

Catholic Health East
Consolidated Financial Statements
December 31, 2007 and 2006

Catholic Health East
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December 31, 2007 and 2006

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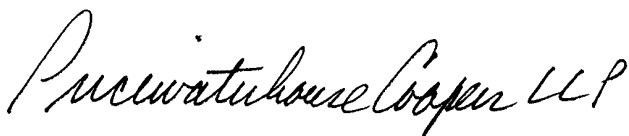
Report of Independent Auditors

To the Board of Directors
Catholic Health East

In our opinion, based on our audits and the report of other auditors, the accompanying consolidated balance sheets and the related consolidated statements of operations and changes in net assets and cash flows present fairly, in all material respects, the financial position of Catholic Health East and its subsidiaries (the Company) at December 31, 2007 and December 31, 2006, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of certain consolidated entities which are represented in the following financial statements for 2007 and 2006 as net assets of \$48,605,000 and \$47,624,000, respectively, and excess of revenues over expenses of \$(2,656,000) and \$6,884,000, respectively. In addition, we did not audit the financial statements of certain unconsolidated entities which are represented in the following financial statements for 2007 and 2006 as investments in unconsolidated organizations of \$954,032,000 and \$870,293,000, respectively, and equity in earnings of unconsolidated organizations of \$70,497,000 and \$104,027,000, respectively. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for these entities, is based solely on the report of the other auditors. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 and the report of other auditors provide a reasonable basis for our opinion.

As discussed in Note 12, the Company changed its method of accounting for defined benefit pension as of December 31, 2007.

As discussed in Note 2 to the consolidated financial statements, the Company re-designated certain investments at December 31, 2007.



May 2, 2008

**Catholic Health East
Consolidated Balance Sheets
December 31, 2007 and 2006**

(in thousands of dollars)

	2007	2006
Assets		
Current assets		
Cash and cash equivalents	\$254,738	\$245,636
Investments	93,793	88,759
Marketable securities whose use is limited	24,947	32,785
Patient accounts receivable, net of estimated uncollectibles of \$273,463 and \$291,809, for 2007 and 2006, respectively	479,111	488,787
Collateral received on securities pledged	177,182	175,300
Other accounts receivable	101,788	92,320
Prepaid expenses and inventories	113,418	119,257
Assets held for sale	197,103	192,516
Total current assets	1,442,080	1,435,360
Marketable securities whose use is limited		
Board-designated funds	411,346	641,339
Trustee-held funds	82,023	118,581
Donor-restricted funds	81,853	81,889
	575,222	841,809
Property and equipment, net	1,766,550	1,603,726
Equity investments in managed funds	405,367	136,316
Investments in unconsolidated organizations	1,100,657	966,256
Investments	458,028	404,620
Other assets	176,591	162,205
Total assets	\$5,924,495	\$5,550,292
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt	\$48,271	\$46,874
Accounts payable and accrued expenses	460,780	420,937
Collateral due broker on securities pledged	177,182	175,300
Estimated third party payor settlements, net	52,520	41,537
Other	121,416	141,953
Liabilities related to assets held for sale	170,804	153,231
Total current liabilities	1,030,973	979,832
Long-term debt, net	1,357,137	1,277,349
Other liabilities	284,158	251,843
Insurance liabilities	236,792	219,844
Deferred revenue from entrance fees	48,949	54,863
Total liabilities	2,958,009	2,783,731
Net assets		
Unrestricted	2,779,376	2,605,574
Temporarily restricted	140,192	115,340
Permanently restricted	46,918	45,647
Total net assets	2,966,486	2,766,561
Total liabilities and net assets	\$5,924,495	\$5,550,292

The accompanying notes are an integral part of these consolidated financial statements.

Catholic Health East
Consolidated Statement of Operations
Years Ended December 31, 2007 and 2006

(in thousands of dollars)

	2007	2006
Unrestricted revenue, gains and other support		
Net patient service revenue	\$3,785,913	\$3,685,209
Investment income	88,752	117,381
Net cumulative unrealized gains transferred to trading securities	82,331	-
Equity in earnings of unconsolidated organizations	131,060	136,249
Other operating revenue	<u>276,433</u>	<u>244,106</u>
	<u>4,364,489</u>	<u>4,182,945</u>
Expenses		
Salaries, wages and benefits	2,034,753	2,008,455
Medical supplies	641,848	630,825
Purchased services, professional fees and other expenses	813,927	769,155
Depreciation and amortization	181,252	165,639
Interest	58,518	60,598
Insurance	55,122	45,282
Provision for bad debts	<u>290,707</u>	<u>301,205</u>
	<u>4,076,127</u>	<u>3,981,159</u>
Operating income	288,362	201,786
Restructuring expenses and impairment losses	(3,094)	(12,380)
Nonrecurring charges	(1,291)	(599)
Loss on extinguishment of debt	(19,724)	(730)
Change in fair value of interest rate swaps	<u>(9,434)</u>	<u>11,131</u>
Excess of revenue over expenses	<u><u>\$254,819</u></u>	<u><u>\$199,208</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

Catholic Health East
Consolidated Statement of Changes in Net Assets
Years Ended December 31, 2007 and 2006

(in thousands of dollars)

	2007	2006
Unrestricted net assets		
Excess of revenue over expenses	\$254,819	\$199,208
Change in unrealized gains on investments	15,203	20,435
Net cumulative unrealized gains transferred to trading securities	(65,467)	-
Change in additional minimum pension liability	35,762	22,981
Other changes	<u>13,383</u>	<u>21,497</u>
Increase in unrestricted net assets before discontinued operations and cumulative effect of change in accounting principle	253,700	264,121
Loss from discontinued operations	(31,081)	(187)
FAS 158 adjustment	(48,817)	-
Cumulative effect of change in accounting principle (FIN 47)	<u>-</u>	<u>1,718</u>
Increase in unrestricted net assets	<u>173,802</u>	<u>265,652</u>
Temporarily restricted net assets		
Contributions	48,846	42,295
Investment income	6,988	5,212
Change in unrealized gains on investments	475	301
Net assets released from restrictions	(29,073)	(24,168)
Other changes	<u>(2,384)</u>	<u>1,668</u>
Increase in temporarily restricted net assets	<u>24,852</u>	<u>25,308</u>
Permanently restricted net assets		
Contributions	416	457
Net realized and unrealized gains on investments	1,567	3,622
Other changes	<u>(712)</u>	<u>(610)</u>
Increase in permanently restricted net assets	<u>1,271</u>	<u>3,469</u>
Increase in net assets	199,925	294,429
Net assets		
Beginning of year	<u>2,766,561</u>	<u>2,472,132</u>
End of year	<u><u>\$2,966,486</u></u>	<u><u>\$2,766,561</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

Catholic Health East
Consolidated Statement of Cash Flows
Years Ended December 31, 2007 and 2006

(in thousands of dollars)

