CENTEGRA HEALTH SYSTEM AND AFFILIATES

Consolidated Financial Statements and Schedules

June 30, 2010 and 2009

(With Independent Auditors’ Report Thereon)

KPMG LLP
303 East Wacker Drive
Chicago, IL 60601-5212

Independent Auditors' Report

The Board of Governors
Centegra Health System:

We have audited the accompanying consolidated statements of financial position of Centegra Health System and affiliates (the Health System) as of June 30, 2010 and 2009, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Health System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit 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 Health System'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, 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 the Health System as of June 30, 2010 and 2009, and the results of their operations, changes in net assets, and cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the 2010 consolidated financial statements taken as a whole. The consolidating information included in schedules 1 and 2 is presented for purposes of additional analysis of the 2010 consolidated financial statements rather than to present the financial position, results of operations, and changes in net assets of the individual organizations. The 2010 consolidating information has been subjected to the auditing procedures applied in the audit of the 2010 consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2010 consolidated financial statements taken as a whole.

KPMG LLP

September 3, 2010

KPMG LLP is a Delaware limited liability partnership, the U.S. member firm of KPMG International Cooperative ("KPMG International"), a Swiss entity.

CENTEGRA HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Financial Position

June 30, 2010 and 2009

(In thousands)

Assets	**2010**	**2009**
Current assets:		
Cash and cash equivalents	$ 58,474	45,886
Short-term investments	17,461	14,682
Assets limited as to use – required for current liabilities	4,092	4,006
Patient accounts receivable, net of allowance for uncollectible accounts of $18,962 in 2010 and $22,581 in 2009	40,481	42,011
Other receivables	3,397	2,890
Inventories	6,612	5,943
Prepaid expenses	4,916	4,388
Total current assets	135,433	119,806
Assets limited or restricted as to use:		
Under bond indenture agreements – held by trustee	10,826	8,317
Interest in investments of charitable remainder trusts	2,001	1,585
Internally designated for capital improvements	30,322	26,654
Pledges receivable, net	280	296
	43,429	36,852
Land, buildings, and equipment, net	220,020	234,300
Long-term investments	79,182	66,066
Deferred finance charges, net	2,022	2,375
Investment in joint ventures and other assets	2,516	1,512
	$ 482,602	460,911

See accompanying notes to consolidated financial statements.

Liabilities and Net Assets		2010	2009
Current liabilities:			
Current installments of long-term debt	$	7,275	7,147
Long-term debt subject to short-term remarketing arrangements		3,507	3,677
Accounts payable		9,197	8,657
Accrued expenses		42,381	41,182
Estimated payables under third-party reimbursement programs		16,573	15,606
Total current liabilities		78,933	76,269
Long-term debt, excluding current installments and unamortized bond discount		195,609	197,704
Estimated self-insured professional and general liability claims		8,134	7,681
Derivative instruments and other		14,953	10,489
Total liabilities		297,629	292,143
Net assets:			
Unrestricted		180,528	165,699
Temporarily restricted		4,445	3,069
Total net assets		184,973	168,768
	$	482,602	460,911

CENTEGRA HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Operations

Years ended June 30, 2010 and 2009

(In thousands)

	2010	2009
Revenue:		
Net patient service revenue	$ 391,540	393,463
Unrestricted contributions	373	863
Other revenue	13,600	11,543
Net assets released from restrictions for operations	37	824
Total revenue	405,550	406,693
Expenses:		
Salaries	164,093	165,912
Employee benefits	39,571	41,093
Purchased services and other	45,587	45,253
Supplies	57,639	56,520
Utilities	4,573	5,635
Professional fees	3,512	3,000
Depreciation and amortization	22,449	22,420
Interest	9,604	9,885
Insurance	5,912	7,077
Illinois Medicaid program assessment	9,166	9,166
Repairs and maintenance	7,033	5,719
Provision for uncollectible accounts receivable	33,149	35,183
Total expenses	402,288	406,863
Income (loss) from operations	3,262	(170)
Nonoperating gains (losses):		
Loss on early extinguishment of long-term debt	—	(710)
Change in fair value of derivative instrument	(2,010)	(3,116)
Dedesignation of hedge accounting	—	(5,113)
Investment income (loss), net	8,381	(35,055)
Revenue and gains in excess (deficient) of expenses and losses	9,633	(44,164)
Other changes in unrestricted net assets:		
Net assets released from restrictions for purchase of land, buildings, and equipment	340	562
Change in fair value of derivative instruments for effective hedges	(2,453)	(3,081)
Dedesignation of hedge accounting	—	5,113
Change in net unrealized gains and losses on other-than-trading securities	7,309	14,630
Increase (decrease) in unrestricted net assets	$ 14,829	(26,940)

See accompanying notes to consolidated financial statements.

CENTEGRA HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2010 and 2009

(In thousands)

		2010	2009
Unrestricted net assets:			
Revenue and gains in excess (deficient) of expenses and losses	$	9,633	(44,164)
Net assets released from restrictions for purchase of land, buildings, and equipment		340	562
Change in fair value of derivative instruments for effective hedges		(2,453)	(3,081)
Dedesignation of hedge accounting		—	5,113
Change in net unrealized gains and losses on other-than-trading securities		7,309	14,630
Increase (decrease) in unrestricted net assets		14,829	(26,940)
Temporarily restricted net assets:			
Contributions		1,599	3,125
Changes in the fair value of charitable remainder trusts		181	19
Provision for uncollectible pledges		(27)	(2,108)
Net assets released from restrictions for purchase of land, buildings, and equipment		(340)	(562)
Net assets released from restrictions for operations		(37)	(824)
Increase (decrease) in temporarily restricted net assets		1,376	(350)
Change in net assets		16,205	(27,290)
Net assets at beginning of year		168,768	196,058
Net assets at end of year	$	184,973	168,768

See accompanying notes to consolidated financial statements.

CENTEGRA HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2010 and 2009

(In thousands)

		2010	2009
Cash flows from operating activities:			
Change in net assets	$	16,205	(27,290)
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		22,449	22,420
Amortization of deferred financing charges included in interest expense		441	495
Provision for uncollectible accounts receivable		33,149	35,183
Gain on sale of land		—	(673)
Loss on early extinguishment of long-term debt		—	710
Change in fair value of derivative instruments		4,463	6,197
Income from investment in joint ventures, net of cash distributions received		(182)	(65)
Other-than-temporary impairments		—	40,147
Changes in fair value of charitable remainder trusts		(181)	(19)
Change in net unrealized gains and losses on other-than-trading securities		(7,309)	(14,630)
Changes in assets and liabilities:			
Patient accounts receivable		(31,539)	(32,623)
Inventories, prepaid expenses, and other receivables		(1,726)	2,094
Accounts payable, accrued expenses, and other liabilities		2,193	(5,004)
Estimated payables under third-party reimbursement programs, net		967	(1,365)
Net cash provided by operating activities		38,930	25,577
Cash flows from investing activities:			
Acquisition of land, buildings, and equipment, net		(8,065)	(35,165)
Increase in short-term investments, net		(2,779)	(819)
Decrease in assets limited as to use, net		827	12,827
Decrease (increase) in long-term investments, net		(13,116)	17,549
Purchase of physician practice		(925)	—
Proceeds from sale of land		—	1,767
Net cash used in investing activities		(24,058)	(3,841)
Cash flows from financing activities:			
Repayments of long-term debt		(6,908)	(55,134)
Proceeds from issuance of long-term debt		4,712	52,925
Payments for deferred financing costs		(88)	(624)
Net cash used in financing activities		(2,284)	(2,833)
Net increase in cash and cash equivalents		12,588	18,903
Cash and cash equivalents at beginning of year		45,886	26,983
Cash and cash equivalents at end of year	$	58,474	45,886
Supplemental disclosure of cash flow information:			
Cash paid for interest, net of amounts capitalized	$	8,820	9,315
Supplemental disclosure of noncash transactions:			
Debt forgiveness	$	50	50

See accompanying notes to consolidated financial statements.

