Catholic Health East

Consolidated Financial Statements
December 31, 2010 and 2009

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Year Ended December 31, 2010

Report of Independent Auditors

To the Board of Directors
Catholic Health East

In our opinion, based on our audits and the reports 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, 2010 and 2009, 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 statements reflect net assets of $64,964,000 and $53,626,000 at December 31, 2010 and 2009, respectively, and excess of revenues over expenses of $11,338,000 and $26,821,000 for the years then ended. In addition, we did not audit the financial statements of certain unconsolidated entities which are represented in the following financial statements for 2010 and 2009 as investments in unconsolidated organizations of $1,160,212,000 and $994,958,000 as December 31, 2010 and 2009, respectively, and equity in earnings of unconsolidated organizations of $167,882,000 and $226,941,000 for the years then ended. Those statements were audited by other auditors whose reports thereon have 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 reports 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 reports of other auditors provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, on January 1, 2010 the Company adopted new accounting standards which included guidance regarding the recognition and subsequent accounting for goodwill, and recorded a transitional impairment charge of $32,625,000.

PricewaterhouseCoopers LLP

May 5, 2011

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Catholic Health East
Consolidated Statements of Operations
Years Ended December 31, 2010 and 2009

(in thousands of dollars)

	2010	2009
Assets		
Current assets		
Cash and cash equivalents	$426,782	$403,737
Investments	78,025	72,399
Marketable securities whose use is limited	35,342	32,356
Patient accounts receivable, net of estimated uncollectibles of $329,394 and $326,314 for 2010 and 2009, respectively	489,120	493,748
Collateral received on securities pledged	35,104	47,376
Other accounts receivable	137,811	127,766
Prepaid expenses and inventories	123,386	119,938
Assets held for sale	8,009	5,923
Total current assets	1,333,579	1,303,243
Marketable securities and investments whose use is limited		
Board-designated funds	371,095	303,979
Trustee-held funds	211,623	214,852
Donor-restricted funds	72,467	63,703
Investments	408,382	396,453
Total marketable securities and investments whose use is limited	1,063,567	978,987
Property and equipment, net	1,720,195	1,683,406
Equity investments in managed funds	286,121	303,336
Investments in unconsolidated organizations	1,325,201	1,150,083
Assets held for sale	370,783	380,719
Goodwill	7,143	39,756
Other assets	129,476	165,196
Total assets	$6,236,065	$6,004,726
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt	$58,308	$52,834
Portion of variable rate demand obligations classified as current	29,518	54,247
Accounts payable and accrued expenses	625,432	548,786
Collateral due broker on securities pledged	35,104	47,376
Estimated third party payor settlements, net	79,783	65,086
Other	182,410	171,708
Liabilities related to assets held for sale	28,307	28,683
Total current liabilities	1,038,862	968,720
Long-term debt, net	1,669,177	1,651,727
Other liabilities	143,781	155,058
Pension liabilities	290,536	283,550
Insurance liabilities, net of current portion	303,718	296,297
Deferred revenue from entrance fees	45,679	47,380
Total liabilities	3,491,753	3,402,732
Net assets		
Unrestricted	2,584,038	2,449,026
Temporarily restricted	132,304	126,964
Permanently restricted	27,970	26,004
Total net assets	2,744,312	2,601,994
Total liabilities and net assets	$6,236,065	$6,004,726

Catholic Health East
Consolidated Statements of Operations
Years Ended December 31, 2010 and 2009

(in thousands of dollars)

	2010	2009
Unrestricted revenue, gains and other support		
Net patient service revenue	$3,788,967	$3,733,340
Other operating revenue, gains and other support	268,542	257,770
Total unrestricted revenue, gains and other support	4,057,509	3,991,110
Expenses		
Salaries, wages and benefits	2,056,527	2,072,609
Medical supplies	587,938	572,870
Purchased services, professional fees and other expenses	851,360	811,462
Depreciation and amortization	170,861	178,150
Interest	56,877	58,358
Insurance	48,584	55,265
Provision for bad debts	252,090	233,791
Total operating expenses	4,024,237	3,982,505
Operating income before losses from Saint Joseph's Health System	33,272	8,605
Losses from Saint Joseph's Health System	(20,037)	(13,481)
Operating income (loss)	13,235	(4,876)
Non-operating gains (losses)		
Investment returns, net	87,959	144,469
Net cumulative unrealized losses transferred to trading securities	-	(59,289)
Equity in gains in earnings of unconsolidated organizations	163,776	227,968
Restructuring expenses and impairment losses	(17,364)	(15,790)
Other non-operating gains (losses)	671	(3,711)
Gain on extinguishment of debt	657	42,674
Change in fair value of interest rate swaps	(13,036)	130,662
Total non-operating gains	222,663	466,983
Excess of revenue over expenses	$235,898	$462,107

Catholic Health East
Consolidated Statements of Changes in Net Assets
Years Ended December 31, 2010 and 2009

(in thousands of dollars)

	2010	2009
Unrestricted net assets		
Excess of revenue over expenses	$235,898	$462,107
Change in unrealized gains on available-for-sale securities	4,704	23,824
Net cumulative unrealized losses transferred to trading securities	-	59,289
(Increase) decrease in pension liability adjustment - consolidated organizations	(37,096)	76,372
(Increase) decrease in pension liability adjustment	(8,585)	6,041
Cumulative effect of change in accounting principle - goodwill	(32,625)	-
Other changes	19,386	33,295
Increase in unrestricted net assets before discontinued operations	181,682	660,928
Loss from discontinued operations	(46,670)	(29,557)
Increase in unrestricted net assets	135,012	631,371
Temporarily restricted net assets		
Contributions	27,250	27,089
Investment income	3,632	2,047
Change in unrealized gains on investments	666	1,525
Net assets released from restrictions	(28,176)	(25,220)
Other changes	1,968	(4,548)
Increase in temporarily restricted net assets	5,340	893
Permanently restricted net assets		
Contributions	585	33
Net realized and unrealized gains on investments	1,300	1,897
Other changes	81	(10,399)
Increase (decrease) in permanently restricted net assets	1,966	(8,469)
Increase in net assets	142,318	623,795
Net assets		
Beginning of year	2,601,994	1,978,199
End of year	$2,744,312	$2,601,994

Catholic Health East
Consolidated Statement of Cash Flows
Years Ended December 31, 2010 and 2009

(in thousands of dollars)