	2007	2006
Cash flows from operating activities		
Increase in net assets	\$199,925	\$294,429
Adjustments to reconcile increase in net assets to net cash provided by operating activities		
Cumulative change in accounting principle	-	(1,151)
Loss from discontinued operations	31,081	187
Contribution of long lived assets	(17,725)	-
Loss on extinguishment of debt	19,724	730
Depreciation and amortization	181,252	165,639
Amortization of deferred entrance fees	(6,602)	(7,221)
Net realized gains on investments	(48,057)	(94,654)
Net unrealized gains on investments	(97,534)	(20,435)
Unrealized gains on managed funds	-	(7,045)
Adjustment to initially FAS 158	48,817	-
Equity in earnings of unconsolidated organizations	(131,060)	(142,551)
Provision for bad debts	290,707	301,205
Gain on sale of assets	(3,025)	(2,726)
Minimum pension liability adjustment, including CHE's share of minimum liability adjustment of unconsolidated organizations	35,762	22,981
Decrease (increase) in market value of interest rate swaps	9,434	(11,131)
Restricted contributions and investment income received	(56,251)	(51,887)
Entrance fees received, net of refunds	7,608	7,981
(Increase) decrease in certain assets and liabilities		
Accounts receivable	(281,031)	(293,711)
Other receivables	(9,468)	(28,444)
Prepaid expenses, inventories and other current assets	5,839	9,730
Assets held for sale	(4,587)	1,997
Accounts payable and accrued expenses	39,845	6,619
Third party payables	10,983	(13,848)
Liabilities related to assets held for sale	17,573	(12,966)
Insurance and other liabilities	43,350	(73,596)
Net cash provided by operating activities	<u>286,560</u>	<u>50,132</u>
Cash flows from investing activities		
Additions to property and equipment	(341,847)	(252,329)
Increase in collateral received on securities pledged	(1,882)	(18,580)
Net (decrease) increase in investments and marketable securities whose use is limited	(2,242)	66,439
Distributions received from unconsolidated organizations	18,003	10,494
Proceeds from sale of long-lived assets	796	2,898
Net cash used in investing activities	<u>(327,172)</u>	<u>(191,078)</u>
Cash flows from financing activities		
Proceeds from restricted contributions and investment income received	56,251	51,887
Proceeds from issuance of long-term debt	367,247	88,434
Cost of issuance of long-term debt	1,670	-
Repayments of long-term debt	(377,336)	(49,262)
Increase in payable under collateral received on securities pledged	1,882	18,580
Net cash provided by financing activities	<u>49,714</u>	<u>109,639</u>
Increase (decrease) in cash and cash equivalents	9,102	(31,307)
Cash and cash equivalents		
Beginning of year	<u>245,636</u>	<u>276,943</u>
End of year	<u>\$254,738</u>	<u>\$245,636</u>
Supplemental disclosures of cash flow information		
Interest paid	\$56,099	\$61,159
Non-cash transaction	\$44,000	\$0

The accompanying notes are an integral part of these consolidated financial statements.

Catholic Health East

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

1. Organization, Mission and Basis of Presentation

Catholic Health East (CHE, the System, or the Company) was incorporated as a Pennsylvania nonprofit corporation on October 1, 1997. CHE is a catholic, multi-facility health system sponsored by ten religious congregations and Hope Ministries. Each sponsoring congregation appoints a representative to the Sponsors Council which maintains certain reserve powers, including the election of the CHE Board of Directors. CHE serves to carry out the health care ministries of the sponsoring congregations. The mission of CHE is to be a community of persons committed to being a transforming, healing presence within the communities it serves.

The consolidated financial statements of CHE include activities of its Regional Health Corporations (RHCs) and related component corporations all of which are wholly or majority owned. These RHCs are located throughout eleven states and the healthcare activities provided by these RHCs include, but are not limited to, general acute care hospitals, long-term care facilities, skilled nursing facilities, behavioral health, residential facilities for the elderly, physician services, home health, outpatient surgery, and other services. A list of the name and location of each RHC is provided below.

Holy Cross Health Ministries, Inc. Fort Lauderdale, Florida	St. Francis Hospital and Affiliates Wilmington, Delaware
Mercy Health System of Southeastern Pennsylvania Conshohocken, Pennsylvania	Pittsburgh Mercy Health System, Inc. Pittsburgh, Pennsylvania
Saint Joseph's Health System, Inc. Atlanta, Georgia	Mercy Medical Corporation Daphne, Alabama
Our Lady of Lourdes Health Care Services, Inc. Camden, New Jersey	Sisters of Providence Health System, Inc. Springfield, Massachusetts
Mercy Community Health, Inc. West Hartford, Connecticut	Mercy Hospital, Inc. Miami, Florida
Mercy Health System of Maine Portland, Maine	St. Mary's Health Care System, Inc. Athens, Georgia
St. Francis Medical Center Trenton, New Jersey	Saint Joseph of the Pines, Inc. Southern Pines, North Carolina
St. Peter's Health Care Services Albany, New York	St. James Mercy Health Systems, Inc. Hornell, New York
St. Mary Medical Center Langhorne, Pennsylvania	Maxis Health System Carbondale, Pennsylvania

Catholic Health East and certain affiliated nonprofit corporations are generally exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

CHE and its RHCs also participate in various joint ventures and partnerships, commonly referred to as joint operating agreements. These arrangements enable CHE to provide healthcare services to the broader community through involvement in larger healthcare organizations or systems.

Catholic Health East

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

The consolidated financial statements of CHE include the financial information of the RHCs and component corporations, the System's wholly owned captive insurance company, various philanthropic foundations of which the System maintains control, and various other organizations or corporations.

2. Summary of Significant Accounting Policies

Basis of Consolidation

The consolidated financial statements include the accounts of all entities of CHE. All significant inter-company balances and transactions have been eliminated.

Use of Estimates

The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make assumptions, estimates, and judgments that affect the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. Management considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of the financial statements including, but not limited to, recognition of net patient service revenue, which includes contractual allowances and provisions for bad debt; estimates for healthcare professional and general liabilities; determination of fair values of certain financial instruments; and assumptions for measurement of pension liabilities. Management relies on historical experience and other assumptions believed to be reasonable relative to the circumstances in making judgments and estimates. Actual results could differ materially from these estimates.

Cash and Cash Equivalents

Cash and cash equivalents include investments in liquid debt instruments with a maturity of three months or less. The carrying value of cash and cash equivalents approximates market value.

Investments and Investment Income

Investments in marketable equities with readily determinable fair market values and all investments in debt securities are measured at fair value in the consolidated balance sheets. Investment income (including realized gains and losses on investments, unrealized gains and losses on trading securities, interest income, and dividends) is included in excess of revenue over expenses unless such earnings are restricted by donor or law. Investment income restricted by donors is reported as an increase in temporarily restricted net assets. Unrealized gains and losses on investments other than trading are reported as a change in unrestricted net assets and, as such, are excluded from excess of revenues over expenses. Investment income is reported net of investment-related expenses.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

The System's investments, including those classified as marketable securities whose use is limited, are invested and managed through the CHE Consolidated Investment Program (the CIP Program) and those investments and marketable securities that are locally managed by the RHCs. The System classifies its unrestricted investments in the CIP Program as trading securities. Accordingly, all unrealized gains and losses on these unrestricted investments are reported as a component of investment income in the accompanying 2007 consolidated statement of operations and changes in net assets. The System classifies locally managed unrestricted investments as available-for-sale. Accordingly, all unrealized gains and losses on these unrestricted investments are reported as a change in unrestricted net assets in the accompanying 2007 consolidated statement of changes in net assets. In 2006, the System classified investments in the CIP Program and locally managed investments as available-for-sale, and all unrealized gains and losses were reported as a component of the change in unrestricted net assets.

During 2007, CHE, which manages and controls the CIP Program, determined that the CIP Program investment portfolio is more appropriately classified as trading as opposed to available-for-sale based on CHE's investment philosophy, strategy, and the nature and frequency of investment activity and in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. This change has been reflected on a prospective basis in the 2007 consolidated financial statements. Locally managed investments are classified as available-for-sale in both 2007 and 2006 and the unrealized gains and losses related to these investments are reflected as a component of the change in unrestricted net assets in the consolidated financial statements.