(1) Organization and Purposes

Centegra Health System (CHS), a not-for-profit corporation, was incorporated for charitable, educational, and scientific purposes to support health and human services by providing management assistance, and in all other relevant ways. The accompanying consolidated financial statements include the accounts of the CHS and the following affiliates, which it controls (collectively referred to as the Health System):

- Northern Illinois Medical Center (NIMC) and Memorial Medical Center (MMC) are both not-for-profit hospitals that provide acute care services to the Chicago Northwest suburban metropolitan area.
- Centegra Health System Foundation (Foundation) is a not-for-profit corporation that solicits funds through fund-raising campaigns and donations from the general public in support of NIMC and MMC and other Health System affiliates.
- NIMED, Corp. (NIMED) is a not-for-profit entity that owns and operates various properties and leases office facilities to physicians and other professionals affiliated with the Health System.
- Centegra Health Bridge Fitness Center, L.L.C. operates a health and wellness center and is a single-member limited liability company disregarded for federal income tax.
- Health Bridge Corporation (Health Bridge) is a not-for-profit entity that operates a health and wellness center.
- Centegra Management Services, Inc. (CMS) is a for-profit medical services organization that provides general management services to physician practices.
- Centegra Primary Care, L.L.C. (CPC) operates various group physician practices with emphasis on primary care and is a single-member limited liability company disregarded for federal income tax.
- Centegra Insurance Services, LTD (CIS) is a Class B licensed captive insurance company domiciled in the Cayman Islands. CIS provides professional and general liability insurance coverage exclusively to CHS and affiliated entities.

CHS, NIMC, and MMC are collectively referred to as the Obligated Group. The Obligated Group was formed for the purpose of issuing debt (note 9). In 2010 and 2009, the Obligated Group transferred $13,356 and $24,692, respectively, to fund the operations and capital projects of certain affiliates, including NIMED and CPC. The Obligated Group intends to continue to transfer assets to the affiliates to fund future operations as necessary.

All significant intercompany balances and transactions have been eliminated in the accompanying consolidated financial statements.

(2) Summary of Significant Accounting Policies

Significant accounting policies of the Health System, which conform to general practice within the health care industry, are as follows:

- In June 2009, the Financial Accounting Standards Board (FASB) issued an accounting standard which established the Codification to become the single source of authoritative accounting principles. The standard also provides the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are represented in conformity with U.S. generally accepted accounting principles (GAAP). All guidance contained in the Codification carries an equal level of authority. The Codification is not intended to change GAAP, but is expected to simplify accounting research by reorganizing current GAAP into specific accounting topics. The Health System adopted this accounting standard in the first quarter of 2010. The adoption of this accounting standard, which was subsequently codified in Accounting Standards Codification (ASC) Topic 105, *Generally Accepted Accounting Principles*, had no impact on the Health System's results of operations, financial position, and liquidity.

- The preparation of financial statements in accordance with GAAP 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

- The consolidated statements of operations include revenue and gains in excess (deficient) of expenses and losses. Transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenue and expenses. Transactions incidental to the provision of healthcare services are reported as gains and losses. Changes in unrestricted net assets, which are excluded from revenue and gains in excess (deficient) of expenses and losses, consistent with industry practice, include reclassifications to nonoperating gains (losses) for the previously effective portion of dedesignated hedges, net changes in unrealized gains and losses on other-than-trading securities, the effective portion of net changes in the fair value of interest rate swaps that are highly effective and are designated and qualify as hedging instruments, and contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets).

- On July 1, 2008, the Health System adopted ASC Subtopic 820-10, *Fair Value Measurements and Disclosures*, for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. ASC Subtopic 820-10 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Subtopic 820-10 also establishes a framework for measuring fair value and expands disclosures about fair value measurements. This pronouncement did not require any new fair value measurements and its adoption did not affect the results of operations or financial position of the Health System. ASC Subtopic 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value (note 7).

- Assets limited as to use include: assets set aside by the Health System's Boards of Governors for future capital improvements, over which the Boards retain control and may at their discretion use for other purposes; assets held by a trustee and limited as to use in accordance with the requirements of bond indenture agreements; the Health System's beneficiary interest under the terms of irrevocable charitable remainder trusts; and pledges receivable. Assets limited as to use required for current liabilities are reported as current assets.

- Unconditional promises to give cash or other assets are reported at fair value at the date the promise is received. Pledges to be received after one year are discounted at an appropriate rate commensurate with the risks involved. Amortization of the discount is recorded as additional contribution revenue in accordance with donor-imposed restrictions, if any, on the contributions. An allowance for doubtful pledges receivable is provided based upon the judgment of the Health System considering such factors as the creditworthiness of the donor, prior collection history, type of contribution, and nature of fund-raising activity.

- The Health System is a beneficiary under the terms of irrevocable charitable remainder trusts. Charitable remainder trusts are arrangements in which the donor establishes and funds a trust with specific distributions to be made to a designated beneficiary or beneficiaries over the trust's term. Obligations to the beneficiaries are limited to the trust's assets. Although the Health System has no control over the administration or investment of the funds held in the trusts, the fair value of the interest is recognized as an asset and direct addition to temporarily restricted net assets in the consolidated financial statements (note 6). Income from the trusts is to be utilized for scholarships, educational programs, continuing education for employees, or educational programs for the public. Investments of the trusts consist primarily of cash and cash equivalents, common stocks, and corporate bonds and notes.

  Changes in the fair value of the Health System's interest and distributions received from the trusts are recorded directly to temporarily restricted net assets. Upon termination of the trusts, the remaining assets will be distributed to a combination of the Health System and other organizations as specified in the trust agreements. The Health System may ultimately have unrestricted use of the assets it receives or the donor may place temporary restrictions on their use.

- Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in revenues and gains in excess (deficient) of expenses in the accompanying consolidated statements of operations unless the income or loss is restricted by donor or law. The change in net unrealized gains and losses on investments is excluded from revenues and gains in excess (deficient) of expenses in the accompanying consolidated statements of operations unless the investments are classified as trading securities. Management deems all securities to be other-than-trading securities. A decline in the market value of any available-for-sale security below cost that is deemed to be other-than-temporary results in a reduction in carrying amount to fair value. The impairment is included in the consolidated statements of operations as a realized loss and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, the Health System considers whether they have the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this

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assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, and forecasted performance of the investee.

- The Health System considers demand deposits with banks, cash on hand, and all highly liquid debt instruments purchased with terms of three months or less to be cash and cash equivalents, excluding those instruments classified as assets limited as to use.
- The Health System considers certificates of deposit and repurchase agreements with terms of one year or less to be short-term investments, excluding those instruments classified as assets limited as to use.
- Except as otherwise noted, the carrying value of all financial instruments of the Health System approximates their fair value.
- Land, buildings, and equipment are stated at cost, or if donated, at fair value at date of donation. Depreciation is provided over the estimated useful lives of depreciable assets and is computed on the straight-line method.
- Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated statements of financial position and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The Health System does not believe that there are any factors or circumstances indicating impairment of its property and equipment as of June 30, 2010 and 2009.
- Goodwill, which represents the excess of purchase price over identified net assets acquired, principally relates to the acquisition of a physician practice within CPC in 2010. Goodwill is amortized over the expected period to be benefited, which is 10 years. Goodwill totaling $800, net of accumulated amortization of $35, is reported in the accompanying consolidated statements of financial position within investment in joint ventures and other assets at June 30, 2010. No such goodwill existed at June 30, 2009.

  CPC's policy is to evaluate goodwill based on consideration of such factors as the occurrence of a significant adverse event or change in the environment in which CPC operates or if the expected future cash flows (undiscounted and without interest) are less than the carrying amount of the asset. An impairment loss of $227 was recorded in 2009 for goodwill from a prior acquisition and is included in depreciation and amortization expense in the accompanying 2009 consolidated statement of operations.
- All contributions are considered to be available for unrestricted use unless specifically restricted by donors. Contributions are reported as direct additions to temporarily restricted net assets if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished,

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temporarily restricted net assets are reclassified as unrestricted net assets and reported as net assets released from restriction. Temporarily restricted net assets used for operating purposes are included with net assets released from restrictions for operations to the extent expended during the period. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service. Donor-restricted contributions whose restrictions are met within the same year as received are reported directly within the consolidated statements of operations.

- Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose.
- Provisions for estimated self-insured professional and general liability, workers' compensation, and employee health care risks include estimates of the ultimate cost of both reported losses and losses incurred but not reported as of the respective consolidated statement of financial position dates.
- The Health System accounts for derivatives and hedging activities in accordance with ASC Topic 815, *Derivatives and Hedging*, as amended, which requires that all derivative instruments be recorded on the consolidated statements of financial position at their respective fair values.

