McLeod Health

Consolidated Financial Statements as of and
for the Years Ended September 30, 2011 and 2010,
Supplemental Consolidating Information as of and
for the Year Ended September 30, 2011, and
Independent Auditors' Report

MCLEOD HEALTH

TABLE OF CONTENTS

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
McLeod Health
Florence, South Carolina

We have audited the accompanying consolidated balance sheets of McLeod Health and subsidiaries ("McLeod Health") as of September 30, 2011 and 2010, 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 McLeod Health's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 McLeod Health'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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of McLeod Health as of September 30, 2011 and 2010, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary consolidating information listed in the table of contents is presented for the purpose of additional analysis and is not a required part of the financial statements. This supplementary consolidating information is the responsibility of McLeod Health's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. Such consolidating information has been subjected to the auditing procedures applied in our audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, such consolidating information is fairly stated in all material respects in relation to the financial statements as a whole.

As discussed in Note 1 to the consolidated financial statements, McLeod Health changed the manner in which it accounts for noncontrolling interests effective October 1, 2010.

Deloitte & Touche LLP

December 19, 2011

MCLEOD HEALTH

CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2011 AND 2010

	2011	2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 21,057,239	$ 19,902,035
Investments	1,847,399	1,880,823
Receivables:		
Patient — net of allowances for doubtful accounts of $57,301,000 and $64,383,000 in 2011 and 2010, respectively	69,652,166	79,686,800
Other	1,865,976	2,320,811
Inventories	3,505,261	3,299,812
Prepaid expenses	7,519,236	7,087,924
Total current assets	105,447,277	114,178,205
ASSETS LIMITED AS TO USE	532,471,216	554,595,052
PROPERTY AND EQUIPMENT — Net	373,423,136	321,090,543
OTHER ASSETS:		
Bond issue costs — net	5,984,186	6,114,774
Goodwill	3,261,544	3,261,544
Other assets	8,499,115	5,955,380
Total other assets	17,744,845	15,331,698
TOTAL	$1,029,086,474	$1,005,195,498
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Current portion of long-term debt	$ 5,247,427	$ 5,306,583
Accounts payable	22,426,141	25,601,651
Accrued expenses and other liabilities	32,394,029	29,643,492
Estimated third-party settlements	36,858,605	35,785,919
Total current liabilities	96,926,202	96,337,645
LONG-TERM DEBT — Net of current portion	283,544,537	287,885,078
Total liabilities	380,470,739	384,222,723
COMMITMENTS AND CONTINGENCIES (Note 10)		
NET ASSETS:		
Unrestricted:		
McLeod Health	640,786,395	615,627,779
Noncontrolling interest in MMP	1,838,339	1,674,543
Total unrestricted	642,624,734	617,302,322
Temporarily restricted	5,274,028	2,953,480
Permanently restricted	716,973	716,973
Total net assets	648,615,735	620,972,775
TOTAL	$1,029,086,474	$1,005,195,498

See notes to consolidated financial statements.

MCLEOD HEALTH

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

	2011	2010
UNRESTRICTED REVENUES, GAINS, AND OTHER SUPPORT:		
Net patient service revenues	$ 710,092,620	$ 700,777,422
Other operating revenues	17,055,801	17,364,906
Net assets released from restrictions	837,068	332,254
Total unrestricted revenues, gains, and other support	727,985,489	718,474,582
EXPENSES:		
Personnel	311,829,650	296,706,798
Professional fees	16,790,772	12,876,065
Supplies	122,667,471	118,185,498
Purchased services	30,482,204	30,179,285
Facility-related costs	13,290,955	13,391,010
Insurance	3,498,627	3,401,061
Other	21,309,231	21,963,279
Interest	11,485,951	8,646,024
Depreciation and amortization	33,075,925	36,018,850
Loss on disposal of property	549,791	17,588
Provision for uncollectible accounts — net	117,292,509	129,207,501
Total expenses	682,273,086	670,592,959
INCOME FROM OPERATIONS	45,712,403	47,881,623
OTHER (EXPENSES) REVENUES — Investment (loss) income — net (including unrealized (losses) gains of $(42,973,000) and $28,801,000 for 2011 and 2010, respectively)	(20,860,100)	36,548,965
EXCESS OF REVENUES OVER EXPENSES FROM CONSOLIDATED OPERATIONS	24,852,303	84,430,588
LESS INCOME ATTRIBUTABLE TO NONCONTROLLING INTEREST	(440,635)	(159,275)
EXCESS OF REVENUES OVER EXPENSES ATTRIBUTABLE TO MCLEOD HEALTH	24,411,668	84,271,313
NET ASSETS RELEASED FROM RESTRICTIONS FOR PURCHASES OF PROPERTY AND EQUIPMENT	746,948	789,666
INCREASE IN UNRESTRICTED NET ASSETS ATTRIBUTABLE TO MCLEOD HEALTH	$ 25,158,616	$ 85,060,979

See notes to consolidated financial statements.

