CONSOLIDATED FINANCIAL STATEMENTS AND OTHER FINANCIAL INFORMATION

Memorial Health System, Inc. and Affiliated Corporations
Years Ended December 31, 2010 and 2009
With Report of Independent Auditors

Ernst & Young LLP

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Consolidated Financial Statements
and Other Financial Information

Years Ended December 31, 2010 and 2009

Contents

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Report of Independent Auditors

The Board of Directors
Memorial Health System, Inc. and Affiliated Corporations

We have audited the accompanying consolidated balance sheets of Memorial Health System, Inc. and Affiliated Corporations (the Corporation) as of December 31, 2010 and 2009, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Corporation's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Memorial Health System, Inc. and Affiliated Corporations at December 31, 2010 and 2009, and the consolidated results of their operations and changes in net assets, and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 10, 2011

Memorial Health System, Inc. and Affiliated Corporations

Consolidated Balance Sheets

	December 31	
	2010	**2009**
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 54,700**	$ 81,513
Short-term investments	**6,787**	3,721
Patient accounts receivable, less allowances for doubtful accounts (2010 – $15,459; 2009 – $14,345)	**70,801**	79,203
Other receivables	**1,638**	3,232
Inventories	**15,085**	13,717
Prepaid expenses	**6,482**	6,780
Total current assets	**155,493**	188,166
Assets limited as to use:		
Internally designated investments	**220,666**	167,228
Externally designated investments under debt agreements	**53**	7,598
Externally designated investments – insurance trust	**2,515**	2,881
Board-designated endowment	**18,031**	16,167
	241,265	193,874
Property and equipment:		
Land	**35,784**	35,771
Buildings and improvements	**368,379**	349,303
Furniture and equipment	**247,877**	237,697
Construction in progress	**11,402**	6,202
	663,442	628,973
Less allowances for depreciation and amortization	**317,671**	287,664
	345,771	341,309
Unamortized bond issuance costs, net	**1,470**	1,551
Deferred charges and other assets	**13,917**	11,157
Interest rate and basis swaps	**–**	3,349
	$ 757,916	$ 739,406

	December 31	
	2010	**2009**
	(In Thousands)	
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 22,213**	$ 22,713
Accrued expenses	**27,307**	32,052
Due to third-party payors	**96**	2,062
Current maturities of long-term debt	**4,552**	4,366
Total current liabilities	**54,168**	61,193
Noncurrent liabilities:		
Long-term debt, less current maturities	**137,745**	139,754
Asset retirement obligations and other liabilities	**42,152**	40,430
Interest rate and basis swaps	**36,316**	11,993
	216,213	192,177
Total liabilities	**270,381**	253,370
Net assets:		
Unrestricted:		
Undesignated	**465,766**	463,370
Board-designated endowment	**18,031**	16,167
Total unrestricted	**483,797**	479,537
Temporarily restricted	**3,738**	6,499
Total net assets	**487,535**	486,036
	$ 757,916	$ 739,406

See accompanying notes.

Memorial Health System, Inc. and Affiliated Corporations

Consolidated Statements of Operations
and Changes in Net Assets

	Year Ended December 31	
	2010	**2009**
	(In Thousands)	
Unrestricted revenue, gains, and other support		
Net patient service revenue	**$ 441,177**	$ 460,473
Other revenue	**17,706**	17,097
Net assets released from restrictions used for operations	**2,126**	1,011
	461,009	478,581
Expenses		
Salaries and wages	**176,053**	170,141
Employee benefits	**48,123**	51,827
Supplies and other	**109,609**	109,932
Professional fees and purchased services	**51,822**	50,128
Depreciation and amortization	**30,746**	29,949
Interest	**2,694**	2,319
Provision for bad debts	**39,787**	30,875
	458,834	445,171
Income from operations	**2,175**	33,410
Non-operating		
Investment income, net	**20,880**	24,831
Unrealized (losses) gains on swap transactions	**(27,672)**	63,588
Loss on early extinguishment of debt	**–**	(591)
Gain on bond purchase	**–**	13,527
Realized gain on swap termination	**5,271**	–
Revenue and gains in excess of expenses	**654**	134,765

Memorial Health System, Inc. and Affiliated Corporations

Consolidated Statements of Operations
and Changes in Net Assets (continued)

	Year Ended December 31	
	2010	**2009**
	(In Thousands)	
Unrestricted net assets		
Revenue and gains in excess of expenses	**$ 654**	$ 134,765
Net assets released from restrictions used for capital purposes	**1,956**	1,132
Net assets released from restrictions to an outside organization	**39**	–
Other	**112**	(153)
Postretirement benefit adjustments other than periodic costs	**1,499**	9,746
Increase in unrestricted net assets	**4,260**	145,490
Temporarily restricted net assets		
Contributions temporarily restricted for use	**1,295**	1,076
Investment income	**65**	142
Net assets released from restrictions used for operating and capital purposes	**(4,121)**	(2,143)
Decrease in temporarily restricted net assets	**(2,761)**	(925)
Increase in net assets	**1,499**	144,565
Net assets at beginning of year	**486,036**	341,471
Net assets at end of year	**$ 487,535**	$ 486,036

See accompanying notes.

Memorial Health System, Inc. and Affiliated Corporations

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2010	2009
	(In Thousands)	
Operating activities		
Change in net assets	**$ 1,499**	$ 144,565
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	**30,746**	29,949
Provision for bad debts	**39,787**	30,875
Unrealized losses (gains) on swap transactions	**27,672**	(63,588)
Realized gain on swap termination	**(5,271)**	–
Collateral returned on swap transactions	**–**	50,669
Loss on early extinguishment of debt	**–**	591
Gain on bond purchase	**–**	(13,527)
Postretirement benefit adjustments other than periodic costs	**(1,499)**	(9,746)
Net unrealized gains on investments	**(15,643)**	(24,826)
Restricted contributions and investment income	**(1,360)**	(1,218)
Changes in operating assets and liabilities:		
Patient accounts receivable	**(31,385)**	(37,732)
Other receivables, inventories, and prepaid expenses	**540**	(4,153)
Other assets	**(1,252)**	1,469
Investments	**(34,814)**	1,393
Accounts payable and accrued expenses	**(5,261)**	4,939
Due to third-party payors	**(1,966)**	(773)
Other long-term liabilities	**3,029**	4,941
Net cash provided by operating activities	**4,822**	113,828
Investing activities		
Net gain on termination of swap transactions	**5,395**	–
Acquisition of net assets of Memorial Lighthouse Medical Imaging, LLC, and Compassionate Care Givers	**(4,804)**	–
Net additions to property and equipment	**(31,658)**	(31,533)
Cash used in investing activities	**(31,067)**	(31,533)
Financing activities		
Principal payments on long-term debt and other debt obligations	**(4,797)**	(29,198)
Partial purchase of Memorial 2007 Series A bonds, net	**–**	(13,473)
Net proceeds from issuance of long-term debt and other debt obligations	**2,869**	15,850
Restricted contributions and investment income	**1,360**	1,218
Net cash used in financing activities	**(568)**	(25,603)
(Decrease) increase in cash and cash equivalents	**(26,813)**	56,692
Cash and cash equivalents at beginning of year	**81,513**	24,821
Cash and cash equivalents at end of year	**$ 54,700**	$ 81,513
Supplemental disclosure on cash flow information		
Interest paid	**$ 3,117**	$ 3,683

See accompanying notes.

1. Organization and Basis of Consolidation

The accompanying consolidated financial statements represent the accounts of Memorial Health System, Inc. (the Corporation) and its various affiliated corporations under the control of the Corporation. The Corporation is an Indiana not-for-profit corporation exempt from federal income tax under Internal Revenue Code (the Code) Section 501(a) as an organization described in Section 501(c)(3) and a public charity as described in Section 509(a)(2). Included among the affiliated corporations are Memorial Hospital of South Bend, Inc. (the Hospital), Memorial Health Foundation, Inc. (MHF), Memorial Health System, Inc. (MHS) and Memorial Home Care, Inc. (Home Care). The Hospital and MHF are also exempt from federal income tax under Section 501(a) as organizations described in Section 501(c)(3) and as public charities described in Sections of 509(a)(1) and 509(a)(2), respectively. Home Care is an Indiana for-profit corporation. All significant intercompany accounts and transactions have been eliminated in the consolidation.