Net unrealized gains on those unrestricted investments in the CIP Program totaling \$16,864,000 for 2007 and \$65,467,000 for 2006 and prior years, respectively, were recorded as a component of investment income in 2007, representing a cumulative change of \$82,331,000 in the current year.

Investments also include equity investments in managed funds, which include hedge funds, private partnerships, and other investments. Investments in hedge funds, private partnerships, and other investments (managed funds), are accounted for under the equity method, which approximates fair value. The equity income from these alternative investments is included as a component of investment income in 2007 and 2006.

For those locally managed investments classified as non-trading or available-for-sale, the System periodically conducts an analysis and evaluates securities for any potential "other than temporary impairment" of investments. If the decline in the market value of an investment below cost is deemed to be other than temporary, an adjustment is made to reduce the cost basis of the investment(s) and a realized loss is recorded in excess of revenues over expenses. The System did not record any other-than-temporary impairments on locally managed, available-for-sale investments in 2007 or 2006.

Derivative Financial Instruments

The System recognizes all derivative instruments in the balance sheets at fair value. The change in the fair value of derivatives is recognized as a component of excess of revenues over expenses in the consolidated statement of operations for the years ended December 31, 2007 and 2006.

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Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Marketable Securities Whose Use Is Limited

Marketable securities whose use is limited primarily include marketable securities designated by governance for future capital improvements and other purposes, in accordance with agreements with outside parties, by trustees under bond indenture agreements and self-insurance trust arrangements, and by restrictions.

Inventories

Inventory is valued at the lower of cost (first-in, first-out) or market, net of reserves for obsolescence.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Depreciation is expensed over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in the depreciation and amortization in the financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of constructing those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from excess of revenue over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or others assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Long-Lived Assets

CHE systematically evaluates the carrying value of its long-lived assets for impairment when impairment indicators are identified. In the event that the carrying value of a long-lived asset is not supported by the fair value, the System will recognize an impairment loss for the difference. Fair value is based on available market prices or discounted cash flows. The System recognized impairment losses of \$266,000 and \$7,771,000 in 2007 and 2006, respectively.

Investments in Unconsolidated Organizations

Investments in unconsolidated organizations represent CHE investments in joint operating agreements, joint ventures, or partnerships. The equity method is used to account for these investments.

Deferred Revenue from Advance Fees

Certain RHCs operate residential facilities for the elderly. Fees paid by residents upon entering into continuing care contracts, net of the portion that is refundable to the resident, are recorded as deferred revenue and amortized to income using the straight-line method over the estimated remaining life expectancy of the resident.

Deferred Debt Issuance Costs

Deferred debt issuance costs included in other assets at December 31, 2007 and 2006, totaling \$15,473,000 and \$17,772,000, respectively are amortized using the straight-line method over the life of the related debt, which approximates the effective interest method.

Catholic Health East

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

Excess of Revenue over Expenses

The statement of operations includes excess of revenue over expenses. Changes in unrestricted net assets which are excluded from excess of revenue over expenses, consistent with industry practice, include unrealized gains and losses on available for sale investments; permanent transfers of assets to and from affiliates for other than goods and services, change in additional minimum pension liability, cumulative effect of change in accounting principle, discontinued operations, 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).

Other Operating Revenue

Other revenue is derived from services other than the provision of health care services or coverage to patients or residents. This revenue consists primarily of federal and state grants, unrestricted contributions, rental income, support services, parking garages, gift shop income, cafeteria income, maintenance fee income, and other miscellaneous income.

Net Patient Service Revenue

Third-party payors (Medicare, Medicaid, and commercial insurance payors) provide payments to the hospitals at amounts different from their established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounts from established charges, and per diem payments. Net patient service revenue is the estimated amount to be realized for services rendered, including estimated retroactive adjustments. Retroactive 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.

Allowance for Doubtful Accounts

The System records an allowance for doubtful accounts for estimated losses resulting from the unwillingness of patients to make payments for services. The allowance is determined by analyzing historical data and trends. Accounts receivable are written off against the allowance for doubtful accounts when management determines that recovery is unlikely and collection efforts cease.

Charity Care

CHE provides services to all patients regardless of ability to pay. In accordance with the System's policy, a patient is classified as a charity patient based on income eligibility criteria as established by the *Federal Poverty Guidelines*. Charges for services to patients who meet the System's guidelines for charity care are not reflected in the accompanying consolidated financial statements. The charges associated with these services for charity care provided by the System approximate \$267,584,000 and \$253,439,000 in 2007 and 2006, respectively. These amounts do not include the provision of bad debts totaling \$290,707,000 and \$301,205,000 in 2007 and 2006, respectively, which is reflected separately in the consolidated statements of operations.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets.

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When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the consolidated financial statements.

Adoption of Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 158, *“Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB statements No. 87, 88, 106 and 132(R),”* (FAS 158). FAS 158 requires plan sponsors of defined benefit pension plans and other postretirement benefit plans (the plans) to recognize the funded status of the plans in the statement of financial position, measure the fair value of plan assets and benefit obligations as of the fiscal year-end statement of financial position, and provide additional disclosures. At December 31, 2007, the Company adopted the recognition and disclosure provisions of FAS 158. The effect of adopting FAS 158 at December 31, 2007 has been included in the accompanying consolidated financial statements.

Reclassifications

Certain amounts have been reclassified in the prior year’s financial statements to conform to the classifications used in the current year.

3. Net Patient Service Revenue

Net patient service revenue from the Medicare and Medicaid programs, exclusive of managed care, accounted for approximately 32.4% and 6.6%, respectively, of total net patient service revenues in 2007, and 33.1% and 7.2%, respectively of total net patient service revenue in 2006. Compliance with laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Management believes that adequate provision has been made for adjustments that may result from reviews by third-party payors. Estimated net settlements related to Medicare and Medicaid, collectively, of \$34,576,000 and \$29,774,000 in 2007 and 2006, respectively, are included as a component of current liabilities in the accompanying consolidated balance sheets.

Net patient service revenue includes approximately \$7,935,000 and \$35,141,000 in 2007 and 2006, respectively, related to favorable changes in estimates for prior year cost report reopenings, appeals, and tentative and final cost reports, of which some are still subject to audit, additional reopening, and/or appeals.

4. Social Accountability Costs (Unaudited)

In keeping with the mission and purpose of Catholic Health East, to carry out the health care ministries of the sponsoring congregations by serving as a community of persons committed to being a transforming, healing presence within the communities it serves, especially the needs of the poor, the System strives to maximize the provision of services in its communities and in collaboration with other organizations. A portion of CHE’s overall operating expense relates to costs incurred in providing and meeting certain community needs for which CHE is not directly compensated.

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A standard reporting and accountability process is utilized throughout CHE to estimate the net cost of these services, referred to as Social Accountability Costs, which provides a basis of accountability and reporting to the communities served for purposes of disclosing the utilization of resources. Costs reported are net of contributions or grants that have been provided to CHE and designated for these purposes.

