Constantino, Mike

11-019

From: So, Jeffrey [jeffrey.so@advocatehealth.com]
Sent: Tuesday, July 19, 2011 5:13 PM
To: Constantino, Mike
Subject: Advocate Financial Information
Attachments: Advocate audited financials 12312010.pdf

Hey Mike.

Attached is the requested Advocate 2010 audited financial information to support the Ambulatory Pavilion Project. Please let me know if you have any questions or additional concerns

Thanks
Jeff

Jeff So
Director of Business Development and Community Relations
Advocate Christ Medical Center
Advocate Hope Children's Hospital
4440 W 95th Street, Oak Lawn, IL 60453
41-5763 Tie Line
708.684.5763 Office
708.684.5707 Fax
www.advocatehealth.com/christ

Inspiring medicine. Changing lives.

Consolidated Financial Statements

Advocate Health Care Network and Subsidiaries
Years Ended December 31, 2010 and 2009
With Report of Independent Auditors

Ernst & Young LLP

Ernst & Young

Advocate Health Care Network and Subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2010 and 2009

Contents

Ernst & Young LLP
155 North Wacker Drive
Chicago, IL 60606-1787
Tel: +1 312 879 2000
Fax: +1 312 879 4000
www.ey.com

Report of Independent Auditors

The Board of Directors
Advocate Health Care Network

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

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the System's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

As discussed in Note 13 to the consolidated financial statements, the System adopted authoritative guidance, which was effective as of January 1, 2010, issued by the Financial Accounting Standards Board related to accounting for not for profit mergers and acquisitions.

Ernst + Young LLP

March 9, 2011

Advocate Health Care Network and Subsidiaries

Consolidated Balance Sheets
(Dollars in Thousands)

	December 31 2010	December 31 2009
Assets		
Current assets:		
Cash and cash equivalents	$ **542,002**	$ 493,830
Short-term investments	**25,464**	22,401
Assets limited as to use	**69,604**	71,529
Patient accounts receivable, less allowances for uncollectible accounts of $129,209 in 2010 and $114,187 in 2009	**400,855**	335,377
Amounts due from primary third-party payors	**4,056**	14,029
Prepaid expenses, inventories, and other current assets	**226,943**	158,628
Collateral proceeds received under securities lending program	**218,777**	140,027
Total current assets	**1,487,701**	1,235,821
Assets limited as to use:		
Internally and externally designated investments limited as to use	**2,998,858**	2,313,569
Investments under securities lending program	**213,830**	136,760
	3,212,688	2,450,329
Other noncurrent assets	**109,766**	109,940
Interest in health care and related entities	**132,324**	88,366
Reinsurance receivable	**164,074**	170,102
Deferred costs and intangible assets, less allowances for amortization	**15,325**	31,300
	3,634,177	2,850,037
Property and equipment – at cost:		
Land and land improvements	**170,705**	156,726
Buildings	**1,971,568**	1,832,973
Movable equipment	**1,111,226**	1,030,396
Construction-in-progress	**132,544**	67,511
	3,386,043	3,087,606
Less allowances for depreciation	**1,786,886**	1,655,402
	1,599,157	1,432,204
	$ **6,721,035**	$ 5,518,062

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	December 31 2010	December 31 2009
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt	$ **17,418**	$ 26,237
Short-term borrowings	**–**	10,500
Long-term debt subject to short-term remarketing arrangements	**122,060**	132,780
Accounts payable	**166,442**	150,580
Accrued salaries and employee benefits	**305,421**	260,419
Accrued expenses	**206,874**	94,657
Amounts due to primary third-party payors	**237,731**	184,631
Current portion of accrued insurance and claims costs	**91,807**	106,636
Obligations to return collateral under securities lending program	**219,052**	140,657
Total current liabilities	**1,366,805**	1,107,097
Noncurrent liabilities:		
Long-term debt, less current portion	**901,091**	801,213
Pension plan liability	**34,296**	60,345
Accrued insurance and claims cost, less current portion	**679,317**	694,991
Accrued losses subject to reinsurance recovery	**164,074**	170,102
Obligations under swap agreements, net of collateral posted	**16,111**	57
Other noncurrent liabilities	**92,356**	86,487
	1,887,245	1,813,195
Total liabilities	**3,254,050**	2,920,292
Net assets:		
Unrestricted	**3,363,405**	2,515,483
Temporarily restricted	**74,786**	64,714
Permanently restricted	**28,794**	17,573
Total net assets	**3,466,985**	2,597,770
	$ **6,721,035**	$ 5,518,062

See accompanying notes to consolidated financial statements.

Advocate Health Care Network and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets
(Dollars in Thousands)

	Year Ended December 31	
	2010	**2009**
Unrestricted revenues, gains, and other support		
Net patient service revenue	**$ 3,885,322**	$ 3,498,389
Capitation revenue	**392,854**	425,886
Other revenue	**227,464**	207,191
	4,505,640	4,131,466
Expenses		
Salaries, wages, and employee benefits	**2,137,097**	1,951,397
Purchased services and operating supplies	**1,053,932**	961,755
Contracted medical services	**180,921**	201,026
Provision for uncollectible accounts	**212,536**	178,587
Insurance and claims costs	**46,422**	90,661
Other	**329,340**	306,012
Depreciation and amortization	**164,984**	151,369
Interest	**45,205**	36,795
	4,170,437	3,877,602
Operating income	**335,203**	253,864
Nonoperating income (loss)		
Investment income	**285,560**	351,492
Change in fair value of interest rate swaps	**(14,335)**	75,222
Fair value of net assets acquired	**225,541**	–
Loss on refinancing of debt	**(453)**	–
Other nonoperating items, net	**(17,447)**	(17,395)
	478,866	409,319
Revenues in excess of expenses	**814,069**	663,183

Advocate Health Care Network and Subsidiaries

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

(Dollars in Thousands)

	Year Ended December 31	
	2010	**2009**
Unrestricted net assets		
Revenues in excess of expenses	$ **814,069**	$ 663,183
Net assets released from restrictions and used for capital purchases	**8,716**	1,813
Postretirement benefit plan adjustments	**25,137**	82,386
Other	**–**	170
Increase in unrestricted net assets	**847,922**	747,552
Temporarily restricted net assets		
Contributions for medical education programs, capital purchases, and other purposes	**11,789**	11,649
Realized gains on investments	**1,199**	1,169
Unrealized gains on investments	**3,524**	4,758
Contribution of net assets of BroMenn Healthcare System and subsidiaries	**9,814**	–
Net assets released from restrictions and used for operations, medical education programs, capital purchases, and other purposes	**(16,254)**	(9,950)
Increase in temporarily restricted net assets	**10,072**	7,626
Permanently restricted net assets		
Contributions for medical education programs, capital purchases, and other purposes	**998**	745
Contribution of net assets of BroMenn Healthcare System and subsidiaries	**10,223**	–
Increase in permanently restricted net assets	**11,221**	745
Increase in net assets	**869,215**	755,923
Net assets at beginning of year	**2,597,770**	1,841,847
Net assets at end of year	$ **3,466,985**	$ 2,597,770

See accompanying notes to consolidated financial statements.

