CONSOLIDATED FINANCIAL STATEMENTS

Marquette General Hospital
Years Ended June 30, 2008 and 2007
With Report of Independent Auditors

0807-0962096

Marquette General Health System

Consolidated Financial Statements

Years Ended June 30, 2008 and 2007

Contents

Report of Independent Auditors

The Board of Trustees
Marquette General Health System

We have audited the accompanying consolidated balance sheets of Marquette General Hospital, Inc. (d/b/a Marquette General Health System) (the System) as of June 30, 2008 and 2007, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the System's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Marquette General Health System at June 30, 2008 and 2007, and the consolidated results of its operations and changes in net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 3 to the consolidated financial statements, in 2007, the System adopted the recognition provision of Statement of Financial Accounting Standards No. 158, *Employees' Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statements No. 87, 88, 106, and 132(R), which changed its method of accounting for its defined benefit pension plan.

Ernst + Young LLP

December 26, 2008

Marquette General Health System

Consolidated Balance Sheets

	June 30 2008	June 30 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 11,922,751	$ 13,824,219
Assets limited as to use – required for current liabilities	430,807	356,327
Accounts receivable, net of allowances for uncollectible accounts of $9,525,000 and $6,220,000 in 2008 and 2007, respectively	37,928,262	39,918,384
Inventories	7,673,266	7,924,963
Third-party settlement receivables	2,830,064	611,672
Prepaid expenses	2,482,687	2,227,093
Assets held for sale	2,851,032	6,677,805
Total current assets	66,118,869	71,540,463
Assets limited as to use, net of current portion:		
Board-designated for capital improvements	27,583,063	57,315,042
Under the following agreements:		
Bond agreements	5,922,238	6,067,087
Self insurance for professional liability and workers' compensation	17,984,132	17,954,232
	51,489,433	81,336,361
Property and equipment:		
Land and land improvements	10,814,186	10,774,964
Buildings	147,372,915	146,702,949
Equipment	137,417,140	133,245,549
Construction in progress	4,972,120	6,937,822
	300,576,361	297,661,284
Less accumulated depreciation	190,333,794	182,494,213
	110,242,567	115,167,071
Other assets:		
Deferred financing costs, net of amortization	1,398,667	2,460,309
Fair value of interest rate swap	–	336,694
Investment in unconsolidated affiliates	14,055,171	8,293,200
Other	5,435,451	3,282,313
	20,889,289	14,372,516
Total assets	$ 248,740,158	$282,416,411

	June 30	
	2008	**2007**
Liabilities and net assets		
Current liabilities:		
Accounts payable and other liabilities	**$ 9,218,284**	$ 11,707,784
Current portion of employee compensation and benefits	**16,886,920**	18,060,887
Accrued interest payable	**375,407**	489,060
Current portion of long-term debt	**3,697,592**	3,517,592
Total current liabilities	**30,178,203**	33,775,323
Professional liability and workers' compensation reserves	**3,965,883**	3,808,432
Accrued employee compensation and benefits, net of current portion	**3,832,044**	2,876,474
Accrued pension liability	**22,853,505**	53,080,860
Fair value of interest rate swap	**1,881,882**	–
Long-term debt, net of current portion	**74,170,123**	77,867,715
Total long-term liabilities	**106,703,437**	137,633,481
Total liabilities	**136,881,640**	171,408,804
Net assets:		
Unrestricted	**110,750,790**	110,361,928
Temporarily restricted	**1,107,728**	645,679
Total net assets	**111,858,518**	111,007,607
Total liabilities and net assets	**$ 248,740,158**	$ 282,416,411

See accompanying notes.