MCLEOD HEALTH

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

	Unrestricted					
	McLeod Health	Noncontrolling Interest	Total	Temporarily Restricted	Permanently Restricted	Total
NET ASSETS — September 30, 2009	$ 530,566,800	$ 1,760,117	$ 532,326,917	$ 1,622,756	$ 716,973	$ 534,666,646
Excess of revenues over expenses	84,271,313	159,275	84,430,588	(332,254)		84,098,334
Restricted donations and investment income			-	2,452,644		2,452,644
Distributions to noncontrolling interest		(244,849)	(244,849)			(244,849)
Net assets released from restrictions for property and equipment	789,666		789,666	(789,666)		-
Change in net assets	85,060,979	(85,574)	84,975,405	1,330,724	-	86,306,129
NET ASSETS — September 30, 2010	615,627,779	1,674,543	617,302,322	2,953,480	716,973	620,972,775
Excess of revenues over expenses	24,411,668	440,635	24,852,303	(837,068)		24,015,235
Restricted donations and investment income			-	3,904,564		3,904,564
Distributions to noncontrolling interest		(276,839)	(276,839)			(276,839)
Net assets released from restrictions for property and equipment	746,948		746,948	(746,948)		-
Change in net assets	25,158,616	163,796	25,322,412	2,320,548	-	27,642,960
NET ASSETS — September 30, 2011	$ 640,786,395	$ 1,838,339	$ 642,624,734	$ 5,274,028	$ 716,973	$ 648,615,735

See notes to consolidated financial statements.

MCLEOD HEALTH

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2011 AND 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	$ 27,642,960	$ 86,306,129
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	33,075,925	36,018,850
Provision for uncollectible accounts — net	117,292,509	129,207,501
Change in fair market value of interest rate swap agreement	(329,824)	330,337
Loss on disposal of property	565,791	17,588
Proceeds from sales of trading securities	315,147,359	292,245,142
Purchases of trading securities	(379,081,124)	(362,548,836)
Unrealized gains on investments	42,973,497	(28,801,320)
Noncontrolling interest distributions	276,839	244,849
Changes in operating assets and liabilities:		
Patient receivables	(107,257,875)	(131,179,792)
Other receivables	454,835	368,943
Inventories	(205,449)	3,204,038
Prepaid expenses	(431,312)	(405,302)
Other assets	(2,543,735)	(644,734)
Accounts payable	(6,464,496)	2,784,510
Estimated third-party settlements	1,072,686	10,867,284
Accrued expenses and other liabilities	3,080,361	(6,913,395)
Net cash provided by operating activities	45,268,947	31,101,792
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of property and equipment	382,667	89,156
Purchase of property and equipment	(81,693,770)	(35,019,692)
Bond proceeds designated for capital purchases	43,117,528	(95,518,367)
Net cash used in investing activities	(38,193,575)	(130,448,903)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of long-term debt		170,200,566
Debt issuance costs		(1,747,136)
Repayments of long-term debt	(5,156,841)	(78,495,346)
Repayments of short-term debt	(59,156)	
Repayments of capital lease obligations	(427,332)	(31,736)
Noncontrolling interest distributions	(276,839)	(244,849)
Net cash (used in) provided by financing activities	(5,920,168)	89,681,499
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,155,204	(9,665,612)
CASH AND CASH EQUIVALENTS — Beginning of year	19,902,035	29,567,647
CASH AND CASH EQUIVALENTS — End of year	$ 21,057,239	$ 19,902,035
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid for interest	$ 10,055,426	$ 8,630,296
Liabilities accrued for the purchase of property and equipment — net	$ 5,339,047	$ 2,050,061
Equipment purchased through capital leases	$ 1,153,262	$ -

See notes to consolidated financial statements.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization — McLeod Health is a South Carolina nonprofit corporation and is also an organization as described under Sections 501(c)(3) and 509(a)(3) of the Internal Revenue Code (IRC). McLeod Health serves as the parent corporation and sole member of McLeod Regional Medical Center of the Pee Dee, Inc. ("McLeod Regional Medical Center" or MRMC), McLeod Medical Center — Dillon, McLeod Health Foundation (the "Foundation"), McLeod Physician Associates II, and the sole shareholder of McLeod Physician Associates, Inc. (MPA)

McLeod Health serves the health care needs of a 12-county region in eastern South Carolina. The activities of the principal entities comprising McLeod Health are summarized as follows:

McLeod Regional Medical Center (MRMC) — MRMC is a 453-bed teaching hospital and tertiary care referral center located in Florence, South Carolina.

