Marquette General Health System

Consolidated Financial Report
with Additional Information
June 30, 2009

Marquette General Health System

Contents

plante moran

Plante & Moran, PLLC
Suite 300
600 E. Front St.
Traverse City, MI 49686
Tel: 231.947.7800
Fax: 231.947.0348
plantemoran.com

Independent Auditor's Report

To the Board of Trustees
Marquette General Health System

We have audited the accompanying consolidated balance sheet of Marquette General Health System (the "System") as of June 30, 2009 and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The consolidated financial statements of Marquette General Health System as of June 30, 2008 were audited by other auditors, whose report dated December 26, 2008 expressed an unqualified opinion on those consolidated financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2009 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Marquette General Health System at June 30, 2009 and the consolidated results of its operations, changes in net assets, and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 21, 2009 on our consideration of Marquette General Health System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grants, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Plante & Moran, PLLC

September 21, 2009

Marquette General Health System

Consolidated Balance Sheet

	June 30, 2009	June 30, 2008
Assets		
Current Assets		
Cash and cash equivalents	$ 28,081,601	$ 11,922,752
Accounts receivable (Note 2)	44,475,168	37,928,261
Estimated third-party payor settlements (Note 3)	1,314,123	2,830,064
Assets limited as to use (Notes 4 and 5)	803,579	430,807
Other current assets	2,117,770	2,482,687
Inventory	8,599,310	7,673,263
Total current assets	85,391,551	63,267,834
Assets Limited as to Use (Notes 4 and 5)	38,101,802	51,489,434
Property and Equipment (Note 6)	105,402,559	110,242,567
Assets Held for Sale (Note 15)	-	2,851,032
Other Assets		
Investment in unconsolidated affiliates	16,130,462	14,105,171
Bond issue costs	1,251,304	1,398,667
Other noncurrent assets	6,342,195	5,385,452
Total assets	**$ 252,619,873**	**$ 248,740,157**
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	$ 14,622,717	$ 7,708,997
Current portion of long-term debt (Note 7)	6,808,575	3,697,592
Estimated third-party payor settlements (Note 3)	1,067,956	-
Accrued liabilities and other:		
Current portion of employee compensation and benefits	19,065,833	16,886,921
Accrued interest	331,315	375,407
Other accrued liabilities	1,044,760	1,509,286
Total current liabilities	42,941,156	30,178,203
Long-term Debt (Note 7)	67,361,548	74,170,123
Accrued Pension Liability (Note 10)	50,677,144	22,853,505
Fair Value of Interest Rate Swap Agreement (Notes 5 and 7)	3,995,153	1,881,882
Other Liabilities		
Long-term portion of employee compensation and benefits	3,674,898	3,832,044
Other long-term liabilities	4,608,241	3,965,882
Total liabilities	173,258,140	136,881,639
Net Assets		
Unrestricted	77,499,381	110,750,790
Temporarily restricted	1,862,352	1,107,728
Total net assets	79,361,733	111,858,518
Total liabilities and net assets	**$ 252,619,873**	**$ 248,740,157**

See Notes to Consolidated Financial Statements.

Marquette General Health System

Consolidated Statement of Operations

	Year Ended	
	June 30, 2009	June 30, 2008
Unrestricted Revenue, Gains, and Other Support		
Net patient service revenue	$ 302,512,916	$ 281,490,075
Other	13,945,481	13,422,423
Income from investment in unconsolidated affiliates	2,853,931	5,761,971
Unrestricted revenue, gains, and other support	319,312,328	300,674,469
Expenses		
Salaries and wages	120,384,009	120,163,605
Employee benefits and payroll taxes	31,350,395	35,835,138
Operating supplies and expenses	66,740,387	63,268,664
Professional services and consultant fees	4,169,614	2,728,387
Purchased services	33,449,686	25,986,842
Utilities	5,357,769	5,151,442
Other	19,739,395	15,735,066
Depreciation	10,860,416	10,848,083
Provision for bad debts	12,677,377	11,950,542
Interest expense	4,016,161	4,421,234
Restructuring and other nonrecurring expenses	367,621	8,196,297
Pension curtailment and special termination benefit	-	6,729,648
Total expenses (Note 11)	309,112,830	311,014,948
Operating Income (Loss)	10,199,498	(10,340,479)
Other Income (Loss)		
Loss on sale of property	(90,816)	(634,161)
Net realized investment (loss) gain (Note 4)	(3,197,843)	3,376,241
Change in unrealized investment loss (Note 4)	(2,820,409)	(3,140,194)
Change in fair value of interest swap agreements (Note 7)	(2,113,271)	(2,218,576)
Loss on extinguishment of debt (Note 7)	-	(1,025,722)
Total other loss	(8,222,339)	(3,642,412)
Excess of Revenue Over (Under) Expenses	1,977,159	(13,982,891)
Contribution Received for Property Acquisitions	112,920	232,296
Pension-related Changes Other Than Net Periodic Benefit (Note 10)	(34,968,977)	19,042,119
(Decrease) Increase Before Extraordinary Items	(32,878,898)	5,291,524
Loss on Discontinued Operations (Note 15)	(372,511)	(4,902,662)
(Decrease) Increase in Unrestricted Net Assets	**$ (33,251,409)**	**$ 388,862**

See Notes to Consolidated Financial Statements.