Advocate Health Care Network and Subsidiaries

Consolidated Statements of Cash Flows
(Dollars in Thousands)

	Year Ended December 31	
	2010	**2009**
Operating activities		
Increase in net assets	**$ 869,215**	$ 755,923
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation, amortization, and accretion	**166,077**	152,922
Provision for uncollectible accounts	**212,536**	178,587
Credit for deferred income taxes	**16,303**	(998)
(Gains) losses on disposal of property and equipment	**(1,989)**	4,729
Loss on refinancing of debt	**453**	–
Change in fair value of interest rate swaps	**14,335**	(75,222)
Postretirement benefit plan adjustments	**(25,138)**	(82,386)
Contribution of certain net assets of BroMenn Healthcare System and subsidiaries, net of $4,918 cash received	**(245,578)**	–
Restricted contributions and gains on investments, net of assets released from restrictions used for operations	**(7,538)**	(8,137)
Changes in operating assets and liabilities:		
Trading securities	**(759,060)**	(533,814)
Patient accounts receivable	**(246,997)**	(125,049)
Amounts due to/from primary third-party payors	**47,926**	87,096
Accounts payable, accrued salaries and employee benefits, accrued expenses, and other noncurrent liabilities	**149,081**	(50,063)
Other assets	**(54,340)**	1,672
Accrued insurance and claims cost	**(39,384)**	2,366
Net cash provided by operating activities	**95,902**	307,626
Investing activities		
Purchases of property and equipment	**(178,656)**	(161,609)
Proceeds from sale of property and equipment	**6,929**	487
Purchase of certain net assets of Midwest Physician Group	**–**	(14,833)
Cash acquired in the acquisition of BroMenn Healthcare System and subsidiaries	**4,918**	–
Purchases of investments designated as nontrading	**(96,976)**	(58,637)
Sales of investments designated as nontrading	**130,414**	117,068
Other	**(6,089)**	(49,043)
Net cash used in investing activities	**(139,460)**	(166,567)
Financing activities		
Proceeds from issuance of debt	**243,746**	10,500
Payments of long-term debt	**(173,456)**	(20,840)
Collateral returned under swap agreements	**3,930**	37,593
Proceeds from restricted contributions and gains on investments	**17,510**	18,321
Net cash provided by financing activities	**91,730**	45,574
Increase in cash and cash equivalents	**48,172**	186,633
Cash and cash equivalents at beginning of year	**493,830**	307,197
Cash and cash equivalents at end of year	**$ 542,002**	$ 493,830

See accompanying notes to consolidated financial statements.

1. Organization and Summary of Significant Accounting Policies

Organization

Advocate Health Care Network (the System or Advocate) is a nonprofit, faith-based, health care organization dedicated to providing comprehensive health care services, including inpatient acute and nonacute care, primary and specialty physician services and various outpatient services to communities in northern and central Illinois. Additionally, through a long-term academic and teaching affiliation, Advocate trains resident physicians. Advocate is affiliated with the United Church of Christ and Evangelical Lutheran Church of America. Substantially all expenses of the System are related to providing health care services.

Effective January 6, 2010 the net assets of BroMenn Healthcare System and subsidiaries (collectively, BroMenn) were merged into the System. BroMenn, a not-for-profit organization, is located in the greater Bloomington-Normal and Eureka, Illinois, areas. The transaction was accounted for as an acquisition in accordance with the authoritative guidance on not-for-profit mergers and acquisitions and is described in Note 13.

Mission and Community Benefit

As a faith-based, health care organization, the mission, values and philosophy of the System form the foundation for its strategic priorities. The System's mission is to serve the health care needs of individuals, families and communities through a holistic philosophy rooted in the fundamental understanding of human beings as created in the image of God. The System's core values of compassion, equality, excellence, partnership and stewardship guide its actions to provide health care services to its communities. Consistent with the values of compassion and stewardship, the System makes a major commitment to patients in need, regardless of their ability to pay. This care is provided to patients who meet the criteria established under the System's charity care policy. Patients eligible for consideration can earn up to 600% of the federal poverty level. Qualifying patients can receive up to 100% discounts from charges and extended payment plans. In 2010 and 2009, $234,295 and $191,731, respectively, of patient charges were foregone under this policy.

1. Organization and Summary of Significant Accounting Policies (continued)

The System is also involved in other numerous wide-ranging community benefit activities that include providing health education, immunizations for children, support groups, health screenings, health fairs, pastoral care, home-delivered meals, transportation services, seminars and speakers, crisis lines, publication of health magazines, medical residency and internships, research and language assistance and other subsidized health services. These activities are provided free of charge or at a fee that is below the cost of providing them. The cost of these activities and the costs of uncompensated care for 2010 will be included in a community benefit report that will be filed with the Office of the Attorney General for the State of Illinois in June 2011.

Principles of Consolidation

Included in the System's consolidated financial statements are all of its wholly owned or controlled subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities and amounts disclosed in the notes to the consolidated financial statements at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Although estimates are considered to be fairly stated at the time made, actual results could differ materially from those estimates.

Cash Equivalents

The System considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Inventories

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

1. Organization and Summary of Significant Accounting Policies (continued)

Investments

Advocate has designated substantially all of its investments as trading. Certain debt-related investments are designated as nontrading. Investments in debt and equity securities with readily determinable fair values are measured at fair value using quoted market prices. Investments in limited partnerships that invest in marketable securities and derivative products (hedge funds) are reported using the equity method of accounting based on information provided by the respective partnership. Investments in private equity limited partnerships are recorded using the cost method of accounting, as Advocate's ownership percentage is less than 5% and Advocate has no significant influence over the partnerships. Investment income or loss (including realized gains and losses, interest, dividends, changes in equity of limited partnerships and unrealized gains and losses) is included in investment income unless the income or loss is restricted by donor or law or is related to assets designated for self-insurance programs. Investment income on self-insurance trust funds is reported in other revenue. Unrealized gains and losses that are restricted by donor or law are reported as a change in temporarily restricted net assets.

Assets Limited as to Use

Assets limited as to use consist of investments set aside by the Board of Directors for future capital improvements and certain medical education and health care programs. The Board of Directors retains control of these investments and may, at its discretion, subsequently use them for other purposes. Additionally, assets limited as to use include investments held by trustees under debt agreements and self-insurance trusts.

Patient Accounts Receivable

Patient accounts receivable are stated at net realizable value. The System evaluates the collectibility of its accounts receivable based on the length of time the receivable is outstanding, payor class, historical collection experience and trends in health care insurance programs. Accounts receivable are charged to the allowance for uncollectible accounts when they are deemed uncollectible.

1. Organization and Summary of Significant Accounting Policies (continued)

Reinsurance Receivable

Reinsurance receivables are recognized in a manner consistent with the liabilities relating to the underlying reinsured contracts.

Deferred Costs

Deferred costs consist primarily of noncurrent deferred tax assets and deferred bond issuance costs. Deferred bond issuance costs are amortized over the life of the bonds using the effective interest method.

Asset Impairment

The System considers whether indicators of impairment are present and performs the necessary tests to determine if the carrying value of an asset is appropriate. Impairment write-downs, except for those related to investments, are recognized in operating income at the time the impairment is identified.

Property and Equipment

Provisions for depreciation of property and equipment are based on the estimated useful lives of the assets ranging from three to eighty years using both accelerated and straight-line methods.

Asset Retirement Obligations

The System recognizes its legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development or the normal operations of long-lived assets when these obligations are incurred. The obligations are recorded as a noncurrent liability and are accreted to present value at the end of each period. When the obligation is incurred, an amount equal to the present value of the liability is added to the cost of the related asset and is depreciated over the life of the related asset. The obligations at December 31, 2010 and 2009 were $19,320 and $18,934, respectively.

1. Organization and Summary of Significant Accounting Policies (continued)

Derivative Financial Instruments

The System has entered into derivative transactions to manage its interest rate risk. Derivative instruments are recorded as either assets or liabilities at fair value. Subsequent changes in a derivative's fair value are recognized currently in nonoperating income (loss).