The information presented below has been calculated and is presented in accordance with the Catholic Health Association's, *A Guide for Planning and Reporting Community Benefits*, Copyright 2006. Social accountability costs for the years ended December 31 are as follows:

<i>(in thousands of dollars)</i>	2007	2006
Cost of care for those who are poor	\$43,235	\$52,814
Cost of community benefit programs	63,064	58,169
Volunteer service provided	4,350	5,899
Unpaid cost of Medicaid programs	78,192	71,196
	<u> </u>	<u> </u>
Social accountability costs	<u>\$188,841</u>	<u>\$188,078</u>
Percentage of operating expenses	<u>4.6%</u>	<u>4.7%</u>
Multiple of operating income	<u>65.5%</u>	<u>96.6%</u>
Unpaid cost of Medicare programs	<u>\$155,050</u>	<u>\$128,365</u>

The cost of care of the poor is based on the System's estimated net cost of providing services to those unable to pay. The cost of the community benefit programs reflects the costs to develop and provide programs that are developed and provided to meet special community needs that would not otherwise be available. Volunteer service reflects both internal and external services provided to support patient care activities and community programs. The difference between amounts reimbursed to the System under the Medicare and Medicaid programs and the estimated cost of providing care for these respective programs is reflected as an unpaid cost of the program.

5. Marketable Securities Whose Use Is Limited and Investments

A significant amount of CHE's investments are held and managed in the CHE Consolidated Investment Program (the Program). The Program is structured under a Program Participation Agreement (the Agreement) between each participant RHC and CHE. All investments in the Program are managed under the administration of CHE. Participants' investments held in the Program are assigned a weighted value for the period of time that the funds are invested in the Program. Investment income from the Program, including interest income, dividends, and realized gains and losses on sales of securities, other than temporary declines in market value of investment, and unrealized gains and losses are distributed to participants based on their weighted value of investments.

The underlying fair value of investments in the Program, which are traded on national exchanges (except for equity investments in managed funds/alternative investments), is based on the final reported sales price on the last business day of the year. The fair value of investments traded in over-the-counter markets is based on the average of the last recorded bid and asked prices.

Catholic Health East
Notes to Consolidated Financial Statements
December 31, 2007 and 2006

The following table summarizes investments and marketable securities whose use is limited:

(in thousands of dollars)

	2007	2006
Investments		
Cash and cash equivalents	\$277,103	\$455,073
Marketable equity securities	555,618	612,623
Marketable debt securities	319,269	300,277
Managed funds and other	405,367	136,316
	<u>\$1,557,357</u>	<u>\$1,504,289</u>

CHE participates in a securities lending program wherein some investments are loaned on an overnight basis to various brokers. CHE receives lending fees and earns interest and dividends on the loaned securities. These securities are returnable on demand and are collateralized by cash deposits and U.S. Treasury Obligations. Collateral received is at 100% of the fair value of the securities on loan. CHE is indemnified against borrower default by the financial institution acting as lending agent. At December 31, 2007 and 2006, securities with a fair market value of \$177,182,000 and \$175,300,000, respectively, were loaned under securities lending agreements.

Investment income and gains on marketable securities whose use is limited, investments and cash and cash equivalents at December 31 are comprised of the following:

(in thousands of dollars)

	2007	2006
Investment return		
Interest and dividends	\$40,695	\$30,651
Net realized gains	48,057	79,685
Subtotal	88,752	110,336
Net cumulative unrealized gains transferred to trading securities	82,331	-
Net unrealized gains on managed funds	-	7,045
Net unrealized gains on investments	15,203	20,435
	<u>\$186,286</u>	<u>\$137,816</u>

Temporarily restricted net assets

Other changes in temporarily restricted net assets

Investment income

Interest and dividends

Net realized gains on investments

\$6,433

\$3,779

555

1,433

\$6,988

\$5,212

Net unrealized gains on investments

\$475

\$301

Permanently restricted net assets

Other changes in permanently restricted net assets

Net realized and unrealized gains on investments

\$1,567

\$3,622

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6. Property and Equipment

Property and equipment at December 31 consisted of the following:

<i>(in thousands of dollars)</i>	2007	2006
Land and improvements	\$111,143	\$97,068
Buildings and improvements	1,849,844	1,643,073
Equipment	<u>1,533,806</u>	<u>1,475,695</u>
	3,494,793	3,215,836
Less: Accumulated depreciation and amortization	<u>(1,899,507)</u>	<u>(1,782,433)</u>
	1,595,286	1,433,403
Construction in progress	<u>171,264</u>	<u>170,323</u>
	<u><u>\$1,766,550</u></u>	<u><u>\$1,603,726</u></u>

At December 31, 2007 and 2006, approximately \$308,753,000 and \$242,287,000 of property and equipment, net, is pledged as collateral under various loan agreements. Interest cost, net of related interest income, totaling approximately \$3,605,000 and \$2,112,000 was capitalized to construction in progress during 2007 and 2006, respectively.

7. Investments in Unconsolidated Organizations

Catholic Health East has investments in unconsolidated organizations totaling \$1,100,657,000 and \$966,256,000 at December 31, 2007 and 2006, respectively. Several significant investments, which are accounted for under the equity method, comprise this balance including, but not limited to, the following:

BayCare Health System

CHE has a fifty percent interest in BayCare Health System Inc. and Affiliates (BayCare), a Florida not-for-profit corporation exempt from state and federal income taxes. BayCare was formed in 1997 pursuant to a Joint Operating Agreement (JOA) among the not-for-profit, tax-exempt members of the Catholic Health East BayCare Participants, Morton Plant Mease Health Care, Inc. and South Florida Baptist Hospital, Inc. (collectively, the Members). BayCare consists of three community health alliances located in the Tampa Bay area of Florida including St. Joseph's-Baptist Healthcare Hospital, St. Anthony's Health Care, and Morton Plant Mease Health Care with an aggregate of approximately 2,900 acute care beds. CHE has the right to appoint nine of the twenty-one members of the Board of Directors of BayCare. At December 31, CHE's recorded investment in BayCare totaled \$882,201,000 and \$806,272,000, excluding wholly owned subsidiaries and other beneficial interests.

Catholic Health System, Inc.

CHE has a one-third interest in Catholic Health System, Inc. and Subsidiaries (CHS). CHS, formed in 1998, is a not-for-profit integrated delivery healthcare system in Western New York jointly sponsored by the Sisters of Mercy, Ascension Health System, the Franciscan Sisters of St. Joseph, and the Diocese of Buffalo. CHE, Ascension Health System, and the Diocese of Buffalo are the corporate members of CHS. CHS operates several organizations, the most significant of which are four acute care hospitals located in Buffalo, New York, Mercy Hospital of Buffalo, Kenmore Mercy Hospital, Sisters of Charity Hospital, and St. Joseph Hospital. At December 31, 2007 and 2006, CHE's recorded investment in CHS totaled \$34,470,000 and \$19,815,000, respectively.

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Condensed consolidated balance sheets of BayCare, including wholly owned foundations and other beneficial interests, and CHS as of December 31 are as follows:

<i>(in thousands of dollars)</i>	Baycare		CHS	
	2007	2006	2007	2006
Assets	\$3,349,800	\$3,188,510	\$447,405	\$401,603
Liabilities	\$1,474,346	\$1,464,917	\$341,890	\$342,099
Net assets	\$1,875,454	\$1,723,593	\$105,515	\$59,504

The following amounts have been recognized in the accompanying consolidated statements of operations and changes in net assets related to the investments in BayCare and CHS for the years ended December 31:

<i>(in thousands of dollars)</i>	Baycare		CHS	
	2007	2006	2007	2006
Equity in earnings of unconsolidated organizations	\$59,669	\$86,883	\$5,966	\$6,112
Net unrealized gains (losses) on investments	13,885	21,881	454	(52)
Other changes in unrestricted and restricted net assets	2,374	5,358	8,236	(4,045)
	<u>\$75,928</u>	<u>\$114,122</u>	<u>\$14,656</u>	<u>\$2,015</u>

Additionally, certain RHCs have investments in unconsolidated organizations, the most significant of which are investments in Medicaid HMO joint ventures at Mercy Health System of Southeastern Pennsylvania (Mercy SEPA). These investments totaling \$183,986,000 and \$140,169,000 in 2007 and 2006, respectively, represent 97% and 97% of the total investments in unconsolidated organizations of Mercy SEPA in 2007 and 2006, respectively. CHE's proportionate share of the income of these investments was \$65,425,000 and \$43,254,000 for the years ended December 31, 2007 and 2006, respectively.