Marquette General Health System

Consolidated Statement of Changes in Net Assets

	Year Ended June 30	
	2009	2008
(Decrease) Increase in Unrestricted Net Assets	$ (33,251,409)	$ 388,862
Increase in Temporarily Restricted Net Assets - Contributions	754,624	462,049
(Decrease) Increase in Net Assets	(32,496,785)	850,911
Net Assets - Beginning of year	111,858,518	111,007,607
Net Assets - End of year	**$ 79,361,733**	**$ 111,858,518**

See Notes to Consolidated Financial Statements.

Marquette General Health System

Consolidated Statement of Cash Flows

	Year Ended June 30, 2009	Year Ended June 30, 2008
Cash Flows from Operating Activities		
(Decrease) increase in net assets	$ (32,496,785)	$ 850,911
Adjustments to reconcile (decrease) increase in net assets to net cash from operating activities:		
Depreciation and amortization	11,007,779	11,575,039
Net change in realized and unrealized gains and losses on investments	6,018,252	(236,047)
Change in fair value of interest rate swap	2,113,271	2,218,576
Net periodic pension cost	5,373,086	15,396,659
Pension contributions	(12,518,424)	(26,581,895)
Pension-related changes other than net periodic benefit	34,968,977	(19,042,119)
Loss on disposal of equipment	90,816	634,161
Loss on extingushment of debt	-	1,025,722
Impairment of discontinued operations	-	4,604,398
Proceeds from assets held for sale	2,784,478	-
Equity earnings in unconsolidated affiliates	(2,853,931)	(5,761,971)
Increase in temporarily restricted net assets	(754,624)	(462,049)
Provision for bad debts	12,677,377	11,950,542
Changes in assets and liabilities which provided (used) cash:		
Accounts receivable	(19,224,284)	(9,960,420)
Estimated third-party payor settlements	2,583,897	(2,218,392)
Inventories	(926,047)	(3,897)
Prepaid and other assets	(158,979)	30,008,495
Accounts payable	6,913,720	(2,489,500)
Accrued and other liabilities	2,155,507	(174,599)
Net cash provided by operating activities	17,754,086	11,333,614
Cash Flows from Investing Activities		
Purchase of property and equipment	(6,271,176)	(7,859,020)
Proceeds from sale of property and equipment	226,506	-
Net purchases and sales of investments	7,392,401	(2,250,730)
Net cash provided by (used in) investing activities	1,347,731	(10,109,750)
Cash Flows from Financing Activities		
Principal payment on long-term debt	(3,697,592)	(3,420,000)
Issuance of bond financing costs	-	(167,380)
Increase in temporarily restricted net assets	754,624	462,049
Net cash used in financing activities	(2,942,968)	(3,125,331)
Net Increase (Decrease) in Cash and Cash Equivalents	16,158,849	(1,901,467)
Cash and Cash Equivalents - Beginning of year	11,922,752	13,824,219
Cash and Cash Equivalents - End of year	**$ 28,081,601**	**$ 11,922,752**

See Notes to Consolidated Financial Statements.

Note 1 - Nature of Business and Significant Accounting Policies

Basis of Consolidation - Marquette General Health System (the "System") is a Michigan nonstock corporation providing healthcare services in Michigan's Upper Peninsula.

The System owns all of the outstanding shares of common stock of Rampart EMS, Inc. and subsidiaries (Rampart). Rampart provides ambulance services for portions of the southern Upper Peninsula of Michigan.

Marquette General Foundation (the "Foundation") is a Michigan nonstock corporation whose sole corporate member is the System. The Foundation receives and administers funds for charitable purposes to promote and support the healthcare mission of the System.

The System owns all of the outstanding shares of common stock of Upcare Technology, Inc. (formerly Klinitek, Inc). Upcare Technology is in business of developing computer software for healthcare applications. The operations of Upcare Technology have been presented as a discontinued operation as described in Note 15.

All intercompany accounts and transactions are eliminated in preparation of the consolidated financial statements.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents - Cash and cash equivalents include investments in highly liquid debt instruments with a maturity of three months or less, excluding amounts included in assets limited as to use.

The System maintains cash and investment balances at several financial institutions. Certain accounts are insured in full under the Transaction Account Guarantee Program which is provided by the Federal Deposit Insurance Corporation through December 31, 2009 since they bear an interest rate of less than .50 percent per year. Other accounts at each institution are insured by the Federal Deposit Insurance Corporation up to $250,000 and $100,000 per account type, per institution, for the years ended June 30, 2009 and 2008, respectively. As of June 30, 2009 and 2008, the consolidated uninsured cash balances were $23,482,309 and $10,523,861, respectively.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Accounts Receivable - Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the System's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible. An allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

Investments - Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated balance sheet. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in excess of revenue over (under) expenses unless the income or loss is restricted by donor or law. The System classifies its investment portfolio as trading, with unrealized gains and losses included in excess of revenue over expenses.

Assets Limited as to Use - Assets whose use is limited primarily include designated assets set aside by the board of trustees for future capital improvements, over which the board retains control and may, at its discretion, subsequently use for other purposes, amounts set aside under revocable self-insurance trust agreements, assets held by trustees under indenture agreements, and assets restricted as to use by donors. Amounts designated to help meet current liabilities of the System have been classified as the current portion of assets whose use is limited in the consolidated balance sheet.