General and Professional Liability Risks

The provision for self-insured general and professional liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those assets whose use by the System has been limited by donors to a specific time period or purpose. Permanently restricted net assets consist of gifts with corpus values that have been restricted by donors to be maintained in perpetuity. Temporarily restricted net assets and earnings on permanently restricted net assets are used in accordance with the donor's wishes primarily to purchase property and equipment or to fund medical education or other health care programs.

Assets released from restriction to fund purchases of property and equipment are reported in the consolidated statements of operations and changes in net assets as increases to unrestricted net assets. Those assets released from restriction for operating purposes are reported in the consolidated statements of operations and changes in net assets as other revenue. When restricted, earnings are recorded as temporarily restricted net assets until amounts are expended in accordance with the donor's specifications.

Patient Service Revenue

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated adjustments under reimbursement agreements with third-party payors, certain of which are subject to audit by administering agencies. These adjustments are accrued on an estimated basis and are adjusted as needed in future periods.

1. Organization and Summary of Significant Accounting Policies (continued)

Capitation Revenue

The System has agreements with various managed care organizations under which the System provides or arranges for medical care to members of the organizations in return for a monthly payment per member. Revenue is earned each month as a result of agreeing to provide or arrange for their medical care.

Other Nonoperating Items, Net

Other nonoperating items, net primarily consist of provisions for environmental remediation, contributions to charitable organizations and income taxes.

Revenues in Excess of Expenses and Changes in Net Assets

The consolidated statements of operations and changes in net assets include revenues in excess of expenses as the performance indicator. Changes in unrestricted net assets, which are excluded from revenues in excess of expenses, primarily include 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) and postretirement benefit adjustments.

New Accounting Pronouncements

On January 1, 2010, the System adopted the authoritative guidance issued by the Financial Accounting Standards Board (FASB) on not-for-profit mergers and acquisitions. This guidance did not have a material impact on the manner in which the System has historically fair valued assets acquired and liabilities assumed as a result of business combinations. The guidance requires that the net fair value of assets acquired and liabilities assumed be reported as a component of revenues in excess of expenses in the consolidated statement of operations and changes in net assets.

1. Organization and Summary of Significant Accounting Policies (continued)

On January 1, 2010, the System adopted the authoritative guidance issued by FASB to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance and settlements of assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance was effective for the System January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which will become effective for the System January 1, 2011. Other than requiring additional disclosures, adoption of this new guidance did not have a material impact on the System's consolidated financial statements.

Recent Accounting Guidance Not Yet Adopted

In August 2010, the FASB issued guidance requiring that cost be used as the measurement basis for charity care disclosure purposes. The method used to identify the direct and indirect costs of providing the charity care must be disclosed. The guidance is effective for the System with the reporting period beginning January 1, 2011. Other than requiring additional disclosures, adoption of this new guidance will not have a material impact on the System's consolidated financial statements.

In August 2010, the FASB issued guidance clarifying that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. The guidance will become effective for the System with the reporting period beginning January 1, 2011. Adoption of this guidance will not have a material impact on the System's consolidated financial statements.

2. Contractual Arrangements With Third-Party Payors

The System provides care to certain patients under payment arrangements with Medicare, Medicaid, Health Care Service Corporation, d/b/a Blue Cross and Blue Shield of Illinois (Blue Cross) and various other health maintenance and preferred provider organizations. Services provided under these arrangements are paid at predetermined rates and/or reimbursable costs, as defined. Reported costs and/or services provided under certain of the arrangements are subject to audit by the administering agencies. Changes in Medicare and Medicaid programs and reduction of funding levels could have a material adverse effect on the future amounts recognized as patient service revenue.

Amounts received under the above payment arrangements accounted for 91% and 92% of the System's net patient service revenue in 2010 and 2009, respectively. For the years ended December 31, 2010 and 2009, 29% of net patient service revenue was under contracts with Blue Cross, 11% was earned from the Medicaid program, and 26% was earned from the Medicare program. Provision has been made in the consolidated financial statements for contractual adjustments, representing the difference between the established charges for services and actual or estimated payment. The extreme complexity of laws and regulations governing the Medicare and Medicaid programs renders at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Changes in the estimates that relate to prior years' third-party payment arrangements resulted in increases in net patient service revenue of $17,758 and $13,889 for the years ended December 31, 2010 and 2009, respectively.

The System's concentration of credit risk related to accounts receivable is limited due to the diversity of patients and payors. The System grants credit, without collateral, to its patients, most of whom are local residents and insured under third-party payor arrangements. Advocate has established guidelines for placing patient balances with collection agencies, subject to terms of certain restrictions on collection efforts as determined by the System. Amounts due to/from primary third-party payors in the consolidated balance sheets primarily relate to the Blue Cross, Medicare or Medicaid programs. At December 31, 2010 and 2009, 18% and 20% of patient accounts receivable, respectively, were due under contracts with Blue Cross, 13% and 12%, respectively, were due from the Medicaid program, and 12% was due from the Medicare program for both 2010 and 2009.

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

Provision has been made in the consolidated financial statements for the estimated cost of providing certain medical services under capitated arrangements with managed care organizations. The System accrues a liability for reported, as well as an estimate for incurred but not recorded (IBNR), contracted medical services. The liability represents the expected ultimate cost of all reported and unreported claims unpaid at year-end. The System uses the services of a consulting actuary to determine the estimated cost of the IBNR claims. Adjustments to the estimates are reflected in current year operations. At December 31, 2010 and 2009, the liabilities for unpaid medical claims amounted to $23,552 and $24,854, respectively, and are included in accrued expenses in the consolidated balance sheets.

In June 1998, and as subsequently amended, the System entered into a capitated physician provider agreement with Humana Health Plan, Inc. and Humana Insurance Company and their affiliates (collectively, Humana), which is scheduled to terminate effective December 31, 2011. Capitation revenues received under this agreement and similar agreements with Humana amounted to 37% and 40% of the System's capitation revenue for the years ended December 31, 2010 and 2009, respectively. The System's other significant physician provider agreements are with Healthspring, Inc. and Wellcare Health Plans, Inc., which are scheduled to terminate December 31, 2011. Capitation revenues received under these agreements amounted to 27% and 26% of the System's capitation revenue for the years ended 2010 and 2009, respectively.

The System participates in the State of Illinois' Hospital Assessment Program, in which the System recognized $147,781 and $138,353 of Illinois hospital assessment revenue in net patient service revenue and $106,274 and $100,585 of expense in other expense in 2010 and 2009, respectively.

(Dollars in Thousands)

3. Cash and Cash Equivalents and Investments (Including Assets Limited as to Use)

Investments (including assets limited as to use) and other financial instruments at December 31 are summarized as follows:

	2010	2009
Assets limited as to use:		
Designated for self-insurance programs	**$ 888,753**	$ 804,642
Internally and externally designated for capital improvements, medical education and health care programs	**2,139,891**	1,539,801
Externally designated under debt agreements	**39,818**	40,655
Investments under securities lending program	**213,830**	136,760
	3,282,292	2,521,858
Other financial instruments:		
Cash and cash equivalents and short-term investments	**567,466**	516,231
	$ 3,849,758	$ 3,038,089

Investments in debt and equity securities with readily determinable fair values are measured at fair value using quoted market prices. Investments in limited partnerships that invest in marketable securities and derivative products (hedge funds) are reported using the equity method of accounting based on information provided by the respective partnership. Investments in private equity limited partnerships are reported using the cost method of accounting. The composition and carrying value of assets limited as to use, short-term investments and cash and cash equivalents at December 31 is set forth in the following table:

	2010	2009
Cash and short-term investments	**$ 709,469**	$ 586,948
Corporate bonds and other debt securities	**160,117**	144,403
United States government obligations	**115,720**	93,832
Government mutual funds	**119,446**	109,576
Bond and other debt security mutual funds	**912,584**	886,408
Commodity mutual funds	**3,770**	914
Hedge funds	**294,002**	121,789
Private equity limited partnership funds	**163,376**	118,779
Equity securities	**948,189**	418,073
Equity mutual funds	**423,085**	557,367
	$ 3,849,758	$ 3,038,089

(Dollars in Thousands)

3. Cash and Cash Equivalents and Investments (Including Assets Limited as to Use) (continued)

The System regularly compares the net asset value (NAV), which is a proxy for the fair value of its private equity investments, to the recorded cost for potential other than temporary impairment. The System did not identify any impairment of these investments in 2010 or 2009. The NAV of these investments based on estimates determined by the investments' management was $173,496 and $108,863 at December 31, 2010 and 2009, respectively.