Marquette General Health System

Consolidated Statements of Operations and Changes in Net Assets

	Year Ended June 30 2008	2007
Unrestricted revenues and other support:		
Net patient service revenue	$ **281,490,075**	$ 262,867,004
Other operating revenue	**13,422,423**	10,073,225
Income from investment in unconsolidated affiliates	**5,761,971**	2,308,840
Total revenue	**300,674,469**	275,249,069
Expenses:		
Salaries and wages	**120,163,605**	112,598,146
Supplies and other services	**112,870,399**	103,657,726
Employee health and welfare benefits	**35,835,138**	41,339,431
Depreciation and amortization	**10,848,083**	12,379,591
Provision for uncollectible accounts	**11,950,543**	6,434,992
Interest and amortization of deferred finance costs	**4,421,235**	3,988,110
Total expenses before impairment, restructuring and other nonrecurring expenses, and pension curtailment	**296,089,003**	280,397,996
Income (loss) from operations, before restructuring and other nonrecurring expenses, and pension curtailment	**4,585,466**	(5,148,927)
Restructuring and other nonrecurring expenses	**(8,196,297)**	–
Pension curtailment and special termination benefit	**(6,729,648)**	–
Loss from operations	**(10,340,479)**	(5,148,927)
Nonoperating income (expense):		
Net realized investment gains	**3,376,241**	8,756,896
Change in unrealized investment (loss) gain	**(3,140,194)**	414,788
Change in fair value of interest rate swap	**(2,218,576)**	–
Loss on disposal of assets	**(634,161)**	(376,713)
	(2,616,690)	8,794,971
(Deficit) excess of revenue over expenses before loss on extinguishment of debt	**(12,957,169)**	3,646,044
Loss on extinguishment of debt	**(1,025,722)**	–
(Deficit) excess of revenue over expenses	**(13,982,891)**	3,646,044

Continued on next page

Marquette General Health System

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

	Year Ended June 30	
	2008	**2007**
(Deficit) excess of revenue over expenses	**$ (13,982,891)**	$ 3,646,044
Change in fair value of interest rate hedge	**–**	394,084
Contribution received for property acquisitions	**232,296**	154,557
Pension liability adjustment	**19,042,119**	–
Decrease in minimum pension liability	**–**	5,929,170
Adjustment to initially apply the recognition provisions of FASB Statement 158	**–**	(34,942,175)
Increase (decrease) in unrestricted net assets before discontinued operations	**5,291,524**	(24,818,320)
Loss on discontinued operations	**(4,902,662)**	(1,434,250)
Increase (decrease) in unrestricted net assets	**388,862**	(26,252,570)
Increase in temporarily restricted net assets	**462,049**	645,679
Increase (decrease) in net assets	**850,911**	(25,606,891)
Net assets at beginning of year	**111,007,607**	136,614,498
Net assets at end of year	**$ 111,858,518**	$111,007,607

See accompanying notes.

Marquette General Health System

Consolidated Statements of Cash Flows

	Year Ended June 30 2008	2007
Operating activities		
Increase (decrease) in net assets	$ **850,911**	$ (25,606,891)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by (used in) operating activities:		
Depreciation and amortization, including amortization of deferred finance costs	**11,575,039**	13,707,606
Change in unrealized investment loss (gain)	**3,140,194**	(414,788)
Loss on extinguishment of debt	**1,025,722**	–
Change in fair value of interest rate swap	**2,218,576**	(394,084)
Impairment of discontinued operations	**4,604,398**	–
Loss on disposal of assets	**634,161**	376,713
Net periodic pension cost	**15,396,659**	13,782,183
Pension contributions	**(26,581,895)**	(14,922,476)
Pension liability adjustment	**(19,042,119)**	–
Change in minimum pension liability	**–**	(5,929,170)
Adjustment to initially apply the recognition provisions of SFAS No. 158	**–**	34,942,175
Equity earnings in unconsolidated affiliates	**(5,761,971)**	(2,380,840)
Provision for uncollectible accounts	**11,950,543**	6,434,992
Increase in temporarily restricted net assets	**(462,049)**	(645,679)
Changes in operating assets and liabilities:		
Accounts receivable	**(9,960,421)**	(11,244,874)
Inventories, prepaid expenses, and other assets	**(3,897)**	(306,199)
Accounts payable and other liabilities	**(2,489,500)**	858,037
Decrease (increase) in assets limited as to use	**26,632,254**	(4,571,232)
Third-party settlement liabilities	**(2,218,392)**	(6,560,912)
Employee compensation and related liabilities	**(218,397)**	1,440,628
Accrued interest payable	**(113,653)**	74,408
Professional liability and workers' compensation reserves	**157,451**	(425,679)
Net cash provided by (used in) operating activities	**11,333,614**	(1,786,082)
Investing activities		
Capital expenditures – net	**(7,859,020)**	(15,277,240)
(Increase) decrease in noncurrent assets	**(2,250,730)**	73,380
Net cash used in investing activities	**(10,109,750)**	(15,203,860)
Financing activities		
Increase in temporarily restricted net assets	**462,049**	645,679
Proceeds from long-term debt	**–**	37,000,000
Principal payments of long-term debt	**(3,420,000)**	(30,547,949)
Deferred financing costs	**(167,381)**	(2,108,533)
Principal payments of capital leases	**–**	(212,485)
Net cash (used in) provided by financing activities	**(3,125,332)**	4,776,712
Net decrease in cash and cash equivalents	**(1,901,468)**	(12,213,230)
Cash and cash equivalents at beginning of year	**13,824,219**	26,037,449
Cash and cash equivalents at end of year	$ **11,922,751**	$ 13,824,219