The Corporation also owns a 50% interest in Community Health Alliance LLC, an Indiana physician hospital organization; a 33.33% interest in Partners Health Plan, an inactive provider-owned health plan; a 40% interest in Skyway Limited Partnership, a professional medical building venture; a 50% interest in Memorial Spine and Neuroscience Center, LLC, an outpatient surgery center specializing in neurologic, spine, and pain control procedures; a 49% interest in LaPorte Medical Group Surgery Center, LLP, an outpatient surgery center; and a 35% interest in Physician's Hospital LLC, a long-term acute care facility.

In May 2010, the Corporation obtained a 50% interest in Michiana Linen Service, LLC, an institutional laundry provider. Prior to June 2010, MHS owned a 50% interest in Memorial Lighthouse Medical Imaging, LLC (MLMI), an outpatient diagnostic imaging center. In June 2010, the Hospital acquired 100% of the assets of MLMI.

The Hospital is a 526-bed acute care facility. The Hospital provides inpatient, outpatient, and 20 emergency care services for residents of South Bend, Indiana, and the surrounding communities. MHF is organized primarily to promote and encourage philanthropic activities for the support of the Corporation and its affiliates. Home Care manages the taxable operations of the Corporation.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time the estimates are made, actual results could differ from those estimates.

Cash Equivalents

All investments that are not limited as to use with a maturity of three months or less at the time of acquisition are reflected as cash equivalents. Cash equivalents include checking accounts, money market accounts, corporate credit card accounts, petty cash, and prepaid vendor accounts. The carrying value of cash equivalents approximates fair value.

Short-Term Investments

Short-term investments include cash reinvested on a daily basis, accrued interest on investments, and money expected to be used in less than a year as part of the Corporation’s community benefit. Also included in short-term investments are restricted and unrestricted investment donations that are in the process of being liquidated.

Accounts Receivable

The Corporation evaluates the collectability of its accounts receivable based on the length of time the receivable is outstanding, payor class, and the anticipated future uncollectible amounts based on historical experience. Accounts receivable are charged to the allowance for doubtful accounts when they are deemed uncollectible.

2. Summary of Significant Accounting Policies (continued)

Assets Limited as to Use

Assets limited as to use include assets set aside by the Board of Directors (the Board) for future capital improvements and community health enhancement initiatives which the Board, at its discretion, may subsequently use for other purposes. Additionally, assets limited as to use also include assets held by trustees under debt and self-funded insurance agreements.

Investments

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value based on quoted market prices for those or similar investments. Dividend and interest income, realized gains and losses, and changes to fair values of investments are reported as non-operating investment income in the consolidated statements of operations and changes in net assets.

Investments in alternative investments, primarily hedge fund of funds, that invest in marketable securities and derivative products, are reported using the equity method. The estimated fair values are provided by the respective fund managers and are based on historical costs, appraisals, and other estimates that require varying degrees of judgment. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and may differ from the value that would have been used had a ready market for such investments existed. Resulting differences could be material. The financial statements of the hedge funds are audited annually. Equity earnings related to these alternative investments are included in non-operating investment income. The Corporation’s holding reflects net contributions to the hedge fund and an allocated share of realized and unrealized investment income and expense.

Inventories

Inventories are stated at the lower of cost (average cost method) or market.

Unamortized Bond Issuance Costs

Costs incurred in connection with the issuance of long-term debt are deferred and amortized over the term of the related financing, which approximates the effective interest method.

2. Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are carried at cost, except donated assets, which are recorded at fair value at the date of donation. Allowances for depreciation and amortization are computed primarily utilizing the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years.

Asset Impairment

The Corporation considers whether indicators of impairment are present and performs the necessary tests to determine if the carrying value of an asset is appropriate. Impairment write-downs are recognized in operating expenses at the time the impairment is identified. There was no impairment of long-lived assets in 2010 and 2009.

Deferred Charges and Other Assets

Included in deferred charges and other assets are intangible assets and investments in unconsolidated affiliates.

The acquisition of a business entity can result in the recording of intangible assets. Acquired intangible assets (excluding goodwill) are amortized over the useful life of the assets. Goodwill is carried at acquisition value, less any impairment reductions.

The Corporation accounts for its investments in less than majority owned and controlled affiliates using either the cost basis or the equity method of accounting. These investments are included in other long-term assets.

Endowment Investments

Income is received directly by MHF from MHF board designated endowment investments. These endowment investments have perpetual existence.

2. Summary of Significant Accounting Policies (continued)

Contributions

Unconditional pledges to give cash and other assets are reported at fair value at the date the pledge is received to the extent estimated to be collectible by MHF or the Hospital. Pledges received with donor restrictions that limit the use of the donated assets are reported as either temporarily or permanently restricted support. 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 consolidated statements of operations and changes in net assets as net assets released from restrictions.

As of December 31, pledges expected to be received, which are included in other receivables, were as follows (in thousands):

	2010	2009
One to five years	**$ 50**	$ 1,398
Total pledges	**$ 50**	$ 1,398

Temporarily Restricted Net Assets

Temporarily restricted net assets are used to differentiate resources, the use of which is restricted by donors or grantors to a specific time period or purpose, from resources on which no restrictions have been placed or that arise from the general operations of the Corporation. Temporarily restricted gifts and bequests are recorded as an addition to temporarily restricted net assets in the period received. Assets released from restrictions that are used for the purchase of property and equipment or capital purposes are reported in the consolidated statements of operations and changes in net assets as additions to unrestricted net assets. Resources restricted by donors for specific operating purposes are reported in unrestricted revenue, gains, and other support to the extent expended within the period.

2. Summary of Significant Accounting Policies (continued)

Net Patient Service Revenue

The Corporation has agreements with various third-party payors that provide for payments to the Corporation at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts received or due from patients, third-party payors, and others for services rendered. These amounts include estimated adjustments under certain reimbursement agreements with third-party payors, which are subject to audit by the applicable administering agency. These adjustments are accrued on an estimated basis and are adjusted in future periods as final settlements are determined (see Note 3).

Community Commitment

The Hospital provides care to all patients regardless of their ability to pay. Charity care provided by the Hospital is excluded from net patient service revenue (see Note 4).

Revenue and Gains in Excess of Expenses

The consolidated statements of operations and changes in net assets include revenue and gains in excess of expenses. Changes in unrestricted net assets, which are excluded from revenue and gains in excess of expenses, consistent with industry practice, include contributions of long-lived assets, including assets acquired using contributions, which by donor restrictions, were to be used for the purpose of acquiring such assets, and pension-related changes other than net periodic costs.

Allocation of Costs

The ability of the Corporation to exercise control over consolidated entities could result in operating results or a financial position of those entities which is significantly different from those which would have been obtained if the entities were autonomous. The manner of allocating certain shared and centralized costs, such as accounts payable processing, information technology support, and other Corporation-managed administration costs, is determined by the Corporation utilizing IRS transfer pricing guidance. Alternate methods of accounting for these cost allocations may produce significantly different operating results for each of the consolidated entities.

2. Summary of Significant Accounting Policies (continued)

Interest Rate and Basis Swaps

All interest rate and basis swaps are measured at fair value based on quoted market interest rates. None of the swaps are designated as hedging instruments; therefore, the unrealized gains or losses on the fair value of the swaps are included in revenue and gains in excess of expenses in the consolidated statements of operations and changes in net assets.

Asset Retirement Obligations

The Corporation accounts for the fair value of legal obligations associated with long-lived asset retirements by recognizing an expense and accreting a liability over the life of the asset to cover potential legal obligations at the end of the asset's useful life. The asset retirement obligation primarily relates to future asbestos remediation related to buildings on the Hospital's campus, as well as ground/soil remediation associated with the removal of underground fuel tanks. The carrying value of the obligation amounted to approximately $3,177,000 and $3,001,000 at December 31, 2010 and 2009, respectively.

Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standard Board (FASB) issued Accounting Standards Update (ASU) No. 2010-06, *Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 amends Accounting Standards Codification (ASC) 820 to require a number of additional disclosures regarding fair value measurements. These disclosures include the amounts of significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for these transfers; the reasons for any transfer in or out of Level 3; and information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances, and settlements on a gross basis, as well as clarification on previously required reporting requirements. This new guidance is effective for the first reporting period, including interim periods beginning after December 15, 2009, for all disclosures except the requirement to separately disclose purchases, sales, issuances, and settlements of recurring Level 3 measurements. The provision for reporting Level 3 measurements is effective for fiscal years beginning after December 15, 2010. The Corporation adopted the required components of this guidance and is evaluating the Level 3 disclosures.