Inventories - Inventories, which consist of medical and office supplies, pharmaceutical products, and durable medical equipment, are valued at the lower of cost (average cost) or market.

Property and Equipment - Property and equipment purchases are recorded at cost. Depreciation is computed principally on the straight-line basis over the estimated useful lives of the assets. Costs of maintenance and repairs are charged to expense when incurred.

In 2008, the System extended the useful lives assigned to several assets based on an independent assessment. The change in depreciable lives resulted in an approximately $1,050,000 reduction in depreciation expense during the year ended June 30, 2008.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Fair Value of Financial Instruments - The fair value of financial instruments, including cash, accounts receivable, and accounts payable, approximates carrying values. Investments are recorded at fair value under generally accepted accounting principles. The fair value of debt is based on current rates at which the System could borrow funds with similar remaining maturities.

Bond Issuance Costs - Bond issuance costs represent financing costs that are being amortized over the period of related debt outstanding using the straight-line method, which approximates the effective interest rate method.

Interest Rate Swap - The System entered into an interest rate swap transaction to reduce economic risks associated with variability in cash outflows for interest required under provisions of variable rate revenue bonds. Interest rate swaps are recognized as assets or liabilities at fair value. Realized gains and losses on interest rate swaps are classified as a component of income from operations and are presented as part of interest expense in the consolidated statement of changes in net assets. Unrealized changes in the fair value of the interest rate swap are recognized in other income, separate from income from operations.

Contributions - The System reports gifts of cash and other assets as 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 to unrestricted net assets and reported in the consolidated statement of changes in net assets as net assets released from restrictions.

The System reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other 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, the System reports the expiration of donor restrictions when the assets are placed in service.

Classification of Net Assets - Net assets of the System are classified as temporarily restricted or unrestricted depending on the presence and characteristics of donor-imposed restrictions limiting the System's ability to use or dispose of contributed assets or economic benefits embodied in those assets. Donor-imposed restrictions that expire with the passage of time or that can be removed by meeting certain requirements result in temporarily restricted net assets. Earnings, gains, and losses on restricted net assets are classified as unrestricted unless specifically restricted by the donor or by applicable state law.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Net Patient Service Revenue - The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

Excess of Revenue Over Expenses - The consolidated 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 pension related changes other than net periodic pension costs, loss from discontinued operations, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

Charity Care - The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Tax Status - The System is a nonprofit, tax-exempt organization as described under Section 501(c)(3) of the Internal Revenue Code (IRC). Rampart is a nonprofit, tax-exempt organization as described under Section 501(c)(3) of the IRC. Upcare Technology is a taxable organization and records a provision for income taxes to the extent required based on its separate earnings and IRC regulations. The Foundation is a nonprofit, tax-exempt organization and is a Type I supporting organization as defined by the IRC.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

In 2008, the System adopted Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*. The adoption of FIN 48 did not have an impact on the System's consolidated financial statements.

Reclassification - Certain 2008 amounts have been reclassified to conform to the 2009 presentation.

Subsequent Events - The consolidated financial statements and related disclosures include evaluation of events up through and including September 21, 2009, which is the date the consolidated financial statements were available to be issued.

Accounting for Conditional Asset Retirement Obligation - Financial Accounting Standards Board Interpretation No. 47 (FIN 47), *Accounting for Conditional Asset Retirement Obligation*, clarified when an entity is required to recognize a liability for a conditional asset retirement obligation. Management has considered FIN 47, specifically as it related to its legal obligation to report asset retirement activities, such as asbestos removed, on its existing properties. Over the past 20 years, management has systematically renovated, replaced, or constructed the majority of the physical plant facilities, resulting in a relatively small portion of the facility with any remaining hazardous material. Management believes that there is an indeterminate settlement date for the asset retirement obligations because the range of time over which the System may settle the obligation is unknown and does not believe that the estimate of the liability related to these asset retirement activities is a material amount at June 30, 2009.

Note 2 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	2009	2008
Patient account receivable	$ 107,088,150	$ 85,521,706
Less:		
Allowance for uncollectible accounts	(11,639,203)	(9,525,000)
Allowance for contractual adjustments	(50,973,779)	(38,068,445)
Net patient accounts receivable	$ 44,475,168	$ 37,928,261

Note 2 - Patient Accounts Receivable (Continued)

The System grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	Percent	
	2009	2008
Medicare	34	35
Blue Cross/Blue Shield of Michigan	15	21
Medicaid	25	17
Commercial insurance	12	13
Self-pay	8	6
Other	6	8
Total	100	100

Note 3 - Patient Service Revenue

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Approximately 74 percent of the System's net patient service revenue is received from the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs. A summary of the basis of reimbursement with these third-party payors for Marquette General Health System is as follows:

- **Medicare** - Inpatient, acute-care, psychiatric, and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient and homecare services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.

- **Medicaid** - Inpatient acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Inpatient psychiatric and rehabilitation services are reimbursed on per diem rates. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. Outpatient and physician services are reimbursed on an established fee-for-service methodology.

- **Blue Cross/Blue Shield of Michigan** - Inpatient acute-care services are reimbursed at prospectively determined rates per discharge. Inpatient psychiatric and rehabilitation services are reimbursed on per diem rates. Outpatient services are reimbursed on a fee-for-service and percentage of charge basis.