See accompanying notes.

1. Significant Accounting Policies

Organization and Nature of Operations

Marquette General Hospital, Inc. (d/b/a Marquette General Health System) (the System) is a Michigan nonstock corporation providing health care 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 health care 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 the business of developing computer software for health care applications. The operations of Klinitek have been presented as a discontinued operation as described in Note 8.

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

Use of Estimates

The preparation of consolidated 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

Cash equivalents consist of highly liquid financial instruments with an original maturity of three months or less when purchased, excluding those amounts included in assets limited as to use.

1. Significant Accounting Policies (continued)

Allowance for Uncollectible Accounts

The allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections considering business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon its review of accounts receivable payor composition and aging taking into consideration recent write-off experience by payor category, payor agreement rate changes, and other factors. The results of these evaluations are used to make any modifications to the provision for uncollectible accounts to establish an appropriate allowance for uncollectible accounts. After satisfaction of amounts due from insurance, the System follows established guidelines for placing certain past-due patient balances with collection agencies.

Inventories

Inventories consist of medical supplies, durable medical equipment, and pharmaceutical items valued at the lower of cost (average cost) or market.

Assets Limited as to Use

Assets whose use is limited primarily include designated assets set aside by the Board of Directors 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 the current liabilities of the System have been classified as the current portion of assets whose use is limited in the consolidated balance sheets.

Investment securities are recorded at fair value, determined primarily from quoted market prices. The cost of securities sold is based on the specific identification method. The System classifies its investment portfolio as trading, with unrealized gains and losses included in excess of revenues over expenses. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The aggregated fair value amounts presented do not represent the underlying value of the System; instead, they represent point-in-time estimates that might not be particularly relevant in predicting the System's future earnings or cash flows. All financial instruments held or issued by the System are considered trading.

1. Significant Accounting Policies (continued)

Investment income (including realized and unrealized gains and losses on investments, interest, and dividends from all other investments) is reported as nonoperating gains (losses) unless the income is restricted by donor or law

Income Taxes

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. Klinitek 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 1 supporting organization as defined by the IRC.

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

Financial Instruments

The System's financial instruments include cash and cash equivalents, accounts receivable, assets limited as to use, accounts payable, and long-term debt. Management's estimate of the fair value of these financial instruments approximates the carrying amounts at June 30, 2008, except for certain long-term debt arrangements which use discounted cash flow analyses based on the System's estimated borrowing rate for similar financing arrangements.

Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Adjustments to recorded estimates are likely in the future and could be material. The System's net patient service revenue was decreased by $1,086,000 in 2008 and $58,000 in 2007 to reflect changes in the estimated settlements for certain prior years. Management believes that adequate provision has been made in the consolidated financial statements for any adjustments that may result from final settlements.