	2010	2009
Cash flows from operating activities		
Increase in net assets	$142,318	$623,795
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities		
Loss from discontinued operations	46,670	29,557
Cumulative effect of change in accounting principle - goodwill	32,625	-
Pension adjustment, including unconsolidated organizations	45,681	(82,414)
Gain on extinguishment of debt	(657)	(42,674)
Depreciation and amortization	170,861	205,483
Amortization of deferred entrance fees	(7,047)	(6,165)
Net realized (gains) losses on investments	(34,943)	15,610
Net unrealized gains on investments	(50,917)	(168,470)
Equity in earnings of unconsolidated organizations	(189,446)	(282,585)
Provision for bad debts	252,090	254,180
Decrease (increase) in market value of interest rate swaps	11,836	(116,624)
Restricted contributions and investment income received	(33,433)	(32,431)
Return on investment in unconsolidated organizations	14,353	10,553
Entrance fees received, net of refunds	5,346	3,779
(Increase) decrease in certain assets and liabilities		
Accounts receivable	(248,617)	(265,018)
Other receivables	(11,925)	14,819
Prepaid expenses, inventories and other assets	31,510	3,914
Assets held for sale	(6,604)	(9,221)
Accounts payable, accrued expenses and other current liabilities	57,441	(19,039)
Third party payables	14,057	(1,720)
Insurance and other liabilities	(14,388)	47,636
Pension liability	(38,695)	3,404
Net cash provided by (used in) operating activities of discontinued operations	1,223	(36,556)
Net cash provided by operating activities	189,339	149,813
Cash flows from investing activities		
Additions to property and equipment	(205,826)	(202,539)
Return of posted collateral on interest rate swaps	-	88,000
Decrease (increase) in collateral received on securities pledged	12,272	(23,435)
Decrease in investments and marketable securities whose use is limited	13,340	88,573
Net cash (used in) provided by investing activities of discontinued operations	(1,363)	19,696
Net cash used in investing activities	(181,577)	(29,705)
Cash flows from financing activities		
Proceeds from restricted contributions and investment income received	33,433	32,431
Proceeds from issuance of long-term debt	441,132	169,081
Decrease in variable rate demand obligations classified as current	(24,729)	(2,920)
Cost of issuance of long-term debt	(2,900)	(2,694)
Repayments of long-term debt	(415,281)	(213,029)
(Decrease) increase in payable under collateral received on securities pledged	(12,272)	23,435
Net cash used in financing activities of discontinued operations	(4,100)	(3,077)
Net cash provided by financing activities	15,283	3,227
Increase in cash and cash equivalents	23,045	123,335
Cash and cash equivalents		
Beginning of year	403,737	280,402
End of year	$426,782	$403,737
Supplemental disclosures of cash flow information		
Interest paid	$59,757	$65,868
Non-cash transaction	$4,640	$18,564

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 nine 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 Hospital, Inc.
Fort Lauderdale, Florida

Mercy Health System of Southeastern Pennsylvania
Conshohocken, Pennsylvania

Saint Joseph's Health System, Inc.
Atlanta, Georgia

Our Lady of Lourdes Health Care Services, Inc.
Camden, New Jersey

Mercy Community Health, Inc.
West Hartford, Connecticut

Mercy Health System of Maine
Portland, Maine

St. Francis Medical Center
Trenton, New Jersey

St. Peter's Health Care Services
Albany, New York

St. Mary Medical Center
Langhorne, Pennsylvania

Saint Michael's Medical Center
Newark, New Jersey

St. Francis Hospital and Affiliates
Wilmington, Delaware

Pittsburgh Mercy Health System, Inc.
Pittsburgh, Pennsylvania

Mercy Medical Corporation
Daphne, Alabama

Sisters of Providence Health System, Inc.
Springfield, Massachusetts

Mercy Hospital, Inc.
Miami, Florida

St. Mary's Health Care System, Inc.
Athens, Georgia

Saint Joseph of the Pines, Inc.
Southern Pines, North Carolina

St. James Mercy Health Systems, Inc.
Hornell, New York

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.

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 fair 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. Equity investments in managed funds, private partnerships, and other investments are accounted for under the equity method, which approximates fair value. Realized gains and losses on investments, unrealized gains and losses on trading securities, interest income (net of investment-related expenses), and dividends are included in investment returns, net, as part of non-operating gains and (losses) in the excess of revenue over expenses. Investment income restricted by donors or law is reported as an increase in temporarily or permanently restricted net assets.

The System's investments and marketable securities whose use is limited are invested and managed through the CHE Consolidated Investment Program (the CIP Program), and some investments are locally managed by the RHCs. Included in these investments are investments in managed funds, private partnerships, and other investments. The income (loss) from these managed funds is included in investment returns, net, in the accompanying consolidated statement of operations and change in net assets.

The System classifies all unrestricted investments as trading securities.

In 2009, CHE determined that the unrestricted investments in the locally-managed investment portfolios should be classified as trading as opposed to available-for-sale based on CHE's investment philosophies, strategies, and the nature and frequency of investment activity and in accordance with accounting guidance for classification of investments. This change in designation was made on January 1, 2009 and resulted in the recognition of $59,289,000 of previously unrecognized unrealized losses on securities transferred to excess of revenues over expenses within non-operating gains (losses). Changes in unrealized gains and losses related to these investments are reflected as a component of investment returns, net in the statements of operations in the consolidated financial statements for the year ended December 31, 2010 and 2009.

Investments are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with these securities and the level of uncertainty related to changes in their value, it is at least reasonably possible that changes in risks in the near term could materially affect account balances and the amounts reported in the consolidated balance sheets and statements of operations and change in net assets.

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

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, 2010 and 2009.

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

Assets Held for Sale
CHE has classified certain long-lived assets as assets held for sale in the consolidated balance sheet when the assets have met applicable criteria for this classification. CHE has classified $378,792,000 and $386,642,000 as current and long-term assets held for sale at December 31, 2010 and 2009, respectively. The Company has also classified $28,307,000 and $28,683,000 at December 31, 2010 and 2009, respectively, as liabilities related to assets held for sale.

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 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 the exchange price that would be received for an asset or paid to transfer a liability. The System recognized impairment losses of $3,023,000 and $5,969,000 for the years ended December 31, 2010 and 2009, 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, 2010 and 2009, totaling $21,758,000 and $22,647,000, respectively are amortized using the straight-line method over the life of the related debt, which approximates the effective interest method.