For all hedging relationships, the Health System formally documents the hedging relationship and its risk management objective and strategy for undertaking the hedge, the hedging instrument, the item, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed, and a description of the method of measuring ineffectiveness. This process includes linking all derivatives that are designated as cash flow hedges to specific assets and liabilities on the consolidated statements of financial position.

The Health System also formally assesses, both at the hedge's inception and on a quarterly basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of the hedged items. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash-flow hedge are recorded as other changes in unrestricted net assets to the extent that the derivative is effective as a hedge, until earnings are affected by the variability in cash flows of the designated hedged item. The ineffective portion of the change in fair value of a derivative instrument that qualifies as a cash-flow hedge is reported as a component of interest expense in the consolidated statements of operations.

The Health System discontinues hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in the cash flows of the hedged item, the derivative expires or is sold, terminated, or exercised, or management determines that designation of the derivative as a hedging instrument is no longer appropriate. In situations in which hedge accounting is discontinued, the Health System will continue to carry the derivative at its fair value in the consolidated statements of financial position and recognize any subsequent changes in its fair value as a nonoperating gain (loss) component in the consolidated statements of operations.

Effective July 1, 2008, the Health System discontinued hedge accounting prospectively for its outstanding 2002 interest rate swap agreement as management determined that designation of the derivative as a hedging instrument was no longer appropriate given overall credit market and interest

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rate conditions. The Health System continues to carry the derivative at fair value and recognize changes in its fair value subsequent to July 1, 2008 as nonoperating gains or losses in the consolidated statements of operations. Cumulative amounts charged to unrestricted net assets for the effective portion of hedges in the amount of $5,113 as of July 1, 2008 were reclassified from unrestricted net assets to nonoperating gains (losses) in the accompanying 2009 consolidated statement of operations.

- Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Those adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.
- Deferred finance charges and unamortized bond discount are amortized using the bonds outstanding method.
- CHS, NIMC, MMC, the Foundation, NIMED, and Health Bridge are not-for-profit organizations as described in Section 501(c)(3) of the Internal Revenue Code (Code) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. A provision for income taxes has not been recorded for CMS as they have incurred operating losses during 2010 and 2009. Additionally, there are net operating losses available for carryforward, which expire at various future dates through 2024. Deferred tax assets arising primarily from net operating loss carryforwards have been offset in their entirety by a valuation allowance at both June 30, 2010 and 2009. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

  ASC Topic 740, *Income Taxes*, addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the consolidated financial statements. Under ASC Topic 740, the Health System must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the consolidated financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement. ASC Topic 740 also provides guidance on derecognition, classification, interest and penalties on income taxes, and accounting in interim periods and requires increased disclosures. At the date of adoption, and as of June 30, 2010, the Health System does not have a liability for unrecognized tax benefits. The adoption of ASC Topic 740 had no impact on the consolidated financial statements of the Health System.
- The Health System incurs expenses for the provision of health care services and related general and administrative activities.
- In connection with the preparation of the consolidated financial statements and in accordance with the recently issued ASC Topic 855, *Subsequent Events*, the Health System evaluated subsequent

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events after the balance sheet date of June 30, 2010 through September 3, 2010, which was the date the consolidated financial statements were available to be issued.

- Certain 2009 amounts have been reclassified to conform to the 2010 consolidated financial statement presentation.

Other significant accounting policies are set forth in the consolidated financial statements and in the following notes.

(3) Third-Party Reimbursement Programs

NIMC, MMC, and CPC (collectively referred to as the Providers) have agreements with third-party payors that provide for reimbursement at amounts different from their established rates. Estimated contractual adjustments arising under third-party reimbursement programs principally represent the differences between the Providers' billings at list price and the amounts reimbursed by Medicare, Blue Cross, and certain other contracted third-party payors; the difference between the Providers' billings at list price and the allocated cost of services provided to Medicaid patients; and any differences between estimated third-party reimbursement settlements for prior years and subsequent final settlements. A summary of the reimbursement methodologies with major third-party payors follows:

(a) Medicare

The Providers are paid for inpatient acute care, outpatient, rehabilitative, and home health services rendered to Medicare program beneficiaries under prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. The prospectively determined rates are not subject to retroactive adjustment. The Providers' classification of patients under the prospective payment systems and the appropriateness of the patients' admissions are subject to validation reviews.

For services rendered to Medicare beneficiaries for psychiatric services, the Providers are reimbursed based upon a combination of prospectively determined rates and cost reimbursement methodologies. For the cost reimbursement, the Providers are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Providers and audits by the Medicare fiscal intermediary. The Providers' Medicare reimbursement reports through June 30, 2007 have been audited by the Medicare fiscal intermediary.

(b) Medicaid

The Providers are paid for inpatient acute care services rendered to Medicaid program beneficiaries under prospectively determined rates-per-discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Medicaid outpatient services are reimbursed based on fee schedules. Medicaid reimbursement methodologies may be subject to periodic adjustment, as well as to changes in existing payment levels and rates, based on the amount of funding available to the State of Illinois Medicaid program and any such changes could have a significant effect on the Hospital's revenues.

(Dollar amounts in thousands)

On December 4, 2008, the State of Illinois (the State) approved an assessment program to assist in the financing of its Medicaid program for the State's fiscal years ended June 30, 2009 through June 30, 2013. Pursuant to this program, hospitals within the State are required to remit payment to the State of Illinois Medicaid program under an assessment formula approved by the Centers for Medicare & Medicaid Services (CMS). The Health System has included its annual assessment of $9,166 in the accompanying consolidated statements of operations for 2010 and 2009. The assessment program also provides hospitals within the State with additional Medicaid reimbursement based on funding formulas also approved by CMS. The Health System has included its additional annual reimbursement of $11,541 within net patient service revenue in the accompanying consolidated statements of operations for 2010 and 2009.

(c) Blue Cross

The Providers also participate as providers of health care services under reimbursement agreements with Blue Cross under its indemnity program. The provisions of the agreements stipulate that services will be reimbursed at a tentative reimbursement rate and that final reimbursement for these services is determined after the submission of an annual cost report by the Providers and a review by Blue Cross. The Blue Cross reimbursement reports for 2008 and prior years have been reviewed by Blue Cross.

(d) Other

The Providers have also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements is negotiated by the Providers and includes prospectively determined rates-per-discharge, discounts from established charges, and prospectively determined per diem rates.

A summary of the Providers' utilization percentages based upon gross patient service revenue follows:

	2010	2009
Medicare	39%	39%
Medicaid	10	10
Managed care	43	44
Patients	8	7
	100%	100%

Accruals for settlements with third-party payors are made based on estimates of amounts to be received or paid under the terms of the respective contracts and related settlement principles and regulations of the federal Medicare program, the Illinois Medicaid program, and the Blue Cross Plan of Illinois. Included in 2010 and 2009 as an addition (reduction) to net patient service revenue is $154 and $(130), respectively, related to changes in prior year third-party revenue estimates.

(Dollar amounts in thousands)

(4) Concentration of Credit Risk

The Providers grant credit without collateral to their patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors as of June 30, 2010 and 2009 follows:

	2010	2009
Medicare	26%	22%
Medicaid	12	12
Managed care	37	36
Patients	25	30
	100%	100%

(5) Charity Care

The Health System provides quality medical healthcare regardless of race, creed, sex, national origin, handicap, age, or ability to pay. Although reimbursement for services rendered is critical to the operation and stability of the Health System, it is recognized that not all individuals possess the ability to purchase essential medical services and that the Health System's mission is to serve the community with respect to providing healthcare services and healthcare education. Therefore, in keeping with the Health System's commitment to serve all members of its community, charity care, and/or subsidized care will be considered where the need and/or individual's inability to pay exists.

The following is a summary of the Health System's community service for 2010 and 2009 in terms of services to the indigent and benefits to the broader community (including the foregone charges of charity care services):

	2010	2009
Benefits for the indigent:		
Charity care	$ 18,339	12,130
Excess of cost over reimbursement for services provided to Public Aid patients (1)	13,501	10,059
Total quantifiable benefits for the indigent	31,840	22,189
Benefits for the community:		
Unpaid costs of Medicare programs	17,766	22,584
Education programs	1,067	937
Other community benefits	2,660	2,138
Total quantifiable benefits for the community	21,493	25,659
Total benefits	$ 53,333	47,848

(Dollar amounts in thousands)

(1) 2010 and 2009 amounts have been reduced to incorporate the net additional reimbursement of $2,375 received by the Health System from the Medicaid tax assessment program.