1. Significant Accounting Policies (continued)

The majority of the System's services are under fixed provisions of third party payment programs (primarily Medicare, Medicaid, and Blue Cross Blue Shield of Michigan). Revenue from these programs accounted for approximately 74% of the Systems net patient service revenue for 2008 (75% for 2007). Payments are also received for capital and medical education costs subject to certain limits. Additionally, the System has entered into payment arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payments to the System under these arrangements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates. Net patient service revenue for such arrangements is recorded at the amount expected to be realized upon payment for such services.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. The System believes it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action. As a result, there is at least a reasonable possibility that recorded amounts will change by a material amount in the near term.

Charity and Other Uncompensated Care

In furtherance of the System's mission, quality medical services are provided regardless of race, creed, sex, national origin, handicap, or ability to pay. In addition to providing services to the financially disadvantaged at no cost or at a discounted charge, the System provides other uncompensated care represented by the provision for uncollectible accounts, which are services provided to uninsured and underinsured patients. The following is management's estimate of charity and other uncompensated care services:

1. Significant Accounting Policies (continued)

The uncompensated cost of community benefits is estimated by applying an overall cost to charge ratio to the charges associated with patients who qualify for charity care. In addition, the System provides services to other medically indigent patients under various state Medicaid programs. Such programs pay providers amounts which are less than the established charges for the services provided to the recipients. The uncompensated costs associated with these state programs is estimated as the total direct and indirect costs in excess of the payments received for the services provided

	Year Ended June 30	
	2008	**2007**
Charity care costs	**$ 456,000**	$ 377,000
Other uncompensated care	**11,951,000**	6,435,000
Total charity and other uncompensated care	**$ 12,407,000**	$ 6,812,000

Operating Indicator

The Organization's operating indicator (loss from operations) includes all net patient service revenues and other revenues and expenses from the System's operations for the reporting period. The operating indicator excludes investment income, changes in fair value of interest rate swap, loss on disposal of assets, and loss on extinguishment of debt.

Performance Indicator

The System's performance indicator (deficit of revenue over expenses) includes all changes in unrestricted net assets other than contributions, pension related changes other than net periodic pension costs and loss from discontinued operations.

Property and Equipment

Property and equipment are stated at cost. Depreciation, including amortization of amounts recorded under capital leases, is computed using the straight-line method over the estimated useful lives of the related assets, which range from 3 to 40 years. Costs of maintenance and repairs are charged to expense when incurred.

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

1. Significant Accounting Policies (continued)

Deferred Financing Costs

Financing costs incurred in connection with outstanding debt are being amortized over the life of the related debt using the straight-line method, which approximates the effective interest rate method.

Contributions

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received. Such unconditional gifts are recorded as other operating revenue unless provided for property acquisitions, in which case, it is recorded as an other increase in unrestricted net assets. Conditional promises to give and indications of intentions 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 donated assets. Donor restrictions are primarily for property or patient care for a specific time period or purpose.

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 on the consolidated statements of operations and changes in net assets 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 accompanying consolidated statements of operations and changes in net assets. Earnings from the investments of contributions and bequests are reflected in unrestricted net assets when earned unless otherwise restricted by the donor.

The System received unconditional promises to give cash and other assets with a fair value of $36,820 in 2008 and $413,669 in 2007.

Derivative and Hedging Activities

The System follows Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which was amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Hedging Activities*, to account for its derivative instruments. SFAS No. 133 requires the System to recognize all of its derivative instruments as either assets or liabilities in the balance sheets at fair value.

1. Significant Accounting Policies (continued)

Effective April 1, 2007, the System designated all of its previous hedging relationships for the swaps. The accumulated unrealized derivative loss is included in unrestricted net assets at June 30, 2008 and 2007, respectively was insignificant. The interest rate swaps are recorded at their estimated fair value and included in other liabilities at $1,881,882 as of June 30, 2008 and is other assets at $336,694 as of June 30, 2007. The unrealized loss on interest rate swaps included in nonoperating losses in the accompanying consolidated statements of operations and changes in net assets was $2,218,576 for the year ended June 30, 2008.

New Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements.* SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. generally accepted accounting principles, and expands disclosure about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The System has not determined the effect that the adoption of SFAS No. 157 will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159 permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The System has not determined the effect that the adoption of SFAS No. 159 will have on its consolidated financial statements.

