

Mercy Alliance, Inc. and Affiliates
Janesville, Wisconsin

Consolidated Financial Statements
Years Ended June 30, 2010 and 2009

Mercy Alliance, Inc. and Affiliates

Consolidated Financial Statements

Years Ended June 30, 2010 and 2009

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Independent Auditor's Report

Board of Directors
Mercy Alliance, Inc.
Janesville, Wisconsin

We have audited the accompanying consolidated balance sheets of Mercy Alliance, Inc. and Affiliates ("Alliance") as of June 30, 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 Alliance'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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mercy Alliance, Inc. and Affiliates as of June 30, 2010 and 2009, 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.

Wipfli LLP

Wipfli LLP

October 26, 2010
Milwaukee, Wisconsin

Mercy Alliance, Inc. and Affiliates

Consolidated Balance Sheets

June 30, 2010 and 2009

<i>Assets</i>	<i>(In Thousands)</i>	
	2010	2009
Current assets:		
Cash and cash equivalents	\$ 20,052	\$ 25,746
Patient accounts receivable - Net	73,086	83,360
Supplies	10,738	8,983
Prepaid expenses	3,705	4,035
Due from third party payors	384	-
Other receivables	7,608	7,899
Total current assets	115,573	130,023
Assets limited as to use	235,789	129,515
Property and equipment - Net	187,157	186,558
Other assets:		
Unamortized debt issue costs - Net	2,933	2,233
Other	1,456	2,991
Total other assets	4,389	5,224
TOTAL ASSETS	\$ 542,908	\$ 451,320

<i>Liabilities and Net Assets</i>	<i>(In Thousands)</i>	
	2010	2009
Current liabilities:		
Current maturities of long-term debt	\$ 5,694	\$ 5,866
Accounts payable	9,676	11,564
Accrued salaries, wages, and payroll taxes	27,093	26,585
Due to third-party payors	1,320	1,673
Other accrued expenses	45,131	38,442
Total current liabilities	88,914	84,130
Long-term liabilities:		
Long-term debt, less current maturities	176,480	111,582
Interest rate swap	2,633	2,151
Deferred compensation	13,004	10,371
Pension liability	35,515	33,148
Total long-term liabilities	227,632	157,252
Total liabilities	316,546	241,382
Total net assets - Unrestricted	226,362	209,938
TOTAL LIABILITIES AND NET ASSETS	\$ 542,908	\$ 451,320

Mercy Alliance, Inc. and Affiliates

Consolidated Statements of Operations and Changes in Net Assets

Years Ended June 30, 2010 and 2009

	(In Thousands)	
	2010	2009
Revenue:		
Net patient service revenue	\$ 381,318	\$ 383,702
Premium revenue	84,371	89,565
Other revenue	1,566	846
Total revenue	467,255	474,113
Expenses:		
Salaries and wages	220,674	215,728
Employee benefits	37,898	35,570
Professional fees and purchased services	25,010	24,329
Medical claims and capitation payments	24,071	27,816
Medical, other supplies, and drugs	70,083	67,015
Utilities	5,309	5,804
Insurance	6,612	11,097
Other	23,762	22,997
Provision for bad debts	13,942	22,274
Depreciation and amortization	19,940	18,887
Interest	5,188	5,558
Total expenses	452,489	457,075
Income from operations	14,766	17,038
Nonoperating income (expense) - Net	6,050	(13,435)
Excess of revenue over expenses	20,816	3,603
Other changes in unrestricted net assets:		
Change in net unrealized gains and losses on investments other than trading securities	2,391	(13,262)
Changes in pension obligation other than pension expense	(6,950)	(15,572)
Amortization of cumulative loss on swap due to dedesignation of cash flow hedge	167	-
Change in fair value of effective portion of interest rate swap	-	(1,201)
Change in unrestricted net assets	16,424	(26,432)
Unrestricted net assets at beginning	209,938	236,370
Unrestricted net assets at end	\$ 226,362	\$ 209,938

See accompanying notes to consolidated financial statements.

Mercy Alliance, Inc. and Affiliates

Consolidated Statements of Cash Flows

Years Ended June 30, 2010 and 2009

	(In Thousands)	
	2010	2009
Increase (decrease) in cash and cash equivalents:		
Cash flows from operating activities:		
Change in net assets	\$ 16,424	\$ (26,432)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Changes in pension obligation other than pension expense	6,950	15,572
Change in net unrealized gains and losses on investments other than trading securities	(2,391)	13,262
Provision for bad debts	13,942	22,274
Net realized (gains) losses on sales of investments	(4,629)	16,211
Change in fair value of interest rate swap	482	1,201
Depreciation and amortization	19,940	18,867
Loss on sale of property and equipment	136	1,028
Loss on early retirement of debt	760	-
Changes in operating assets and liabilities:		
Patient accounts receivable	(3,668)	(17,837)
Supplies and other current assets	(1,134)	(1,576)
Accounts payable	1,145	2,015
Accrued liabilities and other	5,247	6,603
Due from/to third-party payors	(737)	1,360
Net cash provided by operating activities	52,467	52,548
Cash flows from investing activities:		
Increase in assets limited as to use	(99,254)	(11,176)
Capital expenditures	(23,425)	(30,636)
Proceeds from sale of property and equipment	-	238
Change in other assets	1,509	77
Net cash used in investing activities	(121,170)	(41,497)

Mercy Alliance, Inc. and Affiliates

Consolidated Statements of Cash Flows (Continued)