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8. Derivative Financial Instruments

CHE has entered into off-balance sheet derivative transactions for the purpose of mitigating interest rate fluctuations and reducing interest expense.

At December 31, 2007, the System had entered into thirteen basis swap transactions that were outstanding in the CHE program with notional amounts totaling \$473 million. Pursuant to these agreements, the System receives a floating taxable rate and pays a floating tax-exempt rate. One of these basis swap agreements with a combined notional amount of \$195 million was entered into during 2006 and extends for a period of twenty years, maturing in June 2025. The remaining eleven basis swap agreements have maturity dates ranging from February 2023 to June 2030. The System has elected not to designate these interest rate swap agreements as hedges for financial reporting purposes. At December 31, 2007 and 2006, the fair value of these interest rate swap agreements was an asset of approximately \$5,880,000 and \$5,834,000, respectively. The change in the fair value of these interest rate swap agreements during 2007 and 2006 is reflected as an increase in market value of derivative financial instrument as a component of excess of revenue over expenses in the consolidated statement of operations. The changes in fair value of these interest rate swap agreements during 2007 and 2006 are reflected as an increase of \$46,000 and \$10,219,000, respectively.

At December 31, 2007, the System had entered into ten fixed-to-floating interest rate swap agreements with notional amounts totaling \$205 million. Five of these agreements have extendable options that may be exercised by the counterparty upon maturity. These fixed-to-floating interest rate swap agreements effectively convert a portion of the System's fixed rate debt to a floating rate basis and are not designated as hedges for financial reporting purposes. Four of the fixed-to-floating swap agreements, two with an extendable option, with a combined notional amount of \$105 million, were entered into during 2006 and have maturity dates ranging from January 2009 to February 2031. At December 31, 2007 and 2006, the fair value of these interest rate swap agreements was an asset of approximately \$1,791,000 and \$13,000, respectively. The change in the fair value of these interest rate swap agreements during 2007 and 2006 is reflected as an increase in fair market value of derivative financial instrument as a component of excess of revenue over expenses in the consolidated statement of operations. The changes in fair value of these interest rate swap agreements during 2007 and 2006 are reflected as an increase of \$1,778,000 and \$912,000, respectively.

During 2007, CHE entered into six fixed-payor interest rate swap agreements with notional amounts totaling \$333 million. These interest rate swap agreements were executed in March 2007 concurrently with the refinancing of \$333 million of fixed rate debt. Under these interest rate swap agreements CHE pays a fixed rate and receives a variable rate. Additionally, the cash flows from these interest rate swap agreements equal the rates on the bonds and therefore effectively convert the debt to a fixed rate. The notional amount of these interest rate swaps agreements decline in relation to the annual principal payments on the hedged debt. CHE has elected not to designate these interest rate swap agreements as hedges for financial reporting purposes. At December 31, 2007 the fair value of these interest rate swap agreements was a liability of approximately \$11,258,000. The change in fair value of these interest rate swap agreements during 2007 is reflected as a decrease in market value of derivative financial instruments of \$11,258,000 and is recorded as a component of excess of revenue over expenses in the consolidated statement of operations.

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Notes to Consolidated Financial Statements
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9. Long-Term Debt

At December 31, long-term debt consisted of the following:

(in thousands of dollars)

	2007	2006
Revenue bonds		
Catholic Health East Health System Revenue Bonds		
Series 1998A (4.25% - 5.50%), payable from 2026 through 2028	\$354,320	\$457,113
Series 1998B (4.10% - 5.25%), payable through 2028	40,155	101,666
Series 1998C (4.40% - 5.00%), payable through 2028	35,370	36,335
Series 1998D, variable rate, payable from 2008 through 2028	30,000	30,000
Series 1998E (4.10% - 5.25%), payable through 2029	32,135	59,399
Series 1999F Term Bonds (5.625% - 5.75%), payable in 2020 and 2029	18,610	18,610
Series 1999G (7.62%), payable in 2017	6,780	7,256
Series 2002 Serial Bonds (3.50% - 5.50%), payable through 2032	6,670	46,530
Series 2003A Serial Bonds (2.40% - 5.375%), payable through 2033	-	46,200
Series 2003B (2.50% - 5.25%), payable through 2033	31,410	32,045
Series 2003C (2.50% - 5.25%), payable through 2033	14,915	15,215
Series 2003D (2.50% - 5.75%) payable through 2033	18,620	18,995
Series 2004A (3.00% - 5.25%) payable through 2021	12,505	13,155
Series 2004B (3.00% - 5.50%) payable through 2034	9,520	59,960
Series 2004C (4.75% - 5.50%) payable through 2034	1,300	18,450
Series 2006 Serial Bonds, variable rate	36,325	37,600
Series 2007A Serial Bonds, variable rate, payable through 2037	93,515	-
Series 2007B Serial Bonds, variable rate, payable through 2037	20,560	-
Series 2007C Serial Bonds, variable rate, payable through 2037	51,475	-
Series 2007D Serial Bonds, variable rate, payable through 2037	17,135	-
Series 2007E Serial Bonds, variable rate, payable through 2037	100,880	-
Series 2007F Serial Bonds, variable rate, payable through 2037	49,348	-
Mercy Health System Revenue Bonds		
Series 2001 Term Bonds (7.375%) payable through 2016	23,064	24,830
City of Daphne - Special Care Facilities Financing Authority		
Series 1997 with an adjustable rate (1.10% at December 31, 2003), payable through 2027	23,800	24,400
Series 2000 with an adjustable rate (1.10% at December 31, 2003), payable annually 2030	16,000	16,400
City of Miami, Florida Health Facilities Authority Revenue Bonds		
Series of 1998A Serial Bonds (variable interest rate)	14,925	16,430
Series 2002 Serial Bonds (4.03%), payable 2032	35,000	35,000
Maine Health & Higher Educational Facilities Authority		
Revenue Refunding Bonds		
Series 1998A Serial Bonds (4.0% - 5.25%), payable through 2028	11,653	12,178
Series 2001A Serial Bonds (3.45% - 4.125%), payable through 2008	-	373
Series 2006H Serial Bonds, variable rate	63,689	63,690
Other issues under \$10 million	2,810	4,485
Less unamortized discount	(6,031)	(7,754)
	<u>1,166,458</u>	<u>1,188,561</u>

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Notes to Consolidated Financial Statements
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(in thousands of dollars)

	2007	2006
Mortgages payable		
Dormitory Authority of the State of New York		
DASNY (5.20% to 5.375%), payable through 2020	\$21,315	\$22,740
DASNY (5.47%), payable through 2015	10,729	11,886
DASNY (5.56% to 5.64%), payable from 2024 through 2027	14,166	14,639
DASNY (6.23%), payable through 2024	7,313	7,568
Other mortgages and notes payable under \$5 million payable through 2018 with various rates	13,283	14,190
Notes payable		
North Ridge VA Center, LTD (5.04%)	44,000	-
Notes payable due at various dates through 2027, with various rates	24,923	27,137
Revolving credit agreement, due in 2010	66,561	30,042
Capital lease obligations payable in various monthly amounts	36,660	7,460
Total long-term debt and obligations under capital leases	<u>1,405,408</u>	<u>1,324,223</u>
Less current installments	<u>(48,271)</u>	<u>(46,874)</u>
Total long-term debt	<u><u>\$1,357,137</u></u>	<u><u>\$1,277,349</u></u>