Reclassifications

Certain amounts reported in 2007 have been reclassified to conform to the 2008 presentation. These reclassifications had no impact on the change in net assets previously reported and did not materially change individual statement line items.

2. Discontinued Operations

During the year ended June 30, 2008, System management undertook action to sell Brookridge Long-Term Care facility in Marquette, Michigan. Accordingly, Brookridge is considered to be 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.

Revenues 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, while revenues and net income included in the results of discontinued operations for the year ended June 30, 2007, were $1,254,000 and $113,000, 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, and $3,290,339 for the year ended June 30, 2007.

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 qualifies 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.

Revenue and net loss for Upcare included in the results of discontinued operations for the year ended June 30, 2008, were $547,000 and $375,264, respectively, while revenues and net loss included in the results of discontinued operations for the year ended June 30, 2007, were $122,000 and $1,547,250, 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, and $3,387,466 for the year ended June 30, 2007.

3. Assets Limited as to Use

Assets limited as to use are stated at fair value. The composition of assets limited as to use was as follows:

	June 30 2008	June 30 2007
Board designated for capital improvements		
Cash and cash equivalents	$ 1,044,947	$ 4,740,072
Government fixed income securities	9,891,767	24,752,150
Equity securities	16,646,349	27,822,820
	27,583,063	57,315,042
Under bond agreements		
Cash and cash equivalents	430,807	501,176
Government fixed income securities	5,922,238	5,922,238
	6,353,045	6,423,414
Self-insurance for professional liability and workers' compensation		
Cash and cash equivalents	1,510,999	635,822
Government fixed income securities	9,788,566	9,997,680
Equity securities	6,684,567	7,320,730
	17,984,132	17,954,232
	$ 51,920,240	$ 81,692,688

Investment return is summarized as follows:

	June 30 2008	June 30 2007
Interest, dividends, and net realized gains on sale of investments	$ 3,376,241	$ 8,756,896
Net unrealized gain (losses) on investments	(3,140,194)	414,788
Total investment return included in nonoperating (losses) gains	$ 263,047	$ 9,171,684

3. Assets Limited as to Use (continued)

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. Through November 24, 2008, the fair value of investments were negatively impacted by market volatility due to losses resulting from the market downturn.

4. Pension Plan

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 June 30, 2007, the System adopted the recognition and disclosure requirements of SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. Adjustments to pension liability to reflect funded status are charged or credited to unrestricted net assets. The effect of adopting SFAS No. 158 increased the minimum pension liability and decreased unrestricted net assets in the amount of $34,942,175 at June 30, 2007.

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 requirements 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.

4. Pension Plan (continued)

The following table summarizes the funded status and other information related to the Plan:

	Year Ended June 30	
	2008	**2007**
Change in projected benefit obligation		
Benefit obligation at beginning of year	**$188,494,045**	$169,454,983
Service cost	**8,289,639**	9,908,478
Interest cost	**11,683,260**	11,321,077
Plan amendments	**(27,718,886)**	–
Actuarial (gain) loss	**(10,093,682)**	897,434
Benefits paid	**(4,216,071)**	(3,087,927)
Curtailments	**2,813,720**	–
Special termination benefit	**5,751,778**	–
Benefit obligation at end of year	**175,003,803**	188,494,045
Change in plan assets		
Fair value of plan assets at beginning of year	**135,413,185**	108,803,021
Actual return on assets	**(5,628,711)**	14,775,615
Employer contributions	**26,581,895**	14,922,476
Benefits paid	**(4,216,071)**	(3,087,927)
Fair value of plan assets at end of year	**152,150,298**	135,413,185
Funded status	**$ (22,853,505)**	$(53,080,860)
Accumulated benefit obligation at end of year	**$168,958,821**	$155,974,379
Amounts recognized in the consolidated balance sheets		
Accrued pension liability included in the consolidated balance sheets	**$ (22,853,505)**	$(53,080,860)
Unrecognized amounts:		
Net loss	**44,743,031**	38,508,535
Unrecognized prior service cost	**(22,854,106)**	2,422,509
Net amount recognized	**$ (964,580)**	$(12,149,816)