Years Ended June 30, 2010 and 2009

	(In Thousands)	
	2010	2009
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	\$ 114,199	\$ -
Principal payments on long-term debt	(5,864)	(7,321)
Early retirement of refinanced long-term debt	(43,650)	-
Payments for financing costs	(1,676)	-
Net cash used in financing activities	63,009	(7,321)
Net increase in cash and cash equivalents	(5,694)	3,730
Cash and cash equivalents at beginning	25,746	22,016
Cash and cash equivalents at end	\$ 20,052	\$ 25,746
Supplemental cash flow information:		
Cash paid for interest, net of capitalized interest of \$49,999 in 2010	\$ 4,600	\$ 4,918
Capital expenditures in accounts payable	\$ -	\$ 3,033

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 1 Summary of Significant Accounting Policies

The Entity and Principles of Consolidation

The consolidated financial statements include the accounts and operations of Mercy Alliance, Inc. and its affiliates and wholly owned subsidiaries (collectively "Alliance"):

- Mercy Alliance, Inc. (MAI)
Serves as parent corporation for the corporate group and supports the operations of its affiliates and subsidiaries.
- Mercy Health System Corporation (MHSC)
Operates a 240-bed hospital (licensed beds) in Janesville, Wisconsin; approximately 39 physician clinics in southern Wisconsin and northern Illinois; a skilled nursing facility (SNF) that operates as a subacute care unit of the hospital building; and Mercy Walworth Hospital and Medical Center (MWH), a 6-bed hospital facility in Walworth County, Wisconsin. MWH is reimbursed by Medicare as a critical access hospital (CAH).
- Mercy Assisted Care, Inc. (MAC)
MAC operates Mercy Homecare, a supplier of durable medical equipment, the Cooperative Childcare Institute, a residential care center for children and youth, and coordinates home care through nurses, physical therapists, and speech therapists. MAC operated a 40-bed community-based residential facility (CBRF) during a portion of 2009. The CBRF was closed during 2009.
- Mercy Harvard Hospital, Inc. (MHH)
Operates a hospital with 25 acute and 45 long-term care beds located in Harvard, Illinois. MHH also has an affiliate, Harvard Memorial Hospital Foundation, whose purpose is to support the programs of MHH. MHH is reimbursed by Medicare as a CAH.
- Mercy Foundation, Inc. (MFI)
MFI's primary activity is fund-raising for MHSC and its programs in accordance with its by-laws.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 1 **Summary of Significant Accounting Policies (Continued)**

- MercyCare Insurance Company (MCIC)
An indemnity insurance company that contracts with local employers. MCIC has a wholly owned subsidiary, MercyCare HMO which operates as a health maintenance organization (HMO) under Wisconsin statutes. MCIC and its subsidiary contract for services with MHSC and other MAI affiliates.

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

Financial Statement Presentation

The Alliance follows accounting standards set by the Financial Accounting Standards Board (FASB). FASB issued the Accounting Standards Codification (ASC) effective for financial statements for annual periods ending after September 15, 2009. The ASC is an aggregation of previously issued authoritative accounting principles generally accepted in the United States (GAAP) in one comprehensive set of guidance organized by subject area. In accordance with the ASC, references to previously issued accounting standards have been replaced by ASC references.

Use of Estimates in Preparation of Financial Statements

The preparation of the accompanying consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that directly 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 revenue and expenses during the reporting period. Actual results may differ from these estimates.

Cash Equivalents

Highly liquid debt instruments with an original maturity of three months or less are considered to be cash equivalents, excluding amounts limited as to use.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 1 **Summary of Significant Accounting Policies (Continued)**

Patient Accounts Receivable and Credit Policy

Patient accounts receivable are uncollateralized patient obligations that are stated at the amount management expects to collect from outstanding balances. These obligations are primarily from local residents, most of whom are insured under third-party payor agreements. Alliance bills third-party payors on the patients' behalf, or if a patient is uninsured, the patient is billed directly. Once claims are settled with the primary payor, any secondary insurance is billed, and patients are billed for copay and deductible amounts that are the patients' responsibility. Payments on accounts receivable are applied to the specific claim identified on the remittance advice or statement. Alliance does not have a policy to charge interest on past due accounts.

The carrying amounts of accounts receivable are reduced by allowances that reflect management's best estimate of the amounts that will not be collected. Management provides for contractual adjustments under terms of third-party reimbursement agreements through a reduction of gross revenue and a credit to patient accounts receivable. In addition, management provides for probable uncollectible amounts, primarily uninsured patients and amounts patients are personally responsible for, through a charge to operations and a credit to a valuation allowance based on its assessment of historical collection likelihood and the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to patient accounts receivable.

Patient accounts receivable are recorded in the accompanying consolidated balance sheets net of contractual adjustments and allowances for doubtful accounts.

Supplies

Supplies are valued at the lower of cost, determined on the first-in, first-out (FIFO) method, or market.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 1 **Summary of Significant Accounting Policies (Continued)**

Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the accompanying consolidated balance sheets. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in nonoperating income (expense) unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from excess of revenue over expenses unless the investments are trading securities. Realized gains and losses are determined by specific identification.

Alliance monitors the difference between the cost and fair value of its investments. If investments experience a decline in value that Alliance determines is other than temporary, Alliance records a realized loss in investment income.

Assets Limited as to Use

Assets limited as to use include assets the Board of Directors has designated for future plant replacement and expansion over which the Board retains control and may at its discretion subsequently use for other purposes, amounts set aside for compensation agreements, amounts held by MCIC to meet regulatory compliance requirements, and assets held by a trustee under bonds indenture agreements.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Donated property and equipment are recorded at fair market value at the date of donation, which is then treated as cost. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets, net of earning on those funds. Estimated useful lives range from 2 to 20 years for land improvements, 5 to 20 years for leasehold improvements, 5 to 25 years for buildings and improvements, and 3 to 20 years for fixed and major moveable equipment.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 1 **Summary of Significant Accounting Policies (Continued)**

Unamortized Debt Issue Costs and Bond Premiums and Discounts

Bond issue costs and original issue premiums and discounts related to issuance of long-term debt are amortized over the life of the related debt using the straight-line method.