2. Summary of Significant Accounting Policies (continued)

In April 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 164, *Not-for-Profit Entities: Mergers and Acquisitions – including an amendment of FASB Statement No. 142* (codified primarily in ASC 954-805, *Health Care Entities – Business Combinations*). This new guidance is effective for the Corporation beginning January 1, 2010, and fundamentally changes the accounting for mergers and acquisitions entered into by not-for-profit organizations. Under this guidance, most combinations will be accounted for under the acquisition method, and the acquired organization's assets and liabilities will be revalued to their fair values when recorded in the acquirer's financial statements. Additionally, under the new guidance, goodwill and indefinite-lived intangible assets will no longer be amortized but will be evaluated for potential impairment, as is the case with for-profit entities. The Corporation adopted the required components of this guidance.

In August 2010, the FASB issued ASU No. 2010-23, *Measuring Charity Care for Disclosure* (ASU 2010-23). The provisions of ASU 2010-23 are intended to reduce the diversity in how charity care is calculated for disclosures across healthcare entities that provide it. Charity care is required to be measured at cost, defined as the direct and indirect costs of providing the charity care. This new guidance is effective for fiscal years beginning after December 15, 2010, with early application permitted. The Corporation is currently evaluating the impact to the consolidated financial statement disclosures.

Reclassifications

Certain amounts in the 2009 financial statements have been reclassified to conform to the 2010 presentation. These reclassifications did not impact revenues and gains in excess of expenses or net assets previously reported.

3. Contractual Arrangements With Third-Party Payors

The Medicare and Medicaid programs reimburse the Hospital for inpatient and outpatient services at predetermined rates based on treatment diagnosis. Changes in the Medicare and Medicaid programs or reduction of funding levels for the programs could have an adverse effect on future amounts recognized as net patient service revenue.

Managed care reimbursement agreements provide for payment of patient services at a fixed percentage of covered charges. The Hospital has also entered into contractual arrangements with various health maintenance and preferred provider organizations, the terms of which call for the Hospital to be paid for covered services at predetermined rates, including percent of charges, per diem, and case rate.

Revenue is presented net of estimated contractual adjustments, which represent the difference between standard charges for services and the estimated payments from the various third-party payors. Revenues received under the Medicare program account for 26% and 25% of net patient service revenue for the years ended December 31, 2010 and 2009, respectively. Revenues received under the Anthem Payor Contract (Anthem) account for 23% of net patient service revenue for each of the years ended December 31, 2010 and 2009.

The laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. In the normal course of business, the Hospital is subject to audits by third-party payors requests for information and review of past payment practices. The Hospital believes it is in substantial compliance with all applicable laws and regulations, and is not aware of any pending or threatened investigation involving allegations of material wrong doing. Compliance with laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Credit is granted without collateral to patients, most of whom are local residents and are insured under third-party arrangements. Major components of net patient accounts receivable include 23% from Medicare and 22% from Anthem at December 31, 2010, and 23% from Medicare and 26% from Anthem at December 31, 2009.

3. Contractual Arrangements With Third-Party Payors (continued)

Adjustments arising from reimbursement arrangements with third-party payors are accrued for on an estimated basis in the period in which the services are rendered, with the exception of Indiana Medicaid Disproportionate Share (DSH) reimbursement. DSH payments by the state of Indiana, if eligible, are paid according to the fiscal year of the state, which ends on June 30 of each year, and are based on the cost of uncompensated care provided by the DSH providers during their respective fiscal year ended during the state fiscal year. DSH payments are recorded after eligibility is determined, and payments are probable and reasonably estimable. Estimates for DSH, cost report settlements, and contractual allowances can differ from actual reimbursement based on the results of subsequent reviews, government regulatory changes, and cost report audits.

The Corporation did not qualify for state of Indiana DSH payments in 2010.

During the year ended December 31, 2009, the Corporation received $17,930,000 from the state of Indiana for a DSH payment relating to the 2009 Indiana state fiscal year (July 1 to June 30). The payment was recognized as an increase to net patient service revenue in 2009.

Estimates for cost report settlements and contractual allowances can differ from actual reimbursement based on the results of subsequent reviews and cost report audits. For the years ended December 31, 2010 and 2009, net patient service revenue has been increased by approximately $2,219,000 and $1,369,000, respectively, for adjustments related to previous years' third-party settlements.

4. Community Commitment

Community commitment represents charity care and/or unreimbursed costs for services rendered at a reduced fee, or no fee, due to the inability of the patient to pay for services. The estimated amount of the charity care provided, measured by charges forgone, was approximately $24,035,000 and $21,539,000 for the years ended December 31, 2010 and 2009, respectively.

Additionally, the Corporation reinvests funds into the community to improve the health status of community members, in particular, under-served populations. Each year, the Corporation tithes based on the Corporation's income from operations, plus certain investment earnings in a separate unrestricted current asset account. The estimated amount of tithing funds expended was approximately $2,842,000 and $2,536,000 for the years ended December 31, 2010 and 2009, respectively.

5. Pension Plan

The Corporation maintains a defined-contribution employee retirement and savings plan. All employees who have attained 21 years of age and have completed 12 months of continuous service are eligible to participate. The Corporation's contribution is based on 100% of the employee's contributions, up to 5% of an employee's salary if the employee has been employed less than 10 years, and up to 6% of the employee's salary if the employee has been employed 10 years or more. Contributions were approximately $6,371,000 and $5,964,000 for the years ended December 31, 2010 and 2009, respectively. Beginning in 2011, the Corporation's contribution will be based on 100% of the employee's contributions, up to 4% of the employee's salary.

The Corporation also has a non-contributory, defined-benefit pension plan (the Plan), which includes a final average pay plan and a cash balance plan. The cash balance plan was frozen as of December 31, 2007, and the much smaller grandfathered final average pay plan, with fewer participants, remains frozen and was not altered. The assets in the cash balance plan will continue to earn interest, but service credits are frozen.

The Corporation's pension plan expenses for the years ended December 31, 2010 and 2009 was approximately $2,031,000 and $3,655,000, respectively. The Corporation anticipates approximately $1,804,000 in pension expense in 2011.

5. Pension Plan (continued)

The measurement date of December 31 is utilized. The summary of the changes in the benefit obligation and plan assets and the resulting funded status of the Plan is as follows (in thousands):

	December 31	
	2010	**2009**
Accumulated benefit obligation	**$ 123,007**	$ 117,789
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	**$ 122,533**	$ 116,339
Service cost	**1,019**	986
Interest cost	**6,876**	7,035
Actuarial loss	**2,394**	5,455
Benefits paid	**(5,806)**	(7,282)
Projected benefit obligation at end of year	**$ 127,016**	$ 122,533
Change in plan assets:		
Fair value of plan assets at beginning of year	**$ 92,788**	$ 80,200
Actual gain on plan assets	**9,756**	19,569
Employer contributions	**658**	301
Benefits and administration fees paid	**(5,806)**	(7,282)
Fair value of plan assets at end of year	**$ 97,396**	$ 92,788
Funded status:		
Funded status of the Plan and amounts recognized as other long-term liabilities in the consolidated balance sheets	**$ (29,620)**	$ (29,745)

Included in unrestricted net assets are the following amounts that have not been recognized in net periodic pension cost at December 31 (in thousands):

	2010	**2009**
Unrecognized prior service cost	**$ (6)**	$ (6)
Unrecognized actuarial net loss	**1,314**	1,355
	$ 1,308	$ 1,349

5. Pension Plan (continued)

Changes in the Plan's assets and benefit obligations recognized in unrestricted net assets during 2010 and 2009 include the following (in thousands):

	2010	2009
Current year actuarial gain	**$ (1,505)**	$ (9,755)
Current year amortization prior service cost	**6**	7
	$ (1,499)	$ (9,748)

The components of net periodic benefit cost for the defined-benefit pension plan are as follows (in thousands):

	Year Ended December 31 2010	2009
Service cost	**$ 1,019**	$ 986
Interest cost	**6,876**	7,035
Expected return on plan assets	**(7,213)**	(6,514)
Prior service credit recognized	**(6)**	(7)
Amortization of recognized losses	**1,355**	2,155
Benefit cost	**$ 2,031**	$ 3,655

Assumptions used to determine benefit obligations at the measurement date are as follows:

	December 31 2010	2009
Discount rates	**5.25%**	5.75%
Expected return on plan assets	**7.50**	8.00
Rate of compensation increase	**3.50**	4.28

5. Pension Plan (continued)

Assumptions used to determine net pension expense for the fiscal years are as follows:

	December 31	
	2010	**2009**
Discount rates	**5.75%**	6.25%
Expected return on plan assets	**8.00**	8.50
Rate of compensation increase	**4.28**	4.28

The following is a summary of the pension plan asset target and actual allocations at December 31:

Asset Category	Strategic Target	Actual Asset Allocation at December 31	
		2010	**2009**
Equity securities	50%	**44%**	35%
Debt securities	30	**20**	25
Other	20	**36**	40
Total	100%	**100%**	100%

The composition and fair value of the plan assets at December 31 is summarized as follows (in thousands):

	2010	**2009**
Interest-bearing cash	**$ 1,252**	$ 351
Corporate bonds	**19,143**	23,188
Marketable equity securities	**25,192**	22,603
Hedge funds	**26,212**	24,116
Long/short funds	**21,131**	20,023
Other	**4,463**	2,504
Interest receivable	**3**	3
	$ 97,396	$ 92,788

5. Pension Plan (continued)

The following table sets forth by level, within the fair value hierarchy (see Note 9), the Plan's assets carried at fair value as of December 31, 2010 (in thousands):

	Level 1	Level 2	Level 3	Fair Value
Short-term investment funds[a]	$ 1,252	$ –	$ –	$ 1,252
Mutual funds[a]:				
Large cap	8,181	–	–	8,181
International	8,778	–	–	8,778
Other	4,470	–	–	4,470
Corporate bonds[a]	19,143	–	–	19,143
Common stocks[a]	3,763	–	–	3,763
Common collective trust funds[b]	–	1,318	–	1,318
Long/short funds[b,c]:	–		–	
Long/short	–	15,582	–	15,582
Leveraged capital	–	5,549	–	5,549
Hedge funds[c]:				
Multi-strategy	–	9,574	–	9,574
Long/short	–	6,962	–	6,962
Fixed and convertible arbitrage hedge funds	–	2,880	–	2,880
Other hedge funds	–	6,796	–	6,796
Other fund[c]	–	3,148	–	3,148
	$ 45,587	$ 51,809	$ –	$ 97,396

(a) Pricing for corporate bonds, common stocks, mutual funds, short-term investments, and government obligations are based on the open market and are valued on a daily basis.

(b) Pricing is based on the market value of the securities and is valued on a monthly basis. In the event that a security is not actively traded in the open market, the characteristics are matched to a comparable issue to appropriately value the holding.

(c) Investment in other funds, long/short funds, and hedge funds are valued using the Net Asset Value (NAV) provided by the administrator of the fund. These investments are not otherwise traded on a securities exchange. The NAV is based on the underlying assets owned by the fund, minus its liabilities, and then divided by the number of shares outstanding.

5. Pension Plan (continued)

In addition to understanding fair value methodologies, the long/short, hedge and other funds may be subject to redemption and/or liquidity restrictions. Restrictions of such funds by category are as follows:

Type of Fund	Fair Value	Redemption Restrictions	Liquidity Timeframe
Long/short funds			
Long/short	$ 8,076	None	Under 95 days
Long/short	7,506	None	Annual
Long/short leveraged capital	5,549	Two-year soft lock (5% fee first year/3% fee second year)	Annual
Hedge funds			
Multi-strategy hedge funds	9,574	None	Under 95 days
Long/short hedge funds	6,962	None	Under 95 days
Fixed and convertible arbitrage hedge funds	2,880	None	Under 95 days
Other hedge funds	6,796	None	Under 95 days
Other fund	3,148	In capital commitment period. See Note 11.	Illiquid

5. Pension Plan (continued)

The following table sets forth by level, within the fair value hierarchy, the Plan's assets carried at fair value as of December 31, 2009:

	Level 1	Level 2	Level 3	Fair Value
Short-term investment funds[a]	$ 351	$ –	$ –	$ 351
Mutual funds[a]:				
Large cap	7,111	–	–	7,111
International	7,309	–	–	7,309
Other	5,330	–	–	5,330
Corporate bonds[a]	23,188	–	–	23,188
Common stocks[a]	2,853	–	–	2,853
Common collective trust funds[b]:	–	1,333	–	1,333
Long/short funds[b,c]:				
Long/short	–	14,864	–	14,864
Leveraged capital	–	5,159	–	5,159
Hedge funds[c]:				
Multi-strategy	–	7,363	–	7,363
Long/short	–	6,236	–	6,236
Fixed and convertible arbitrage hedge funds	–	2,903	–	2,903
Other hedge funds	–	7,612	–	7,612
Other fund[c]	–	1,176	–	1,176
	$ 46,142	$ 46,646	$ –	$ 92,788

(a) Pricing for corporate bonds, common stocks, mutual funds, short-term investments, and government obligations are based on the open market and are valued on a daily basis.

(b) Pricing is based on the market value of the securities and is valued on a monthly basis. In the event that a security is not actively traded in the open market, the characteristics are matched to a comparable issue to appropriately value the holding.

(c) Investment in other funds, long/short funds, and hedge funds are valued using the NAV provided by the administrator of the fund. These investments are not otherwise traded on a securities exchange. The NAV is based on the underlying assets owned by the fund, minus its liabilities, and then divided by the number of shares outstanding.

5. Pension Plan (continued)

The Corporation employs a total return investment approach, whereby a mix of equities and fixed-income investments are used to maximize the long-term return of plan assets for a prudent level of risk. Risk tolerance is established through careful consideration of plan liabilities, plan funded status, and corporate financial condition. The investment portfolio contains a diversified blend of equity, fixed-income, and alternative investments. Equity investments are diversified across U.S. and non-U.S. corporate stocks, as well as growth, value, and small and large capitalizations.

Other assets such as real estate, private equity, and hedge funds are used to enhance long-term returns while improving portfolio diversification. The Corporation's external investment managers may use derivatives to gain market exposure in an efficient and timely manner. Investment risk is measured and monitored on an ongoing basis through quarterly investment portfolio reviews, annual liability measurements, and periodic asset/liability studies.

The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid in the years ended December 31 (in thousands):

2011	$ 6,362
2012	6,667
2013	7,251
2014	7,488
2015	7,584
2016-2020	45,072

The Corporation contributed $658,000 to plan assets during 2010 from employer assets. The Corporation plans to contribute approximately $3,334,000 to plan assets in 2011 from employer assets. The Corporation contributed $219,000 to plan assets from employer assets in January 2011.

6. Lease Obligations

The Corporation leases certain office space and equipment under non-cancelable operating leases. At December 31, 2010, the minimum future rental payments under these leases are as follows (in thousands):

2011	$	4,063
2012		3,671
2013		1,878
2014		1,767
2015		1,742
Thereafter		5,749
	$	18,870

Rental expense for the years ended December 31, 2010 and 2009 was approximately $4,335,000 and $4,014,000, respectively.

7. Long-Term Debt

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

	2010	2009
Tax-exempt bonds issued on behalf of the Hospital by the Hospital Authority of St. Joseph County:		
Health System Revenue Bonds, Series 2008A, bearing interest at variable rates retaining the hedge from the Series 2006 with a floating to fixed interest rate swap at 3.5% at December 31, 2010 and 2009, due in varying annual installments on August 15 of each year through 2033	**$ 38,580**	$ 38,580
Health System Revenue Bonds, Series 2008B, bearing interest at variable rates of .31% and .21% at December 31, 2010 and 2009, respectively, due in varying annual installments on August 15 of each year through 2034	**38,105**	39,000
Health System Revenue Bonds, Series 2007, bearing interest at variable rates of .27% and 1.05% at December 31, 2010 and 2009, respectively, due in varying annual installments on August 15 of each year through 2046	**1,000**	1,000
Health System Revenue Bonds, Series 2000, interest ranging from 4.875% to 5.00%, due in varying annual installments from 2007 to 2010	**–**	110
Health System Revenue Bonds, Series 1998A, interest ranging from 4.60% to 5.50%, due in varying annual installments on August 15 of each year through 2028	**63,430**	65,965
Mortgage for MLMI bearing interest at variable rates of 2.56% at December 31, 2010, LIBOR plus 2.25%, due in varying annual installments on the last day of every month through 2015	**1,781**	–
Madison Center Note to purchase fixed assets through 2013	**17**	–
Capital leases	**1,707**	1,925
	144,620	146,580
Less unamortized discount	**2,323**	2,460
	142,297	144,120
Less current portion	**4,552**	4,366
	$ 137,745	$ 139,754

7. Long-Term Debt (continued)

The Corporation purchased $27,000,000 par value of the Series 2007 Bonds for $13,230,000 in March 2009. The transaction resulted in a gain of $13,527,000, which is included in the consolidated statement of operations and changes in net assets for the year ended December 31, 2009. In October 2008, the Corporation purchased $52,000,000 par value of the Series 2007 Bonds for $29,640,000. The par value of the Series 2007 remains outstanding with the Hospital as owner of record. The consolidated balance sheet reflects these purchases as a reduction of long-term debt for the Series 2007 Bonds of $79,000,000 at par value. These bonds are available for reissuance.