4. Pension Plan (continued)

Components of net periodic pension cost are as follows:

	Year ended June 30	
	2008	**2007**
Service cost	**$ 8,289,639**	$ 9,908,478
Interest cost	**11,683,260**	11,321,077
Expected return on plan assets	**(12,321,609)**	(9,808,040)
Amortization of unrecognized prior service cost	**(606,421)**	523,623
Amortization of net loss	**1,622,142**	1,837,045
Net periodic pension cost	**8,667,011**	13,782,183
Curtailment loss	**977,870**	–
Special termination benefit	**5,751,778**	–
Net periodic benefit cost after curtailments and settlements	**$15,396,659**	$13,782,183

Accumulated adjustments to unrestricted net assets at June 30, 2008 include amounts related to net actuarial loss and unrecognized prior service costs that have not yet been recognized in net periodic benefit costs. Expected amortization of unrecognized amounts of $911,389 will be recognized in fiscal 2009.

The actuarial assumptions used in determining the projected benefit obligation and net periodic cost shown above were as follows:

	Year ended June 30	
	2008	**2007**
Weighted-average discount rate used to determine projected benefit obligation	**6.95%**	6.43%
Weighted-average discount rate used to determine net periodic cost	**6.43**	6.75
Expected return on plan assets	**8.00**	8.00
Rate of compensation increase	**4.00**	4.00

The System's estimate of total contributions to the pension plan for the next fiscal year is $14,399,633.

4. Pension Plan (continued)

The benefits expected to be paid in each of the next five fiscal years and in aggregate for the following five years are as follows:

2009	$ 6,198,414
2010	7,126,933
2011	7,722,688
2012	8,384,877
2013	9,159,318
2014 to 2018	$62,661,424

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-benefit 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. Through November 24, 2008, the fair value of investments were negatively impacted by market volatility due to losses resulting from the market downturn.

The target allocation and actual allocation of plan assets by type of asset at the end of each year is as follows:

		June 30	
	Target	**2008**	**2007**
Equity	40 – 70%	70%	53%
Bonds and notes	30 – 60	22%	37
Cash equivalents	2 – 10	8%	10

4. Pension Plan (continued)

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% of compensation. Expenses charged to operations under these plans were $128,497 and $14,905 for the years ended June 30, 2008 and 2007, respectively.

5. 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 the retention of $2,000,000 per occurrence and $6,000,000 annual aggregate for its general liability claims. Prior to March 29, 2005, the System was covered by a commercial insurance policy for general liability claims. 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.

The System, with the 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 5% 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, 2008 and 2007, 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.

6. Long-Term Debt

Long-term debt consisted of the following:

	June 30	
	2008	**2007**
Michigan State Hospital Finance Authority Hospital Revenue Bonds, Series 2006	**$ 37,000,000**	$37,000,000
Michigan State Hospital Finance Authority Hospital Revenue Bonds, Series 2005A	**28,465,000**	28,465,000
City of Marquette Hospital Finance Authority Variable Rate Demand Hospital Revenue Bonds, Series 2004A	**5,490,000**	8,110,000
Term loan	**6,584,615**	7,384,615
Bond premium, less accumulated amortization	**328,100**	425,692
	77,867,715	81,385,307
Less current portion	**3,697,592**	3,517,592
	$ 74,170,123	$77,867,715

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 and loaned the proceeds to the Obligated Group (which is comprised of the System) under the terms of a 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. The Bonds bear interest as determined by an auction rate and are to be repaid in annual amounts ranging from $4,000,000 in June 2015 to $5,325,000 in June 2022. Proceeds were used to repay certain amounts outstanding on the Term Loan and for various property acquisitions. Effective April 16, 2008, the System converted from interest determined by an auction rate to a weekly rate, as allowed under the initial bond agreement. As a result of this conversion, a mandatory tender feature was invoked and the debt was considered extinguished and reissued. Certain deferred finance costs related to the extinguished debt in the amount of $1,025,000 were written off as a result of this extinguishment. No other terms changed as a result of this transaction.