Note 3 - Patient Service Revenue (Continued)

Cost report settlements result from the adjustment of interim payments to final reimbursement under Medicare, Medicaid, Blue Cross/Blue Shield of Michigan, and HMO programs that are subject to audit by fiscal intermediaries. Laws and regulations governing the Medicare and Medicaid programs are extremely 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.

The Medicare program has initiated a recovery audit contractor (RAC) initiative, whereby claims subsequent to October 1, 2007 will be reviewed by contractors for validity, accuracy, and proper documentation. A demonstration project completed in several other states resulted in the identification of potential significant overpayments. The RAC program is scheduled for Michigan hospitals in 2009. The System is unable to determine if it will be audited and if so, the extent of liability for overpayments, if any. If selected for audit, the potential exists for significant overpayment of claims liability for the System at a future date.

Note 4 - Assets Limited as to Use

The detail of assets limited as to use is summarized in the following schedule:

	2009	2008
Assets limited as to use and temporarily restricted:		
Funds held by trustees under bond indenture	$ 6,725,817	$ 6,353,045
Funds held in trust for payment of professional and other liability claims	6,944,197	17,086,096
By the board of trustees for future capital improvements	23,373,016	27,583,063
By donors for specific purposes	1,466,558	709,334
Total investments limited as to use and temporarily restricted	38,509,588	51,731,538
Pledges receivable	395,793	188,703
Less current portion	(803,579)	(430,807)
Total assets limited as to use	$ 38,101,802	$ 51,489,434

Note 4 - Assets Limited as to Use (Continued)

Investments consist of the following:

	2009	2008
Cash and cash equivalents	$ 8,562,396	$ 2,986,754
Government securities	15,939,267	25,602,571
Equity securities	14,007,925	23,330,916
Total	$ 38,509,588	$ 51,920,241

Investment income and gains and losses are comprised of the following for the years ended June 30, 2009 and 2008:

	2009	2008
Net realized investment (loss) gain	$ (3,197,843)	$ 3,376,241
Change in net unrealized losses on investments	(2,820,409)	(3,140,194)
Total	$ (6,018,252)	$ 236,047

Note 5 - Fair Value Measurements

As of January 1, 2008, the System adopted Statement of Financial Accounting Standards No. 157 (SFAS 157), *Fair Value Measurements*. SFAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures for fair value measurements. The standard applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements.

The following table presents information about the System's assets and liabilities measured at fair value on a recurring basis at June 30, 2009, and the valuation techniques used by the System to determine those fair values.

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that the System has the ability to access.

Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The System's assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

Note 5 - Fair Value Measurements (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis at June 30, 2009

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at June 30, 2009
Assets - Investment securities	$ 4,817,415	$ 25,129,777	$ -	$ 29,947,192
Liabilities - Derivative financial instruments	-	3,995,153	-	3,995,153

Note 6 - Property and Equipment

Costs of property, plant, equipment, and depreciable lives are summarized as follows:

	2009	2008	Depreciable Life - Years
Land	$ 7,570,000	$ 7,570,300	-
Land improvements	3,217,390	3,243,887	3-15
Buildings	147,825,616	147,372,914	7-40
Equipment	143,102,097	137,417,140	3-10
Construction in progress	4,062,296	4,972,120	
Total cost	305,777,399	300,576,361	
Accumulated depreciation	(200,374,840)	(190,333,794)	
Total property and equipment	$ 105,402,559	$ 110,242,567	

Note 7 - Long-term Debt

A summary of long-term debt at June 30, 2009 and 2008 is as follows:

	2009	2008
Hospital Revenue Bonds, Series 2004	$ 2,790,000	$ 5,490,000
Hospital Revenue Bonds, Series 2005	28,465,000	28,465,000
Hospital Revenue Bonds, Series 2006	37,000,000	37,000,000
Term loan	5,684,615	6,584,615
Bond premium - Less accumulated amortization	230,508	328,100
Total	74,170,123	77,867,715
Less current portion	6,808,575	3,697,592
Long-term portion	$ 67,361,548	$ 74,170,123

The Michigan State Hospital Finance Authority (MSHFA) and City of Marquette Hospital Finance Authority (CMHFA) have at various times issued Hospital Revenue Bonds on behalf of the Marquette General Hospital Obligated Group (the "Obligated Group") and loaned the proceeds to the Obligated Group (which is comprised of the System) under the terms of the Master Indenture and Security Agreement. The Obligated Group has pledged to Wells Fargo Bank, N.A. (as master trustee) the gross revenues of the System. The loans are also secured by a first priority mortgage on the real property and the structures and improvements of the main campus of the Obligated Group and a security interest in personal property, accounts receivable, and other intangible property.

The Series 2006 Bonds were issued by MSHFA on behalf of the Obligated Group in the amount of $37,000,000. Proceeds were used to repay certain amounts outstanding on the term loan and for various property acquisitions. The bonds are to be repaid in annual amounts ranging from $4,000,000 in June 2015 to $5,325,000 in June 2022. Effective April 16, 2008, the System converted from interest rates determined by an auction process to a weekly rate (.3 percent and 1.7 percent at June 30, 2009 and 2008, respectively). As a result of this conversion, a mandatory tender feature was invoked. Therefore, certain deferred finance costs related to the debt in the amount of $1,025,000 were written off as a loss on extinguishment of debt. No other terms changed as a result of this transaction.