Interest Rate Swap

Alliance uses an interest rate swap to manage its risk related to interest rate movements. Alliance's risk management strategy is to stabilize cash flow variability on its variable rate debt with interest rate swaps. At the inception of a swap agreement, Alliance documents its risk management strategy and assesses the interest rate swap's effectiveness at producing offsetting cash flows. The interest rate swap is reported at fair value on the consolidated balance sheets with the change in fair value of the effective portion of the hedge included in other changes in net assets and the change in fair value for any ineffective portion is included in non-operating income (expense). Cumulative changes in fair value included in net assets at the time a cash flow hedge is de-designated are amortized and reclassified from net assets to other income or expense over the remaining life of the hedged transaction.

Asset Retirement Obligation

ASC Topic 410-20, *Accounting for Conditional Asset Retirement Obligation*, clarifies when an entity is required to recognize a liability for a conditional asset retirement obligation. Management has considered ASC Topic 410-20, specifically as it relates to its legal obligation to perform asset retirement activities, such as asbestos removal, on its existing properties. Management believes there is an indeterminate settlement date for the asset retirement obligations because the range of time over which Alliance may settle the obligation is unknown and cannot reasonably estimate the liability related to these asset retirement activities as of June 30, 2010.

Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If an impairment has occurred, a loss will be recognized. No impairment was recognized in 2010 or 2009.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 1 **Summary of Significant Accounting Policies (Continued)**

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity. When a temporary donor restriction expires, that is when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

There were no temporarily or permanently restricted net assets at June 30, 2010 and 2009.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Revenue under third-party payor agreements is subject to audit and retroactive adjustments. Provisions for estimated third-party payor settlements and adjustments are estimated in the period the related services are rendered and adjusted in future periods as final settlements are determined. Management believes that adequate provision has been made in the accompanying consolidated financial statements for any adjustments that may result from final settlements.

Premium Revenue and Claims Payable

Premiums are billed monthly for coverage in the following month and are recognized as revenue in the month for which insurance protection is provided. Claims payable, included in other accrued expenses, are determined using statistical analyses and represent estimates of the ultimate net cost of all reported and unreported claims that are unpaid at the end of each accounting period. Although it is not possible to measure the degree of variability inherent in such estimates, management believes that the liabilities for claims are adequate. The estimates are reviewed periodically, and as adjustments to these liabilities become necessary, such adjustments are reflected in current operations.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 1 **Summary of Significant Accounting Policies (Continued)**

Hospital Assessments

During the year ended June 30, 2009, the Wisconsin state legislature enacted legislation under which eligible hospitals, including Alliance, are required to pay the state an annual assessment. The assessment period is the state's fiscal year which runs from July 1 to June 30. The assessment is based on each hospital's gross revenues, as defined. The revenue generated from the assessment is to be used, in part, to increase overall reimbursement under the Wisconsin Medicaid program, including increases retroactive to July 1, 2008. Alliance's assessment expense was approximately \$6,271,000 and \$5,417,000 for the years ended June 30, 2010 and 2009, respectively, and is included in other expense in the accompanying statements of operations and changes in net assets. Any increases in the reimbursement from Medicaid are included in net patient service revenue.

Excess of Revenue Over Expenses

The accompanying consolidated statements of operations and changes in net assets include excess of revenue over expenses, which is considered the operating indicator. Changes in unrestricted net assets which are excluded from the operating indicator, include unrealized gains and losses on investments other than trading securities, changes in fair value related to the effective portion of the interest rate swap, changes in the pension obligation other than pension expense, permanent transfer of assets to and from affiliates for other than goods and services, and contributions of long-lived assets.

Charity Care

Alliance provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because collection is not pursued on amounts determined to qualify as charity care, these amounts are not included in net patient service revenue in the accompanying consolidated statements of operations and changes in net assets. Alliance also gives discounts from established charges to patients who are uninsured and considers these discounts a part of their community benefit.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 1 **Summary of Significant Accounting Policies (Continued)**

Charity Care (Continued)

Charges forgone under Alliance's charity care, based on established rates, approximated \$18,769,000 and \$15,621,000 for the years ended June 30, 2010 and 2009, respectively.

Contributions and Unconditional Promises to Give

Contributions are considered to be available for unrestricted uses unless specifically restricted by the donor.

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 deemed unconditional. The gifts are reported as either temporarily restricted or permanently restricted support if they are received with donor stipulations that limit the use of donated assets. Donor-imposed contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the accompanying consolidated financial statements.

Advertising Costs

Advertising costs are expensed as incurred.

Income Taxes

MAI, MHSC, MAC, MHH, and MFI are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (the "Code") and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. They are also exempt from state income taxes on related income.

Federal and state income taxes are paid on nonexempt unrelated business income in accordance with the Code regulations.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 1 **Summary of Significant Accounting Policies (Continued)**

Income Taxes (Continued)

MCIC and MercyCare HMO are taxable entities for both federal and Wisconsin income tax purposes and file a consolidated return. Deferred income taxes have been provided under the asset and liability method. Deferred tax assets and liabilities are determined based upon the difference between the financial statement and tax bases of assets and liabilities, as measured by the enacted tax rates expected to apply to taxable income in the years when these differences are expected to reverse.

In order to account for any uncertain tax positions, Alliance determines whether it is more likely than not that a tax position will be sustained upon examination on the technical merits of the position, assuming the taxing authority has full knowledge of all information. If the tax position does not meet the more likely than not recognition threshold, the benefit of that position is not recognized in the financial statements. Alliance recorded no assets or liabilities related to uncertain tax positions in 2010 and 2009. Tax returns for the years ended June 30, 2009, 2008, and 2007 remain subject to examination by the applicable taxing authorities.