6. Long-Term Debt (continued)

The 2006 Bonds are secured by a Standby Bond Purchase Agreement which is available to the Obligated Group if the holders of the obligations tender such obligations for purchase and the obligations are not remarketed. Accordingly, the bonds have been classified as long-term as it is the Obligated Group's intent to remarket these obligations, if presented. The Standby Bond Purchase Agreement expires on April 16, 2011, and there were no borrowings during 2008 and 2007 on the agreement. The payment of principal and interest on the 2006 Bonds are also guaranteed under a financial guaranty insurance policy.

The Series 2005A Bonds were issued by MSHFA on behalf of the Obligated Group in the amount of $28,465,000 (unamortized premium of $328,100 and $425,692 at June 30, 2008 and 2007, 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 redemption, bear interest at 5.0%, 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% 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 by a remarketing agent (1.90% and 3.83% at June 30, 2008 and 2007, respectively) and are to be repaid in annual amounts of $2,700,000 in July 2008 and $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 available to the Obligated Group if the holders of the obligations tender such obligations for purchase and the obligations are not remarketed. Accordingly, the variable rate demand bonds have been classified as long-term as it is the Obligated Group's intent to remarket these obligations, if presented. There were no borrowings on the letter of credit during 2008 and 2007.

The Term Loan outstanding is payable in annual amounts ranging from $900,000 in December 2008 to $2,034,615 in December 2011. The Term Loan bears interest at a variable rate.

6. Long-Term Debt (continued)

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 Marquette did not meet for the year ended June 30, 2008. The Trustee has agreed to waive these covenants for the year ended June 30, 2008.

Marquette 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 the Reimbursement Agreement entered into in connection with the 2004 Bonds, the Obligated Group has obtained a waiver for the debt service and days cash on hand requirements for the periods ended March 31, 2008 and 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 requirements 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 reimbursement agreement between the bond insurer 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 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% 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. 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.

6. 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 master 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% 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. 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*.

Future maturities of long-term debt during the four years subsequent to fiscal 2009 are as follows: 2010 – $6,808,575; 2011 – $4,254,844; 2012 – $4,477,965; 2013 – $2,544,275; and thereafter – $56,084,464.

The System made interest payments of approximately $4,421,000 and $3,988,000 for the years ended June 30, 2008 and 2007, respectively. At June 30, 2008 and 2007, the carrying value of long-term debt approximated fair value.

7. Commitments

The System has several operating lease commitments, principally for office and storage space. The following is a schedule of future minimum rental payments required under these operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2008:

Years ending June 30:	
2009	$ 1,837,313
2010	1,560,810
2011	1,332,645
2012	876,115
2013	419,869
	$ 6,026,752

Lease expense for all operating leases amounted to approximately $2,864,000 and $2,227,000 in 2008 and 2007, respectively.

The System has entered into certain purchase commitments with vendors for the construction of building additions and acquisition of equipment totaling $1,297,000 as of June 30, 2008.

8. Related Party and Related-Party Transactions

At June 30, 2008, the System has contributed 57% of the capital for a 7% voting interest in Upper Peninsula Health Plan, Inc. (UPHP). UPHP is a Medicaid only HMO in Michigan's Upper Peninsula and is recorded by the System using the equity method. The net carrying value of the UPHP interest at June 30, 2008 and 2007 was $10,347,000 and $5,499,000, respectively.

At June 30, 2008, the System has contributed 57% of capital for a 7% voting interest in Upper Peninsula Managed Care, LLC (UPMC). UPMC serves as the management company for UPHP. The net carrying value of the UPMC interest at June 30, 2008 and 2007 was $1,089,000 and $475,000, respectively.

8. Related Party and Related-Party Transactions (continued)

The System provides health care services to enrollees of UPHP. Net patient service revenue for services rendered to plan participants totaled $6,367,406 and $4,692,885 for the year ended June 30, 2008 and 2007, respectively.

9. 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 are as follows:

	Year Ended June 30	
	2008	**2007**
Health care services	**$287,206,330**	$ 271,986,060
General and administrative	**8,882,670**	8,411,940
	$296,089,000	$ 280,398,000