Payment of the Series 2006 Bonds principal and interest is guaranteed under a financial guaranty insurance policy. Also, a Standby Bond Purchase Agreement is available for the purchase of bonds tendered but not remarketed. Accordingly, the bonds have been classified as long-term as the Obligated Group has engaged a remarketing agent to remarket these obligations, if presented. The Standby Bond Purchase Agreement expires on April 16, 2011, and there were no borrowings during 2009 and 2008 on the agreement.

Note 7 - Long-term Debt (Continued)

The Series 2005A Bonds were issued by MSHFA on behalf of the Obligated Group in the amount of $28,465,000 (unamortized premium of $230,508 and $328,100 at June 30, 2009 and 2008, respectively). Proceeds were used to finance construction projects and certain capital equipment. The Series 2005A Serial Bonds, totaling $12,015,000, mature through May 15, 2014, are not subject to optional redemption, bear interest at 5.0 percent, and are due in annual amounts ranging from $2,175,000 in 2010 to $2,645,000 in 2014. Bonds maturing thereafter (Term Bonds), totaling $16,450,000, are redeemable at a price of par plus accrued interest. The Term Bonds are subject to mandatory annual redemption at par commencing May 15, 2020 through May 15, 2034. The Term Bonds bear interest at fixed rates of 5.0 percent and are to be repaid in annual amounts ranging from $760,000 in 2020 to $1,510,000 in 2034.

The 2004A Bonds were issued by CMHFA on behalf of the Obligated Group. The 2004 Bonds are variable rate demand bonds, which bear interest as determined weekly by a remarketing agent (0.35 percent and 1.90 percent at June 30, 2009 and 2008, respectively) and were repaid with a final payment of $2,790,000 in July 2009. The 2004 bonds are secured by a letter of credit, which expires on July 16, 2009, and contain an option to convert to a fixed interest rate. Proceeds were used to refund amounts previously outstanding and for various capital purchases. The letter of credit is also available for the purchase of bonds tendered but not remarketed. Accordingly, the variable rate demand bonds have been classified as long-term as the Obligated Group has engaged a remarketing agent to remarket these obligations, if presented. There were no borrowings on the letter of credit during 2009 and 2008.

The Term Loan outstanding is payable in annual amounts ranging from $1,750,000 in December 2009 to $2,034,615 in December 2011. The Term Loan bears interest at a variable rate.

The MSHFA Series 2006 and 2005A Bonds, the CMHFA Variable Rate Demand Hospital Series 2004A, and the Term Loan have all been issued under a Master Indenture and Security Agreement, which contains certain restrictive covenants, including a required debt service coverage ratio and days cash on hand ratio which the Obligated Group did not meet for the year ended June 30, 2008. The trustee waived these covenants for the year ended June 30, 2008.

Note 7 - Long-term Debt (Continued)

The Obligated Group is required to meet the requirements of agreements or documents collateral to the Master Indenture and Security Agreements. In connection with the Term Loan Agreement and with the Reimbursement Agreement entered into in connection with the 2004 Bonds, the Obligated Group obtained a waiver for the debt service coverage ratio covenant for the periods ended March 31, 2008 and June 30, 2008 and the days cash on hand requirement for June 30, 2008. Additionally, the debt service coverage ratio will not be measured for the rolling four-quarter period ended September 30, 2008, and days cash on hand requirement as of June 30, 2009, and future measurement dates have been amended.

In connection with the Standby Bond Purchase Agreement associated with the 2006 bonds, a waiver of covenants has been received for the year ended June 30, 2008 measurement period. Additionally, days cash on hand requirements as of June 30, 2009, and future measurement dates have been amended.

In connection with the supplemental indenture between the master trustee and the Obligated Group associated with the 2006 Bonds, the Obligated Group entered into a waiver and reservation of rights agreement in which the bond insurer agreed to forbear its right to exercise any rights or remedies related to the failure to meet the debt service coverage ratio and days cash on hand ratio and failure to obtain its prior approval of the bond insurer to retain a consultant. The forbearance provisions of the agreement require the Obligated Group to maintain debt service coverage in excess of 1.35, measured at the close of the fiscal year, while the 2006 Bonds are outstanding; days cash on hand equal to 55 days at June 30, 2009 and December 31, 2009; days cash on hand equal to 65 at June 30, 2010 and December 31, 2010; days cash on hand equal to 75 days at June 30, 2011, and thereafter; operating margin targets which are within 25 percent of amounts approved by the board of trustees; and monthly reports prepared by a consultant which describe the Obligated Group's progress in meeting operational improvement recommendations of a consultant for fiscal year 2009. If the Obligated Group is unable to meet the provisions of the waiver and reservation of rights agreement, or if the debt service coverage ratio falls below 1.0, or if days cash on hand fall below 50, the bond insurer may, by written notice to the bond trustee, declare an immediate event of default under the Master Indenture.