At December 31, 2010 and 2009, the System has commitments to fund an additional $122,184 and $102,060, respectively. The unfunded commitments at December 31, 2010 are expected to be funded over the next six years.

Investment returns for assets limited as to use, cash and cash equivalents and short-term investments comprise the following for the years ended December 31:

	2010	2009
Interest and dividend income	$ **79,511**	$ 112,982
Net realized gains (losses)	**89,063**	(23,323)
Net unrealized gains	**182,750**	323,303
	$ **351,324**	$ 412,962

Investment returns are included in the consolidated statements of operations and changes in net assets for the years ended December 31 as follows:

	2010	2009
Other revenue	$ **61,041**	$ 55,543
Investment income	**285,560**	351,492
Realized and unrealized gains on investments – temporarily restricted net assets	**4,723**	5,927
	$ **351,324**	$ 412,962

3. Cash and Cash Equivalents and Investments (Including Assets Limited as to Use) (continued)

As part of the management of the investment portfolio, the System has entered into an arrangement whereby securities owned by the System are loaned primarily to brokers and investment bankers. The loans are arranged through a bank. Borrowers are required to post collateral in the form of United States Treasury securities for securities borrowed equal to approximately 102% of the value of the security on a daily basis at a minimum. The bank is responsible for reviewing the creditworthiness of the borrowers. The System has also entered into an arrangement whereby the bank is responsible for the risk of borrower bankruptcy and default. At December 31, 2010 and 2009, the System loaned approximately $213,830 and $136,760, respectively, in securities and accepted collateral for these loans in the amount of $219,052 and $140,657, respectively, of which $218,777 and $140,027, respectively, represents cash collateral and is included in current assets and current liabilities in the accompanying consolidated balance sheets.

4. Fair Value Measurements

The System accounts for certain assets and liabilities at fair value. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in active markets. The System categorizes each of its fair value measurements in one of the three levels based on the highest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1: Quoted prices in active markets for identified assets or liabilities.

Level 2: Inputs, other than the quoted process in active markets, that are observable either directly or indirectly.

Level 3: Unobservable inputs in which there is little or no market data, which then requires the reporting entity to develop its own assumptions about what market participants would use in pricing the asset or liability.

4. Fair Value Measurements (continued)

The following section describes the valuation methodologies the System uses to measure financial assets and liabilities at fair value. In general, where applicable, the System uses quoted prices in active markets for identical assets and liabilities to determine fair value. This pricing methodology applies to Level 1 investments such as domestic and international equities, United States Treasuries, exchange-traded mutual funds and agency securities. If quoted prices in active markets for identical assets and liabilities are not available to determine fair value, then quoted prices for similar assets and liabilities or inputs other than quoted prices that are observable either directly or indirectly are used. These investments are included in Level 2 and consist primarily of corporate notes and bonds, foreign government bonds, mortgage-backed securities, commercial paper and certain agency securities. The fair value for the obligations under swap agreements included in Level 2 is estimated using industry standard valuation models. These models project future cash flows and discount the future amounts to a present value using market-based observable inputs, including interest rate curves. The fair values of the obligation under swap agreements include fair value adjustments related to the System's credit risk.

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

(Dollars in Thousands)

4. Fair Value Measurements (continued)

The following are assets and liabilities measured at fair value on a recurring basis at December 31, 2010 and 2009:

		Fair Value Measurements at Reporting Date Using		
Description	**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 short-term investments	$ 709,469	$ 607,254	$ 102,215	$ –
Corporate bonds and other debt securities	160,117	–	160,117	–
United States government obligations	115,720	–	115,720	–
Government mutual funds	119,446	–	119,446	–
Bond and other debt security mutual funds	912,584	2,079	910,505	–
Commodity mutual funds	3,770	–	3,770	–
Equity securities	948,189	948,189	–	–
Equity mutual funds	423,085	367,212	55,873	–
Investments at fair value	3,392,380	$ 1,924,734	$ 1,467,646	$ –
Investments not at fair value	457,378			
Total investments	$ 3,849,758			
Collateral proceeds received under securities lending program	$ 218,777		$ 218,777	
Liabilities				
Obligations under swap agreements	$ (44,080)	$ –	$ (44,080)	$ –
Collateral under swap agreements	27,969	–	27,969	–
Liability under swap agreements	$ (16,111)	$ –	$ (16,111)	$ –
Obligations to return collateral under securities lending program	$ (219,052)	$ –	$ (219,052)	$ –

(Dollars in Thousands)

4. Fair Value Measurements (continued)

		Fair Value Measurements at Reporting Date Using		
Description	**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 short-term investments	$ 586,948	$ 539,109	$ 47,839	$ –
Corporate bonds and other debt securities	144,403	–	144,403	–
United States government obligations	93,832	–	93,832	–
Government mutual funds	109,576	–	109,576	–
Bond and other debt security mutual funds	886,408	135,242	751,166	–
Commodity mutual funds	914	–	914	–
Equity securities	418,073	418,073	–	–
Equity mutual funds	557,367	415,221	142,146	–
Investments at fair value	2,797,521	$ 1,507,645	$ 1,289,876	$ –
Investments not at fair value	240,568			
Total investments	$ 3,038,089			
Collateral proceeds received under securities lending program	$ 140,027		$ 140,027	
Liabilities				
Obligations under swap agreements	$ (31,956)	$ –	$ (31,956)	$ –
Collateral under swap agreements	31,899	–	31,899	–
Liability under swap agreements	$ (57)	$ –	$ (57)	$ –
Obligations to return collateral under securities lending program	$ (140,657)	$ –	$ (140,657)	$ –

4. Fair Value Measurements (continued)

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

The estimated fair value of long-term debt based on quoted market prices for the same or similar issues was $1,060,842 and $986,921 at December 31, 2010 and 2009, respectively, which included a consideration of third-party credit enhancements, of which there was no impact.

5. Interest in Health Care and Related Entities

During 2000, in connection with the acquisition of a medical center, the System acquired an interest in the net assets of the Masonic Family Health Foundation (the Foundation), an independent organization, under the terms of an asset purchase agreement (the Agreement). The use of substantially all of the Foundation's net assets is designated to support the operations and/or capital needs of one of the System's medical facilities. Additionally, 90% of the Foundation's investment yield, net of expenses, on substantially all of the Foundation's investments is designated for the support of one of the System's medical facilities. The Foundation must pay the System, annually, 90% of the investment yield or an agreed-upon percentage of the beginning of the year net assets.