Benefits for the community include services provided to other needy populations that may not qualify as poor but that need special services and support. Examples include the elderly, substance abusers, and victims of child abuse. They also include the cost of health promotion and education, health clinics, and screenings. Examples of these programs include a group for people with life-threatening illnesses, a breast cancer support program, a bereavement support group, a support group for people (and their families) recovering from strokes, and a support group for survivors of traumatic brain injuries.

The Health System also provides a variety of educational programs designed to promote the wellness of all members of the community. Although many of these programs are offered for a low fee to help defray costs, this fee has been waived if the participant does not have the ability to pay. Programs offered include smoking cessation clinics, weight control programs, diabetic education, babysitting clinics, CPR classes, and infant and child saver classes, among other educational programs.

During 2010 and 2009, the Health System contributed 51,527 and 46,569 hours, respectively, toward the common purpose of servicing the healthcare of the community. The estimated values of these contributions in 2010 and 2009 were $485 and $426, respectively. These amounts are appropriately not reflected within the consolidated financial statements.

(6) Investments

The Health System reports investments in equity securities with readily determinable fair values and all investments in debt securities at fair value. Fair value is determined primarily on the basis of quoted market prices or other observable market inputs. A summary of the composition of the Health System’s investment portfolio at June 30, 2010 and 2009 follows:

	2010	2009
Certificates of deposit/repurchase agreements	$ 1,031	1,016
Money market funds	26,904	18,794
Mutual funds	113,948	96,153
Corporate bonds and notes	—	3,762
Interest in investments of charitable remainder trusts	2,001	1,585
	$ 143,884	121,310

(Dollar amounts in thousands)

Investments are reported in the accompanying consolidated statements of financial position as follows:

		2010	2009
Short-term investments	$	17,461	14,682
Assets limited as to use:			
Required for current liabilities		4,092	4,006
Internally designated for capital improvements		30,322	26,654
Under bond indenture agreements – held by trustee		10,826	8,317
Interest in investments of charitable remainder trusts		2,001	1,585
Long-term investments		79,182	66,066
	$	143,884	121,310

The composition of investment return from the Health System's investment portfolio for 2010 and 2009 is as follows:

		2010	2009
Interest and dividend income, net of fees and expenses	$	5,655	8,584
Realized gains (losses), net		2,831	(2,903)
Other-than-temporary impairments		—	(40,147)
Change in fair value of charitable remainder trusts		181	19
Net change in unrealized gains and losses during the holding period		7,309	14,630
	$	15,976	(19,817)

Changes in unrealized gains and losses during the holding period, excluding other-than-temporary impairments, are attributable to other-than-trading securities and, accordingly, are excluded from the determination of revenue and gains in excess (deficient) of expenses and losses. Investment returns are included in the accompanying consolidated statements of operations and changes in net assets for 2010 and 2009 as follows:

		2010	2009
Other revenue	$	105	189
Nonoperating gains (losses) – investment income (loss), net		8,381	(35,055)
Net change in net unrealized gains and losses on other-than-trading securities		7,309	14,630
Changes in fair value of charitable remainder trusts		181	19
Interest income capitalized on borrowed funds		—	400
	$	15,976	(19,817)

As of June 30, 2010, the Health System held only one investment in an unrealized loss position. The mutual fund had a cost basis of $2,970 and market value of $2,870 as of June 30, 2010. The Health System has the intent and ability to hold this investment until a market price recovery, and therefore, this investment is not considered other-than-temporarily impaired. There are no gross unrealized losses at June 30, 2009, as all such losses were considered other-than-temporary impairments and were included as realized losses within nonoperating losses.

(Dollar amounts in thousands)

(7) Fair Value Measurements

(a) Fair Value of Financial Instruments

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

- The carrying amount reported in the consolidated statements of financial position for the following approximates fair value because of the short maturities of these instruments: cash and cash equivalents, certificates of deposit/repurchase agreements, money market funds, accounts payable, accrued expenses, and estimated payables under third-party reimbursement programs.
- Short-term investments, assets limited as to use, and long-term investments: mutual funds and corporate bonds and notes are measured using quoted market prices at the reporting date multiplied by the quantity held. The carrying value equals fair value.
- Interest rate swaps: The fair value of interest rate swaps is determined using pricing models developed based on the LIBOR swap rate and other observable market data. The value was determined after considering the potential impact of collateralization and netting agreements, adjusted to reflect nonperformance risk of both the counterparty and the Health System. The carrying value equals fair value.
- Long-term debt: The fair value of fixed-rate long-term debt is estimated based on quoted market prices for the same or similar issues on the current rates offered to the Health System for debt of the same remaining maturities. For variable-rate debt, carrying amounts approximate fair value. The following table presents the carrying amounts and estimated fair values of the Health System's financial instruments.

	2010		2009	
	Carrying amount	Fair value	Carrying amount	Fair value
Long-term debt	$ 206,391	206,813	208,528	206,690

(b) Fair Value of Financial Instruments

The Health System adopted ASC Subtopic 820-10 on July 1, 2008 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. ASC Subtopic 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure 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 measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Health System has the ability to access at the measurement date.
- Level 2 are observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

(Continued)

(Dollar amounts in thousands)

The following tables present assets and liabilities that are measured at fair value on a recurring basis at June 30, 2010 and 2009:

	June 30, 2010	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Cash and cash equivalents:				
Cash	$ 58,474	58,474	—	—
Total cash and cash equivalents	58,474	58,474	—	—
Short-term investments:				
Certificates of deposit	1,031	1,031	—	—
Money market funds	8,313	8,313	—	—
Mutual funds	8,117	8,117	—	—
Total short-term investments	17,461	17,461	—	—
Assets limited as to use (including current portion):				
Money market funds	15,798	15,798	—	—
Mutual funds	29,442	29,442	—	—
Interests in investments of charitable remainder trusts	2,001	—	2,001	—
Total assets limited as to use	47,241	45,240	2,001	—
Long-term investments:				
Money market funds	2,793	2,793	—	—
Mutual funds	76,389	68,919	7,470	—
Total long-term investments	79,182	71,712	7,470	—
Total assets	$ 202,358	192,887	9,471	—
Liabilities:				
Interest rate derivatives	$ 14,881	—	14,881	—

(Continued)

(Dollar amounts in thousands)

	June 30, 2009	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Cash and cash equivalents:				
Cash	$ 45,886	45,886	—	—
Total cash and cash equivalents	45,886	45,886	—	—
Short-term investments:				
Certificates of deposit	1,016	1,016	—	—
Money market funds	4,435	4,435	—	—
Mutual funds	9,231	9,231	—	—
Total short-term investments	14,682	14,682	—	—
Assets limited as to use (including current portion):				
Money market funds	8,616	8,616	—	—
Mutual funds	26,599	26,599	—	—
Corporate bonds and notes	3,762	—	3,762	—
Interests in investments of charitable remainder trusts	1,585	—	1,585	—
Total assets limited as to use	40,562	35,215	5,347	—
Long-term investments:				
Money market funds	5,743	5,743	—	—
Mutual funds	60,323	57,632	2,691	—
Total long-term investments	66,066	63,375	2,691	—
Total assets	$ 167,196	159,158	8,038	—
Liabilities:				
Interest rate derivatives	$ 10,418	—	10,418	—

(Dollar amounts in thousands)

(8) Land, Buildings, and Equipment

A summary of land, buildings, and equipment at June 30, 2010 and 2009 follows:

		2010	2009
Land and land improvements	$	43,413	43,375
Buildings		228,637	225,682
Equipment		138,119	170,547
Construction in progress		5,085	4,660
		415,254	444,264
Less accumulated depreciation		(195,234)	(209,964)
Property and equipment, net	$	220,020	234,300

Construction in progress as of June 30, 2010 and 2009 consists of costs for various renovation projects. As of June 30, 2010, the Health System has $9,614 of contractual commitments associated with an information technology and software implementation project. Interest cost is capitalized as a component cost of significant capital projects to the extent that such interest expense exceeds interest income earned on any project specific borrowed funds. For the years ended June 30, 2010 and 2009, the Health System capitalized interest cost of $17 and $733, respectively. The Health System offset 2009 capitalized interest cost by $400 of interest income earned on unexpended project specific borrowed funds. No such offset was required in 2010.