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 the excess of revenue over expenses. Changes in unrestricted net assets which are excluded from excess of revenue over expenses include unrealized gains and losses on available for sale investments of unconsolidated organizations; permanent transfers of assets to and from affiliates for other than goods and services, pension adjustment, 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).

Non-Operating Gains (Losses)
Non-operating gains (losses) consist primarily of investment returns, which include investment income, dividends, net unrealized gains (losses) on trading securities, and realized gains and losses on trading securities; equity in earnings of unconsolidated organizations; restructuring expenses and impairment losses; losses on extinguishment of debt; and the change in the fair value of interest rate swaps.

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, income from health plan operations, support services, parking garages, gift shop income, cafeteria income, maintenance fee income, foundation investment 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 or failure of payors 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 $463,752,000 and $434,390,000 in 2010 and 2009, respectively. These amounts do not include the provision of bad debts totaling $252,090,000 and $233,791,000 in 2010 and 2009, respectively, which is reflected separately in the consolidated statements of operations. The charges and provisions for bad debts do not include amounts classified as discontinued 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.

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.

Subsequent Events
CHE evaluated the impact of subsequent events through May 5, 2011, representing the date at which the consolidated financial statements were issued. See Note 21 for a discussion of CHE's material subsequent events related to the December 31, 2010 consolidated financial statements.

Adoption of Accounting Pronouncements
Effective January 1, 2010, the Company adopted new accounting standards issued by the Financial Accounting Standards Board (FASB) which provide guidance on the accounting for mergers and acquisitions by not-for-profit organizations, including the recognition and subsequent accounting for goodwill resulting from an acquisition. In accordance with the provisions of this guidance, beginning in 2010, goodwill is no longer amortized. Goodwill is evaluated and reviewed for impairment at least annually or whenever events or circumstances indicate that the carrying value may not be recoverable. Upon adoption of this guidance, CHE recorded a transitional impairment charge of $32,625,000 related to goodwill recorded from the acquisition of St. Michael's Medical Center in 2008. The transitional impairment was determined by comparing the present value of the reporting unit's future cash flows to the carrying value of the goodwill. This charge is included as the cumulative effect of a change in accounting principle in the 2010 statement of changes in net assets.

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 30.9% and 9.4%, respectively, of total net patient service revenues in 2010, and 30.9% and 8.4%, respectively of total net patient service revenue in 2009. 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 $19,626,000 and $20,173,000 in 2010 and 2009, respectively, are included as a component of current liabilities in the accompanying consolidated balance sheets. The amounts recorded for these estimated settlements approximate their fair value.

Net patient service revenue includes approximately $6,077,000 and $18,613,000 in 2010 and 2009, 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.

The following summarizes net patient service revenue for the years ended December 31:

(in thousands of dollars)	**2010**	**2009**
Gross patient service revenue	$14,421,929	$14,245,185
Less:		
Contractual allowances	(10,214,482)	(10,127,824)
Charity care	(463,752)	(434,390)
Other	45,272	50,369
Net patient service revenue	$3,788,967	$3,733,340

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, and in particular 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.

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 in presented in accordance with the Catholic Health Association's, *A Guide for Planning and Reporting Community Benefits*, Copyright 2008. Social accountability costs for the years ended December 31 are as follows:

(in thousands of dollars)	**2010**	**2009**
Cost of care for those who are poor	$58,495	$59,979
Cost of community benefit programs	76,178	72,964
Other public programs	12,079	10,449
Unpaid cost of Medicaid programs	83,948	89,395
Social accountability costs	$230,700	$232,787
Percentage of operating expenses	4.8%	4.9%
Unpaid cost of Medicare programs	$181,675	$214,065

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 and Investments Whose Use Is Limited and Equity Investments in Managed Funds

The composition of investments at December 31 is as follows:

(in thousands of dollars)

	2010	2009
Reported at fair value		
Cash and cash equivalents	$337,459	$399,767
Marketable equity securities	478,433	374,773
Marketable debt securities	361,042	309,202
	1,176,934	1,083,742
Reported under the equity method		
Managed funds	286,121	303,336
	$1,463,055	$1,387,078

A portion of CHE's long-term investment assets are held in the CIP Program. The CIP Program is structured under a Program Participation Agreement (the Agreement) between each participant RHC and CHE. All investments in the CIP Program are professionally managed under the administration of CHE.

Participants' investments held in the CIP Program are assigned a weighted value for the period of time the funds are invested in the CIP Program. Investment income from the CIP Program, including interest income, dividends, and realized gains and losses on sales of securities, and unrealized gains and losses are distributed to participants based on their weighted value of investment.

The underlying fair value of investments in the CIP Program, which are traded on national exchanges (except for managed funds), 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.

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, 2010 and 2009, securities with a fair market value of $35,104,000 and $47,376,000, respectively, were loaned under securities lending agreements.

Investment returns, net, is comprised of the following for the years ended December 31:

(in thousands of dollars)	2010	2009
Unrestricted net assets		
Investment returns, net		
Interest and dividends	$13,637	$11,198
Net realized gains (losses)	21,991	(12,434)
Net unrealized gains on investments - trading securities	52,331	145,705
	$87,959	$144,469
Net change in unrealized gains on available for sale securities (held by unconsolidated organizations)	$4,704	$23,824
Temporarily restricted net assets		
Other changes in temporarily restricted net assets		
Investment income		
Interest and dividends	$1,001	$726
Net realized gains on investments	2,631	1,321
	$3,632	$2,047
Net unrealized gains on investments	$666	$1,525
Permanently restricted net assets		
Other changes in permanently restricted net assets		
Net realized and unrealized gains on investments	$1,300	$1,897

The following managed fund investments are recorded under the equity method of accounting, which approximates the net asset value per share of the investments as of December 31, 2010:

(in thousands of dollars)	Recorded Value	Unfunded Commitments	Commitment Term	Redemption Terms
Fund of Hedge Funds	$253,719	$0	n/a	Quarterly, semiannually, or anniversary date
Real Estate	13,118	$6,235	4-9 years	Redemption permitted upon expiration of commitment term
Private Equity	19,284	$18,632	5-13 years	Redemption permitted upon expiration of commitment term
Total	$286,121			

6. Fair Value Measurements

The System adheres to applicable accounting guidance for fair value measurements. This guidance defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States of America and requires certain disclosures about fair value measurements. Fair value is defined under the guidance as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

As a basis for considering assumptions, the guidance establishes a hierarchical framework for measuring fair value (the fair value hierarchy) as follows:

Level 1: Quoted prices in active markets for identical assets.