The interest in the net assets of this organization amounted to $82,927 and $77,559 as of December 31, 2010 and 2009, respectively, and is reflected in interest in health care and related entities in the accompanying consolidated balance sheets. The System's interest in the investment yield is reflected in the accompanying consolidated statements of operations and changes in net assets and amounted to $8,460 and $14,965 for the years ended December 31, 2010 and 2009, respectively. Cash distributions received by the System from the Foundation under terms of the Agreement amounted to $2,691 and $3,860 during the years ended December 31, 2010 and 2009, respectively. In addition to the amounts distributed under the Agreement, the Foundation contributed $376 and $477 to the System for program support of one of its medical facilities during the years ended December 31, 2010 and 2009, respectively.

(Dollars in Thousands)

5. Interest in Health Care and Related Entities (continued)

The System has a 50% membership and governance interest in Advocate Health Partners (dba Advocate Physician Partners) (APP), which has been accounted for on an equity basis. The System's carrying value in this interest was $0 at December 31, 2010 and 2009. Financial information relating to this interest is as follows:

	2010	2009
Assets	**$ 130,785**	$ 109,741
Liabilities	**129,394**	109,688
Revenues in excess of expenses	**–**	–

The System contracts with APP for certain operational and administrative services. Total expenses incurred for these services were $16,010 and $12,982 in 2010 and 2009, respectively. At December 31, 2010 and 2009, the System had an accrued liability to APP for those services for $836 and $1,736, respectively.

APP purchased claims processing and certain management services from the System in the amounts of $8,071 and $8,207 in 2010 and 2009, respectively. Under terms of an agreement with the System, APP reimburses the System for salaries, benefits and other expenses that are incurred by the System on APP's behalf. The amount billed for these services in 2010 and 2009 was $13,948 and $11,262, respectively. The System had a receivable from APP at December 31, 2010 and 2009, for claims processing and management services of $3,139 and $1,950, respectively.

(Dollars in Thousands)

6. Long-Term Debt

Long-term debt, net of unamortized original issue discount or premium consisted of the following at December 31:

	2010	2009
Revenue bonds and revenue refunding bonds, Illinois Finance Authority Series:		
1993C, 6.0% to 7.0%, principal payable in varying annual installments through April 2018	**$ 24,805**	$ 25,010
1998A, 5.20%, principal payable in varying annual installments through August 2022	**4,667**	7,721
1998B, 4.60% to 5.25%, principal payable in varying annual installments through August 2018	**11,821**	23,167
2000, 6.00%, principal payable in varying annual installments through November 2022; refunded in full during 2010	**–**	3,289
2003A (weighted-average rate of 4.38% and 3.13% during 2010 and 2009, respectively), principal payable in varying annual installments through November 2022; interest based on prevailing market conditions at time of remarketing	**28,405**	30,475
2003C (weighted-average rate of 0.46% and 1.02% during 2010 and 2009, respectively), principal payable in varying annual installments through November 2022; interest based on prevailing market conditions at time of remarketing	**27,695**	30,495
2008A (weighted-average rate of 1.61% and 1.65% during 2010 and 2009, respectively), principal payable in varying annual installments through November 2030; interest based on prevailing market conditions at time of remarketing	**145,510**	153,430
2008B (weighted-average rate of 0.22% and 0.34% during 2010 and 2009, respectively), principal payable in varying annual installments through November 2020; interest based on prevailing market conditions at time of remarketing; refunded in full during 2010	**–**	121,150

(Dollars in Thousands)

6. Long-Term Debt (continued)

	2010	2009
Revenue bonds and revenue refunding bonds, Illinois Finance Authority Series (continued):		
2008C (weighted-average rate of 0.51% and 0.92% during 2010 and 2009, respectively), principal payable in varying annual installments through November 2038; interest based on prevailing market conditions at time of remarketing	$ 343,270	$ 348,300
2008D, 4.00% to 6.50%, principal payable in varying annual installments through November 2038	167,755	171,411
2010A, 5.50%, principal payable in varying annual installments through April 2044	37,307	–
2010B, 5.38%, principal payable in varying annual installments through April 2044	52,173	–
2010C, 5.38%, principal payable in varying annual installments through April 2044	25,526	–
2010D, 2.00% to 5.25%, principal payable in varying annual installments through April 2038	128,143	–
Capital lease obligations	31,552	32,051
Other	11,940	13,731
	1,040,569	960,230
Less current portion of long-term debt	17,418	26,237
Less long-term debt subject to short-term remarketing arrangements	122,060	132,780
	$ 901,091	$ 801,213

Maturities of long-term debt, capital leases and sinking fund requirements, assuming remarketing of the variable rate demand revenue refunding bonds, for the five years ending December 31, 2015 are as follows: 2011 – $17,418, 2012 – $22,440, 2013 – $18,766, 2014 – $18,602, and 2015 – $20,825.

The System's unsecured variable rate revenue bonds, Series 2003C of $27,695 and Series 2008 (A-1 and A-2) of $94,365, while subject to a long-term amortization period, may be put to the System at the option of the bondholders in connection with certain remarketing dates. To the extent that bondholders may, under the terms of the debt, put their bonds within 12 months after December 31, 2010, the principal amount of such bonds has been classified as a current obligation in the accompanying consolidated balance sheets. To address the possibility that a material amount of these bonds would be put back to the System, steps have been taken to provide various sources of liquidity in such event, including maintaining unrestricted assets as a source of self-liquidity.

6. Long-Term Debt (continued)

All outstanding bonds were issued pursuant to a Master Trust Indenture dated as of December 1, 1996 (the Master Indenture), as subsequently amended, between the System and Bank of New York Mellon as master trustee. Under the terms of the Master Indenture and other arrangements, various amounts are to be on deposit with trustees, and certain specified payments are required for bond redemption and interest payments. The Master Indenture and other debt agreements, including a bank credit agreement, also place restrictions on the System and require the System to maintain certain financial ratios. Interest paid, net of capitalized interest, amounted to $38,591 and $32,104 in 2010 and 2009, respectively. The System capitalized interest of approximately $2,340 and $4,717 in 2010 and 2009, respectively.

In 2000, the System entered into an investment sale arrangement with an investment bank related to certain funds held in trust under debt agreements. The investment sale agreement is for $10,000 and provides the System with a fixed annual investment return of approximately 6.1% over the life of a related bond issue. The System terminated the agreement in November 2010 without penalty.

On January 6, 2010, the Illinois Finance Authority, on behalf of the System, issued its Revenue Bonds, Series 2010 A-D, in the amount of $238,255. The proceeds of the Series 2010 Bonds were used, together with other funds available to the System, to pay the costs related to the merger with BroMenn and the construction and equipping of a new patient tower, to pay or reimburse the System for the payment of certain costs of acquiring, constructing, renovating and equipping certain capital projects, to refund prior bonds (Series 2008B) and to pay certain costs of issuing the Series 2010 Bonds and refunding the prior bonds.

On April 29, 2008, the Illinois Finance Authority, on behalf of the System, completed the issuance of uninsured variable rate bonds, Series 2008 A, B and C in the amount of $624,180. The proceeds were used to refund the Series 2005 and Series 2007 insured auction rate securities in the amount of $623,225. In connection with the issuance of the Series 2008 B and C bonds, the System transferred multiple floating-to-fixed interest rate swap agreements, which were previously attached to the Series 2005 and Series 2007B bonds, effectively converting the variable rate demand bonds to fixed rates of 3.20% and 3.605%. In December 2009, the interest rate swap agreement related to the Series 2008B bonds was terminated. Effective March 10, 2010, the notional amount of the Series 2008C interest rate swap was reduced by $21,975. The System maintains an interest rate swap program on certain of its variable rate debt as described in Note 7.