Note 7 - Long-term Debt (Continued)

In connection with the supplemental indenture between the Master Trustee and the Obligated Group associated with the 2005 Bonds, the Obligated Group entered into a waiver and reservation of rights agreement in which the bond trustee agreed to forbear its right to exercise any rights or remedies related to the failure to meet the debt service coverage ratio and days cash on hand ratio and failure to obtain the prior approval of the bond insurer to retain a consultant. The forbearance provisions of the agreement require the Obligated Group to maintain debt service coverage in excess of 1.35, measured at the close of the fiscal year, while the 2005 Bonds are outstanding; days cash on hand equal to 55 days at June 30, 2009 and December 31, 2009; days cash on hand equal to 65 days at June 30, 2010 and December 31, 2010; days cash on hand equal to 75 days at June 30, 2011, and thereafter; operating margin targets which are within 25 percent of amounts approved by the board of trustees; and monthly reports prepared by a consultant which describe the Obligated Group's progress in meeting operational improvement recommendations of a consultant for fiscal year 2009. If the Obligated Group is unable to meet the provisions of waiver and reservation of rights agreement, or if the debt service coverage ratio falls below 1.0, or if days cash on hand fall below 50, the master trustee may, by written notice to the bond trustee, declare an immediate event of default under the Master Indenture.

During 2006, the System entered into a fixed payor interest rate swap agreement. The interest rate swap agreement is based on a notional amount of $37,000,000 and allows the System to offset the changes in overall cash flows due to the repricing of debt obligations from the date of transaction through the fiscal 2022 termination date. The interest rate swap agreement has not been designated as a cash flow hedge for accounting purposes as defined in SFAS No. 133, *Accounting for Derivative Instruments as Hedging Activities*.

The fair market value of long-term debt was estimated to be $69,147,000 and $75,655,000 at June 30, 2009 and 2008, respectively.

Future maturities of long-term debt for the next five years and thereafter are as follows:

Years Ending June 30		Amount
2010		$ 6,715,000
2011		4,185,000
2012		4,429,615
2013		2,515,000
2014		2,645,000
Thereafter		53,450,000
	Total	$ 73,939,615

Note 8 - Operating Leases

The System is obligated under certain operating leases, primarily for facilities and equipment. Total rent expense under these leases was approximately $2,991,000 and $2,864,000 in 2009 and 2008, respectively.

The following is a schedule of future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year:

Years Ending June 30		Amount
2010		$ 2,916,537
2011		2,651,893
2012		2,018,353
2013		1,076,551
2014		324,864
Thereafter		19,846
	Total	$ 9,008,044

Note 9 - Professional Liability, Workers' Compensation, and General Liability Reserves

The System is self-insured up to certain levels of risk for professional liability, workers' compensation, and general liability claims. Effective June 1, 1997, the System purchased excess professional liability insurance. The current level of excess insurance covers losses over the retention of $2,000,000 per occurrence and $6,000,000 annual aggregate for its professional liability claims. Prior to June 1, 1997, the System was completely self-insured for its professional liability claims. Insurance coverage has been obtained for workers' compensation claims in excess of $500,000 per occurrence. Effective March 29, 2005, the System became self-insured up to certain levels of risk for its general liability claims. Also on that date, the System purchased excess general liability insurance. The current level of excess insurance covers losses over retention of $2,000,000 per occurrence and $6,000,000 annual aggregate for its general liability claims. The System's malpractice insurance coverage currently expires on March 29, 2010. The System is insured under an umbrella policy for professional liability, workers' compensation, and general liability claims up to $8,000,000 per occurrence and $8,000,000 annual aggregate.

Note 9 - Professional Liability, Workers' Compensation, and General Liability Reserves (Continued)

The System, with assistance of an independent actuary, estimates a range of loss for these claims based on its past experience along with relevant industry data. This estimate includes provisions for known claims and unreported incidents. The System has accrued the present value of what it believes to be the most likely amount of loss in the range, discounted at 4 percent per annum. Trusts have been established to which contributions are made based upon these estimates. The revocable trust agreements restrict trust assets to the payment of claims and the cost of trust administration.

It is management's belief that adequate provision has been made at June 30, 2009 and 2008 for all professional liability, workers' compensation, and general liability claims incurred to date. Management further believes that the ultimate disposition of these claims, after consideration of recorded reserves, will not have a material adverse effect on the consolidated financial position of the System.

Note 10 - Pension Plans

The System maintains a defined-benefit pension plan (the "Plan"), which covers substantially all employees hired prior to January 1, 2006. The System's funding policy is to contribute amounts to the Plan sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974, plus such additional amounts as the System may determine to be appropriate from time to time.

Effective January 1, 2006, new employees are not eligible to participate in the defined benefit pension plan, but are eligible, subject to the vesting requirement of the Plan, for participation in the 401(k) defined contribution plan along with all existing employees. Effective January 1, 2006, the System began matching contributions in this plan of up to 4 percent of compensation. Expenses charged to operations under these plans were $438,233 and $128,497 for the years ended June 30, 2009 and 2008, respectively.

On April 1, 2008, the System amended its retirement plan to offer an early retirement payout to eligible participants. Approximately 124 participants elected to early retire. The curtailment of future pension accruals related to this action reduced the projected benefit obligation by $2,813,720. Additionally, special accounting requirement under SFAS No. 88, *Employers' Accounting for Settlement and Curtailments of Defined Benefit Plans and for Termination Benefits*, as amended by SFAS No. 158, resulted in the immediate recognition of previously unrecognized prior service costs special termination payouts.

Note 10 - Pension Plans (Continued)

Obligations and Funded Status

	Pension Benefits	
	2009	2008
Projected benefit obligation	$ 190,803,814	$ 175,003,803
Fair value of plan assets at beginning of year	140,126,670	152,150,298
Funded status at end of year	$ (50,677,144)	$ (22,853,505)

Amounts recognized in the consolidated balance sheet consist of noncurrent liabilities of $50,677,144 and $22,853,505 at June 30, 2009 and 2008, respectively.

