (435)	$ 2,178	$ 1,743
Investment return:				
Investment income	0	394	0	394
Total investment income	0	394	0	394
Appropriation of endowment asset for expenditure	0	(3)	0	(3)
Endowment net assets, end of year	$ 0	$ (44)	$ 2,178	$ 2,134

Changes in endowment net assets for the fiscal year ended June 30, 2010, consisted of the following:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$ 0	$ (658)	$ 2,220	$ 1,562
Investment return:				
Investment gain	0	225	0	225
Total investment loss	0	225	0	225
Appropriation of endowment asset for expenditure	0	(2)	0	(2)
Other changes:				
Reclassification of net assets	0	0	(42)	(42)
Endowment net assets, end of year	$ 0	$ (435)	$ 2,178	$ 1,743

(Dollars in thousands)

Note W – Other Long-Term Liabilities

Other long-term liabilities consist of the following at June 30:

	2011	2010
Interest rate swaps	$ 22,789	$ 32,600
Deferred compensation plan	6,648	5,908
Retirement annuity plan	3,130	3,904
GIC claims estimated tail	1,000	1,000
Other	457	444
	$ 34,024	$ 43,856

COHEN
RUTHERFORD
+ KNIGHT PC
Certified Public Accountants

Report of Independent Auditors on Other Financial Information

The Board of Trustees
Mercy Health Services, Inc. and Subsidiaries
Baltimore, MD

The 2011 audited consolidated financial statements of Mercy Health Services, Inc. and Subsidiaries and our report thereon are presented in the preceding section of this report. The audit was made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplemental consolidating information presented hereinafter as of and for the year ended June 30, 2011 is presented for purposes of additional analysis of the basic consolidated financial statements rather than to present the balance sheets and statements of operations of the individual entities, and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

Cohen, Rutherford + Knight, P.C.

August 31, 2011

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Mercy Health Services, Inc. and Subsidiaries
Consolidating Balance Sheet Information
June 30, 2011
(Dollars in thousands)

	Mercy Health Services, Inc.	Mercy Health Foundation, Inc.	Mercy Medical Center, Inc.	Stella Maris, Inc.	St. Paul Place Specialists, Inc.	Maryland Family Care, Inc.	Eliminations	Consolidated
ASSETS								
CURRENT ASSETS								
Cash, cash equivalents and short term investments	$ 324	$ 379	$ 74,297	$ 11,527	$ 233	$ (1)	$ 0	$ 86,759
Current portion of funds held by trustee or authority	0	0	12,642	1,001	0	0	0	13,643
Resident prepayments/security deposits	0	0	0	763	0	0	0	763
Patient receivables, net	0	0	20,434	3,060	10,191	2,549	0	36,234
Other receivables, net	540	0	2,425	(657)	472	19	(171)	2,628
Current pledges receivable, net	0	6,197	0	0	0	0	0	6,197
Inventory	0	0	6,740	179	0	0	0	6,919
Other current assets	0	0	3,537	76	139	22	0	3,774
TOTAL CURRENT ASSETS	864	6,576	120,075	15,949	11,035	2,589	(171)	156,917
PROPERTY AND EQUIPMENT	0	2	512,739	25,856	383	3,993	0	542,973
INVESTMENTS AND OTHER ASSETS								
Funds held by trustee or authority, less current portion	0	0	21,641	1,668	0	0	0	23,309
Long-term investments	13,173	0	35,561	0	0	0	0	48,734
Board designated and donor restricted investments	1,643	9,988	74,646	9,023	0	0	0	95,300
Restricted cash	0	2,055	39,165	0	0	0	0	41,220
Interest in net assets of MHF	0	0	28,451	4,904	0	0	(33,355)	0
Long-term pledges receivable, net	0	16,975	0	0	0	0	0	16,975
Investments in and advances to affiliates	9,767	(1,190)	18,996	(220)	(8,692)	(15,332)	(3,000)	329
Reinsurance balances receivable	0	0	2,032	0	0	0	0	2,032
Other assets	141	0	10,714	405	1,113	1,639	0	14,012
TOTAL ASSETS	$ 25,588	$ 34,406	$ 864,020	$ 57,585	$ 3,839	$ (7,111)	$ (36,526)	$ 941,801