Level 2: Observable inputs other than Level 1 prices, such as quoted prices for similar instruments; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Financial instruments measured at fair value are based on one or more of the three valuation techniques noted in the fair value guidance. The three valuation techniques are as follows:

Market approach: Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

Cost approach: Amount that would be required to replace the service capacity of an asset (i.e., replacement cost).

Income approach: Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques and option-pricing models).

The System measures its interest rate swaps at fair market value on a recurring basis. The fair market value of the interest rate swaps is determined based on financial models that consider current and future market interest rates and adjustments for non-performance risk.

Financial instruments at fair value at December 31, 2010 and 2009 are as follows:

(in thousands of dollars)

	2010				
	Level 1	Level 2	Level 3	Total	Valuation Technique
Consolidated investment program:					
Cash and cash equivalents	$46,964	$56,532	$ -	$103,496	Market
Marketable equity securities	355,890	1,995	11	357,896	Market
Marketable debt securities	49,655	122,383	-	172,038	Market
Total consolidated investment program	452,509	180,910	11	633,430	
Locally invested:					
Cash and cash equivalents	233,963	-	-	233,963	Market
Marketable equity securities	102,691	17,840	6	120,537	Market
Marketable debt securities	64,087	119,553	5,364	189,004	Market
Total locally invested	400,741	137,393	5,370	543,504	
Total marketable securities and investments whose use is limited at fair value	$853,250	$318,303	$5,381	1,176,934	
Managed funds				286,121	
Total marketable securities and investments whose use is limited and managed funds				$1,463,055	
Derivative financial instruments					
Interest rate swaps - liability		($302)			Market

	2009				
	Level 1	Level 2	Level 3	Total	Valuation Technique
Consolidated investment program:					
Cash and cash equivalents	$115,518	$29,410	$ -	$144,928	Market
Marketable equity securities	270,932	246	-	271,178	Market
Marketable debt securities	40,281	105,726	345	146,352	Market
Total consolidated investment program	426,731	135,382	345	562,458	
Locally invested:					
Cash and cash equivalents	253,492	1,347	-	254,839	Market
Marketable equity securities	86,996	16,593	6	103,595	Market
Marketable debt securities	81,246	76,553	5,051	162,850	Market
Total locally invested	421,734	94,493	5,057	521,284	
Total marketable securities and investments whose use is limited at fair value	$848,465	$229,875	$5,402	1,083,742	
Managed funds				303,336	
Total marketable securities and investments whose use is limited and managed funds				$1,387,078	
Derivative financial instruments					
Interest rate swaps - asset		$12,718			Market

A roll forward of those financial instruments that have been classified by the Company as Level 3 within the fair value hierarchy (defined above) is as follows:

(in thousands of dollars)

	2010		
	Consolidated Investment Program	**Locally Invested**	**Total**
Fair value January 1	$345	$5,057	$5,402
Purchases	-	2,436	2,436
Realized and unrealized gains	9	216	225
Transfers out	(343)	(2,116)	(2,459)
Change in fair value	-	284	284
Sales	-	(507)	(507)
Fair value December 31	$11	$5,370	$5,381
Amount of unrealized losses related to Level 3 investments held at December 31, included in the statement of operations	$9	$284	$293

	2009		
	Consolidated Investment Program	**Locally Invested**	**Total**
Fair value January 1	$201	$4,357	$4,558
Purchases	340	181	521
Realized and unrealized gains	236	48	284
Transfers out	-	(69)	(69)
Change in fair value	-	641	641
Sales	(432)	(101)	(533)
Fair value December 31	$345	$5,057	$5,402
Amount of unrealized losses related to Level 3 investments held at December 31, included in the statement of operations	$236	$49	$285

7. Property and Equipment

The following summarizes property and equipment at December 31:

(in thousands of dollars)	**2010**	**2009**
Land and improvements	$104,970	$105,591
Buildings and improvements	1,918,664	1,870,960
Equipment	1,458,132	1,394,842
	3,481,766	3,371,393
Less: Accumulated depreciation and amortization	(1,971,840)	(1,816,579)
	1,509,926	1,554,814
Construction in progress	210,269	128,592
	$1,720,195	$1,683,406

At December 31, 2010 and 2009, approximately $633,142,000 and $596,130,000 of property and equipment, net, is pledged as collateral under various loan agreements. Interest cost, net of related interest income, totaling approximately $5,952,000 and $6,837,000 was capitalized to construction in progress during 2010 and 2009, respectively.

8. Investments in Unconsolidated Organizations

Catholic Health East has investments in unconsolidated organizations totaling $1,325,201,000 and $1,150,083,000 at December 31, 2010 and 2009, 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, 2010 and 2009, CHE's recorded investment in BayCare totaled $1,071,455,000 and $918,741,000, 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, 2010 and 2009, CHE's recorded investment in CHS totaled $24,523,000 and $24,370,000, respectively.

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

(in thousands of dollars)	Baycare		CHS	
	2010	2009	2010	2009
Assets	$3,883,968	$3,633,116	$566,164	$521,160
Liabilities	$1,600,427	$1,655,002	$487,683	$443,140
Net assets	$2,283,541	$1,978,114	$78,481	$78,020

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:

(in thousands of dollars)	Baycare		CHS	
	2010	2009	2010	2009
Equity in earnings of unconsolidated organizations	$149,748	$212,240	$6,532	$10,766
Net unrealized losses on investments	(7)	(77)	-	-
Other changes in unrestricted and restricted net assets	(137)	13,180	(6,268)	(1,363)
	$149,604	$225,343	$264	$9,403

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 total $229,223,000 and $206,972,000 in 2010 and 2009, respectively. CHE's proportionate share of the income of these investments was $32,911,000 and $28,739,000 for the years ended December 31, 2010 and 2009, respectively.

9. Derivative Financial Instruments

CHE has entered into derivative transactions for the purpose of reducing interest rate volatility and to reduce interest expense. CHE has entered into fixed-to-floating interest rate swaps, basis swaps, and fixed-payor swaps.

At December 31, 2010, fourteen basis swap transactions were outstanding in the CHE program with notional amounts totaling $717 million and maturity dates ranging from February 2023 to December 2028. In the basis swap transactions, CHE receives a floating taxable rate and pays a floating tax-exempt rate. CHE has elected not to designate these interest rate swap agreements as hedges for financial reporting purposes.

At December 31, 2010, four fixed-to-floating interest rate swap agreements were outstanding in the CHE program with notional amounts totaling $95 million and maturity dates ranging from May 2012 to December 2021. 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.