Fair Value Measurements

Alliance measures fair value of its financial instruments, including assets within the defined benefit noncontributory retirement plan, using a three-tier hierarchy which prioritizes the inputs used in measuring fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

The three levels of fair value hierarchy are described below:

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

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 1 **Summary of Significant Accounting Policies (Continued)**

Fair Value Measurements (Continued)

Level 2 Inputs to the valuation methodology include:

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

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

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

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Subsequent Events

Subsequent events have been evaluated through October 26, 2010, which is the date the financial statements were issued.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 2 Reimbursement Arrangements With Third-Party Payors

Agreements are maintained with third-party payors that provide for reimbursement at amounts which vary from its established rates. A summary of the basis of reimbursement with major third-party payors follows.

Government Payors

MHSC and MAC:

Medicare - Inpatient hospital acute care services provided by MHSC are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

Outpatient, clinic, home health, and subacute care services are reimbursed primarily on a prospective payment methodology based upon a patient classification system or fixed fee schedules.

Medicaid - Inpatient and outpatient services are reimbursed primarily based upon prospectively determined rates.

MHH and MWH:

Under the CAH designation, inpatient and outpatient hospital services rendered to Medicare and Wisconsin Medicaid beneficiaries are paid based upon a cost-reimbursement methodology. Hospital services rendered to Illinois Medicaid beneficiaries are paid at prospectively determined rates based on a patient classification system.

Other Payors

Alliance has entered into payment agreements with commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges, fee schedules, and prospectively determined daily rates.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 2 Reimbursement Arrangements With Third-Party Payors (Continued)

Accounting for Contractual Arrangements

Certain Medicare and Medicaid charges are cost-based reimbursable items and are reimbursed at tentative rates, with final settlements determined after audit of the related annual cost reports. The cost reports have been audited by the Medicare and Medicaid fiscal intermediaries through June 30, 2007.

Compliance

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, particularly those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Violations of these laws and regulations by health care providers could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenue from patient services. Management believes Alliance is in substantial compliance with current laws and regulations.

The Centers for Medicare and Medicaid Services (CMS) has implemented a new project using Recovery Audit Contractors (RACs) as part of CMS's further efforts to ensure accurate payments under the Medicare program. CMS is using RACs to search for potentially inaccurate Medicare payments that may have been made to health care providers and that were not detected through existing CMS program integrity efforts. Once a RAC identifies a claim it believes is inaccurate, the RAC makes a deduction from or addition to the provider's Medicare reimbursement in an amount estimated to equal the overpayment or underpayment. The provider will then have the opportunity to appeal the adjustment before final settlement of the claim is made. As of June 30, 2010, Alliance had not been notified by the RAC of any potential significant reimbursement adjustments.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 3 Patient Accounts Receivable

Patient accounts receivable consisted of the following at June 30:

	(In Thousands)	
	2010	2009
Patient accounts receivable	\$ 151,100	\$ 156,681
Less:		
Allowance for contractual adjustments	64,287	52,091
Allowance for doubtful accounts	13,727	21,230
Patient accounts receivable - Net	\$ 73,086	\$ 83,360

Note 4 Assets Limited as to Use

Assets limited as to use, stated at fair value, are invested as follows at June 30:

	(In Thousands)	
	2010	2009
Certificates of deposit	\$ 1,278	\$ 1,183
Money market funds	28,482	11,768
Government and agency obligations	41,549	19,695
Municipal obligations	767	98
Corporate obligations	29,561	12,944
Fixed income funds	7,989	11,245
Foreign obligations	6,684	-
Equity mutual funds	73,721	33,952
Common stock	45,758	38,630
Total assets limited as to use	\$ 235,789	\$ 129,515

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 4 Assets Limited as to Use (Continued)

The composition of assets limited as to use was as follows at June 30:

	(In Thousands)	
	2010	2009
Held by trustee under bond indenture agreements:		
Debt service reserve and sinking funds	\$ 9,647	\$ 4,818
Project funds	50,640	-
Held by Treasurer of State of Wisconsin for regulatory requirements	4,024	3,868
Internally designated:		
Deferred compensation	13,004	10,371
Expansion and capital improvements	138,414	92,964
Regulatory compliance	20,060	17,494
Total assets limited as to use	\$ 235,789	\$ 129,515

Investment income, which includes investment earnings on cash equivalents and assets limited as to use, was comprised of the following:

	(In Thousands)	
	2010	2009
Interest and dividend income	\$ 2,719	\$ 3,158
Net realized gains and losses on sales of investments	4,629	(16,211)
Total investment income (loss)	7,348	(13,053)
Change in net unrealized gains and losses on investments other than trading securities	2,391	(13,262)
Totals	\$ 9,739	\$ (26,315)

Investments, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investments, it is reasonably possible that changes in the values of certain investments will occur in the near term and that such changes could materially affect the amounts reported in the consolidated financial statements.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 4 Assets Limited as to Use (Continued)

Management assesses individual investment securities as to whether declines in market value are other-than-temporary and result in an impairment. For equity securities, Alliance considers whether it has the ability and intent to hold the investment until a market price recovery. Evidence considered in this includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, the issuer's financial condition, and the general market condition in the geographic area or industry the investee operates in. For debt securities, if Alliance has made a decision to sell the security, or if it's more likely than not the Alliance will sell the security before the recovery of the security's cost basis, an other-than-temporary impairment is considered to have occurred. If Alliance has not made a decision or does not have an intent to sell the debt security, but the debt security is not expected to recover its value due to a credit loss, an other-than temporary impairment is considered to have occurred.