Mercy Health Services, Inc. and Subsidiaries

Consolidating Balance Sheet Information-Continued

June 30, 2011

(Dollars in thousands)

	Mercy Health Services, Inc.	Mercy Health Foundation, Inc.	Mercy Medical Center, Inc.	Stella Maris, Inc.	St. Paul Place Specialists, Inc.	Maryland Family Care, Inc.	Eliminations	Consolidated
LIABILITIES AND NET ASSETS								
CURRENT LIABILITIES								
Current maturities of long-term debt	$ 26	$ 0	$ 5,015	$ 1,259	$ 0	$ 0	$ 0	$ 6,300
Accounts payable and accrued expenses	32	37	55,148	5,649	6,619	3,306	(284)	70,507
Resident prepayments/security deposits	0	0	0	763	0	0	0	763
Construction retainage	0	0	780	0	0	0	0	780
TOTAL CURRENT LIABILITIES	58	37	60,943	7,671	6,619	3,306	(284)	78,350
Long-term debt	198	0	436,262	17,733	0	0	0	454,193
Accrued interest	0	0	0	3,373	0	0	0	3,373
Provision for outstanding losses	0	0	32,587	0	0	0	0	32,587
Post-retirement obligation	0	0	6,819	0	0	0	0	6,819
Other long-term liabilities	0	130	33,894	0	0	0	0	34,024
TOTAL LIABILITIES	256	167	570,505	28,777	6,619	3,306	(284)	609,346
NET ASSETS								
Unrestricted	25,332	884	263,980	20,795	(3,099)	(10,417)	(2,887)	294,588
Temporarily restricted	0	31,300	28,412	6,958	319	0	(31,300)	35,689
Permanently restricted	0	2,055	1,123	1,055	0	0	(2,055)	2,178
TOTAL NET ASSETS	25,332	34,239	293,515	28,808	(2,780)	(10,417)	(36,242)	332,455
TOTAL LIABILITIES AND NET ASSETS	$ 25,588	$ 34,406	$ 864,020	$ 57,585	$ 3,839	$ (7,111)	$ (36,526)	$ 941,801

Mercy Health Services, Inc. and Subsidiaries
Consolidating Statement of Operations Information
Year ended June 30, 2011
(Dollars in thousands)

	Mercy Health Services, Inc.	Mercy Health Foundation, Inc.	Mercy Medical Center, Inc.	Stella Maris, Inc.	St. Paul Place Specialists, Inc.	Maryland Family Care, Inc.	Eliminations	Consolidated
REVENUES								
Net patient service revenues	$ 0	$ 0	$ 387,668	$ 48,483	$ 73,984	$ 28,256	$ 0	$ 538,391
Other operating revenues	1,995	1,264	15,669	5,827	3,776	707	(9,941)	19,297
Net assets released from restrictions used for operations	0	0	3,872	899	139	0	0	4,910
TOTAL REVENUES	1,995	1,264	407,209	55,209	77,899	28,963	(9,941)	562,598
EXPENSES								
Salaries and benefits	1,190	985	174,753	35,230	63,653	23,532	(3,330)	296,013
Medical and surgical supplies	0	0	43,525	849	315	293	0	44,982
Pharmacy supplies	0	0	22,148	1,069	278	2,176	0	25,671
Other expendable supplies	0	522	21,555	3,963	697	456	0	27,193
Professional fees	0	0	7,801	2,780	4,648	318	(1,146)	14,401
Insurance	0	0	5,093	802	3,467	364	12	9,738
Other purchased services	14	291	44,362	3,851	(489)	1,972	(6,022)	43,979
Interest expense	0	0	13,226	473	1	0	0	13,700
Repairs	0	7	8,696	633	197	305	0	9,838
Depreciation and amortization	0	4	26,524	2,181	730	965	0	30,404
Provisions for bad debt	0	0	23,062	474	4,938	894	0	29,368
TOTAL EXPENSES	1,204	1,809	390,745	52,305	78,435	31,275	(10,486)	545,287
OPERATING INCOME (LOSS)	791	(545)	16,464	2,904	(536)	(2,312)	545	17,311