At December 31, 2010, five fixed-payor interest rate swap agreements were outstanding in the CHE program with notional amounts totaling $37.8 million and maturity dates ranging from November 2028 to November 2034. 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.

The fair value of derivative instruments at December 31 is as follows:

(in thousands of dollars)	2010		2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate contracts				
Basis	Other assets	$2,872	Other assets	$27,583
Fixed-to-floating	Other assets	$1,559	Other liabilities	($3,339)
Fixed-payor	Other liabilities	($4,627)	Other liabilities	($11,234)
Other	Other liabilities	($106)	Other liabilities	($292)

The effects of derivative instruments on the consolidated statements of operations and changes in net assets for 2010 and 2009 are as follows:

(in thousands of dollars)

	Location of Gain (Loss) Recognized in Statement of Operations	Amount of Gain (Loss) Recognized in Statement of Operations	
		2010	2009
Interest rate contracts			
Basis	Change in fair value of interest rate swaps	($24,894)	$70,819
Fixed-to-floating	Change in fair value of interest rate swaps	4,857	(6,503)
Fixed-payor	Change in fair value of interest rate swaps	6,815	66,104
Other	Change in fair value of interest rate swaps	186	242
Total		($13,036)	$130,662

Certain of CHE's derivative instruments contain credit-risk-related provisions that require CHE and its counterparties to post collateral in varying amounts based on respective credit ratings. If CHE's debt were to fall below investment grade, the counterparties to the derivative instruments would require CHE to post collateral only if the aggregate position of all derivative instruments is negative. Based on CHE’s current credit rating, the System was not required to post collateral as of December 31, 2010 or 2009.

10. Long-Term Debt

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

(in thousands of dollars)	2010	2009
Revenue bonds		
Catholic Health East Health System Revenue Bonds		
Various Fixed Rate Series issued from 1998 to 2008; coupon rates ranging from 2.50% to 7.50%; annual principal payments through 2037	$1,357,914	$1,259,179
Various Variable Rate Series issued from 1997 to 2008; rates ranging from 0.13% to 4.0%; annual principal payments through 2036	171,183	176,984
Various Variable Rate Series swapped to fixed rating ranging from 1.09% to 2.27%; annual principal payments through 2034	37,745	135,970
Taxable Rate Series issued 1999 with rate of 7.62%; annual principal payments through 2017	5,070	5,680
	1,571,912	1,577,813
Other issues under $10 million	2,989	2,849
Less amortization and unamortized premium (discount)	1,011	(9,257)
Mortgages payable		
Dormitory Authority of the State of New York mortgage payable with a rate of 6.23%; semi-annual principal payments through 2024	6,447	6,754
Century Health Capital, Inc. mortgage payable with rate of 5.47%; monthly prinical payment through to 2015	6,851	8,215
Various HUD insured mortgages (5.56% to 5.64%) payable through January 2027	12,577	13,137
Other mortgages and notes payable under $5 million, individually	5,633	6,075
Notes payable		
North Ridge VA Center, LTD (5.04%), semi-annual principal payments through 2023	36,780	38,853
Notes payable due at various dates through 2027; various rates	1,300	50
Revolving credit agreement, due in 2014	52,800	54,190
Capital lease obligations payable in various monthly amounts	58,703	60,129
Total long-term debt and obligations under capital leases	1,757,003	1,758,808
Less: Current maturities of long term debt	(58,308)	(52,834)
Less: Portion of variable rate demand obligations classified as current	(29,518)	(54,247)
Total long-term debt	$1,669,177	$1,651,727

Aggregate maturities of long-term debt and capital lease obligations as of December 31, 2010 are shown below.

(in thousands of dollars)

2011	$87,826
2012	78,924
2013	80,018
2014	106,706
2015	79,057
Thereafter	1,323,446
Unamortized premium and discount and imputed interest	1,026
	$1,757,003

The fair value of the System's long term debt is based on 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, 2010 and 2009 was $1.61 billion and $1.60 billion, respectively, compared to the carrying value of $1.59 billion and $1.58 billion, respectively. This excludes capital leases, notes payable, and mortgage notes.

In March 2010, CHE issued a tender offer to bondholders of the Series 2007 bonds that were previously issued in New Jersey. Of the $99.6 million in outstanding bonds, offers totaling $98.2 million were accepted, or 98.5% of the total. In exchange for the $98.2 million, CHE issued $90.0 million of fixed rate bonds and terminated $10.4 million of related interest rate swaps.

In March 2010, CHE issued $130.7 million of Series 2010 Hospital Revenue Bonds through New Jersey Health Care Facilities Financing Authority. The bonds were issued as fixed rate bonds with interest rates ranging from 2.0% to 5.0%. The proceeds of this issue were used to refund and redeem certain of the outstanding Series 1998 and Series 2007 Revenue Bonds previously issued in New Jersey, and to pay the costs of issuance. As part of this transaction, the System recorded a gain on extinguishment totaling $7.8 million.

On April 7, 2010, CHE issued $287.6 million of Series 2010 Hospital Revenue Bonds through financing authorities in Florida, Connecticut, Georgia, Massachusetts, North Carolina, and Pennsylvania. The bonds were issued as fixed rate bonds with interest rates ranging from 2.0% to 5.0%. The proceeds of this issue were used to advance refund and redeem and to pay the costs of issuance of certain outstanding Series 1998 and Series 1999 Revenue bonds issued in Massachusetts, Connecticut, Pennsylvania, New Jersey, North Carolina, Georgia, and Florida, and to finance $50 million in capital projects for St. Mary Medical Center in Pennsylvania. As part of this transaction, the System recorded a loss on extinguishment totaling $6.9 million.

In March, 2009, CHE issued a tender offer to bondholders of the Series 2007 bonds that were previously issued in Georgia, Massachusetts, and Pennsylvania. The bonds issued in New Jersey were not included in the tender offer. Of the $231.6 million in outstanding bonds, offers totaling $195.1 million were accepted, or 84.1% of the total. In exchange for the $195.1 million, CHE issued $157.0 million of fixed rate bonds and paid off/terminated $34.0 million of related interest rate swaps. As part of this transaction, the System recorded a gain on extinguishment totaling $42.7 million.