Because Alliance has the intent and the ability to hold investment securities until a market price recovery or maturity, investment securities at June 30, 2010 are not temporarily impaired and no impairment losses were recognized by Alliance during 2010. Alliance recognized a realized loss of \$724,000 during 2009 for an other than temporary impairment.

The following table shows unrealized losses and fair values of investments at June 30, 2010, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

Description of Securities	(In Thousands)					
	2010					
	Less Than 12 Months		12 Months or More		Total	
Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	
Government and agency obligations	\$ 10,197	\$ (144)	\$ 199	\$ (1)	\$ 10,396	\$ (145)
Municipal obligations	15	-	80	(3)	95	(3)
Corporate obligations	20,154	(454)	681	(124)	20,835	(578)
Fixed income funds	123	(2)	-	-	123	(2)
Foreign bonds	57	-	-	-	57	-
Equity mutual funds	11,260	(1,117)	52,210	(8,880)	63,470	(9,997)
Common stock	24,659	(3,375)	1,441	(141)	26,100	(3,516)
Total	\$ 66,465	\$ (5,092)	\$ 54,611	\$ (9,149)	\$ 121,076	\$ (14,241)

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 5 Fair Value Measurements

Following is a description of the valuation methodologies used for assets measured at fair value.

Money market funds and certificates of deposit are valued based at historical cost, which approximates fair value. Mutual funds are valued at quoted market prices which represent the net asset value (NAV) of shares held by Alliance at year-end. Corporate and foreign debt obligations, municipal obligations, and government and agency obligations are valued using quotes from pricing vendors based on recent trading activity and other observable market data. Common stocks are valued using quoted market prices. Common collective trusts are valued at the unit value as reported by the investment manager. The interest rate swap is valued using discounted cash flows based on observable interest yield curves and other factors.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while Alliance believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 5 Fair Value Measurements (Continued)

The following table sets forth by level, within the fair value hierarchy, Alliance's assets at fair value as of June 30, 2010 and 2009:

	(In Thousands)			
	2010			
	Level 1	Level 2	Level 3	Total
Certificates of deposit	\$ -	\$ 1,278	\$ -	\$ 1,278
Money market funds	22,835	5,647	-	28,482
Government and agency obligations	-	41,549	-	41,549
Municipal obligations	-	767	-	767
Corporate obligations	-	29,561	-	29,561
Fixed income funds	7,989	-	-	7,989
Foreign obligations	-	6,684	-	6,684
Equity mutual funds	62,764	-	10,957	73,721
Common stock	45,758	-	-	45,758
Total assets at fair value	\$ 139,346	\$ 85,486	\$ 10,957	\$ 235,789
Liability - Interest rate swap agreement	\$ -	\$ 2,633	\$ -	\$ 2,633

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 5 Fair Value Measurements (Continued)

	(In Thousands)			
	2009			
	Level 1	Level 2	Level 3	Total
Certificate of deposit	\$ -	\$ 1,183	\$ -	\$ 1,183
Money market funds	4,946	6,822	-	11,768
Government and agency obligations	-	19,695	-	19,695
Municipal obligations	-	98	-	98
Corporate obligations	-	12,944	-	12,944
Fixed income funds	11,245	-	-	11,245
Equity mutual funds	33,952	-	-	33,952
Common stock	38,630	-	-	38,630
Total assets at fair value	\$ 88,773	\$ 40,742	\$ -	\$ 129,515
Liability - Interest rate swap agreement	\$ -	\$ 2,151	\$ -	\$ 2,151

The table below sets forth a summary of the changes in the fair value of level 3 assets:

	(In Thousands) Equity Mutual Funds
	2010
Balance at beginning of year	\$ -
Purchases, sales	12,030
Earnings, expenses and change in fair value	(1,073)
Balance at end of year	\$ 10,957

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 6 Property and Equipment

Property and equipment consisted of the following at June 30, 2010 and 2009:

	(In Thousands)	
	2010	2009
Land	\$ 26,674	\$ 26,005
Land improvements	6,040	6,022
Leasehold improvements	5,605	5,596
Buildings and improvements	183,558	173,841
Fixed equipment	1,358	1,229
Major movable equipment	129,525	130,880
Total property and equipment	352,760	343,573
Less - Accumulated depreciation	180,037	168,541
Net depreciated value	172,723	175,032
Construction in progress	14,434	11,526
Property and equipment - Net	\$ 187,157	\$ 186,558

Alliance is in the process of a construction project to expand and renovate MWH. The total project is estimated to be approximately \$42,000,000. Alliance has a commitment of approximately \$31,500,000 million for a fixed price construction contract as of June 30, 2010. Construction in progress at June 30, 2010 includes approximately \$5,000,000 related to the construction project. The project is estimated to be completed in fiscal year 2013.

Alliance is also in the process of implementing an electronic medical record (EMR) system. The total project is estimated to be approximately \$6,900,000. Construction in progress at June 30, 2010 includes approximately \$1,800,000 related to the EMR project. The project is estimated to be completed in fiscal year 2012.