Mercy Health Services, Inc. and Subsidiaries
Consolidating Statement of Operations Information - Continued
Year ended June 30, 2011
(Dollars in thousands)

	Mercy Health Services, Inc.	Mercy Health Foundation, Inc.	Mercy Medical Center, Inc.	Stella Maris, Inc.	St. Paul Place Specialists, Inc.	Maryland Family Care, Inc.	Eliminations	Consolidated
OTHER INCOME (EXPENSES)								
Investment income	97	233	3,529	136	0	0	(233)	3,762
Equity in gains of affiliates	540	0	0	0	0	0	0	540
Net unrealized gain(loss) on trading securities	43	312	7,332	(55)	0	0	(312)	7,320
Unrealized loss on interest rate swap	0	0	9,811	0	0	0	0	9,811
Gain (loss) on asset disposal	0	0	(157)	0	10	0	0	(147)
New facility nonrecurring costs	0	0	(1,714)	0	0	0	0	(1,714)
Other	0	0	11	0	0	0	0	11
NET OTHER EXPENSES	680	545	18,812	81	10	0	(545)	19,583
EXCESS (DEFICIT) OF REVENUES OVER EXPENSES	1,471	0	35,276	2,985	(526)	(2,312)	0	36,894
Changes to post retirement plans obligations	0	0	200	0	0	0	0	200
Net assets released from restrictions for the purchase of property and equipment	0	0	4,862	234	0	0	0	5,096
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	$ 1,471	$ 0	$ 40,338	$ 3,219	$ (526)	$ (2,312)	$ 0	$ 42,190

Mercy Medical Center, Inc.
Income Statement
FY Ended 6.30.2011
(Amounts in Thousands)

Net Operating Revenue:		
Net Patient Service Revenue	$	383,968
Other Operating Revenues		14,273
Net Assets Released- Operations		3,872
Total Operating Revenue	$	402,113
Operating Expenses:		
Salaries & Benefits	$	172,635
Medical/Surgical Supplies		43,439
Pharmacy Supplies		21,872
Other Supplies		21,738
Professional Fees		7,742
Insurance		6,806
Other Purchased Services		43,533
Interest Expense		13,226
Repairs		8,696
Depreciation & Amortization		26,504
Provision for Bad Debt		23,062
Total Operating Expense	$	389,253
Income from Operations	$	12,860
Investment Income (Loss)		3,529
Unrealized Gain (Loss) on Interest Rate Swap		9,811
Unrealized Gain (Loss) on Trading Securities		6,016
Loss on Disposal of PPE		(157)
Other		(1,698)
Excess of Expenses over Revenue	$	30,361
Change in Post Retirement Plan Oblig		200
Released Restricted Assets		4,857
Change in Net Assets	$	35,418

Mercy Medical Center, Inc.
Balance Sheet
6.30.2011
(Amounts in Thousands)

Assets:		
Cash & Short Term Investments	$	68,807
Current Portion of Cash Held by Trustee		12,642
Patient Receivables (Hospital)		19,106
Other Receivables		2,629
Inventory		6,739
Other Current Assets		3,531
Total Current Assets	$	113,454
Plant, Property & Equipment, Net		512,510
Funds Held by Trustee		21,641
Board Designated Funds		74,646
Long Term Investments		26,156
Restricted Cash		10,918
Other Assets		40,034
Due from Subsidiaries		14,065
Total Assets	$	813,424
Liabilities:		
Accounts Payable & Accrued Expenses	$	55,268
Current Portion of Long Term Debt		5,015
Construction Retainage		780
Total Current Liabilities	$	61,063
Long Term Debt		436,262
Post Retirement Obligation		6,819
Other Long Term Liabilities		33,894
Total Liabilities	$	538,038
Unrestricted Fund Balance		245,851
Temporarily Restricted Fund Balance		28,412
Permanently Restricted Fund Balance		1,123
Total Liabilities & Fund Balance	$	813,424