The accumulated benefit obligation for all defined benefit pension plans was $179,543,159 and $168,958,821 at June 30, 2009 and 2008, respectively.

Information for pension plans with an accumulated benefit obligation in excess of plan assets is as follows:

	2009	2008
Projected benefit obligation	$ 190,803,814	$ 175,003,803
Accumulated benefit obligation	179,543,159	168,958,821
Fair value of plan assets	140,126,670	152,150,298

Net Periodic Benefit Cost, Employer Contributions, Participant Contributions, and Benefits Paid

	Pension Benefits	
	2009	2008
Net periodic benefit cost	$ (5,373,086)	$ (15,396,659)
Employer contributions	12,518,424	26,581,895
Benefits paid	(6,339,033)	(4,216,071)

Other Changes in Plan Assets and Benefit Obligations Recognized in Pension-related Changes Other than Net Periodic Benefit Cost

	Pension Benefits	
	2009	2008
Net loss	$ 77,590,157	$ 44,743,031
Prior service credit	(20,732,255)	(22,854,106)
Total recognized in pension-related changes other than net periodic benefit pension cost	$ 56,857,902	$ 21,888,925

Note 10 - Pension Plans (Continued)

The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized from pension-related changes other than net periodic benefit cost into net periodic benefit cost over the next fiscal year is $2,122,032.

Assumptions

Weighted Average Assumptions Used to Determine Benefit Obligations at June 30

	Pension Benefits	
	2009	2008
Discount rate	6.85 %	6.95 %
Rate of compensation increase	4.00	4.00

Weighted Average Assumptions Used to Determine Net Periodic Benefit Cost for Years Ended June 30

	Pension Benefits	
	2009	2008
Discount rate	6.85 %	6.95 %
Expected long-term return on plan assets	8.00	8.00
Rate of compensation increase	4.00	4.00

The overall expected rate of return on plan assets is based on overall market expectations for a portfolio with an asset mix similar to the System.

Plan Assets

The System's pension plan weighted average asset allocations at June 30, 2009 and 2008 by asset category are as follows:

	2009	2008
Equity securities	49 %	70 %
Debt securities	38	22
Cash equivalents	13	8
Total	100 %	100 %

Note 10 - Pension Plans (Continued)

The investment policy, as established by the board of trustees, is to assist the Marquette General Hospital Plan Finance Committee with supervising and monitoring the investment of the Marquette General Hospital Retirement Fund's assets. The investment policy objectives include meeting and funding the liabilities of the defined pension plan; providing long-term growth of principal without undue risk, through capital appreciation, income, and System contributions; and focusing on consistent long-term capital appreciation and income.

The System invests in various financial instruments which are publicly traded. Financial instruments are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investments will occur in the near term, and that such changes could materially affect the amounts reported in the statements of operations and changes in net assets.

The System's targeted allocation of assets by category is as follows:

Equity securities	45%-65%
Debt securities	25%-45%
Cash equivalents	0%-10%

Contributions

The System expects to contribute $4,639,001 to its pension plan in 2010.

Estimated Future Benefit Payments

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

2010	$ 7,283,885
2011	7,832,919
2012	8,451,638
2013	9,107,442
2014	9,926,781
2015-2019	67,128,036

Note 11 - Functional Expenses

The System fulfills the health requirements of residents within the communities it serves by providing, as its principal function, a complete array of health services. Expenses relating to providing these services for the years ended June 30, 2009 and 2008 are as follows:

	2009	2008
Healthcare services	$ 299,863,174	$ 294,243,016
General and administrative	8,547,653	16,114,674
Fund-raising	702,003	657,258
Total	$ 309,112,830	$ 311,014,948

Note 12 - Investment in Affiliates

At June 30, 2009, the System has contributed 57 percent of the capital for Upper Peninsula Health Plan, Inc. (UPHP) and Upper Peninsula Managed Care, LLC (UPMC). For both entities, an affirmative vote of members holding a greater than 50 percent of the equity interests is required for routine operational matters submitted to a vote, and greater than 70 percent for other significant matters. Based on the requirement for 70 percent approval on significant transactions, the System does not have control of these entities and records them using the equity method. UPHP is a Medicaid-only HMO in Michigan's Upper Peninsula. The net carrying value of the UPHP interest at June 30, 2009 and 2008 was approximately $12,163,000 and $10,347,000, respectively. UPMC serves as the management company for UPHP. The net carrying value of UPMC's interest at June 30, 2009 and 2008 was approximately $1,116,000 and $1,089,000, respectively.

The System provides healthcare services to enrollees of UPHP. Net patient service revenue for services rendered to plan participants totaled $7,584,236 and $6,367,406 for the years ended June 30, 2009 and 2008, respectively.

The System has additional investments in affiliates that are not material to the financial statements.