Aggregate maturities of long-term debt and capital lease obligations as of December 31, 2007 are as follows:

(in thousands of dollars)

2008	\$48,271
2009	62,569
2010	47,520
2011	49,775
2012	50,519
Thereafter	1,152,785
Less unamortized discount and imputed interest	<u>(6,031)</u>
	<u><u>\$1,405,408</u></u>

In March 2007, CHE issued \$333 million of synthetically fixed rate debt the proceeds of which were used to advance refund \$327 million of existing fixed rate debt. The refunded series were issued in the states of Massachusetts (Series 1998B and Series 2002B), Pennsylvania (Series 2004C), New Jersey (Series 1998B, Series 1998E, and Series 2003A), and Georgia (Series 1998A, Series 2002C, and Series 2004B). A total of nine series of outstanding bonds were refunded partially or entirely. The average coupon on the new debt is 4.384% as compared to 5.195% on the refunded debt. The System recorded a loss on extinguishment of debt totaling \$19.7 million.

In March 2007, Holy Cross executed a promissory note in the amount of \$44 million, payable with interest through maturity in 2023 and recorded an unrestricted contribution (operating revenue) of approximately \$17.7 million.

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Notes to Consolidated Financial Statements

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On November 1, 2006, CHE issued \$37,600,000 of Series 2006 Bonds through the City of Miami, Florida Health Facilities Authority. The proceeds of this issue were used to provide funds for the current refunding and redemption of the outstanding portion of the City of Miami, Florida, Health Facilities Revenue Refunding Bonds (Mercy Hospital Project), Series 1994A, scheduled for February 15, 2007.

On December 1, 2006, CHE issued \$68,400,000 of Series 2006H Bonds through the Maine Health and Higher Educational Facilities Authority. The proceeds of this issue will be used to finance new capital projects in Portland, Maine.

Under the Amended and Restated Master Trust Indenture dated January 1, 1998 and amended and restated as of September 30, 2006, Catholic Health East and other members of the Obligated Group are subject to a gross revenue pledge.

Additionally, the Obligated Group has agreed to comply with certain covenants including the repayment of principal and interest, notification regarding admission or withdrawal of members of the Obligated Group, to deliver financial statements and other related information by specified due dates, to maintain insurance, and to maintain a long-term debt service coverage of at least 1.10 to 1.00.

CHE has a revolving credit loan facility with seven banks. The credit facility totals \$150,000,000 with an option to increase the credit facility to \$200,000,000. Borrowings under this agreement may be repaid at any time, and are payable upon termination of the agreement in December 2010. At December 31, 2007 and 2006, approximately \$82,219,000 and \$63,819,000, respectively, of the total credit facility was obligated for standby letters of credit. Additionally, approximately, \$66,561,000 and \$30,042,000 at December 31, 2007 and 2006, respectively, had been borrowed against the total credit facility. These borrowings were used to finance various capital projects at several of the RHCs. Use of the credit facility for standby letters of credit is limited to \$100,000,000 of the total credit facility.

Pursuant to loan agreements between CHE and various RHCs, promissory notes have been executed by each RHC in amounts equal to the amount of proceeds necessary to defease previously existing debt and provide for capital projects.

The City of Daphne Series 2000 and 1997 Bonds and the City of Miami 1998A Bonds are supported by irrevocable letters of credit which expire in 2011, 2008 and 2010, respectively. CHE is the guarantor for these letters of credit.

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Notes to Consolidated Financial Statements
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10. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity. Temporarily restricted net assets at December 31 are available for the following purposes:

<i>(in thousands of dollars)</i>	2007	2006
Temporarily restricted net assets		
Education and research	\$8,260	\$7,452
Building and equipment	55,824	56,256
Patient care	27,409	11,290
Cancer Center/research	3,222	2,534
Education and research grants	22	91
Other	45,455	37,717
	<u>\$140,192</u>	<u>\$115,340</u>

Permanently restricted net assets at December 31 are restricted as follows:

<i>(in thousands of dollars)</i>	2007	2006
Permanently restricted net assets		
Investments to be held in perpetuity, the income from which is expendable to support health care services (reported as operating income)	\$36,387	\$35,426
Endowments requiring income to be added to the original gift	2,782	2,969
Other	7,749	7,252
	<u>\$46,918</u>	<u>\$45,647</u>

11. Insurance

Professional and general liability risk is insured through Stella Maris Insurance Company, Ltd. a wholly owned, captive insurance company, commercial insurance and reinsurance companies, and self-insured programs. Excess insurance over self-insured amounts and coverage provided by the captive has been purchased from the commercial insurance and reinsurance markets. The excess professional liability coverage is provided on a claims-made basis. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients. CHE has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued malpractice losses have been discounted and in management's opinion provide an adequate reserve for loss contingencies.

CHE maintains a self-insurance program for worker's compensation claims. Losses from asserted claims and from unasserted claims identified under CHE's incident reporting systems are accrued based on estimates that incorporate CHE's experience, relevant trends, and other factors. CHE has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued workers compensation losses have been discounted and in management's opinion provide an adequate reserve for loss contingencies.

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Total amounts accrued under these programs approximate \$246,661,000 and \$231,256,000 at December 31, 2007 and 2006, respectively.

Bank-administered trust and other accounts have been established for the purpose of segregating assets. These trusts are funded based on actuarial estimates and can only be used for payment of malpractice losses, related expenses, and administrative costs of the trusts. Assets of the trusts are included in marketable securities whose use is limited.

The total amount charged to expense for insurance was \$55,122,000 and \$45,282,000 in 2007 and 2006, respectively.

12. Pension Plans

Effective December 31, 2007, the System adopted the recognition and disclosure provisions of Statement of Financial Accounting Standard No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS 158) which amends FASB Statement Nos. 87, 88, 106 and 132(R). SFAS 158 requires employers to recognize the funded status of a defined benefit pension plan or postretirement plan as an asset or liability in the balance sheet.

The funded status represents the difference between the fair value of the plan assets and the projected benefit obligation (PBO). The PBO represents the actuarial present value of benefits attributed to employee service including estimated future salary increases. SFAS 158 also requires employers to recognize annual changes in gains or losses, prior services costs, or other credits that were not previously recognized as a component of net periodic pension cost through unrestricted net assets.

Prior to the issuance of SFAS 158, an employer was required to recognize, at a minimum, an amount equal to the unfunded accumulated benefit obligation (ABO) pursuant to the provisions of SFAS 87. The adoption of SFAS 158 at December 31, 2007 did not impact excess of revenue over expenses for the current or prior year. The following table summarizes the effect of the adjustments to record the adoption of SFAS 158:

<i>(in thousands of dollars)</i>	Before adoption of SFAS 158	Change due to SFAS 158	After adoption of SFAS 158
Retirement Plan Liability	\$32,358	\$48,817	\$81,175
Unrestricted Net Assets	\$2,730,559	\$48,817	\$2,779,376

At December 31, 2007, unamortized prior service costs of \$5,422,000 and unamortized actuarial losses of \$77,220,000 are included in unrestricted net assets at December 31, 2007 and have not yet been recognized in net periodic pension cost. The unamortized prior service costs and unamortized actuarial losses that are expected to be recognized as components of net periodic pension expense during the year ending December 31, 2008 are \$1,359,000 and \$2,162,000, respectively.