The remaining amounts in construction in progress relate to routine capital projects for renovating and updating Alliance's facilities.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 7 Long-Term Debt

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

	(In Thousands)	
	2010	2009
Wisconsin Health and Educational Facilities Authority Revenue Bonds, Series 2010A, dated June 9, 2010; interest payable semi-annually at varying rates (3.00% to 5.50%), principal due in annual installments through June 2026	\$ 48,445	\$ -
Wisconsin Health and Educational Facilities Authority Adjustable Rate Revenue Bonds, Series 2009, dated December 31, 2009; interest payable monthly at a variable rate set weekly (.26% at June 30, 2010), principal due in annual installments through June 2039	65,000	-
Illinois Finance Authority Revenue Bonds, Series 2005, dated March 15, 2005; interest payable monthly at a variable rate set weekly (1.00% at June 30, 2010), principal due in annual installments through February 2035	30,700	31,610
Wisconsin Health and Educational Facilities Authority Revenue Bonds, Series 1999, dated August 1, 1999; payable in annual installments including principal and varying interest (5.00% to 5.50%) through August 2025	37,810	38,000
Wisconsin Health and Educational Facilities Authority Adjustable Rate Refunding Revenue Bonds, Series 2007, dated May 18, 2007; refinanced with the Series 2010A Revenue Bonds	-	29,525

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 7 Long-Term Debt (Continued)

	(In Thousands)	
	2010	2009
Wisconsin Health and Educational Facilities Authority Revenue Bonds, Series 2003C, dated October 9, 2003; refinanced with the Series 2010A Revenue Bonds	-	17,835
Letter of credit draw to repurchase City of Harvard Health Care Facility Revenue Bonds, Series 1998	-	1,005
Other	50	99
Totals	182,005	118,074
Less:		
Unamortized bond discounts (premiums) - Net	(169)	626
Current maturities	5,694	5,866
Long-term portion	\$ 176,480	\$ 111,582

The bond indenture agreements require the creation of funds to be held by a trustee for payment of construction costs and bond principal and interest. These funds, which are not available for general purposes, are classified as assets limited as to use under bond indenture agreements. In addition, the bond agreements require maintenance of certain debt service coverage ratios, limit additional borrowings, and require compliance with various other restrictive covenants. Mercy Health System Obligated Group, which includes MAI, MAC, MHSC, and MHH, has pledged as security for long-term debt substantially all of its property, equipment, and revenue.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 7 Long-Term Debt (Continued)

In June 2010, Alliance issued its Series 2010A Revenue Bonds with a total principal value of \$48,445,000, and a net premium of \$758,000. The proceeds from the 2010A Revenue Bonds were used to refund the Series 2007 and Series 2003C bonds, establish a reserve fund, and finance costs of acquiring, constructing, renovating, and equipping its facilities. The Series 2010A Bonds were issued pursuant to a Bond Trust Indenture by and between Wisconsin Health and Educational Facilities Authorities ("WHEFA") and U.S. Bank National Association ("U.S. Bank"), as bond trustee, with the proceeds loaned to Alliance pursuant to a Loan Agreement by and between Alliance and WHEFA. The Series 2010A Bonds were also issued pursuant to a Master Trust Indenture between Alliance and U.S. Bank as Master Trustee. Alliance is liable for all obligations under the Loan Agreement.

In conjunction with the refinancing of the Series 2007 and 2003C Revenue Bonds, Alliance expensed \$760,000 of the remaining unamortized debt issue costs, which are included in non-operating income (expense) in the accompanying consolidated statements of operations and changes in net assets.

In December 2009, Alliance issued its Series 2009 Adjustable Rate Revenue Bonds with a total principal value of \$65,000,000. The proceeds from the Series 2009 Revenue Bonds were used to finance and/or reimburse Alliance for costs of acquiring, constructing, renovating, and equipping its facilities. The Series 2009 Bonds were issued pursuant to a Bond Trust Indenture by and between WHEFA and U.S. Bank, as bond trustee, with the proceeds loaned to Alliance pursuant to a Loan Agreement by and between Alliance and WHEFA. The Series 2009 Bonds were also issued pursuant to a Restated Master Trust Indenture between Alliance and U.S. Bank as Master Trustee. Alliance is liable for all obligations under the Loan Agreement.

The Illinois Finance Authority Revenue Bonds, Series 2005, and the WHEFA Series 2009 Revenue Bonds, can be tendered on a weekly basis by the bondholders. Alliance has remarketing agreements with underwriters that provide for a "best efforts" remarketing of the bonds. The bonds are secured by letters of credit. The letters of credit are secured by mortgages on Alliance's property and equipment. The letters of credit securing the Series 2005 and Series 2009 Revenue Bonds expire August 13, 2013 and December 31, 2012, respectively. Amounts drawn on the letter of credit to repurchase bonds that could not be remarketed can be converted into term loans if certain conditions are not met.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 7 Long-Term Debt (Continued)

Principal amounts on such term loans would be due in 8 quarterly installments beginning on the first quarterly date, as defined, approximately one year after the drawing date.

The City of Harvard Health Care Facility Revenue Bonds were also subject to a remarketing agreement. During the year ended June 30, 2009, the underwriter was unable to remarket the bonds and accordingly the letter of credit was drawn upon to purchase the bonds. The letter of credit draw was reimbursed by Alliance subsequent to the year ended June 30, 2009, effectively retiring the Series 1998 Revenue Bonds.

During the year ended June 30, 2009, Alliance called \$2,500,000 of the Series 2005 bonds for early redemption which approximated the amount of unexpended bond proceeds. The redemption price was equal to the principal amount and there was no prepayment penalty on the early redemption.

Scheduled payments of principal on long-term debt at June 30, 2010, including current maturities, are summarized as follows:

	(In Thousands)
2011	\$ 5,694
2012	5,746
2013	5,965
2014	6,220
2015	6,495
Thereafter	151,885
Total	<u>\$ 182,005</u>

The stated value of long-term debt approximates fair value.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 8 Interest Rate Swap

In conjunction with the issuance of the Series 2007 Revenue Bonds (Note 7), Alliance entered into an agreement with a financial institution for an interest rate swap for the purpose of hedging the variable interest rate on the bonds. The interest rate swap has a notional amount of \$29,525,000 which amortizes over the term of the agreement. The interest rate swap agreement terminates June 1, 2022. The fair value of the interest rate swap was a liability of \$2,633,000 and \$2,151,000 as of June 30, 2010 and 2009, respectively.