(9) Long-Term Debt

A summary of long-term debt at June 30, 2010 and 2009 follows:

		2010	2009
NIMC:			
Variable rate revenue bonds, Series 2002, due in varying installments through 2032, with interest payable at an effective interest rate of 0.27% and 1.25% at June 30, 2010 and 2009, respectively	$	27,391	28,082
Revenue bonds, Series 1998, due in varying installments through 2024, with interest payable at varying effective tax-exempt interest rates from 4.10% to 5.50%		41,099	42,871
MMC:			
Variable rate revenue bonds, Series 2002, due in varying installments through 2032, with interest payable at an effective interest rate of 0.27% and 1.25% at June 30, 2010 and 2009, respectively		20,184	20,693

(Continued)

(Dollar amounts in thousands)

		2010	2009
Revenue bonds, Series 1998, due in varying installments through 2024, with interest payable at varying effective tax-exempt interest rates from 4.10% to 5.50%	$	23,611	24,629
CHS:			
Promissory note, due in varying installments through 2013, with interest payable at a fixed taxable rate of 4.87%		2,176	2,777
Promissory note, due in varying installments through 2021, with interest payable at a variable taxable rate of 1.15% and 1.12% as of June 30, 2010 and 2009, respectively		13,364	14,150
Revenue bonds, Series 2010, due in monthly installments, beginning July 2012 through June 2017 at a fixed rate of 3.97%		3,281	—
Revenue bonds, Series 2010, due in monthly installments beginning July 2012 through June 2017 at a fixed rate of 3.97%		1,325	—
Other		89	—
Total Obligated Group		132,520	133,202
NIMED:			
Revenue bonds, Series 2007A, due in varying quarterly installments through 2038, with interest payable at a variable tax-exempt rate of 1.31% and 1.29% as of June 30, 2010 and 2009, respectively		34,440	34,760
Revenue bonds, Series 2007B, due in varying quarterly installments through 2038, with interest payable at a variable tax-exempt rate of 1.31% and 1.29% as of June 30, 2010 and 2009, respectively		16,305	16,465
Revenue bonds, Series 2007C, due in varying quarterly installments through 2038, with interest payable at a variable taxable rate of 1.70% and 1.67% as of June 30, 2010 and 2009, respectively		3,310	3,330
Revenue bonds, Series 2003B, due in varying installments through 2028, with interest payable at fixed taxable rates of 5.03% and 5.03% in 2010 and 2009, respectively		6,956	7,164
Revenue bonds, Series 2003A, due in varying installments through 2028, with interest payable at fixed tax-exempt rates of 3.52% and 3.52% in 2010 and 2009, respectively		5,250	5,434
Other		320	474
Health Bridge:			
Special limited obligation revenue bonds, Series 2000A, due in varying installments through 2021, with interest payable at a variable tax-exempt rate of 1.39% and 1.37% at June 30, 2010 and 2009, respectively		5,474	5,816

(Dollar amounts in thousands)

		2010	2009
Promissory note, due in varying installments through 2021 with interest payable at a taxable variable rate of 1.75% and 1.72% as of June 30, 2010 and 2009, respectively	$	2,372	2,498
Total		206,947	209,143
Less:			
Current installments		7,275	7,147
Long-term debt subject to short-term remarketing arrangements		3,507	3,677
Unamortized bond discount		556	615
Long-term debt, excluding current installments and unamortized bond discount	$	195,609	197,704

The Obligated Group entered into a Master Trust Indenture dated as of March 15, 1998, which was amended as of March 1, 2002 and supplemented as of July 17, 2008. The purpose of the Master Trust Indenture is to provide a mechanism for the efficient and economical issuance of notes by individual members of the Obligated Group using the collective borrowing capacity and credit rating of the Obligated Group. The Master Trust Indenture requires members of the Obligated Group to make principal and interest payments on notes issued for their benefit as well as other Obligated Group members, if the other members are unable to make such payments.

On July 17, 2008, the Obligated Group exercised its option to convert the outstanding principal amount of the Series 2002 bonds from bearing interest at a short-term adjustable rate to bear interest at a variable rate for a weekly rate period. The bonds were subject to mandatory tender for purchase on July 17, 2008 at a price of 100% of the principal amount and the holders had no right to retain their bonds. The Health System entered into a remarketing agreement as of July 1, 2008 with an underwriter to remarket the tendered bonds. Upon conversion of the Series 2002 bonds, the original bond indenture and loan agreement was amended and restated. Under the terms of the amended and restated bond indenture and loan agreement, NIMC and MMC are required to maintain certain reserve funds and make additional deposits with a trustee for the payment of principal and interest on the converted Series 2002 bonds. The converted Series 2002 bonds are secured by a standby bond purchase agreement issued by a bank and springing mortgage and security agreements and assignments of leases and rents covering substantially all NIMC and MMC properties. Payment of principal and interest on the converted Series 2002 bonds when due is guaranteed under a municipal bond insurance policy.

On March 1, 2002, the Illinois Finance Authority issued revenue bonds, Series 2002, in the amount of $55,000 on behalf of the NIMC and MMC. The Series 2002 bonds were issued pursuant to the amended Master Trust Indenture. Principal payments were due each September 1, and interest was payable semiannually on September 1 and March 1. Under the terms of the related bond indenture, NIMC and MMC were required to maintain certain reserve funds and make additional deposits with a trustee for the payment of principal and interest on the Series 2002 bonds. The Series 2002 bonds were secured by springing mortgage and security agreements and assignments of leases and rents covering substantially all

NIMC and MMC properties. Payment of principal and interest on the Series 2002 bonds when due was guaranteed under a municipal bond insurance policy.

On March 15, 1998, the Illinois Finance Authority issued revenue bonds, Series 1998, in the amount of $88,700 on behalf of the NIMC and MMC. The Series 1998 bonds were issued pursuant to the Master Trust Indenture. Principal payments are due each September 1, and interest is payable semiannually on September 1 and March 1. Under the terms of the related bond indenture, NIMC and MMC are required to make quarterly deposits with a trustee for the payment of principal and interest on the Series 1998 bonds. The Series 1998 bonds are secured by springing mortgage and security agreements and assignments of leases and rents covering substantially all NIMC and MMC properties.

On December 30, 2008, First Midwest Bank issued a promissory note in the amount of $3,000 on behalf of CHS. The promissory note was issued pursuant to the Master Trust Indenture. Beginning in January 2009, fixed principal and interest payments are due on a monthly basis. The note is collateralized by Tomotherapy equipment.

On August 21, 2006, First Midwest Bank issued a promissory note in the amount of $14,150 on behalf of CHS. The promissory note was issued pursuant to the Master Trust Indenture. Beginning September 21, 2009, fixed principal payments of $79 are due on a monthly basis. Interest is payable monthly, beginning September 21, 2006, at a taxable variable rate based on LIBOR plus 80 basis points. The note is unsecured.

On May 1, 2010, CHS, The Illinois Finance Authority, and G.E. Government Finance, Inc. entered into a Master Financing Agreement for tax-exempt revenue bonds. The bonds were issued to acquire and implement information technology equipment and software and are secured by such property. Principal and interest payments are due monthly beginning July 2012. In consideration for deferral of principal and interest payments until July 2012, the outstanding principal amount of the obligation is being increased each month by the interest component of payments deferred.

On May 1, 2010, CHS, The County of Boone Kentucky, and G.E. Government Finance, Inc. entered into a Master Financing Agreement for tax-exempt revenue bonds. The bonds were issued to acquire and implement information technology equipment located in an offsite data center located in Boone County Kentucky and are secured by such property. Principal and interest payments are due monthly beginning July 2012. In consideration for the deferral of principal and interest payments until July 2012, the outstanding principal amount of the obligation is being increased each month by the interest component of payments deferred.

On October 1, 2007, the Upper Illinois River Valley Development Authority issued variable rate demand revenue bonds, Series 2007A and Series 2007B, and taxable revenue bonds, Series 2007C (collectively referred to as the Series 2007 bonds), in the aggregate amount of $55,000 on behalf of NIMED. The proceeds from the Series 2007 bond issuance are used for the purpose of constructing a health and wellness center as well as an ambulatory care mall. The Series 2007 bonds were issued pursuant to a Master Trust Indenture dated September 1, 2007. The purpose of the Master Trust Indenture is to provide a mechanism for the efficient and economical issuance of bonds by NIMED. Principal payments are due quarterly for the Series 2007 bonds. Interest is payable monthly at tax-exempt variable rates for the Series 2007A&B bonds and at a taxable variable rate for the Series 2007C bonds. NIMED is required to maintain certain reserve funds and make additional deposits with a trustee for the payment of principal and interest on the Series 2007 bonds. The Series 2007 bonds are further collateralized by the health and wellness center and ambulatory care mall.