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The following table sets forth the change in benefit obligation and the change in fair value of plan assets based on the measurement date, and the amounts recognized in the consolidated financial statements at December 31:

<i>(in thousands of dollars)</i>	2007	2006
Changes in benefit obligations:		
Benefit obligation at the beginning of year	\$737,376	\$711,611
Service cost	28,561	28,966
Interest cost	42,234	39,560
Actuarial loss	(43,924)	(16,096)
Benefits paid	(24,806)	(21,340)
Plan admendments	6	(1,992)
Curtailment	(252)	(669)
Change in plan provisions	-	(2,664)
Benefit obligation at the end of year	<u>\$739,195</u>	<u>\$737,376</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$585,916	\$492,067
Actual return on plan assets (net of expenses)	55,853	59,359
Employer contributions	41,109	55,544
Benefits paid	(24,858)	(21,054)
Fair value of plan assets at end of year	<u>\$658,020</u>	<u>\$585,916</u>
Funded status	(\$81,175)	(\$151,460)
Reconciliation of funded status:		
Fair value of plan assets less benefit obligation	(\$81,175)	(\$152,455)
Unrecognized transition obligation	-	4,516
Unrecognized prior service cost	5,396	6,989
Unrecognized actuarial loss	74,651	130,609
Accrued benefit cost	<u>(1,128)</u>	<u>(10,341)</u>
Additional liability	(80,047)	120,268
Net balance sheet liability	<u>(\$81,175)</u>	<u>\$109,927</u>
Reconciliation of amounts recognized in the consolidated balance sheets		
Other current assets	\$352,352	\$68,011
Current portion of accrued pension liability	-	(31,514)
Non-current portion of accrued pension liability - PBO (2007) and ABO (2006)	(432,941)	(76,278)
Intangible asset	-	8,555
Unrecognized actuarial loss	-	596
Accumulated other comprehensive income	-	45,901
Minimum pension liability included in unrestricted net assets	(586)	(62,862)
Net balance sheet liability	<u>(\$81,175)</u>	<u>(\$47,591)</u>

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The following table sets for the components of net periodic benefit cost for the applicable plan(s) at December 31:

<i>(in thousands of dollars)</i>	2007	2006
Components of net periodic benefit cost:		
Service cost	\$29,371	\$29,086
Interest cost	42,234	39,560
Expected return on plan assets	(49,595)	(42,069)
Amortization of transition obligation	1,010	1,010
Amortization of prior service costs	1,883	1,925
Amortization of actuarial gain	5,481	9,482
Net periodic benefit cost	<u>\$30,384</u>	<u>\$38,994</u>

The accumulated benefit obligation for the Plan was \$677,343,000 and \$663,328,000 at December 31, 2007 and 2006, respectively.

The assumptions used to determine the benefit obligation at December 31 are as follows:

	2007	2006
Benefit obligation:		
Weighted average discount rate	6.15% - 6.40%	5.65% - 6.00%
Weighted average rate of compensation increases	4.25%	3.75% - 5.60%
Weighted average expected long-term rate of return on plan assets	8.50%	8.50%

The assumptions used to determine periodic benefit cost at December 31 are as follows:

	2007	2006
Periodic benefit cost:		
Weighted average discount rate	5.85% - 6.00%	5.65% - 6.00%
Weighted average rate of compensation increases	3.75% - 4.25%	3.00% - 5.00%
Weighted average expected long-term rate of return on plan assets	8.50%	7.50% - 8.50%

Investment Policy and Asset Allocations – In developing the assumption for the expected rate of return on assets, CHE evaluates historical returns, the 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 rate of return for each asset class is then weighted based on the target asset allocation to develop the assumption for the expected long-term rate of return on assets. This methodology was utilized to develop the long-term rate of return assumptions at December 31, 2007 and 2006.

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The weighted average asset allocation for the plan at December 31 and the target allocation for calendar year 2008, by asset category, are as follows:

Asset category	Target		
	Allocation 2008	2007	2006
Cash and cash equivalents	5.0 %	5.6 %	6.8 %
Marketable equity securities	68.7 %	66.3 %	66.8 %
Marketable debt securities	13.8 %	17.5 %	15.5 %
Managed funds other	12.5 %	10.6 %	10.9 %
	<u>100.0 %</u>	<u>100.0 %</u>	<u>100.0 %</u>

The portfolio is diversified among a mix of assets including large and small cap, domestic and foreign equities, fixed income, alternatives (a fund of hedge funds), and cash. Asset mix is targeted to a specific allocation, either intermediate or long-term, that is established by evaluating expected return, standard deviation, and correlation of various assets against the plan's long-term objectives. Asset performance is monitored quarterly and rebalanced if asset classes exceed explicit ranges. The investment policy governs permitted types of investments, and outlines specific benchmarks and performance percentiles. The Investment Subcommittee of the Stewardship Committee of the CHE Board oversees the pension investment program and monitors investment performance. Risk is closely monitored through the evaluation of portfolio holdings and tracking the beta and standard deviation of the portfolio performance. The use of derivative financial instruments as an investment vehicle is specifically limited.

Contributions – Expected contributions to the defined benefit plans in 2008 are approximately \$29,501,000

Estimated Future Benefit Payments

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

(in thousands of dollars)

2008	\$32,629
2009	35,689
2010	38,213
2011	42,844
2012	46,379
2013-2016	<u>282,762</u>
	<u>\$478,516</u>

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13. Concentration of Credit Risk

CHE grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31 was as follows:

	2007	2006
Managed care	31.4 %	32.8 %
Medicare	26.7 %	26.8 %
Medicaid	9.2 %	9.2 %
Self-pay	11.1 %	11.9 %
Other third-party payors	10.2 %	9.7 %
Commercial	11.4 %	9.6 %
	<u>100.0 %</u>	<u>100.0 %</u>

In addition, CHE invests its cash and cash equivalents primarily with banks and financial institutions. These deposits may be in excess of federally insured limits. Management believes that the credit risk related to these deposits is minimal.

14. Commitments and Contingencies

The RHCs are defendants in various lawsuits relating primarily to rendering of health care services. In each instance, management of the respective RHCs is of the opinion that the liability, if any, resulting there from will be covered by insurance or will not have a material adverse impact on the consolidated financial statements of CHE. In addition, certain CHE entities have been contacted by governmental agencies regarding alleged violations of practices for certain services. Management of the respective RHCs has performed, with the advice and assistance of outside legal counsel, an evaluation of billing practices and compliance with related laws and regulations. In the opinion of management, after consultation with outside legal counsel, the ultimate outcome of these matters will not have a material adverse impact on the consolidated financial statements of CHE.

15. Leases

The RHCs lease office space and certain equipment under noncancelable operating leases. Rental expense was approximately \$59,328,000 and \$60,620,000 in 2007 and 2006, respectively.

Future minimum lease payments for all noncancelable leases as of December 31, 2007 are as follows:

(in thousands of dollars)

2008	\$39,467
2009	35,572
2010	30,032
2011	24,187
2012	20,264
Thereafter	<u>58,507</u>
	<u>\$208,029</u>

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16. Functional Expenses

CHE provides general health care services to residents within their geographic location including acute care, skilled nursing, outpatient care, home healthcare, physician practices, and behavioral services. Expenses related to providing these services at December 31 are as follows:

<i>(in thousands of dollars)</i>	2007	2006
Health care services	\$3,305,773	\$3,239,104
General and administrative	<u>770,354</u>	<u>742,055</u>
	<u><u>\$4,076,127</u></u>	<u><u>\$3,981,159</u></u>

17. Fair Value of Financial Instruments

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

Cash and Cash Equivalents: The carrying amount reported in the consolidated balance sheets for cash and cash equivalents approximates fair value.