6. Long-Term Debt (continued)

At December 31, 2010 the System had lines of credit with banks aggregating to $200,000. These lines of credit provide for various interest rates, payment terms and expire as follows, $100,000 in March 2011, $50,000 in December 2011 and $50,000 in November 2013. These lines of credit may be used to redeem bonded indebtedness, pay costs related to such redemptions, for capital expenditures or for general working capital purposes. At December 31, 2010 and 2009, no amounts were outstanding on these lines of credit.

On March 1, 2011 the terms of $100,000 of the lines of credit which expired in March 2011, were extended to March 2012 and March 2013.

7. Derivatives

The System has interest rate related derivative instruments to manage its exposure on its variable rate debt instruments and does not enter into derivative instruments for any purpose other than risk management purposes. By using derivative financial instruments to manage the risk of changes in interest rates, the System exposes itself 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 System, which creates credit risk for the System. When the fair value of a derivative contract is negative, the System owes the counterparty, and therefore, it does not possess credit risk. The System minimizes the credit risk in derivative instruments by entering into transactions that require the counterparty to post collateral for the benefit of the System based on the credit rating of the counterparty and the fair value of the derivative contract. 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. The System also mitigates risk through periodic reviews of its derivative positions in the context of its total blended cost of capital.

At December 31, 2010, the System maintains an interest rate swap program on its Series 2008C variable rate demand revenue bonds. These bonds expose the System to variability in interest payments due to changes in interest rates. The System believes that it is prudent to limit the variability of its interest payments. To meet this objective and to take advantage of low interest rates, the System entered into various interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk. These swaps limit the variable rate cash flow exposure on the variable rate demand revenue bonds to synthetically fixed cash flows. The

(Dollars in Thousands)

7. Derivatives (continued)

notional amount under each interest rate swap agreement is reduced over the term of the respective agreement to correspond with reductions in various outstanding bond series. In December 2009, the System's interest rate swap program on its 2008B Series was terminated. The following is a summary of the outstanding positions under these interest rate swap agreements at December 31, 2010:

Bond Series	Notional Amount	Maturity Date	Rate Received	Rate Paid
2008C-1	$ 129,900	November 1, 2038	61.7% of LIBOR + 26 bps	3.60%
2008C-2	$ 108,425	November 1, 2038	61.7% of LIBOR + 26 bps	3.60%
2008C-3	$ 88,000	November 1, 2038	61.7% of LIBOR + 26 bps	3.60%

As a part of the System's acquisition of certain net assets of Condell Health Network and affiliates (collectively, Condell) on December 1, 2008, the System acquired a swaption agreement that Condell entered into with a commercial bank in October 2002. The swaption agreement was terminated on June 16, 2009.

Neither the swaps nor the swapation agreement were designated as hedging instruments and therefore hedge accounting has not been applied. As such, unrealized changes in fair value of the swaps are included as a component of nonoperating income (loss) in the consolidated statements of operations and changes in net assets as changes in the fair value of interest rate swaps. The net cash settlement payments, representing the realized changes in fair value of the swaps and swaption, are included as interest expense in the consolidated statements of operations and changes in net assets.

The fair value of derivative instruments is as follows:

	December 31 2010	December 31 2009
Consolidated balance sheet location		
Obligations under swap and swaption agreements	$ **(44,080)**	$ (31,956)
Collateral posted under swap agreements	**27,969**	31,899
Obligations under swap agreements, net	$ **(16,111)**	$ (57)

(Dollars in Thousands)

7. Derivatives (continued)

Amounts recorded in the consolidated statements of operations and changes in net assets for the derivatives are as follows:

	Year Ended December 31	
Consolidated statement of operations and changes in net assets location	**2010**	**2009**
Net cash payments on interest rate swap agreements (interest expense)	**$ 10,429**	$ 14,009
Change in the fair value of interest rate swaps (nonoperating)	**$ (14,335)**	$ 75,222

The System's swap instruments contain provisions that require the System's debt to maintain an investment grade credit rating from certain major credit rating agencies. If the System's debt were to fall below investment grade on the valuation date, it would be in violation of these provisions, and the counterparty to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value of all swap instruments with credit risk-related contingent features that are in a liability position was $44,080 and $31,956 at December 31, 2010 and 2009, respectively, for which the System has posted collateral of $27,969 and $31,899, at December 31, 2010 and 2009, respectively, in the normal course of business. If the credit risk-related contingent features underlying these swap agreements were triggered on December 31, 2010, the System would be required to post an additional $16,111 collateral to the counterparty.

(Dollars in Thousands)

8. Restricted Net Assets

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

	2010	2009
Net assets currently available for:		
Purchases of property and equipment	$ 5,542	$ 6,403
Medical education and other health care programs	57,876	48,834
Net assets available for future periods:		
Purchases of property and equipment	3,031	2,852
Medical education and other health care programs	8,337	6,625
	$ 74,786	$ 64,714

Permanently restricted net assets generate investment income, which is used to benefit the following purposes or periods at December 31:

	2010	2009
Net assets currently producing investment income:		
Purchases of property and equipment	$ 1,000	$ 1,000
Medical education and other health care programs	21,047	16,498
Net assets available to produce investment income in future periods:		
Medical education and other health care programs	6,747	75
	$ 28,794	$ 17,573

(Dollars in Thousands)

9. Retirement Plans

The System maintains defined-benefit pension plans that cover a majority of its employees (associates). A plan measurement date of December 31 for 2010 and 2009 is used for these plans.

A summary of changes in the plan assets, projected benefit obligation and the resulting funded status of the System's defined-benefit pension plans is as follows:

	2010	2009
Change in plan assets:		
Plan assets at fair value at beginning of year	**$ 606,558**	$ 538,005
Actual return on plan assets	**78,296**	80,406
Employer contributions	**22,560**	35,151
Benefits paid	**(34,645)**	(47,004)
Plan assets at fair value at end of year	**$ 672,769**	$ 606,558
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	**$ 666,903**	$ 688,310
Service cost	**37,104**	39,256
Interest cost	**38,106**	42,026
Actuarial gain	**(404)**	(11,842)
Plan changes	**–**	(43,843)
Benefits paid	**(34,645)**	(47,004)
Projected benefit obligation at end of year	**$ 707,064**	$ 666,903
Plan assets less than projected benefit obligation	**$ (34,296)**	$ (60,345)
Accumulated benefit obligation at end of year	**$ 650,664**	$ 639,664

(Dollars in Thousands)

9. Retirement Plans (continued)

During 2010 the Condell Retirement Plan paid lump sums totaling $4,250. This amount is greater than the sum of the plan's service cost and interest cost for 2010. As a result the System is recognizing a settlement charge in the amount of $767.

The System implemented two plan changes to its retirement plan in 2009. The retirement plan changes included the elimination of the payment of lump sum withdrawals before the age of 55 and the removal of the minimum interest rate crediting floor for all participants.

	2010	2009
Net periodic pension expense consists of the following for the years ended December 31:		
Service cost	$ 37,104	$ 39,256
Interest cost	38,106	42,026
Expected return on plan assets	(54,340)	(55,143)
Amortization of:		
Prior service credit	(4,910)	(945)
Recognized actuarial loss	5,100	971
Settlement/curtailment	767	–
Net pension expense	$ 21,827	$ 26,165

The amount of actuarial loss and prior service cost (credit) included in other changes in unrestricted net assets expected to be recognized in net periodic pension cost during the fiscal year ending December 31, 2011, is $7,393 and $4,823, respectively.

Changes in plan assets and benefit obligations recognized in unrestricted net assets during 2010 and 2009 include actuarial losses of $30,227 and $38,077 and net prior service costs of $4,910 and $42,898, respectively.