Note 12 - Investment in Affiliates (Continued)

The following is a summary of financial position and results of operations of UPHP and UPMC, respectively, as of June 30, 2009 and 2008:

	2009	2008
UPHP		
Total assets	$ 33,851,466	$ 28,597,009
Total liabilities	12,512,136	10,443,693
Stockholders' equity	$ 21,339,330	$ 18,153,316
Net income	$ 3,186,013	$ 8,496,073
UPMC		
Total assets	$ 2,506,312	$ 2,263,809
Total liabilities	548,371	353,752
Stockholders' equity	$ 1,957,941	$ 1,910,057
Net income	$ 1,819,277	$ 1,795,600

Note 13 - Community Benefit

In support of its mission, the System provides various health-related services, at a loss, to the indigent and other residents in its service area. The following is a summary of the System's community benefit expense for the years ended June 30, 2009 and 2008:

	2009	2008
Community partnership programs (unaudited)	$ 12,019,146	$ 13,060,831
Donations/contributions (unaudited)	120,945	114,257
Traditional charity care	502,168	46,660
Unpaid costs for government program patients (unaudited)	8,686,148	8,264,807
Other community benefit activities (unaudited)	6,521,825	5,246,269
Total	$ 27,850,232	$ 26,732,824

Note 13 - Community Benefit (Continued)

Community Partnership Programs - Community partnership programs include programs provided to persons with inadequate healthcare resources or for other groups with the community that need special services and support. Examples include programs related to the poor, elderly, substance abuse, child abuse, and others with specific particular healthcare needs. They also include broader populations who benefit from health community initiatives such as health promotion, education, and health screening.

Donations/Contributions - Donations/contributions include cash and in-kind donations that are made on behalf of the poor and needy to community agencies and to special funds for charitable activities as well as resources contributed directly to programs, organizations, and foundations for efforts on behalf of the poor and disadvantaged.

Traditional Charity Care - Traditional charity care covers services provided to persons who cannot afford to pay. The amount reflects the cost of free or discounted health services, net of contributions and other revenues received, as direct assistance for the provision of charity care. Charity care is determined based on established policies, using patient income and assets to determine payment ability.

Unpaid Costs for Government Program Patients - The System is a licensed Medicaid provider with approximately 10 percent of its patient base qualifying for this program. At present, the reimbursement rates for this program do not fully cover the cost of provider care to these patients. This represents the estimated "shortfall" created when a facility receives payments below the costs of treating Medicaid beneficiaries.

Note 14 - Union Contract

Approximately 17 percent of the Hospital's employees are subject to a collective bargaining agreement. The collective bargaining agreement expires May 31, 2010.

Note 15 - Discontinued Operations

During the year ended June 30, 2008, the System's management undertook action to sell Brookridge Long-term Care Facility (Brookridge) in Marquette, Michigan. Accordingly, Brookridge was considered an asset held for sale as of June 30, 2008 in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets*. The System recognized an impairment charge of $450,000 during the year ended June 30, 2008 to reduce the carrying value of the Brookridge facility to its net realizable value. The net realizable value was determined by management based on the expected sales proceeds for the facility. The transaction has been accounted for as a discontinued operation in the accompanying consolidated financial statements. Final sale of Brookridge to an outside party occured on February 12, 2009.

Note 15 - Discontinued Operations (Continued)

Revenue and net income for Brookridge included in the results of discontinued operations for the year ended June 30, 2008 were $1,232,000 and $77,000, respectively. Revenue and net loss for the year ended June 30, 2009 were $702,000 and $150,000, respectively. Assets included in the results of discontinued operations primarily consisted of property, plant, and equipment with a net book value of $2,821,671 for the year ended June 30, 2008.

In addition, management undertook action to terminate the operations and dispose of the net assets of Upcare Technology, Inc. (formerly Klinitek, Inc.) effective June 30, 2008. This action qualified as a discontinued operation. The System recognized an impairment charge of $4,154,398 during the year ended June 30, 2008 to reflect the abandonment of construction in progress assets of Upcare Technology, Inc. The transaction has been accounted for as a discontinued operation in the accompanying consolidated financial statements. Upcare Technology, Inc. has terminated all contracts as of June 30, 2009, and complete dissolution is expected to occur prior to December 31, 2009.

Revenue and net loss for Upcare Technology, Inc. included in the results of discontinued operations for the year ended June 30, 2008 were $547,000 and $375,624, respectively. Revenue and net loss for the year ended June 30, 2009 were $124,000 and $223,000, respectively. Assets included in the results of discontinued operations primarily consisted of property, plant, and equipment with a net book value of $29,361 for the year ended June 30, 2008.

Note 16 - Subsequent Event

The System purchased a sports medicine practice on September 1, 2009 for $622,000, of which $62,200 was paid at the time of closing, and for the remainder the System has incurred debt that is payable over a 10-year period at an interest rate of 5 percent per annum.

The System has a covenant related to the 2006 Bonds preventing the System from obtaining additional debt. The System received a waiver from Assured Guaranty Corp. regarding this covenant.

Additional Information

plante moran

Plante & Moran, PLLC
Suite 300
600 E. Front St.
Traverse City, MI 49686
Tel: 231.947.7800
Fax: 231.947.0348
plantemoran.com

Report Letter on Compliance with Laws and Regulations and Internal Control - Basic Financial Statements

To the Board of Trustees
Marquette General Health System

We have audited the consolidated financial statements of Marquette General Health System as of and for the year June 30, 2009 and have issued our report thereon dated September 21, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Marquette General Health System's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Marquette General Health System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

We have issued a letter of recommendations to management regarding certain financial operating and efficiency matters. This report is solely intended for the information and use of the board of trustees, management, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Plante & Moran, PLLC

September 21, 2009