(Dollar amounts in thousands)

On October 1, 2003, the City of McHenry issued revenue refunding bonds, Series 2003A&B, in the aggregate amount of $14,845 on behalf of NIMED. The Series 2003A&B bonds were issued pursuant to a separate Trust Indenture. Principal and interest are payable monthly at a tax-exempt fixed rate for the Series 2003A bonds and at a taxable fixed rate for the Series 2003B bonds. Under the terms of the related bond indenture, NIMED is required to maintain certain reserve funds and make additional deposits with a trustee for the payment of principal and interest on the Series 2003A&B bonds. The Series 2003A&B bonds are further secured by a mortgage on property with a net book value of $17,007 and $17,173 as of June 30, 2010 and 2009, respectively, assignment of rents, and security agreement.

On December 15, 2000, the City of Crystal Lake issued special limited obligation revenue bonds, Series 2000A, in the amount of $8,288 on behalf of Health Bridge. The Series 2000A bonds were issued pursuant to a financing agreement. Principal and interest is payable monthly at a tax-exempt variable rate. The Series 2000A bonds are secured by a mortgage property with a net book value of $10,145 and $10,628 as of June 30, 2010 and 2009, respectively, and security agreement.

The Obligated Group has variable rate revenue bonds that have a put option available to the creditor. If the bonds are not remarketed and the put option is exercised, the bonds are presented to the bank for purchase and become bank bonds. The series and the underlying standby bond purchase agreement terms are described as follows:

Series	Terms
Converted Series 2002 Bonds	Ten equal semiannual principal installments, the first such installment being payable on the first business day of January or July, whichever first occurs on or following the 180th day after the purchase date

(Dollar amounts in thousands)

Scheduled principal repayments on long-term debt based on the terms of the standby bond purchase agreement for the variable rate revenue bonds are as follows:

		Amount
Year:		
2011	$	10,782
2012		15,788
2013		16,949
2014		18,178
2015		18,543
Thereafter		126,707
	$	206,947

Scheduled principal repayments on the long-term debt based on the scheduled redemptions according to the Master Trust Indenture are as follows:

		Amount
Year:		
2011	$	7,275
2012		7,573
2013		8,809
2014		10,088
2015		10,503
Thereafter		162,699
	$	206,947

(10) Derivative Instruments and Hedging Activities

The Health System has interest rate related derivative instruments to manage its exposure on debt instruments. By using derivative financial instruments to hedge exposures to changes in interest rates, the Health System 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 a derivative contract is positive, the counterparty owes the Health System, which creates credit risk for the Health System. When the fair value of a derivative contract is negative, the Health System owes the counterparty, and therefore, it does not possess credit risk. The Health System minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. Health System management also mitigates risk through periodic reviews of its derivative positions in the context of their total blended cost of capital.

2002 Interest Rate Swap Agreement

In an effort to lower its overall cost of capital on the Series 2002 debt, the Health System entered into an interest rate swap agreement, which, in effect, changes the variable rate on the Series 2002 debt to a fixed rate. The notional amount under the interest rate swap agreement is reduced over the term of the agreement to match the corresponding outstanding debt ($47,575 and $48,775 at June 30, 2010 and 2009, respectively). Under the swap agreement, the Health System receives, every 35 days, 67% of one-month USD-LIBOR-BBA and makes payments at an annual fixed rate of 4.28% through September 2032.

Effective July 1, 2008, the Health System discontinued hedge accounting treatment for the 2002 interest rate swap agreement and recognizes changes in fair value of the swap as a component of nonoperating gains (losses) in the accompanying consolidated statement of operations. The effective portion of the cumulative change in fair value of the swap at July 1, 2008 of $(5,113) was reclassified from unrestricted net assets to nonoperating gains (losses). Changes in the fair value of the swap of $(2,010) and $(3,116) were recognized as a component of nonoperating gains (losses) for the years ended June 30, 2010 and 2009, respectively. The fair value of the 2002 interest rate swap agreement of $10,241 and $8,231 at June 30, 2010 and 2009, respectively, has been included with other long-term liabilities in the accompanying consolidated statements of financial position.

The differential to be paid or received under the interest rate swap agreement is recognized monthly and amounted to net payments of $96 in 2010 and $726 in 2009, which have been included in interest expense in the accompanying consolidated statements of operations.

2008 Interest Rate Swap Agreements

NIMED entered into interest rate swap agreements in May 2008 to manage fluctuations in cash flows resulting from interest rate risk on its Series 2007 debt, with a notional amount of $55,000. The notional amounts of the 2007A&B interest rate swap agreements correlate with 77% of the principal repayment amounts on the underlying Series 2007A&B debt. The notional amount of the 2007C interest rate swap agreement correlates with the principal repayment amounts on the underlying Series 2007C debt. The swap agreement changes the variable rate cash flow exposure on the Series 2007 debt to fixed cash flows. Under the terms of the interest rate swap agreements, NIMED receives, on a monthly basis, payments at one-month LIBOR. In exchange for this indexed payment received, NIMED pays, on a monthly basis, an annualized fixed rate of 4.16%. With the issuance of the Series 2007 debt, the 2008 interest rate swap agreements have been designated as cash flow hedge instruments, and accordingly, the change in fair value of the 2008 interest rate swap agreements are recognized directly to unrestricted net assets for the effective portion of the hedge.

The fair value of the Series 2008 interest rate swap agreements was a liability of $4,640 and $2,187 at June 30, 2010 and 2009, respectively, and is included as a component of other long-term liabilities in the accompanying 2010 consolidated statements of financial position. The change in fair value of the effective portion of the Series 2008 interest rate swap agreements of $2,453 and $3,081 in 2010 and 2009, respectively, has been recorded as a direct reduction to unrestricted net assets. The differential to be paid or received under the interest rate swap agreement is recognized monthly and amounted to net payments of $1,662 and $1,123 in 2010 and 2009, respectively. All of the net payments for 2010 are included in interest expense in the accompanying 2010 consolidated statement of operations. For 2009, $181 of the net payments has been included within net capitalized interest cost and the remainder of $942 included in interest expense in the accompanying 2009 consolidated statement of operations.

The Series 2008 interest rate swap agreements have been designated as hedge instruments and meet the hedging criteria. Changes in the fair value of interest rate swap agreements designated as hedging instruments that effectively offset the variability of cash flows associated with variable rate long-term debt obligations are reported as a component of other changes in unrestricted net assets. These amounts are subsequently reclassified into interest expense as a yield adjustment of the hedged interest payments in the same period in which the related interest affects earnings. Ineffective changes in fair value of the interest rate swap agreements designated as hedging instruments are reported within interest expense. No ineffectiveness was recorded in 2010 or 2009.

(11) Retirement Plans

The Health System sponsors a Savings and Retirement Plan (the Plan), which covers substantially all employees. The Plan is a defined contribution plan. The Health System, NIMC, MMC, CPC, and CMS provide discretionary contributions of up to 6%, and CPC contributes 12%, of eligible pay for employees who have completed one year of service (with a minimum of 1,000 hours each year) and reached age 21. Discretionary contributions are funded on an annual basis. Discretionary contributions to the Plan approximated $2,368 and $2,129 in 2010 and 2009, respectively, and are included within employee benefits expense. The Plan also includes a 401(k) feature, which the Health System, NIMC, MMC, Horizons, and CMS match employee contributions up to a maximum amount of 2% of employee salary, as defined in the plan document. Matching contributions for 2010 and 2009 approximated $728 and $746, respectively, and are included in employee benefits expense. Matching contributions are funded on a current basis.

The Health System also sponsors a supplemental retirement plan. Eligibility for this plan is limited to specified employees. The supplemental plan is a defined benefit plan and is not a qualified plan under Section 401 of the Code. The Health System has recognized employee benefits expense under the terms of this supplemental retirement plan in the amount of $406 and $261 for 2010 and 2009, respectively.

(Continued)

Amounts owed to specified employees under the supplemental retirement plan are included with accrued expenses.

(12) Self-Insured Risks

(a) Professional and General Liability

The Health System maintains a self-insurance program for professional and general liability coverage. The self-insurance program includes varying levels of self-insured retention and excess malpractice insurance coverage purchased from commercial insurance carriers. In connection with the self-insurance program, the Health System has engaged the services of a professional actuarial consultant to assist in the estimation of self-insurance provisions and claim liability reserves.