Included in unrestricted net assets are the following amounts that have not yet been recognized in net periodic pension cost:

	2010	2009
Unrecognized prior credit	$ (37,886)	$ (42,796)
Unrecognized actuarial loss	180,638	210,865
	$ 142,752	$ 168,069

(Dollars in Thousands)

9. Retirement Plans (continued)

Employer contributions were paid from employer assets for both years presented. No plan assets are expected to be returned to the employer. All benefits paid under the defined-benefit pension plan were paid from the plan's assets. The System anticipates making $28,020 in contributions to the plan's assets during 2011. Expected associate benefit payments are $46,400 in 2011, $50,450 in 2012, $51,870 in 2013, $54,130 in 2014, $57,690 in 2015, and $335,726 in 2016 through 2019.

The System's pension plan's asset allocation and investment strategies are designed to earn returns on plan assets consistent with a reasonable and prudent level of risk. Investments are diversified across classes, economic sectors and manager style to minimize the risk of loss. The System uses investment managers specializing in each asset category and, where appropriate, provides the investment manager with specific guidelines that include allowable and/or prohibited investment types. The System regularly monitors manager performance and compliance with investment guidelines.

The System's target and actual pension asset allocations are as follows:

		Actual Asset Allocation	
Asset Category	**Strategic Target**	**2010**	**2009**
Domestic and international equity securities	**47.5%**	**50.7%**	52.8%
Private equity limited partnerships and hedge funds	**12.5**	**12.5**	9.2
Fixed income securities	**30.0**	**29.7**	31.3
Real estate	**10.0**	**7.1**	6.6
Cash and cash equivalents	**–**	**–**	0.1
	100.0%	**100.0%**	100.0%

Within the domestic and international equity portfolio, investments are diversified among large and mid-capitalizations (21%), nonlarge capitalizations (13%) and international and emerging markets (17%).

9. Retirement Plans (continued)

Fair value methodologies for Level 1 and Level 2 are consistent with the inputs described in Note 4. Fair value for Level 3 represents the plan's ownership interests in the NAVs of the respective private equity partnerships, hedge funds and real estate commingled funds for which active markets do not exist (alternative investments). The System opted to use the NAV per share, or its equivalent, as a practical expedient for fair value of the Plan's interest in hedge funds and private equity funds. The alternative investment assets consist of marketable securities as well as securities and other assets that do not have readily determinable fair values. The fair values of the alternative investments that do not have readily determinable fair values are determined by the general partner or fund manager taking into consideration, among other things, the cost of the securities or other investments, prices of recent significant transfers of like assets and subsequent developments concerning the companies or other assets to which the alternative investments relate. There is inherent uncertainty in such valuations, and the estimated fair values may differ from the values that would have been used had a ready market for these investments existed. Private equity partnerships and real estate commingled funds typically have finite lives ranging from 5 to 10 years, at the end of which all invested capital is returned. For hedge funds, the typical lock-up period is one year, after which invested capital can be redeemed on a quarterly basis with at least 30 days' but no more than 90 days' notice. The Plan's investment assets are exposed to the same kinds and levels of risk as described in Note 4.

At December 31, 2010 and 2009, the System has commitments to fund an additional \$34,273 and \$30,720, respectively. The unfunded commitments at December 31, 2010 are expected to be funded over the next six years.

(Dollars in Thousands)

9. Retirement Plans (continued)

The following are the plan's financial instruments at December 31, 2010, measured at fair value on a recurring basis by the valuation hierarchy defined in Note 4:

	Fair Value Measurements at Reporting Date Using			
Description	**Fair Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Cash and cash equivalents	$ 7,457	$ 97	$ 7,360	$ –
Equity securities:				
Small cap	3,265	3,125	140	–
Large cap	58,593	58,559	34	–
Value equity	37,756	35,346	2,410	–
Growth equity	86,304	85,217	1,087	–
U.S. equity	41,593	38,816	2,777	–
International equity	96,891	96,370	521	–
International equity – emerging	22,810	21,841	969	–
Fixed income securities:				
Core plus bonds	196,836	95,072	101,764	–
Other types of investments:				
Hedge funds	30,414	–	–	30,414
Private equity funds	46,290	–	–	46,290
Real estate	44,560	–	33,366	11,194
Total	$ 672,769	$ 434,443	$ 150,428	$ 87,898

(Dollars in Thousands)

9. Retirement Plans (continued)

The table below sets forth a summary of changes in the fair value of the plan's Level 3 assets for 2010:

	Hedge Funds	Private Equity	Real Estate
Fair value at January 1, 2010	$ 27,860	$ 28,109	$ 6,333
Net purchases and sales	3,464	14,631	1,910
Realized gains and losses	–	882	–
Unrealized gains and losses	(910)	2,668	2,951
Fair value at December 31, 2010	$ 30,414	$ 46,290	$ 11,194

The following are the plan's financial instruments at December 31, 2009, measured at fair value on a recurring basis by the valuation hierarchy defined in Note 4:

		Fair Value Measurements at Reporting Date Using		
Description	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 767	$ 41	$ 726	$ –
Equity securities:				
Large cap	40,390	40,390	–	–
Value equity	67,158	63,878	3,280	–
Growth equity	78,007	76,062	1,945	–
U.S. equity	15,103	14,971	132	–
International equity	95,393	95,048	345	–
International equity – emerging	23,844	22,533	1,311	–
Fixed income securities:				
Core plus bonds	189,726	83,082	106,644	–
Other types of investments:				
Hedge funds	27,860	–	–	27,860
Private equity funds	28,109	–	–	28,109
Real estate	40,201	–	33,868	6,333
Total	$ 606,558	$ 396,005	$ 148,251	$ 62,302

(Dollars in Thousands)

9. Retirement Plans (continued)

The table below sets forth a summary of changes in the fair value of the plan's Level 3 assets for 2009:

	Hedge Funds	Private Equity	Real Estate
Fair value at January 1, 2009	$ 23,089	$ 21,178	$ 12,270
Net purchases and sales	1,087	6,718	520
Realized gains and losses	–	201	(17)
Unrealized gains and losses	3,684	12	(6,440)
Fair value at December 31, 2009	$ 27,860	$ 28,109	$ 6,333

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

	2010	2009
Discount rate	**5.40%**	5.65%
Assumed rate of return on assets	**8.00**	8.00
Weighted-average rate of increase in future compensation (age-based table)	**4.80**	4.80

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

	2010	2009
Discount rate	**5.65%**	6.30%
Assumed rate of return on assets	**8.00**	8.00
Weighted-average rate of increase in future compensation (age-based table)	**4.80**	4.80

9. Retirement Plans (continued)

To develop the assumed long-term rate of return on plan assets assumption, the System considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the strategic target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio. This resulted in the selection of the 8.00% assumption for 2010 and 2009. For comparative purposes, the 10-year historical return on pension plan assets for the period ended December 31, 2010, was 4.49%.

In addition to the defined-benefit pension plan, the System sponsors various defined-contribution plans. Amounts contributed by the System approximated $35,042 and $30,981 in 2010 and 2009, respectively, and are included in salaries, wages and employee benefits expense in the consolidated statements of operations and changes in net assets.

10. General and Professional Liability Risks

The System is self-insured for substantially all general and professional liability risks. The self-insurance programs combine various levels of self-insured retention with excess commercial insurance coverage. In addition, various umbrella insurance policies have been purchased to provide coverage in excess of the self-insured limits. Revocable trust funds, administered by a trustee and a captive insurance company, have been established for the self-insurance programs. Actuarial consultants have been retained to determine the estimated cost of claims, as well as to determine the amount to fund into the irrevocable trust and captive insurance company.