On May 20, 2009, CHE and Mercy Hospital, Miami issued $29.9 million of Series 2010 Hospital Revenue Bonds through the City of Miami, Florida Health Facilities Authority. The proceeds of this issue were used to repay amounts outstanding on the CHE line of credit. The bonds were issued as variable rate demand bonds, initially bearing interest in a weekly mode, and are secured by an irrevocable letter of credit issued by Bank of New York Mellon. The letter of credit was issued for an initial three-year term and expires on May 25, 2012.

Certain CHE constituent corporations are members of the CHE Obligated Group. Under the Amended and Restated Master Trust Indenture dated January 1, 1998 and amended and restated as of September 30, 2007, Obligated Group members provide a revenue pledge and are joint and severally liable on all obligations outstanding under the Master Indenture. 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.

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.

In prior years, CHE advance refunded certain of its bonds which are no longer reflected in the consolidated financial statements since CHE has legally satisfied its obligation through defeasance. Funds are held in an irrevocable escrow with a trustee and are expected to be sufficient to satisfy the obligations.

The CHE revolving credit loan facility was refinanced in 2010. The credit facility is structured through a consortium with five banks and extends through June 9, 2014. CHE has a revolving credit loan facility with five banks. The credit facility totals $200,000,000 with an option to increase the credit facility to $250,000,000. At December 31, 2010 and 2009, approximately $37,933,000 and $55,345,000, respectively, of the total credit facility was obligated for standby letters of credit. Additionally, approximately $52,800,000 and $54,190,000 at December 31, 2010 and 2009, respectively, had been borrowed against the total credit facility. Borrowings under this agreement may be repaid at any time and are payable upon termination of the agreement. 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.

Certain of the System's variable rate demand bonds are supported by irrevocable letters of credit with expiration dates from 2011 to 2014. CHE is the guarantor for these letters of credit. Those letters of credit with expiration dates in 2011 are classified as current liabilities in the consolidated balance sheet. The letters of credit and dates of expiration are as follows:

RHC	Associated Bond Issue	Expiration
Mercy Medical Corporation	Series 1997	11/1/2013
Mercy Hospital, Inc., Miami	Series 1998	9/9/2011
Mercy Medical Corporation	Series 2000	9/30/2012
St. Francis Medical Center	Series 2003	6/15/2012
Mercy Health System of Maine	Series 2006	9/30/2012
St. Joseph of the Pines, Inc.	Series 2008	4/23/2014
Mercy Hospital, Inc., Miami	Series 2008	5/14/2013
Mercy Hospital, Inc., Miami	Series 2009	5/25/2012

Blended Cost of Debt Program

CHE maintains a Blended Cost of Debt Program (the Debt Program) to provide a uniform cost of debt for participating RHCs and to mitigate the interest rate risk of an RHC.

Under the Debt Program, all debt costs, excluding taxable debt, capitalized leases, and short-term borrowing, are blended. The calculation of the blended costs incorporates bond interest, both fixed and variable, debt-related fees, such as letters of credit, credit enhancement, remarketing, auction, as well as periodic rating agency, bond trustee, master trustee and issuing authority fees, net swap payments/receipts and put/guaranty receipts, along with other miscellaneous fees related to tax-exempt debt issued by CHE and its affiliates.

Participants in the Debt Program make periodic payments to CHE. Each participant's periodic payment is based on their respective percentage of total indebtedness included in the Debt Program. Principal payments are not blended. Participants make their scheduled principal payments to CHE in the month they are due.

11. 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:

(in thousands of dollars)	**2010**	**2009**
Temporarily restricted net assets		
Education and research	$7,790	$9,439
Building and equipment	48,025	44,455
Patient care	11,162	13,658
Cancer Center/research	1,976	3,309
Education and research grants	7	73
Other	63,344	56,030
	$132,304	$126,964

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

(in thousands of dollars)	**2010**	**2009**
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)	$18,554	$17,419
Endowments requiring income to be added to the original gift	2,335	2,193
Other	7,081	6,392
	$27,970	$26,004

The System classifies the portions of donor-restricted endowment funds of perpetual duration as permanently restricted net assets. Permanently restricted net assets of the System are comprised of a) the original value of gifts donated to the System through a permanent endowment, b) the

original value of subsequent gifts to the System through a permanent endowment, and c) accumulations to the permanent endowment in accordance with applicable donor gift instruments. Any portions of donor-restricted endowment funds that are not classified as permanently restricted are appropriated in accordance with donor intent.

The System considers the following factors in determining if donor-restricted endowment funds are accumulated or appropriated:

1) the duration and preservation of the fund
2) the purposes of the System's donor-restricted endowment funds
3) general economic conditions
4) effect of possible inflation or deflation
5) the expected total investment return and appreciation of investments
6) other resources of the System
7) investment policies of the System

The System's permanently restricted net assets consist of individual endowment accounts. Unless otherwise directed by the donor, gifts received for endowments are invested in accordance with the System's investment policy. Unless otherwise directed by the donor, the System annually appropriates a certain percentage of each endowment fund, which is then available for spending in accordance with the donor's intent. In order to preserve the real value of a donor's gift and to sustain funding consistent with donor intent, the annual appropriation rate is set to strike a reasonable balance between long-term objectives of preserving and growing each endowment fund for the future and providing stable, annual appropriations.

The composition of endowment fund net assets, by type of fund, at December 31, 2010 and 2009 are as follows:

(in thousands of dollars)

	2010		
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**
Donor-restricted endowment funds	$7	$88,420	$27,970
Board-designated endowment funds	17,510	1,560	-
Total endowment funds	$17,517	$89,980	$27,970

	2009		
	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**
Donor-restricted endowment funds	$16	$82,831	$26,004
Board-designated endowment funds	16,898	3,795	-
Total endowment funds	$16,914	$86,626	$26,004

Changes in the composition of endowment fund net assets as of December 31, 2010 and 2009 are as follows:

(in thousands of dollars)

	2010		
	Unrestricted	Temporarily Restricted	Permanently Restricted
Endowment fund net assets, beginning of year	$16,914	$86,626	$26,004
Investment return:			
Realized investment income	175	486	817
Unrealized investment income	323	337	441
Net appreciation	-	643	42
Total investment return	498	1,466	1,300
Other changes in endowment funds	105	1,888	666
Endowment fund net assets, end of year	$17,517	$89,980	$27,970

	2009		
	Unrestricted	Temporarily Restricted	Permanently Restricted
Endowment fund net assets, beginning of year	$16,162	$84,394	$34,476
Investment return:			
Realized investment income (loss)	(42)	427	(277)
Unrealized investment income	454	804	1,482
Net appreciation	-	336	120
Total investment return	412	1,567	1,325
Other changes in endowment funds	340	665	(9,797)
Endowment fund net assets, end of year	$16,914	$86,626	$26,004

12. 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 at a rate of 4.0% at December 31, 2010 and 2009, and in management's opinion provide an adequate reserve for loss contingencies.