During the first quarter of 2009, the Corporation obtained short-term obligations in order to capitalize on the Series 2007 Bond purchase opportunities. A revolving line of credit in the amount of $8,000,000 was obtained and drawn in full from Fifth Third Bank in March 2009, with a maturity date of February 26, 2010. The interest on the revolving line of credit was one-month LIBOR plus 2.50%. In August of 2009, the Corporation paid off the revolving line of credit. The Corporation also obtained a promissory note and line of credit from 1st Source Bank. The promissory note was obtained in March 2009 for $6,000,000. In June 2009, the Corporation paid off the promissory note with 1st Source Bank in the amount of $6,000,000. The interest on the promissory note was equal to the prime rate, with a provision indicating the interest rate would never be lower than 4¼% per annum. The Corporation has a $2,000,000 revolving line of credit with 1st Source Bank. In March 2009, $1,850,000 was drawn down on the revolving line of credit and was subsequently paid back in May 2009. The line of credit was renewed and extended through May 31, 2011. No draws were taken by the Corporation in 2010. The interest rate on the line of credit is prime rate minus ½%. No amounts were outstanding on the line of credit as of December 31, 2010 and 2009.

In the first quarter of 2009, the Corporation defeased $8,815,000 of the Series 1998A, and incurred a loss of $591,000. The defeased bonds had a maturity date of August 15, 2028.

In August 2008, the Hospital Authority of St. Joseph County, on behalf of the Corporation, issued revenue refunding bonds in the principal amount of $78,495,000. The interest rate for the Series 2008A and 2008B Bonds is a weekly interest rate determined by the remarketing agent. The 2008 bond issue was secured by two separate irrevocable direct-pay letters of credit issued by Fifth Third Bank. In October 2009, there was a substitution on the letters of credit from Fifth Third Bank to JPMorgan Chase Bank. In October 2010, the JPMorgan Chase letters of credit expiration date was extended to October 12, 2015. As long as no default has occurred, draws on the direct-pay letters of credit made for failed remarketing will be required to be repaid in twelve equal quarterly installments commencing twelve months after the date of draw.

7. Long-Term Debt (continued)

The Series 2008A Bonds are subject to mandatory redemption through the operation of a sinking fund on each August 15 commencing with the year 2011 to, and including the year, 2033 in amounts sufficient to redeem the principal amounts. The Series 2008B Bonds are subject to mandatory redemption through the operation of a sinking fund on each August 15 that commenced with the year 2009 to, and including the year, 2034 in amounts sufficient to redeem the principal amounts.

As of the date of the issuance of the Series 2007 Bonds, under the terms of a Master Trust Indenture, the Corporation and the Hospital formed the Obligated Group. MHF and Home Care constitute designated affiliates under the terms of the Master Trust Indenture. The terms of the bond agreements require that various funds be held on deposit with a trustee in accordance with the terms of the Master Trust Indenture. These funds are classified on the Hospital's balance sheet as externally designated investments and consist primarily of a debt service reserve fund of $53,000 at December 31, 2010, and a construction fund of $7,545,000 and a debt service reserve fund of $53,000 at December 31, 2009.

The Series 2008A, 2008B, 2007, 2000, and 1998A Bonds were issued pursuant to the Master Trust Indentures which are secured by pledged revenues of the Obligated Group and contain various covenants, including achievement of specified financial ratios and limitations on additional debt.

Interest capitalized during the years ended December 31, 2010 and 2009 was approximately $23,000 and $1,008,000, respectively.

Maturities of long-term debt and capital lease obligations for each of the next five years are as follows (in thousands):

2011	$ 4,552
2012	4,682
2013	4,588
2014	4,387
2015	5,415

8. Interest Rate and Basis Swaps

The Corporation has various derivative instruments to manage the exposure on interest rates and interest expense. Through the use of derivative financial instruments, the Corporation is exposed to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contracts. When the fair value of the derivative contract is positive, the counterparty owes the Corporation, which creates credit risk to the Corporation. When the fair value of the derivative contract is negative, the Corporation owes the counterparty, and there is no credit risk to the Corporation at that point in time. The Corporation minimizes the credit risk in derivative instruments by entering into transactions that require the counterparty to post collateral for the benefit of the fair value of the derivative contract. Market risk is the adverse effect on the value of the financial instrument that results from a change in interest rates. The management of market risk associated with interest rate changes is defined in the Corporation's Swap Management Policy. The policy includes continuous monitoring of market conditions, emergent opportunities, and risks. Swap management is meant to be long term in nature, and any modifications to the program are reviewed for the long-term costs and benefits. Management also mitigates risk through periodic reviews of its derivative position in the context of its total blended cost of capital. In October 2010, the Corporation terminated two yield curve swaps in order to maximize the benefit from these swaps. The termination of the yield curve swaps resulted in a realized gain of $5,271,000, which is included in non-operating in the consolidated statement of operations and changes in net assets for the year ended December 31, 2010.

As of December 31, 2010, the mark to market valuation on the swap portfolio was below the required collateral posting threshold of $30,000,000 with Citigroup, Inc., $25,000,000 with Morgan Stanley, and $25,000,000 with Deutsche Bank.

As of December 31, 2009, the mark to market valuation on the swap portfolio was below the required collateral posting threshold of $30,000,000 with Citigroup, Inc., and $25,000,000 with Morgan Stanley. Two swaps with the notional amounts of $77,630,000 and $9,250,000 as of December 31, 2010 have notional adjustments on specified dates as further described in their swap agreements.

8. Interest Rate and Basis Swaps (continued)

The following is a summary of the outstanding fixed payer rate swaps as of December 31, 2010:

Origination Date	Notional Amounts	Corporation Receives	Corporation Pays	Maturity Date
March 2006	$ 38,580,000	61.9% of 30-day LIBOR plus 0.31%	3.5%	August 15, 2033
March 2003	$ 9,250,000	65% of 30-day LIBOR plus 0.45%	3.8%	July 28, 2034

The following is a summary of the outstanding basis rate swaps as of December 31, 2010:

Origination Date	Notional Amounts	Corporation Receives	Corporation Pays	Maturity Date
January 2007	$42,000,000	74.6% of LIBOR-BBA	SIFMA tax-exempt index+.0715%	January 2041
August 2007	$54,000,000	61.7% of USD-LIBOR-BBA + 0.76%	SIFMA tax-exempt index+.0715%	September 2041
March 2001	$140,000,000	75.125% of 90-day LIBOR	SIFMA tax-exempt index	March 2031
July 2002	$56,000,000	75.125% of 90-day LIBOR	SIFMA tax-exempt index	July 2022
February 2003	$30,000,000	81.125% of 90-day LIBOR	SIFMA tax-exempt index	February 2033
February 2003	$30,000,000	80.625% of 90-day LIBOR	SIFMA tax-exempt index	February 2023
June 2004	$77,630,000	62.6% of USD-LIBOR-BBA + 0.785%	SIFMA tax-exempt index	August 2033
July 2009	$63,000,000	74.6% of 1m-LIBOR	SIFMA tax-exempt index + 0.17%	January 2041
August 2009	$81,000,000	61.7% of 1m LIBOR + 0.76%	SIFMA tax-exempt index + 0.17%	August 2041

8. Interest Rate and Basis Swaps (continued)

In October 2010, the Corporation terminated two yield curve swaps. The termination of the yield curve swaps resulted in a realized gain of $5,271,000 and the receipt of accrued interest of $245,000. The following is a summary of the terminated yield curve swaps as of October 29, 2010:

Origination Date	Notional Amounts	Corporation Receives	Corporation Pays	Maturity Date
August 2008	$60,000,000	Ten year USD-SIFMA -0.65%	SIFMA tax-exempt index	August 2027
September 2008	$60,000,000	Ten year r USD-SIFMA -0.65%	SIFMA tax-exempt index	September 2027

The following is a summary of the outstanding swaps as of December 31, 2009:

Origination Date	Notional Amounts	Corporation Receives	Corporation Pays	Maturity Date
January 2007	$42,000,000	74.6% of LIBOR -BBA	SIFMA tax-exempt+.0715% index	January 2041
August 2007	$54,000,000	61.7% of USD- LIBOR-BBA + 0.76%	SIFMA tax-exempt index+.0715%	September 2041
March 2001	$140,000,000	75.125% of 90-day LIBOR	SIFMA tax-exempt index	March 2031
July 2002	$56,000,000	75.125% of 90-day LIBOR	SIFMA tax-exempt index	July 2022
February 2003	$30,000,000	81.125% of 90-day LIBOR	SIFMA tax-exempt index	February 2033
February 2003	$30,000,000	80.625% of 90-day LIBOR	SIFMA tax-exempt index	February 2023
June 2004	$77,850,000	62.6% of USD- LIBOR-BBA + 0.785%	SIFMA tax-exempt index	August 2033
July 2009	$63,000,000	74.6% of 1m-LIBOR	SIFMA tax-exempt index + 0.17%	January 2041
August 2009	$81,000,000	61.7% of 1m LIBOR + 0.76%	SIFMA tax-exempt index + 0.17%	August 2041
August 2008	$60,000,000	Ten year r USD-SIFMA -0.65%	SIFMA tax-exempt index	August 2027
September 2008	$60,000,000	Ten year USD-SIFMA -0.65%	SIFMA tax-exempt index	September 2027

8. Interest Rate and Basis Swaps (continued)

Net interest paid or received under the above swap agreements is included in interest expense. The net differential for the Corporation as a result of the swap agreements amounted to receipt of $1,575,000 and receipt of $2,857,000 for the years ended December 31, 2010 and 2009, respectively, and is reflected as a reduction to interest expense. The swap agreements do not qualify for hedge accounting; therefore, the change in the fair value of the swap agreements is recorded as an unrealized non-operating loss of $27,672,000 and non-operating gain of $63,588,000 for the years ended December 31, 2010 and 2009, respectively.

The fair value of derivative instruments at December 31 is as follows (in thousands):

	Asset Derivatives		
	Balance Sheet Location	**2010**	**2009**
		(In Thousands)	
Derivatives not designated as hedging instruments:			
Interest rate contracts	Interest rate and basis swaps	**$ –**	$ 3,349
		$ –	$ 3,349

	Liability Derivatives		
	Balance Sheet Location	**2010**	**2009**
		(In Thousands)	
Derivatives not designated as hedging instruments:			
Interest rate contracts	Interest rate and basis swaps	**$ 36,316**	$ 11,993
		$ 36,316	$ 11,993

9. Fair Value of Financial Instruments

The fair value of the Corporation's long-term debt, excluding capital leases and the mortgage on MLMI, is approximately $138,825,000 and $143,951,000 at December 31, 2010 and 2009, respectively.

The composition of investment assets held by the Corporation at December 31 is summarized as follows (in thousands):

	2010	2009
United States government and agency securities and government-insured repurchase agreements	**$ 17,013**	$ 25,040
Corporate bonds	**43,523**	43,525
Mutual funds	**20,862**	379
Marketable equity securities	**55,863**	46,609
Alternative investments	**104,784**	70,998
Cash and cash equivalents	**6,007**	11,044
	$ 248,052	$ 197,595

Total investment return for the years ended December 31 is summarized as follows (in thousands):

	2010	2009
Investment return:		
Dividend and interest income	**$ 4,051**	$ 3,588
Net realized and unrealized gains/losses on investments, net	**11,244**	14,802
Net equity earnings on alternative investments	**5,585**	6,441
	$ 20,880	$ 24,831
Reported as:		
Investment income, net	**$ 20,880**	$ 24,831
	$ 20,880	$ 24,831

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable and accrued expenses are reasonable estimates of their fair value due to the short-term nature of these financial instruments.

9. Fair Value of Financial Instruments (continued)

ASC 820-10-50-2 establishes a three-level valuation hierarchy. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instruments.
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following tables present the financial instruments carried as of December 31, 2010 and 2009, by caption, on the consolidated balance sheets by the valuation hierarchy defined above for those instruments carried at fair value, as well as the alternative investments that are reported on the equity method. Deferred compensation investments are included in other assets on the consolidated balance sheets (in thousands).

9. Fair Value of Financial Instruments (continued)

December 31, 2010	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
Assets						
Short-term investments[a]	$ 6,787	$ –	$ –	$ 6,787	$ –	$ 6,787
Internally designated investments:						
Mutual funds[a]:						
Large cap equity	12,863	–	–	12,863	–	12,863
International equity	22,919	–	–	22,919	–	22,919
Small cap equity	4,377	–	–	4,377	–	4,377
Total return fund	48,428	–	–	48,428	–	48,428
Blended fund	8,626	–	–	8,626	–	8,626
Total mutual funds	97,213	–	–	97,213	–	97,213
Common stock[c]	5,534	–	–	5,534	–	5,534
Bonds[b]	2,584	15,686	184	18,454	–	18,454
Alternatives:						
Fixed income	–	–	–	–	3,571	3,571
Fund of hedge funds	–	–	–	–	45,650	45,650
Long/short credit	–	–	–	–	5,549	5,549
Long/short equity	–	–	–	–	38,515	38,515
Real estate	–	–	–	–	6,180	6,180
Total alternatives	–	–	–	–	99,465	99,465
	105,331	15,686	184	121,201	99,465	220,666
Ext. designated investments under debt agreements[a]	53	–	–	53	–	53
Ext. designated invest.– insurance trust[a]	2,515	–	–	2,515	–	2,515
Board-designated endowment:						
Mutual funds[a]:						
Equities	7,663	–	–	7,663	–	7,663
Fixed income	3,849	368	–	4,217	–	4,217
Equities[c]	831	–	–	831	–	831
Alternatives	–	–	–	–	5,320	5,320
	12,343	368	–	12,711	5,320	18,031
	127,029	16,054	184	143,267	104,785	248,052
Other long-term assets[a, c]	3,852	–	–	3,852	–	3,852
Total	$ 130,881	$ 16,054	$ 184	$ 147,119	$ 104,785	$ 251,904
Liabilities						
Swaps[d]	$ –	$ –	$ (36,316)	$ (36,316)	$ –	$ (36,316)
Total	$ –	$ –	$ (36,316)	$ (36,316)	$ –	$ (36,316)

9. Fair Value of Financial Instruments (continued)

In addition to understanding fair value methodologies, the alternative funds may have redemption and/or liquidity restrictions. Restrictions of such funds by category are as follows as of December 31, 2010:

Type of Fund	Fair Value *(In Thousands)*	Redemption Restrictions	Liquidity Timeframe
Fixed income	$ 3,571	In capital commitment period. See Note 11.	Illiquid
Fund of hedge funds	2,856	Fund is being liquidated following schedule provided by fund manager.	Illiquid
Fund of hedge funds	10,410	Semi-annual redemptions after one year lock. One year lock ends on 8/1/11	Illiquid
Fund of hedge funds	23,935	None	Under 95 days
Fund of hedge funds	6,124	15% redemption gate	Under 95 days
Fund of hedge funds	5,505	Quarterly redemptions after one year lock. One year lock ends on 11/1/11	Under 95 days
Long/short credit	5,549	Two years soft lock (5% fee first year and 3% fee second year)	Under 95 days
Long/short equity	18,667	None	Annual
Long/short equity	21,987	None	Under 95 days
Real estate	3,186	None	Annual
Real estate	2,994	Quarterly redemptions after one year lock. One year lock ends on 1/31/11	Annual