The estimated cost of claims is actuarially determined based on past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. Accrued insurance liabilities and contributions to the revocable trust were determined using a discount rate of 4.00% for 2010 and 2009. Accrued insurance liabilities for the System's captive insurance company were determined using a discount rate of 3.00% for 2010 and 2009. Total accrued insurance liabilities would have been approximately $62,786 greater at December 31, 2010 had these liabilities not been discounted.

10. General and Professional Liability Risks (continued)

The System is a defendant in certain litigation, related to professional and general liability risks. Although the outcome of the litigation cannot be determined with certainty, management believes, after consultation with legal counsel, that the ultimate resolution of this litigation will not have any material adverse effect on the System's operations or financial condition.

11. Legal, Regulatory, and Other Contingencies and Commitments

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. During the last few years, as a result of nationwide investigations by governmental agencies, various healthcare organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, exclusion from the Medicare and Medicaid programs, and revocation of federal or state tax-exempt status. Moreover, Advocate expects that the level of review and audit to which it and other healthcare providers are subject will increase.

Various federal and state agencies have initiated investigations, which are in various stages of discovery, relating to reimbursement, billing practices and other matters of Advocate. There can be no assurance that regulatory authorities will not challenge Advocate's compliance with these laws and regulations, and it is not possible to determine the impact, if any, such claims or penalties would have on Advocate. As a result, there is a reasonable possibility that recorded amounts will change by a material amount in the near term. To foster compliance with applicable laws and regulations, Advocate maintains a compliance program designed to detect and correct potential violations of laws and regulations related to its programs.

The System is committed to constructing additions and renovations to its medical facilities and implementing information technology projects, which are expected to be completed in future years. The estimated cost of these commitments is $296,975, of which $244,264 has been incurred as of December 31, 2010.

11. Legal, Regulatory, and Other Contingencies and Commitments (continued)

Future minimum rental commitments at December 31, 2010, for all noncancelable leases with original terms of more than one year are $51,007, $36,634, $26,205, $20,434 and $18,528 for the years ending December 31, 2011 through 2015, respectively, and $35,095 thereafter.

Rent expense, which is included in other expenses, amounted to approximately $86,283 and $82,613 in 2010 and 2009, respectively.

In October 2002, the System sold certain of its medical office buildings to an unrelated party. As part of this transaction, the System entered into agreements to lease back space within these buildings. These leases have been accounted for as sale-leaseback transactions. At the time of the sale, $9,383 of the $30,890 total gain on the sale was deferred and is being amortized over the terms of the related leases. The unamortized deferred gain was $3,234 and $3,767 at December 31, 2010 and 2009, respectively, and deferred gain accretion was $533 in both 2010 and 2009. The System has no future commitments, obligations, provisions or circumstances that require or result in the System's continuing involvement with these properties. The future minimum lease obligations under the leaseback terms are included in the above-stated future minimum rental commitments.

(Dollars in Thousands)

12. Income Taxes and Tax Status

Certain subsidiaries of the System are for-profit corporations. Significant components of the for-profit subsidiaries' deferred tax assets (liabilities) are as follows at December 31:

	2010	2009
Deferred tax assets		
Allowance for uncollectible accounts	$ 3,363	$ 2,515
Other accrued expenses	487	609
Reserves for incurred but not reported claims	384	1,373
Accrued insurance	6,351	17,734
Accrued compensation and employee benefits	3,279	3,472
Third-party settlements	802	848
Prepaid and other assets	373	373
Total deferred tax assets	15,039	26,924
Net deferred tax assets, included in deferred costs and intangible assets and prepaid expenses, inventories, and other assets	$ 15,039	$ 26,924
Deferred tax liabilities		
Property and equipment	$ (3,110)	$ (3,433)
Deferred gain on BroMenn acquisition	(5,064)	–
Total deferred tax liabilities, included in other noncurrent liabilities	$ (8,174)	$ (3,433)

Significant components of the provision (credit) for income taxes are as follows for the years ended December 31:

	2010	2009
Current:		
Federal	$ (5,505)	$ 5,369
State	(1,239)	1,208
Deferred	16,626	(998)
	$ 9,882	$ 5,579

12. Income Taxes and Tax Status (continued)

Federal and state income taxes paid relating to the System's for-profit corporations were $1,697 and $10,635 in 2010 and 2009, respectively.

Advocate and all other controlled or wholly owned subsidiaries are exempt from income taxes under Internal Revenue Code Section 501(c)(3). They do, however, operate certain programs that generate unrelated business income. The current tax provision recorded on this income was $685 and $875 for the years ended December 31, 2010 and 2009, respectively. Federal, state, and local governments are increasingly scrutinizing the tax status of not-for-profit hospitals and health care systems.

13. Acquisition

On January 6, 2010, the System merged with BroMenn, which was accounted for as an acquisition in accordance with the authoritative guidance on not-for-profit mergers and acquisitions. The BroMenn system, which is located in the greater Bloomington-Normal and Eureka, Illinois, areas, includes a 224-bed acute care hospital, a 34-bed acute care hospital and approximately 60 employed physicians in one medical group.

For accounting purposes, this transaction was accounted for under the purchase accounting rules, and a contribution of $225,541 was recorded in the accompanying consolidated statements of operations and changes in net assets for the year ended December 31, 2010. This contribution reflected the fair value of the unrestricted net assets of BroMenn on the date of the merger. The total increase in net assets attributable to the merger, which included the fair value of temporarily and permanently restricted net assets contributed, was $245,578. No goodwill was recorded as a result of this transaction. In valuing these assets and liabilities, fair values were based on, but not limited to professional appraisals, discounted cash flows, replacement costs and actuarially determined values.

(Dollars in Thousands)

13. Acquisition (continued)

The fair value of assets and liabilities of BroMenn contributed at January 6, 2010, consists of the following:

Cash and cash equivalents	$ 10,998
Other current assets	61,836
Property and equipment	160,788
Other long-term assets	47,759
Total assets	281,381
Current liabilities	26,354
Other long-term liabilities	9,449
Total liabilities	35,803
Increase in net assets	$ 245,578

Following are the unaudited pro forma results for the year ended December 31, 2009. These results reflect the addition of BroMenn's unaudited results for the year ended December 31, 2009 to the System's results for the year ended December 31, 2009. These results do not include the addition to revenues in excess of expenses that would have occurred on January 1, 2009 for the contribution of BroMenn's unrestricted net assets.

	December 31 2009
Total operating revenue	$ 4,351,637
Operating income	260,106
Revenues in excess of expenses	683,707

The pro forma information provided is a compilation of results only and should not be construed to accurately reflect what the actual results would have been had the merger been consummated on January 1, 2009. These results are also not intended to be indicative of or project the System's results of operations for any future periods.

14. Subsequent Events

The System evaluated events occurring between January 1, 2011 and March 9, 2011, which is the date when the consolidated financial statements were issued.

Ernst & Young LLP

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Region: West Chicago

Reviewer: AAH

Local Health Jurisdiction: Kendall County Health Department

Priorities: 1) Reduction of indoor Radon Exposure

2) Increase of Socioeconomic Well-being

3) Prevention on Youth High Risk Behaviors

Others (List) Reduction of Obesity

CHECKLIST FOR SUBSTANTIAL COMPLIANCE WITH CERTIFICATION RULES FOR PUBLIC HEALTH PRACTICE STANDARDS (SECTION 600.400)

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Notes:

Region: West Chicago

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ADDITIONAL PRIORITIES

COMMUNITY HEALTH PLAN			
Item	**Page Number(s)**		
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Data and Information	110-111		
Population Groups Affected	111-112		
Related to Year 2010 Objectives	113		
Risk Factor(s)	114-119		
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Impact Objective(s)	123		
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Community Resources	123		
Funding Needs			
Anticipated Sources			

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