CHE maintains a self-insurance program for workers' 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 at a rate of 4.0% at December 31, 2010 and 2009, and in management's opinion provide an adequate reserve for loss contingencies.

Total amounts accrued under these programs as current liabilities approximate $20,996,000 and $22,436,000 at December 31, 2010 and 2009, respectively. Total amounts accrued under these

programs as long-term liabilities approximate $303,718,000 and $296,297,000 at December 31, 2010 and 2009, 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 under these self-insured programs was $48,584,000 and $55,265,000 in 2010 and 2009, respectively.

13. Pension Plans

The System maintains non-contributory defined benefit pension plans that vary from one RHC to another, collectively, "the Plan."

During 2010, CHE amended substantially all defined benefit pension plans to freeze service accruals. As a result of the service accrual freeze curtailment charges of $1,166,000 were recognized and curtailment credits of $2,978,000 were recognized in 2010 representing the immediate recognition of unamortized prior service costs and credits. The plan freeze also resulted in a decrease to the projected benefit obligation of $29,694,000 due to plan curtailment.

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:

(in thousands of dollars)	**2010**	**2009**
Changes in benefit obligation:		
Benefit obligation, beginning of year	$934,097	$864,372
Service cost	11,724	28,740
Interest cost	48,447	52,729
Actuarial loss	95,862	29,250
Benefits paid	(29,252)	(27,321)
Plan amendments	-	(4,131)
Curtailment	(29,694)	(9,542)
Benefit obligation, end of year	$1,031,184	$934,097
Accumulated benefit obligation, end of year	$988,730	$874,301
Change in plan assets:		
Fair value of plan assets, beginning of year	650,547	501,811
Actual return on plan assets	73,257	101,099
Employer contributions	48,040	76,475
Benefits paid	(29,252)	(27,321)
Other	(1,944)	(1,517)
Fair value of plan assets, end of year	$740,648	$650,547
Funded status		
Fair value of plan assets	$740,648	$650,547
Projected benefit obligation	(1,031,184)	(934,097)
Funded status	(290,536)	(283,550)
Amount recognized, end of year	($290,536)	($283,550)

(in thousands of dollars)	**2010**	**2009**
Amounts recognized in unrestricted net assets		
Net actuarial loss (gain)	$45,694	($37,410)
Amortization of actuarial loss	(7,171)	(34,133)
Prior service cost	(261)	(131)
Current year prior service cost	-	(568)
Curtailment Charge	(1,166)	(4,131)
Total	$37,096	($76,373)

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

(in thousands of dollars)	**2010**	**2009**
Components of net periodic benefit cost:		
Service cost	$11,891	$28,815
Interest cost	48,447	52,729
Expected return on plan assets	(51,463)	(41,943)
Amortization of prior service costs	261	568
Amortization of actuarial loss	7,171	34,133
Other adjustments	1,296	972
Net periodic benefit cost	$17,603	$75,274

Significant decreases in the net periodic benefit cost for the plans in 2010 resulted from the service cost freeze. Additionally, the change in the amortization period for actuarial losses from expected service period of plan participants to expected life of plan participants resulted in significant reductions of net periodic benefit cost.

The net actuarial loss that will be amortized from unrestricted net assets in the net periodic benefit cost in 2011 is $11,513,000.

The accumulated benefit obligation for the Plan was $988,730,000 and $874,301,000 at December 31, 2010 and 2009, respectively.

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

	2010	**2009**
Assumptions used to determine the benefit obligation at December 31:		
Weighted average discount rate	5.60% - 6.10%	5.95% - 6.15%
Weighted average rate of compensation increases	4.25%	4.25%
Weighted average expected long-term rate of return on plan assets	8.00%	8.00% - 8.50%

	2010	**2009**
Assumptions used to determine periodic benefit cost at December 31:		
Weighted average discount rate	6.05% - 6.20%	5.85% - 6.35%
Weighted average rate of compensation increases	4.25%	4.25%
Weighted average expected long-term rate of return on plan assets	8.00% - 8.50%	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. For plans with frozen service accruals, the investment policy was modified to allow for asset allocation changes over time as the plans become more fully funded in order to de-risk the plans. This strategy utilizes a "glide path" approach, consisting of a series of target asset allocations for various funded ratio levels, reduces exposure to return seeking assets (marketable equity securities and managed funds) and increases exposure to the liability-hedging assets (cash and marketable debt securities) over time. This strategy will be utilized going forward for the plans with frozen service accruals.

The weighted average asset allocation for the plan at December 31 and the target allocation for calendar year 2010, by asset category, are as follows:

	Target Allocation 2010 From-To	2010	Target Allocation 2009 From-To	2009
Asset category				
Cash & marketable debt securities	20.0-50.0%	21.7 %	40.0-18.7%	27.3%
Marketable equitity securities & managed funds	50.0-80.0%	78.3 %	60.0-81.3%	72.7%
	100.0%	100.0 %	100.0%	100.0%

The portfolio is diversified among a mix of assets including large and small cap, domestic and foreign equities, fixed income, managed 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 following table presents the Plan's financial instruments as of December 31, 2010 measured at fair value on a recurring basis using the fair value hierarchy defined in Note 6. The investments are not included in the marketable securities whose use is limited in the accompanying consolidated balance sheet. These investments are maintained separately in a pension investment program that is controlled by a trustee:

(in thousands of dollars)

	2010				
	Level 1	Level 2	Level 3	Total	Valuation Technique
Pension investment program:					
Cash and cash equivalents	$34,473	$23,460	$ -	$57,933	Market
Marketable equity securities	443,399	42,108	19	485,526	Market
Marketable debt securities	42,368	79,347	-	121,715	Market
Managed funds	-	-	75,474	75,474	Market
Total pension investment program	$520,240	$144,915	$75,493	$740,648	

	2009				
	Level 1	Level 2	Level 3	Total	Valuation Technique
Pension investment program:					
Cash and cash equivalents	$91,645	$18,636	$ -	$110,281	Market
Marketable equity securities	306,483	33,381	-	339,864	Market
Marketable debt securities	56,744	80,034	136	136,914	Market
Managed funds	-	-	63,488	63,488	Market
Total pension investment program	$454,872	$132,051	$63,624	$650,547	

The fair value of these investments is offset against the projected benefit obligation of the associated defined benefit plans and the resulting unfunded liability is recorded by the System.