Provisions for estimated self-insured professional and general liability claims include estimates of the ultimate cost of both reported losses and losses incurred but not reported. The Health System has also designated attorneys to handle legal matters relating to malpractice and general liability claims. The Health System has recorded reserves of $8,134 and $7,681 for professional and general liability claims at June 30, 2010 and 2009, respectively, which are reported as estimated self-insured professional and general liability claims in the accompanying consolidated statements of financial position. The liability for estimated self-insured professional and general liability claims is undiscounted as of June 30, 2010 and 2009. The portion of the accrual for estimated self-insured professional and general liability claims expected to be paid within one year of the statements of financial position is not readily determinable, and therefore, the entire accrual is classified as a noncurrent liability. Provisions for self-insured professional and general liability claims for the years ended June 30, 2010 and 2009 amounted to $824 and $1,864, respectively, and are included with insurance expense in the accompanying consolidated statements of operations.

(b) Workers' Compensation

The Health System maintains a self-insurance program for workers' compensation coverage. This program limits the self-insured retention to $400 per claim. Coverage from commercial insurance carriers is maintained for claims in excess of the self-insured retention. Reserves for workers' compensation claims amounted to $4,356 and $3,669 for 2010 and 2009, respectively, and are included with accrued expenses in the accompanying consolidated statements of financial position. The liability for estimated self-insured workers' compensation claims is undiscounted as of June 30, 2010 and 2009. Provisions for self-insured workers' compensation for the years ended June 30, 2010 and 2009 amounted to $2,425 and $2,326, respectively, and are included with insurance expense in the accompanying consolidated statements of operations.

(c) Health Care

The Health System also has a program of self-insurance for employee health care coverage. Stop-loss reinsurance coverage is maintained for claims in excess of stop-loss limits. Undiscounted reserves for self-insured employee health care claims amounted to $3,320 and $3,571 for 2010 and 2009, respectively, and are included with accrued expenses in the accompanying consolidated statements of financial position. Provisions for self-insured employee health care claims amounted to

(Dollar amounts in thousands)

$26,621 and $28,855 for the years ended June 30, 2010 and 2009, respectively, and are included with employee benefits expense in the accompanying consolidated statements of operations.

(13) Investment in Joint Ventures

NIMED has a joint venture investment in Valley Infusion Care, L.L.C. NIMC and MMC each hold joint venture investments in ARSC Real Estate Holding, L.L.C. and Algonquin Road Surgery Center, L.L.C. These investments are accounted for using the equity method. The following is a summary of financial information as of and for the year ended June 30, 2010 relating to the joint ventures:

	Total for joint venture				Recognized by Health System		
	Assets	Equity	Revenue	Income (loss)	Ownership percentage	Carrying value	Income (loss)
Valley Infusion Care, L.L.C.	$ 661	599	2,094	(155)	30.0%	$ 180	(46)
ARSC Real Estate Holding, L.L.C.	5,400	2,563	382	146	50.0%	1,281	73
Algonquin Rd Surgery Center, L.L.C.	2,820	1,092	5,264	1,627	25.5%	223	415
	$ 8,881	4,254	7,740	1,618		$ 1,684	442

The Health System has recorded its proportional share of joint venture income of $442 and $395 for the years ended June 30, 2010 and 2009, respectively, as nonoperating investment income and other, net. The Health System provided no capital contributions during 2010 and 2009 and received capital distributions from joint ventures of $260 and $330 for the years ended June 30, 2010 and 2009, respectively.

(14) Commitments and Contingencies

(a) Line of Credit

The Health System renewed a $15,000 line of credit agreement with a financial institution, which expires on November 1, 2010. This agreement provides for variable interest based on LIBOR plus 1.25%. There were no outstanding amounts or activity on the line of credit during the years ended June 30, 2010 and 2009.

(Dollar amounts in thousands)

(b) Operating Leases

The Health System maintains operating lease agreements for certain office facilities and equipment. Rental expense recognized under these and other operating leases approximated $14,738 and $13,410 in 2010 and 2009, respectively, and is included with purchased services and other in the accompanying consolidated statements of operations. Future minimum rental payments over the remainder of operating lease terms are as follows:

		Amount
Year ending June 30:		
2011	$	6,566
2012		5,393
2013		4,373
2014		2,424
2015		1,744
Total future minimum lease payments	$	20,500

(c) Litigation

The Health System is involved in litigation arising in the normal course of business. In consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Health System's financial position or results of operations.

(d) Regulatory Investigations

The U.S. Department of Justice and other federal agencies routinely conduct regulatory investigations and compliance audits of health care providers. The Health System is subject to these regulatory efforts. Management is currently unaware of any regulatory matters, which may have a material adverse effect on the Health System's consolidated financial position or results of operations.

(e) Insurance Coverage

The Health System is commercially insured for excess workers' compensation coverage and employee health reinsurance coverage. There are no assurances that the Health System will be able to renew existing policies or procure coverage on similar terms in the future.

(f) Medicare Reimbursement

For the year ended June 30, 2010, the Health System recognized approximately $103,552 of net patient service revenue from services provided to Medicare beneficiaries. Federal legislation routinely includes provisions to change Medicare reimbursement mechanisms and reimbursement levels. Recently enacted health care reform and other Medicare legislation may have an adverse effect on the Health System's net patient service revenue.

In 2010, the Health System received notices from the Medicare program requiring that they provide Medicare with documentation for claims to carry out the Recovery Audit Contract (RAC) program. The Health System is responding to these requests. Review of claims through the RAC program may result in a liability to the Medicare program and could have an adverse impact on the Health System's net patient service revenues. No amounts have been accrued as of June 30, 2010 related to the RAC program reviews.

(g) Charity Care Legislation

The Illinois attorney general and state legislature are considering legislation directed at Illinois not-for-profit hospitals. Such legislation could mandate the level of charity care, as defined by the State, that hospitals must provide in the future in order to retain state and local tax exemption benefits. Management is unable to predict the outcome of these legislative initiatives and any related impacts such legislation may have on the Health System.

(h) Investment Risk and Uncertainties

The Health System invests in various investment securities. Investment securities are exposed to various risks such as interest rate, credit, and overall market volatility risks. Due to the level of risk associated with certain investment securities and current market conditions, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and such changes could materially affect the amounts reported in the accompanying 2010 consolidated statement of financial position.

(i) Information Technology Outsourcing Agreement

Effective August 15, 2008, the Health System entered into a master services agreement with Perot Systems Corporation to provide comprehensive information technology services. The agreement is effective for an initial 10-year period, including optional renewal provisions for two 1-year annual periods. Expense recognized in 2010 and 2009 under the terms of this agreement amounted to $9,216 and $6,697, respectively, and is included with purchased services and other expense. The total estimated costs remaining over the initial term of the project at June 30, 2010 are approximately $71,548.

CENTEGRA HEALTH SYSTEM AND AFFILIATES

Consolidating Schedule – Financial Position Information

June 30, 2010

(In thousands)

	Obligated Group				Affiliates								
Assets	**Northern Illinois Medical Center**	**Memorial Medical Center**	**Centegra Health System**	**Total**	**Centegra Health System Foundation**	**NIMED Corporation**	**Health Bridge Corporation**	**Centegra Health Bridge Fitness Center**	**Centegra Management Services, Inc.**	**Centegra Primary Care**	**Centegra Insurance Services**	**Eliminations**	**Consolidated**
Current assets:													
Cash and cash equivalents	$ 110	15	48,940	49,065	47	3,032	3,637	2	2	40	2,649	—	58,474
Short-term investments	14,761	2,700	—	17,461	—	—	—	—	—	—	—	—	17,461
Assets limited as to use – required for current liabilities	2,536	1,556	—	4,092	—	—	—	—	—	—	—	—	4,092
Patient accounts receivable, net of allowance for uncollectible accounts of $18,962	24,604	13,468	—	38,072	—	—	—	—	—	2,409	—	—	40,481
Other receivables	8	315	205	528	275	139	490	351	(94)	54	1,654	—	3,397
Due from affiliates	46,529	11,530	(54,755)	3,304	2,013	1,808	5,645	49	1,757	8	—	(14,584)	—
Inventories	4,183	2,125	—	6,308	—	—	—	—	304	—	—	—	6,612
Prepaid expenses	1,461	759	2,481	4,701	20	43	5	11	113	17	6	—	4,916
Total current assets	94,192	32,468	(3,129)	123,531	2,355	5,022	9,777	413	2,082	2,528	4,309	(14,584)	135,433
Assets limited as to use:													
Under bond indenture agreements held by trustee	2,226	1,638	4,589	8,453	—	2,373	—	—	—	—	—	—	10,826
Interest in investments of charitable remainder trust	—	—	—	—	2,001	—	—	—	—	—	—	—	2,001
Board-designated for capital requirements	21,624	8,698	—	30,322	—	—	—	—	—	—	—	—	30,322
Pledges receivable	—	—	—	—	280	—	—	—	—	—	—	—	280
	23,850	10,336	4,589	38,775	2,281	2,373	—	—	—	—	—	—	43,429
Land, buildings, and equipment, net	60,907	42,859	2,913	106,679	—	99,524	10,306	—	3,511	—	—	—	220,020
Long-term investments	44,950	11,431	11,766	68,147	3,094	471	—	—	—	—	7,470	—	79,182
Deferred finance charges, net	672	475	88	1,235	—	666	121	—	—	—	—	—	2,022
Investment in joint ventures and other	752	752	120	1,624	32	180	—	—	—	800	—	(120)	2,516
Beneficial interest in Foundation	3,644	3,875	—	7,519	—	—	—	—	—	—	—	(7,519)	—
	$ 228,967	102,196	16,347	347,510	7,762	108,236	20,204	413	5,593	3,328	11,779	(22,223)	482,602