9. Fair Value of Financial Instruments (continued)

December 31, 2009	Level 1	Level 2	Level 3	Fair Value	Equity Method	Carrying Value
Assets						
Short-term investments[a]	$ 3,721	$ –	$ –	$ 3,721	$ –	$ 3,721
Internally designated investments:						
Cash	8,000	–	–	8,000	–	8,000
Mutual funds[a]:						
Large cap equity	11,181	–	–	11,181	–	11,181
International equity	3,680	–	–	3,680	–	3,680
Small cap equity	19,083	–	–	19,083	–	19,083
Total return fund	18,583	–	–	18,583	–	18,583
Blended fund	19,441	–	–	19,441	–	19,441
Total mutual funds	71,968	–	–	71,968	–	71,968
Common stock[c]	4,269	–	–	4,269	–	4,269
Bonds[b]	2,418	14,682	173	17,273	–	17,273
Alternatives:						
Fixed income	–	–	–	–	786	786
Fund of hedge funds	–	–	–	–	30,603	30,603
Long/short credit	–	–	–	–	5,159	5,159
Long/short equity	–	–	–	–	29,170	29,170
Total alternatives	–	–	–	–	65,718	65,718
	86,655	14,682	173	101,510	65,718	167,228
Ext. designated investments under debt agreements[a]	7,598	–	–	7,598	–	7,598
Ext. designated investments insurance trust[a]	2,881	–	–	2,881	–	2,881
Board-designated endowment:						
Mutual funds[a]:						
Equities	6,503	–	–	6,503	–	6,503
Fixed income	3,272	368	–	3,640	–	3,640
Equities[c]	745	–	–	745	–	745
Alternatives	–	–	–	–	5,279	5,279
	10,520	368	–	10,888	5,279	16,167
Swaps[d]	–	–	3,349	3,349	–	3,349
	111,375	15,050	3,522	129,947	70,997	200,944
Other long-term assets[a, c]	3,522	–	–	3,522	–	3,522
Total	$ 114,897	$ 15,050	$ 3,522	$ 133,469	$ 70,997	$ 204,466
Liabilities						
Swaps[d]	$ –	$ –	$ (11,993)	$ (11,993)	$ –	$ (11,993)
Total	$ –	$ –	$ (11,993)	$ (11,993)	$ –	$ (11,993)

9. Fair Value of Financial Instruments (continued)

(a) Pricing for mutual funds, short-term investments, and government obligations are based on the open market and are valued on a daily basis.
(b) Pricing is based on the fair value of the securities and is valued on a monthly basis. Information used to value this account is provided by International Data Corp. (IDC). In the event that a security is not actively traded in the open market, the characteristics are matched to a comparable issue from the IDC data to appropriately value the holding.
(c) Level 1 equities are priced based on the open market and are valued on a daily basis. Net asset values are based on the fair value of fund assets minus the fund's liabilities. Generally accepted accounting principles are used for accrual-based accounting. Assets are valued using independent market quotations except to the extent that current independent market quotations are not readily available or do not reflect current fair values, in which case investments may be valued using fair value pricing. The frequency with which a fund's investments are valued using fair value pricing is primarily a function of the types of securities and other assets in which the fund invests, pursuant to its investment objectives, strategies, and limitations.
(d) Pricing is based on discounted cash flows to reflect a credit spread adjustment to the LIBOR discount curve in order to reflect "non-performance" risk. The credit spread adjustment is derived from how other comparable entities' bonds price and trade in the market. As the credit spread adjustment is a significant component of the swap valuation and is an unobservable input, the swaps have been classified as Level 3.

The table below sets forth a summary of changes in the fair value of the Plan's Level 3 swaps for the year ended December 31, 2010 (in thousands):

Balance, beginning of the year:	$ (8,644)
Unrealized gains/loss, net	(27,672)
Balance, end of the year	$ (36,316)

For the year ended December 31, 2010, the Corporation recorded approximately $27,672,000 in non-operating losses, which relates to losses of $30,077,000 due to the change in the swap's value, and credit of $2,405,000 to reflect the fair value of the uncollateralized portion of the swap balance. For the year ended December 31, 2009, the Corporation recorded approximately $63,588,000 in non-operating income, which relates to income of $67,077,000 due to the change in the swap's value, and credit of $3,489,000 to reflect the fair value of the uncollateralized portion of the swap balance.

9. Fair Value of Financial Instruments (continued)

The Corporation's investments are exposed to various kinds and levels of risk. Equity mutual funds expose the Corporation to market risk, performance risk, and liquidity risk. Market risk is the risk associated with major movements of the equity markets. Performance risk is the risk associated with a company's operating performance. Fixed-income securities expose the Corporation to interest rate risk, credit risk, and liquidity risk. As interest rates change, the value of many fixed-income securities is affected, including those with fixed interest rates. Credit risk is the risk that the obligor of the security will not fulfill its obligations. Liquidity risk is affected by the willingness of market participants to buy and sell given securities. Liquidity risk tends to be higher for equities related to small capitalization companies. Due to the volatility of the capital markets, there is a reasonable possibility of changes in fair value, resulting in additional gains and losses in the near term.

10. Functional Expenses

The Corporation provides general health care services to residents within its geographic location. Expenses related to this and general and administrative functions for each of the years ended December 31 are as follows (in thousands):

	2010	2009
Health care services	**$ 283,569**	$ 280,912
Affiliated health services	**72,635**	67,782
General and administrative	**102,630**	96,477
	$ 458,834	$ 445,171

11. Commitments

At December 31, 2010, the Hospital is contractually obligated for approximately $2,956,000, which primarily relates to routine capital expenditures. During 2010, the Corporation's Board of Trustees approved a project for the construction of a cancer center on the first floor of the Hospital. In addition to the routine capital expenditures, the Corporation is contractually obligated for approximately $2,529,000 related to the construction of a cancer center at December 31, 2010.

The Corporation was a co-guarantor with an unaffiliated business for the debt of an unconsolidated joint venture, MLMI, in which the Corporation recorded an equity interest. The portion of the debt guaranteed by the Corporation at December 31, 2009 and through June 30, 2010, was $2,473,000. In June 2010, the Hospital purchased the assets of MLMI and assumed the debt. The debt of $1,781,000 is reflected as a long-term liability, less the current portion, at December 31, 2010.

During 2009, the Corporation committed to investing up to $7,500,000 in Legacy Securities Public Private Investment Funds. As of December 31, 2010 and 2009, the Corporation had made investments of $6,008,000 and $1,500,000, respectively. As of December 31, 2010 and 2009, the Corporation had unfunded commitments of $1,492,000 and $6,000,000, respectively.

12. Professional Liability Insurance

The Corporation is a defendant in certain litigation arising in the ordinary course of business. Professional liability insurance coverage is provided under a claims-made policy. The Corporation terminated self-funding of its professional and general liability coverage on November 30, 2009 and obtained claims-made insurance policies for coverage. The Indiana Medical Malpractice Act has provided recovery up to $1,250,000 per occurrence, with the first $250,000 covered by the Corporation. The Corporation maintains a trust fund for its self-insurance program, which it continues to maintain until all claims have been settled. The fair value of the trust funds at December 31, 2010 and 2009 was approximately $2,515,000 and $2,881,000, respectively. The discounted amount of malpractice and general liability claims, including a component for incurred but not reported claims, was approximately $2,501,000 and $2,493,000 at December 31, 2010 and 2009, respectively. The interest rate used to discount these claims was 4.5% at December 31, 2010 and 2009.

13. Income Taxes

The Corporation and its related affiliates, except for Home Care, have been determined to qualify as exempt from federal income tax under 501(a) as organizations described in Section 501(c)(3) of the Code.

Most of the income received by the Corporation and its related affiliates, except for Home Care, is exempt from taxation, as income related to the mission of the organization. Accordingly, there is no material provision for income tax for these entities. However, some of the income received by exempt entities is subject to taxation as unrelated business income. The Corporation and its subsidiaries file federal and various state income tax returns in the United States.

14. Restricted Net Assets

Temporarily restricted net assets are available for the following purposes or periods at December 31 (in thousands):

	2010	2009
Net assets currently available for:		
Community services	**$ 425**	$ 678
Hospital support services	**113**	198
Quality initiatives	**539**	1,226
People development/education	**1,184**	1,270
Financial support services	**2**	2
Growth initiatives	**1,475**	3,125
	$ 3,738	$ 6,499

15. Board-Designated Endowment

MHF has a Board-Designated Endowment. The Board provides direction to use the income, profits for support, betterment, improvement, upkeep, expansion, and replacement of MHS and its corporate affiliates.

MHF follows its Statement of Investment Objectives and Policy, which established formal yet flexible investment guidelines incorporating prudent risk parameters, appropriate asset guidelines, and realistic return goals. Per the policy, the primary objective is to meet commitments to employees at a reasonable cost to the company. Therefore, MHF will actively invest to achieve real growth of capital over inflation through appreciation of securities held and through the accumulation and reinvestment of dividends and interest income. MHF utilizes an investment consulting firm to assist in development of asset allocation targets, review investment performance to benchmarks, review investment strategies, and communicate this information to the MHF Investment Committee and management.