This interest rate swap effectively changed Alliance's interest rate exposure on the bonds to a fixed rate of 3.463% and during 2009 was deemed to be effective as a cash flow hedge. However, with the refinancing of the Series 2007 Revenue Bonds during 2010, the interest swap was deemed to be no longer effective as a cash flow hedge and was dedesignated. Alliance recognized \$482,000 of expense, included in nonoperating income (expense) in the accompanying consolidated statements of operations and change in net assets during 2010 for the change in fair value of the swap. During 2009, the change in fair value of the swap is included in other changes in net assets and decreased net assets by \$1,201,000. At the time of the dedesignation of the cash flow hedge, the accumulated loss on the swap agreement included in net assets was \$2,151,000. This cumulative loss will be amortized to expense over the remaining term of the swap agreement. Amortization expense of \$167,000 has been recognized in nonoperating income (expense) during 2010.

Alliance is exposed to credit loss in the event of nonperformance by the counterparty to the interest rate swap. However, Alliance does not anticipate nonperformance by the counterparty.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 9 Net Patient Service Revenue

The following table sets forth the detail of net patient service revenue for the years ended June 30:

	(In Thousands)	
	2010	2009
Gross patient service revenue	\$ 807,098	\$ 761,842
Revenue deductions:		
Medicare contractual allowances	(168,886)	(153,024)
Medicaid contractual allowances	(79,601)	(57,109)
Managed care allowances	(45,285)	(46,516)
Commercial and other	(132,008)	(121,491)
<u>Net patient service revenue</u>	<u>\$ 381,318</u>	<u>\$ 383,702</u>

During the years ended June 30, 2010 and 2009, approximately 35.2% and 31.4% of Alliance's net patient service revenue related to patients participants in the Medicare and Medicaid programs.

Note 10 Retirement Plans

Alliance has a defined benefit noncontributory retirement plan (the "Plan") which covers its employees who work more than 1,000 hours annually, in addition to meeting certain eligibility requirements as specified in the Plan. All assets of the Plan, principally marketable securities, are held in a separate bank-administered trust. The funding policy is to contribute amounts sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 10 Retirement Plans (Continued)

The following table provides further information about the Plan as of the Plan years ended June 30:

	(In Thousands)	
	2010	2009
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 80,711	\$ 73,828
Service cost	6,563	7,867
Interest cost	5,065	5,774
Benefits paid	(5,102)	(5,678)
Actuarial gain	8,043	(1,080)
Benefit obligation at end of year	95,280	80,711
Change in Plan assets:		
Fair value of Plan assets at beginning of year	47,563	49,066
Actual return on Plan assets	5,970	(9,508)
Employer contributions	5,624	13,683
Benefits paid	(5,102)	(5,678)
Fair value of Plan assets at end of year	54,055	47,563
Funded status	\$ (41,225)	\$ (33,148)
Accumulated benefit obligation	\$ 88,001	\$ 70,422

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 10 Retirement Plans (Continued)

Amounts recognized in the accompanying consolidated balance sheets at June 30, 2010 and 2009, consisted of:

	(In Thousands)	
	2010	2009
Current liability - Other accrued expenses	\$ 5,710	\$ 5,667
Noncurrent liability	35,515	27,481
Total	\$ 41,225	\$ 33,148
Total net assets - Unrestricted:		
Prior service cost	\$ 835	\$ 942
Net actuarial loss	29,979	22,922
Total amount recognized in net assets	\$ 30,814	\$ 23,864

Pension expense for the years ended June 30, 2010 and 2009, was comprised of the following:

	(In Thousands)	
	2010	2009
Pension expense:		
Service cost	\$ 6,563	\$ 6,294
Interest cost	5,065	4,619
Expected return on assets	(5,019)	(4,522)
Amortization of prior service cost	107	107
Amortization of unrecognized actuarial loss	35	-
Total pension expense	6,751	6,498
Other changes in Plan assets and benefit obligations recognized in other changes in net assets:		
Net actuarial loss	7,057	14,081
Prior service cost	(107)	(134)
Adjustment for measurement date change	-	1,625
Total recognized in other changes in net assets	6,950	15,572
Total recognized as pension expense and other changes in net assets	\$ 13,701	\$ 22,070

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 10 Retirement Plans (Continued)

The estimated prior service cost and actuarial loss that will be amortized from net assets into pension expense over the next fiscal year is \$987,000.

Weighted average assumptions used as of June 30, the measurement date, in developing the projected benefit obligation are as follows:

	2010	2009
Discount rate for obligation	5.30%	6.50%
Discount rate for net periodic cost	6.50%	6.50%
Expected long-term return on plan assets	8.00%	8.00%
Rate of compensation increase for obligation	4.50%	4.75%
Rate of compensation increase for net periodic cost	3.00%	4.50%

To develop the expected long-term rate of return on assets assumptions, Alliance considered the historical returns and future expectations for returns in each asset class, as well as targeted allocation percentages within the pension portfolio.

Alliance intends to provide an appropriate range of investment options that span the risk/return spectrum. The investment options allow for an investment portfolio consistent with the Plan's circumstances, goals, time horizons, and tolerance for risk.