Marketable Securities Whose Use Is Limited and Investments: Fair values, which are the amounts reported in the balance sheet, are based on quoted market prices, if available, or estimated using quoted market prices for similar securities.

Accounts Payable and Accrued Expenses: The carrying amount reported in the balance sheet for accounts payable and accrued expenses approximates its fair value.

Estimated Third-Party Payor Settlements: The carrying amount reported in the balance sheet for estimated third-party payor settlements approximates its fair value.

Long-Term Debt: Quoted market prices or estimates using discounted cash flow analyses, based on the participating facility's incremental borrowing rates for similar types of borrowing arrangements. The fair value of the System's long-term debt, based on quoted market prices, at December 31, 2007 and 2006 was \$1,295,145,000 and \$1,296,681,000, respectively, compared to the carrying value of \$1,166,458,000 and \$1,324,223,000, respectively. This excludes capital leases, notes payable, and mortgage notes.

Derivative Financial Instruments: Quoted market price of these or similar instruments.

At December 31, 2007, the carrying amount approximates the fair values of financial instruments recorded as assets.

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18. Restructuring Expenses, Impairment Losses and Nonrecurring Charges

During 2007 and 2006, several RHCs approved restructuring plans designed to reduce ongoing operating costs. The plans primarily involve the reduction of workforce, the elimination of small unprofitable business lines, and the divestiture/closure of certain physician practices and ambulatory care clinics.

Total restructuring costs and impairment losses associated with carrying out the above plans were \$3,095,000 and \$12,380,000 in 2007 and 2006, respectively. Total nonrecurring charges were \$1,291,000 for the year ended December 31, 2007.

19. Assets Held for Sale and Discontinued Operations

In accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*, the System classified certain long-lived assets as "held for sale" in fiscal years 2007 and 2006.

During 2006, CHE and Pittsburgh Mercy Health System (PMHS) announced that a letter of intent had been signed with the University of Pittsburgh Medical Center (UPMC) to transfer ownership of The Mercy Hospital of Pittsburgh (MHP), Mercy Primary Care Center (MPCC), Emergency Medical Association (EMA), and Health Association of Western PA (HAW) to UPMC. This transaction was completed on January 2, 2008.

During 2007, CHE and PMHS announced that an Asset Purchase Agreement had been signed with Excelsa Health (Excelsa) whereby CHE will sell certain assets of Mercy Jeannette Hospital (MJH), Jeannette Medical Properties (JMP), and Jefferson Properties (JP) to Excelsa Health. This transaction was completed on April 30, 2008.

Collectively, these entities are referred to as the Disposal Group.

All related assets, liabilities, and gains or losses from operations for the Disposal Group have been accounted for as discontinued operations as of and for the years ended December 31, 2007 and 2006. For the years ended December 31, 2007 and 2006, the net operating loss of the Disposal Group was \$31,081,000 and \$187,000, respectively.

Details of the assets held for sale, the related liabilities, and discontinued operations at December 31 are provided below:

<i>(in thousands of dollars)</i>	2007	2006
Assets Held for Sale and Related Liabilities		
Patient accounts receivable, net	\$32,519	\$31,770
Property, plant, and equipment, net	132,052	127,497
Other assets	32,532	33,249
Total assets	<u>\$197,103</u>	<u>\$192,516</u>
Current liabilities	\$54,990	\$47,148
Other long-term liabilities	115,814	106,083
Total liabilities	<u>\$170,804</u>	<u>\$153,231</u>
Total revenues from discontinued operations	<u>\$368,564</u>	<u>\$353,770</u>
Net loss from discontinued operations	<u>(\$31,081)</u>	<u>(\$187)</u>

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20. Subsequent Events

In January 2008, St. Peter's Hospital issued \$230.4 million of Civic Facilities Tax-Exempt Revenue Bonds consisting of the Series 2008-A through Series 2008-E (the Series 2008 Albany Bonds). The Series 2008 Albany Bonds were issued through the City of Albany Industrial Development Agency. Two additional bond series are expected to be issued in 2009 for approximately \$25.6 million. The proceeds of the Series 2008 Albany Bonds were used to finance the St. Peter's Master Facilities Plan with an estimated project cost of \$258.7 million, to advance refund and defease the Series 1993 Bonds totaling \$21.7 million, to fund a debt service reserve fund for the Series 2008 Bonds totaling \$18.0 million, and for payment of capitalized interest and debt issuance costs on the Series 2008 bonds of approximately \$32.6 million. The St. Peter's Master Facilities Plan includes, but is not limited to, the renovation of hospital facilities, construction of a new patient pavilion, construction of a new parking facility, and the acquisition of related medical equipment. In relation to the refinancing of the 1993 Bonds, St. Peter's Hospital recorded a loss on extinguishment of debt in 2008 totaling \$1.0 million.

In January 2008, CHE and Mercy Hospital, Miami issued \$30.0 million of Series 2008 Private Placement Bonds through the City of Miami, Florida Health Facilities Authority (the Series 2008 Miami Bonds). The proceeds of this issue were used to finance the construction of a new parking facility, the expansion and renovation of the emergency room, miscellaneous equipment acquisition, construction, renovation, improvements and to pay the costs of issuance of the bonds. The Series 2008 Miami Bonds were issued as fixed rate bonds, and include a put option and guaranty agreement for which CHE will receive fees during the term of the bonds. The fixed rate, net of the put and guaranty fees, is 3.40%. Merrill Lynch, as the put option holder, has the right to exercise the option and put the bonds back to CHE on January 5, 2009.

On January 2, 2008, CHE concluded a transaction whereby certain entities of Pittsburgh Mercy Health System (PMHS) were sold to the University of Pittsburgh Medical Center (UPMC). The PMHS entities that were sold include The Mercy Hospital of Pittsburgh (MHP), Mercy Primary Care Center (MPCC), Emergency Medical Association (EMA), and Health Association of Western PA (HAW). The sales price related to the transaction included approximately \$60.0 million of cash and investments retained by CHE/PMHS related to those entities that were sold, the elimination and legal defeasance of bond debt approximating \$93.3 million, and a pledge receivable from UPMC totaling \$30.0 million to be paid to CHE/PMHS in equal annual installments, without interest, over the next six years. Related to this transaction, the System recorded a gain on the sale approximating \$2.1 million.

On March 31, 2008, HCH concluded a transaction that resulted in the acquisition of North Ridge Medical Center (NRMC) from Tenet Healthcare Corporation. The acquisition included all major assets of NRMC, including the land, buildings and equipment for a purchase price of \$20.0 million. In connection with the transaction, the Company executed short term borrowings of \$20.0 million from Catholic Health East at an interest rate approximating 3.6% which is reset monthly. HCH consolidated the operations of North Ridge with its main campus and filed a notice of closure of NRMC with the State of Florida Agency for Health Care Administration on April 1, 2008.

On April 30, 2008 CHE concluded a transaction whereby certain assets of Mercy Jeannette Hospital, Jeannette Medical Properties, and Jefferson Properties were sold to Excelsa Health. Total proceeds received from the sale approximated \$17.3 million.