Endowment Net Asset Composition by Type of Fund

	December 31, 2010	
	Unrestricted	**Total**
	(In Thousands)	
Board designated endowment funds	**$ 18,031**	**$ 18,031**
Total funds	**$ 18,031**	**$ 18,031**

	December 31, 2009	
	Unrestricted	**Unrestricted**
	(In Thousands)	
Board-designated endowment funds	$ 16,167	$ 16,167
Total funds	$ 16,167	$ 16,167

15. Board-Designated Endowment (continued)

Changes in Endowment Net Assets

	Unrestricted	Total
Board-designated endowment funds, beginning of year (January 1, 2009)	$ 13,171	$ 13,171
Investment return:		
Investment income	(14)	(14)
Net realized gains on investments	2,065	2,065
Net equity gains on investments	945	945
Total investment return	2,996	2,996
Board-designated endowment funds, end of year (December 31, 2009)	$ 16,167	$ 16,167
Board-designated endowment funds, beginning of year (January 1, 2010)	**$ 16,167**	**$ 16,167**
Investment return:		
Investment income	**(10)**	**(10)**
Net realized gains on investments	**1,613**	**1,613**
Net equity gains on investments	**261**	**261**
Total investment return	**1,864**	**1,864**
Board-designated endowment funds, end of year (December 31, 2010)	**$ 18,031**	**$ 18,031**

16. Subsequent Events

The Corporation evaluated events and transactions occurring subsequent to December 31, 2010 through March 10, 2011, the date of issuance of the consolidated financial statements. During this period, there were no subsequent events requiring recognition or disclosure in the consolidated financial statements.

Other Financial Information

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Report of Independent Auditors on Other Financial Information

The Board of Directors
Memorial Health System, Inc. and Affiliated Corporations

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The following financial information is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

Ernst & Young LLP

March 10, 2011

Memorial Health System, Inc. and Affiliated Corporations

Details of Consolidated Balance Sheet

December 31, 2010

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Memorial Health System, Inc.	Memorial Health Foundation, Inc.	Memorial Home Care, Inc.
	(In Thousands)					
Assets						
Current assets:						
Cash and cash equivalents	$ 54,700	$ –	$ 44,358	$ 2,865	$ 3,718	$ 3,759
Short-term investments	6,787	–	5,862	–	925	–
Patient accounts receivable, net	70,801	–	61,958	5,861	–	2,982
Other receivables	1,638	–	827	756	50	5
Inventories	15,085	–	13,706	–	–	1,379
Prepaid expenses	6,482	–	1,083	5,305	2	92
Due from affiliates	–	(551)	13	538	–	–
Total current assets	155,493	(551)	127,807	15,325	4,695	8,217
Assets limited as to use:						
Internally designated investments	220,666	–	220,666	–	–	–
Externally designated investments under debt agreements	53	–	53	–	–	–
Externally designated investments – insurance trust	2,515	–	2,484	20	–	11
Board-designated endowment	18,031	–	–	–	18,031	–
	241,265	–	223,203	20	18,031	11
Property and equipment:						
Land	35,784	–	18,965	16,819	–	–
Buildings and improvements	368,379	–	309,219	51,397	–	7,763
Furniture and equipment	247,877	–	202,153	40,178	386	5,160
Construction in progress	11,402	–	10,870	530	–	2
	663,442	–	541,207	108,924	386	12,925
Less allowances for depreciation and amortization	317,671	–	261,294	46,976	248	9,153
	345,771	–	279,913	61,948	138	3,772
Unamortized bond issuance costs	1,470	–	1,470	–	–	–
Deferred charges and other assets	13,917	(12,367)	1,937	22,700	38	1,609
Interest in net assets of recipient organization	–	(3,739)	3,739	–	–	–
	$ 757,916	$ (16,657)	$ 638,069	$ 99,993	$ 22,902	$ 13,609

Memorial Health System, Inc. and Affiliated Corporations

Details of Consolidated Balance Sheet (continued)

December 31, 2010

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Memorial Health System, Inc.	Memorial Health Foundation, Inc.	Memorial Home Care, Inc.
	(In Thousands)					
Liabilities and net assets						
Current liabilities:						
Accounts payable	$ 22,213	$ –	$ 15,405	$ 6,031	$ 9	$ 768
Accrued expenses	27,307	–	18,577	5,766	1,130	1,834
Due to third-party payors	96	–	96	–	–	–
Due to affiliates	–	(551)	–	–	–	551
Current maturities of long-term debt	4,552	–	4,546	6	–	–
Total current liabilities	54,168	(551)	38,624	11,803	1,139	3,153
Noncurrent liabilities:						
Long-term debt, less current maturities	137,745	–	137,734	11	–	–
Asset retirement obligations and other liabilities	42,152	–	7,264	34,834	38	16
Interest rate and basis swaps	36,316	–	36,316	–	–	–
	216,213	–	181,314	34,845	38	16
Total liabilities	270,381	(551)	219,938	46,648	1,177	3,169
Net assets:						
Unrestricted:						
Undesignated	465,766	(12,367)	414,392	53,345	(44)	10,440
Board-designated endowment	18,031	–	–	–	18,031	–
Total unrestricted	483,797	(12,367)	414,392	53,345	17,987	10,440
Temporarily restricted	3,738	(3,739)	3,739	–	3,738	–
Total net assets	487,535	(16,106)	418,131	53,345	21,725	10,440
	$ 757,916	$ (16,657)	$ 638,069	$ 99,993	$ 22,902	$ 13,609

Memorial Health System, Inc. and Affiliated Corporations

Details of Consolidated Statement of Operations and Changes in Net Assets

Year Ended December 31, 2010

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Memorial Health System, Inc.	Memorial Health Foundation, Inc.	Memorial Home Care, Inc.
	(In Thousands)					
Unrestricted revenue, gains, and other support						
Net patient service revenue	$ 441,177	$ (82)	$ 370,806	$ 43,804	$ –	$ 26,649
Other revenue	17,706	(1,132)	10,587	6,519	70	1,662
Net assets released from restrictions used for operations	2,126	–	1,496	629	1	–
	461,009	(1,214)	382,889	50,952	71	28,311
Expenses						
Salaries and wages	176,053	(9)	115,011	48,680	–	12,371
Employee benefits	48,123	–	33,382	11,680	23	3,038
Supplies and other	109,609	(1,137)	86,813	14,403	406	9,124
Management fees	–	–	19,804	(21,594)	408	1,382
Professional fees and purchased services	51,822	(68)	40,500	9,965	672	753
Depreciation and amortization	30,746	–	24,491	5,473	46	736
Interest	2,694	–	2,676	–	18	–
Provision for bad debts	39,787	–	37,434	1,896	–	457
	458,834	(1,214)	360,111	70,503	1,573	27,861
Income (loss) from operations	2,175	–	22,778	(19,551)	(1,502)	450
Non-operating						
Investment income, net	20,880	–	18,327	542	2,006	5
Unrealized losses on swap transactions	(27,672)	–	(27,672)	–	–	–
Realized gain on swap termination	5,271	–	5,271	–	–	–
Revenue and gains in excess of (less than) expenses	654	–	18,704	(19,009)	504	455

Memorial Health System, Inc. and Affiliated Corporations

Details of Consolidated Statement of Operations and Changes in Net Assets (continued)

Year Ended December 31, 2010

	Consolidated	Eliminations	Memorial Hospital of South Bend, Inc.	Memorial Health System, Inc.	Memorial Health Foundation, Inc.	Memorial Home Care, Inc.
	(In Thousands)					
Unrestricted net assets						
Revenue and gains in excess of (less than) expenses	$ 654	$ –	$ 18,704	$ (19,009)	$ 504	$ 455
Net assets released from restrictions used	–					
for capital purposes	1,956	–	1,955	1	–	–
Net assets released from restrictions to an outside organization	39	–	–	–	39	–
Other	112	–	(20,902)	19,823	1,191	–
Postretirement benefit adjustments, other than periodic costs	1,499	–	–	1,499	–	–
Increase (decrease) in unrestricted net assets	4,260	–	(243)	2,314	1,734	455
Temporarily restricted net assets						
Contributions temporarily restricted for use	1,295	–	–	–	1,295	–
Investment income	65	–	–	–	65	–
Net assets released from restrictions used for operating						
and capital purposes	(4,121)	–	–	–	(4,121)	–
Change in interest in recipient organization	–	2,760	(2,760)	–	–	–
Decrease in temporarily restricted net assets	(2,761)	2,760	(2,760)	–	(2,761)	–
Increase (decrease) in net assets	1,499	2,760	(3,003)	2,314	(1,027)	455
Net assets at beginning of year	486,036	(18,866)	421,134	51,031	22,752	9,985
Net assets at end of year	$ 487,535	$ (16,106)	$ 418,131	$ 53,345	$ 21,725	$ 10,440

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