The table below sets forth a summary of changes in the fair value of the Level 3 assets for the Plan for the period from December 31, 2009 to December 31, 2010.

(in thousands of dollars)

	2010	2009
Fair value January 1	$63,624	$58,162
Purchases	24,500	135
Realized and unrealized gains	2,566	5,465
Transfers Out	154	-
Sales	(15,351)	(138)
Fair value December 31	$75,493	$63,624

Contributions – Expected contributions to the defined benefit plans in 2011 are approximately $44,217,000.

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

(in thousands of dollars)

2011	$39,115
2012	43,707
2013	46,630
2014	49,532
2015	52,576
2016-2019	325,639
	$557,199

14. 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:

	2010	2009
Managed care	32.6 %	34.0 %
Medicare	27.5 %	26.6 %
Medicaid	10.4 %	9.2 %
Self-pay	7.0 %	9.5 %
Other third-party payors	10.8 %	11.3 %
Commercial	11.7 %	9.4 %
	100.0 %	100.0 %

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.

15. 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.

16. Leases

The RHCs lease office space and certain equipment under noncancelable operating leases. Rental expense was approximately $70,712,000 and $67,327,000 in 2010 and 2009, respectively.

Future minimum lease payments for all noncancelable leases as of December 31, 2010 are as follows:

(in thousands of dollars)	
2011	$63,288
2012	54,245
2013	47,040
2014	37,185
2015	28,732
Thereafter	87,952
	$318,442

17. 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:

(in thousands of dollars)	**2010**	**2009**
Health care services	$3,244,701	$3,180,744
General and administrative	779,536	801,761
	$4,024,237	$3,982,505

18. Restructuring Expenses and Impairment Losses

During 2010 several RHCs approved restructuring plans designed to reduce ongoing operating costs. The plans primarily involve the reduction of workforce and the elimination of unprofitable business lines. Total restructuring costs associated with carrying out the above plans were $14,341,000 and $9,821,000 in 2010 and 2009, respectively.

Total impairment losses were $3,023,000 and $5,969,000 in 2010 and 2009, respectively.

19. Significant Events

In 2010, St. James Mercy Health System in Hornell, New York, signed a non-binding Letter of Intent with another local healthcare organization to initiate formal discussions regarding an affiliation of the two organizations. Discussion among the entities is ongoing with the intent to finalize the affiliation in 2011.

In 2010, St. Peter's Health Care Services in Albany, New York, signed an affiliation agreement with two local healthcare organizations. The affiliation is projected to close in 2011 subject to certain regulatory and governmental approvals.

20. Assets Held for Sale and Discontinued Operations

In June 2010, the Board of Trustees of Mercy Hospital, Miami approved a non-binding Letter of Intent (LOI) with the Hospital Corporation of America (HCA) for the sale of certain Mercy Hospital entities to HCA. The entities to be sold under the LOI include Mercy Hospital, Sister Emmanuel Hospital for Continuing Care, Mercy Medical Development, and Mercy Physician Group. In February 2011, HCA and Mercy Hospital, Miami signed a definitive agreement for the sale of these entities. The assets to be sold to HCA are classified as assets held for sale in the accompanying consolidated balance sheet as of December 31, 2010 and 2009. The related operating results are classified in the accompanying statement of operations and changes in net assets as discontinued operations. The transaction was completed on May 1, 2011.

In October 2010, the Board of Directors of St. Joseph's Health System approved a plan to divest certain assets and operations through sale. Subsequently in 2011, the Board voted to consider a joint operating company with another local healthcare organization. The entities subject to this divestiture plan are St. Joseph Hospital of Atlanta, St. Joseph's Real Estate Corporation, St. Joseph's Service Corporation, The Medical Group of St. Joseph's, St. Joseph's Translational Research Institute, and the International College of Robotic Surgery. The assets are being actively marketed with a transaction expected in 2011, and are classified as assets held for sale in the consolidated balance sheets at December 31, 2010 and 2009. The related operating results are classified separately within operating income.

During 2009, Mercy Medical Corporation approved a plan to sell certain facilities and campuses of the RHC and exit the associated service lines. These facilities and campuses include the Mercy Mobile skilled nursing facility, the McAuley Place assisted living facility, and the Daphne Main campus, which contains facilities for skilled nursing and rehabilitation services. Mercy Medical completed the sale of Mercy Mobile and McAuley place in March, 2010. The Daphne Main facilities and campus are being actively marketed with sale expected in 2011, and are classified as assets held for sale in the accompanying consolidated balance sheet as of December 31, 2010 and 2009. The related operating results are classified in the accompanying statement of operations as discontinued operations.

Collectively these entities are referred to as the Disposal Group.

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

(in thousands of dollars)	**2010**	**2009**
Assets Held for Sale and Related Liabilities		
Other current assets	$8,009	$5,923
Property, plant, and equipment, net	370,783	380,719
Total assets	$378,792	$386,642
Current liabilities	$25,498	$25,420
Other long-term liabilities	2,809	3,263
Total liabilities	$28,307	$28,683

(in thousands of dollars)	**2010**	**2009**
Discontinued Operations		
Unrestricted revenues, gains and other support		
Net patient service revenue	$265,970	$283,144
Other operating revenue	31,792	28,921
Total Revenues	297,762	312,065
Expenses		
Salaries, wages and benefits	132,762	147,572
Medical supplies	63,772	67,111
Purchased services, professional fees, and other expenses	82,677	77,371
Depreciation and amortization	7,680	15,871
Interest	4,395	4,386
Insurance	6,322	7,978
Provision for bad debts	28,995	19,615
Other	17,829	1,718
Total Expenses	344,432	341,622
Operating Loss	($46,670)	($29,557)

(in thousands of dollars)	**2010**	**2009**
St. Joseph's Health System		
Operating Revenues	$404,506	$378,445
Operating Expenses	424,543	391,926
Losses from St. Joseph's Health System	($20,037)	($13,481)

21. Subsequent Events

In February 2011, St. Peter's Hospital issued $34.2 million of tax-exempt Revenue Bonds, Series 2011 (the Series 2011 Bonds) through the City of Albany Capital Resource Corporation. The proceeds of the Series 2011 Bonds will be used to finance capital projects and equipment, to fund a debt service reserve fund, and to pay capitalized interest and debt issuance costs on the Series 2011 Bonds.