(Continued)

Schedule 1

CENTEGRA HEALTH SYSTEM AND AFFILIATES

Consolidating Schedule – Financial Position Information

June 30, 2010

(In thousands)

Liabilities and Net Assets	**Obligated Group** Northern Illinois Medical Center	Memorial Medical Center	Centegra Health System	Total	**Affiliates** Centegra Health System Foundation	NIMED Corporation	Health Bridge Corporation	Centegra Health Bridge Fitness Center	Centegra Management Services, Inc.	Centegra Primary Care	Centegra Insurance Services	Eliminations	Consolidated
Current liabilities:													
Current installments of long-term deb	$ 2,587	1,604	1,547	5,738	—	994	543	—	—	—	—	—	7,275
Long-term debt subject to short-term remarketing arrangement	2,021	1,486	—	3,507	—	—	—	—	—	—	—	—	3,507
Accounts payable	2,851	1,964	1,133	5,948	157	1,136	745	1,089	120	2	—	—	9,197
Accrued expenses	14,657	9,840	11,448	35,945	4	479	421	388	1,913	1,579	1,652	—	42,381
Estimated payables under third-party reimbursement program	10,115	6,458	—	16,573	—	—	—	—	—	—	—	—	16,573
Due to affiliates	—	—	—	—	80	—	46	3,803	5,414	5,103	138	(14,584)	—
Total current liabilities	32,231	21,352	14,128	67,711	241	2,609	1,755	5,280	7,447	6,684	1,790	(14,584)	78,933
Long-term debt, excluding current installments and unamortized bond discount	63,529	40,502	18,689	122,720	—	65,587	7,302	—	—	—	—	—	195,609
Estimated self-insured professional and general liability claim	686	430	—	1,116	—	—	—	—	—	958	6,060	—	8,134
Derivative instruments and other	5,899	4,414	—	10,313	—	4,640	—	—	—	—	—	—	14,953
Total liabilities	102,345	66,698	32,817	201,860	241	72,836	9,057	5,280	7,447	7,642	7,850	(14,584)	297,629
Net assets (deficit):													
Unrestricted	124,862	32,814	(16,470)	141,206	3,091	35,400	11,147	(4,867)	(1,854)	(4,314)	3,929	(3,210)	180,528
Temporarily restricted	1,760	2,684	—	4,444	4,430	—	—	—	—	—	—	(4,429)	4,445
Total net assets (deficit)	126,622	35,498	(16,470)	145,650	7,521	35,400	11,147	(4,867)	(1,854)	(4,314)	3,929	(7,639)	184,973
	$ 228,967	102,196	16,347	347,510	7,762	108,236	20,204	413	5,593	3,328	11,779	(22,223)	482,602

See accompanying independent auditors' report.

Schedule 2

CENTEGRA HEALTH SYSTEM AND AFFILIATES

Consolidating Schedule – Operations and Changes in Unrestricted Net Assets Information

Year ended June 30, 2010

(In thousands)

	Obligated Group					Affiliates								
	Northern Illinois Medical Center	Memorial Medical Center	Centegra Health System	Eliminations	Total	Centegra Health System Foundation	NIMED Corporation	Health Bridge Corporation	Centegra Health Bridge Fitness Center	Centegra Management Services, Inc.	Centegra Primary Care	Centegra Insurance Services	Eliminations	Consolidated
Revenue:														
Net patient service revenue	$ 231,276	139,660	(3)	(125)	370,808	—	—	—	—	—	21,246	—	(514)	391,540
Unrestricted contributions	88	59	—	—	147	373	—	—	—	—	—	—	(147)	373
Other revenue	2,844	2,846	—	(1,939)	3,751	—	7,918	6,232	4,222	19,812	22	4,089	(32,446)	13,600
Net assets released from restrictions for operations	33	4	—	—	37	37	—	—	—	—	—	—	(37)	37
Total revenue	234,241	142,569	(3)	(2,064)	374,743	410	7,918	6,232	4,222	19,812	21,268	4,089	(33,144)	405,550
Expenses:														
Salaries	81,670	57,767	—	—	139,437	326	131	1,867	1,962	8,596	11,774	—	—	164,093
Employee benefits	19,862	14,300	2	—	34,164	81	32	388	415	2,589	1,902	—	—	39,571
Purchased services and other	26,711	17,859	35	(2,064)	42,541	215	1,250	968	3,557	5,812	19,911	241	(28,908)	45,587
Supplies	35,643	19,945	—	—	55,588	3	25	217	204	1,602	—	—	—	57,639
Utilities	1,761	1,588	7	—	3,356	—	315	333	367	175	27	—	—	4,573
Professional fees	1,852	1,660	—	—	3,512	—	—	—	—	—	—	—	—	3,512
Depreciation and amortization	11,268	6,503	—	—	17,771	—	3,008	612	—	1,024	34	—	—	22,449
Interest	4,037	2,507	—	—	6,544	—	2,932	128	—	—	—	—	—	9,604
Insurance	3,848	2,383	—	—	6,231	—	21	44	47	31	957	2,670	(4,089)	5,912
Illinois Medicaid program assessment	4,951	4,215	—	—	9,166	—	—	—	—	—	—	—	—	9,166
Repairs and maintenance	4,005	2,295	5	—	6,305	9	221	173	98	227	—	—	—	7,033
Provision for uncollectible accounts receivable	19,711	12,840	(16)	—	32,535	—	—	8	9	244	353	—	—	33,149
Total expenses	215,319	143,862	33	(2,064)	357,150	634	7,935	4,738	6,659	20,300	34,958	2,911	(32,997)	402,288
Income (loss) from operations	18,922	(1,293)	(36)	—	17,593	(224)	(17)	1,494	(2,437)	(488)	(13,690)	1,178	(147)	3,262
Nonoperating gains (losses):														
Change in fair value of derivative instrument	(1,158)	(852)	—	—	(2,010)	—	—	—	—	—	—	—	—	(2,010)
Investment income, net	5,642	1,758	774	—	8,174	192	8	6	—	—	—	1	—	8,381
Revenue and gains in excess (deficient) of expenses and losses	23,406	(387)	738	—	23,757	(32)	(9)	1,500	(2,437)	(488)	(13,690)	1,179	(147)	9,633
Other changes in unrestricted net assets:														
Net assets released from restrictions for purchase of land, buildings, and equipment	235	105	—	—	340	—	—	—	—	—	—	—	—	340
Transfers to affiliated organizations	(13,356)	—	—	—	(13,356)	—	—	—	—	—	13,356	—	—	—
Change in fair value of derivative instruments for effective hedges	—	—	—	—	—	—	(2,453)	—	—	—	—	—	—	(2,453)
Change in net unrealized gains and losses on other-than-trading securities	4,779	1,323	697	—	6,799	179	27	—	—	—	—	304	—	7,309
Increase (decrease) in unrestricted net assets	$ 15,064	1,041	1,435	—	17,540	147	(2,435)	1,500	(2,437)	(488)	(334)	1,483	(147)	14,829

See accompanying independent auditors' report.