Alliance's asset allocations are as follows at June 30:

	2010	2009
Asset category:		
Cash and cash equivalents	1.0%	10.8%
Government and agency obligations	7.2%	10.7%
Municipal obligations	0.6%	0.0%
Corporate obligations	3.3%	7.9%
Fixed income funds	21.0%	20.0%
Equity funds	37.0%	0.0%
Common stock	29.9%	50.6%
Totals	100.0%	100.0%

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 10 Retirement Plans (Continued)

The following table sets forth by level, within the fair value hierarchy, the Corporation's Plan assets at fair value as of June 30, 2010:

	(In Thousands)			
	Level 1	Level 2	Level 3	Total
Cash equivalents	\$ -	\$ 573	\$ -	\$ 573
Government and agency obligations	-	3,447	-	3,447
Municipal obligations	-	326	-	326
Corporate obligations	-	1,799	-	1,799
Fixed income funds	11,328	-	-	11,328
Foreign bonds	-	644	-	644
Equity mutual funds	17,466	-	-	17,466
Common stock	16,167	-	-	16,167
Common collective trust	-	-	2,305	2,305
Total assets at fair value	\$ 44,961	\$ 6,789	\$ 2,305	\$ 54,055

The table below sets forth a summary of changes in the fair value of the Plan's level 3 assets for the year ended June 30, 2010:

	(In Thousands)
Balance, beginning of year	\$ -
Purchases and sales - Net	2,305
Balance, end of year	\$ 2,305

Alliance expects to contribute \$6,695,000 to the plan in fiscal 2011.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 10 Retirement Plans (Continued)

Benefit payments are expected to be paid as follows:

	(In Thousands)
2010	\$ 5,710
2011	\$ 5,883
2012	\$ 6,764
2013	\$ 7,076
2014	\$ 8,005
Years 2015 through 2017	\$ 51,811

MHSC, MAC, and MHH also participate in a contributory tax-deferred annuity plan which covers all employees at least 18 years of age with one year of service. Employees may contribute up to 4% of compensation to the annuity plan on a tax-deferred basis, plus additional amounts subject to a regulatory limit. Effective January 1, 2010, MHSC, MAC, and MHH may contribute a discretionary amount up to 50% of employees' tax-deferred contribution, up to 4% of compensation. Prior to January 1, 2010, MHSC, MAC, and MHH were required to contribute 25% of employees' tax-deferred contributions and could contribute discretionary amounts up to an additional 25% of employees' contributions. MHSC, MAC, and MHH recognized expense of \$1,242,000 and \$1,251,000 related to this plan for the years ended June 30, 2010 and 2009, respectively.

MHSC also contributes to a multi-employer defined benefit plan which cover employees pursuant to the terms of collective bargaining agreements. MHSC recognized expense of \$228,000 and \$212,000 related to this plan for the years ended June 30, 2010 and 2009, respectively. MHSC also contributes to a 401(k) plan for this same group of employees an amount, based on a matching percentage of participant contributions, set by the terms of collective bargaining agreements. MHSC recognized expense of \$71,000 and \$48,000 related to the 401(k) plan for the years ended June 30, 2010 and 2009, respectively.

MHSC also sponsors deferred compensation programs covering certain physicians and officers. Investments designated for deferred compensation and corresponding liabilities totaling \$13,004,000 and \$10,371,000 at June 30, 2010 and 2009, respectively, are included in the accompanying consolidated balance sheets. Total deferred compensation expense was \$2,200,000 and \$2,429,000 in 2010 and 2009, respectively.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 11 Operating Leases

Alliance leases office space, office equipment, and certain medical equipment from unrelated organizations. Total rental expense was approximately \$3,189,000 and \$3,300,000 in 2010 and 2009, respectively.

Future minimum lease payments at June 30, 2010, by year and in the aggregate, under these operating lease agreements are summarized as follows:

	(In Thousands)
2011	\$ 1,857
2012	1,249
2013	953
2014	683
2015	136
Total minimum lease payments	<u>\$ 4,878</u>

Note 12 Malpractice Insurance

During 2005, Alliance began a self-insurance program for its professional liability on a claims-made basis. Alliance retains the first \$1,000,000 per occurrence and \$3,000,000 per year for Wisconsin claims. Coverage against losses in excess of these amounts is maintained through mandatory participation in the Patients' Compensation Fund of the State of Wisconsin. For Illinois claims, Alliance retains the first \$2,100,000 of loss per claim and has purchased an umbrella policy that provides excess coverage. Alliance has provided a reserve of \$22,300,000 and \$20,203,000 for potential claims for services provided to patients through June 30, 2010 and 2009, respectively, which have not yet been asserted. These amounts are included in other accrued expenses in the accompanying consolidated balance sheets.

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 13 Concentration of Credit Risk

Financial instruments that potentially subject Alliance to credit risk consist principally of accounts receivable and cash deposits in excess of insured limits in financial institutions.

The mix of receivables from patients and third-party payors is as follows at June 30:

	2010	2009
Medicare	22%	17%
Medicaid	12%	11%
Other third-party payors	41%	42%
Patients	25%	30%
	100%	100%

Alliance maintains depository relationships with area financial institutions, including banks participating in the Federal Deposit Insurance Corporation's (FDIC's) Transaction Account Guarantee Program. Under this Program, non-interest-bearing transaction accounts are fully guaranteed by the FDIC through December 31, 2010. Cash, investments, and assets limited as to use held by financial institutions in excess of the FDIC limit of \$250,000 are uninsured. At June 30, 2010, Alliance's deposits exceeded the insured limits by approximately \$14,981,000.

Note 14 Functional Expenses

Alliance provides general health care services to residents within its geographic location and contracts with various health care providers to provide medical services to members insured by MCIC. Expenses related to providing these services are as follows:

	(In Thousands)	
	2010	2009
Health care services	\$ 338,761	\$ 342,588
General and administrative	113,728	114,487
Total expenses	\$ 452,489	\$ 457,075

Mercy Alliance, Inc. and Affiliates

Notes to Consolidated Financial Statements

Note 15 Reclassifications

Certain reclassifications have been made to the 2009 consolidated financial statements to conform to the 2010 classifications.