McLeod Medical Center — Dillon — McLeod Medical Center — Dillon is a 79-bed community hospital located in Dillon, South Carolina.

McLeod Medical Center — Darlington — McLeod Medical Center — Darlington is a division of MRMC and operates a 49-bed community hospital located in Darlington, South Carolina.

McLeod Behavioral Health — McLeod Behavioral Health is a division of MRMC and operates a 23-bed psychiatric facility located in Darlington, South Carolina.

McLeod Hospice House — McLeod Hospice House is a division of MRMC and operates a 12-bed inpatient hospice facility located in Florence, South Carolina.

McLeod Home Health — McLeod Home Health is a division of MRMC that provides home health care services.

McLeod Health Foundation (the "Foundation") — The Foundation is a not-for-profit foundation organized to solicit funds for facilities, research, and general support of McLeod Health.

McLeod Health and Fitness Center — McLeod Health and Fitness Center is a division of MRMC that operates a health and fitness center.

McLeod Physician Associates, Inc. (MPA) — MPA is a for-profit corporation that was composed of approximately 30 medical practices located throughout the Pee Dee region prior to October 1, 2006. Effective October 1, 2006, substantially all assets and operations were transferred to McLeod Physician Associates II, which is a not-for-profit corporation (see discussion below).

McLeod Physician Associates II — McLeod Physician Associates II is a not-for-profit corporation that is composed of 37 medical practices located throughout the Pee Dee region.

McLeod Ambulatory Surgery Center — McLeod Ambulatory Surgery Center is a division of MRMC that provides outpatient surgery services.

McLeod Medical Partners, LLC (MMP) — MMP is a for-profit corporation that owns and operates three medical office buildings adjacent to MRMC. MRMC owns approximately a 61% controlling share in the equity of MMP.

Principles of Consolidation — The consolidated financial statements include the accounts of McLeod Health and all wholly owned or controlled subsidiaries. All significant intercompany balances and transactions have been eliminated. The Obligated Group consists of McLeod Health, MRMC, McLeod Medical Center — Dillon, and McLeod Physician Associates II. The Nonobligated Group consists of the Foundation, MPA, and MMP.

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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions.

Cash and Cash Equivalents — Cash and cash equivalents include investments with original maturities of three months or less at the time of purchase, which have not been designated as limited as to use.

Investments and Investment Income — Investments are stated at fair value in the accompanying consolidated balance sheets. Investment income or loss is included in excess of revenues over expenses, unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from excess of revenues over expenses, unless the investments are classified as trading securities or permanent impairment has been deemed to occur. In fiscal years 2011 and 2010, McLeod Health classified its investments as trading securities. Accordingly, unrealized losses of $(42,973,000) and gains of $28,801,000 are included in investment (loss) income in the accompanying consolidated statements of operations for 2011 and 2010, respectively. In 2011, investment income (loss) also includes realized gains of $14,783,000 and interest income of $8,884,000. In 2010, investment income (loss) also includes realized gains of $2,725,000 and interest income of $7,349,000.

Assets Limited as to Use — Assets limited as to use include investments designated by the Board of Trustees of McLeod Health ("Board of Trustees") for future capital improvements (over which the Board of Trustees retains control and may at its discretion subsequently use for other purposes) and funds held by trustees under bond indenture agreements. Assets limited as to use that are required for settlement of current liabilities are reported within current assets in the accompanying consolidated balance sheets.

Inventories — Inventories are stated at the lower of cost (first-in, first-out method) or market.

Property and Equipment — Property and equipment are recorded at cost, except for donated assets, which are recorded at fair value at the date of receipt. Assets under capital lease obligations are stated at the present value of the minimum lease payments at the inception of the lease. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets, which range from 3 to 40 years. Equipment under capital lease obligations is amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the accompanying consolidated financial statements.

Expenditures, which materially extend the useful lives of the related assets, are capitalized. Routine maintenance and repair costs are charged to expense.

Interest costs incurred during the construction period for significant construction projects are capitalized as part of the cost of the constructed asset and amortized over the applicable useful lives.

Bond Issue Costs — Bond issue costs are amortized over the term of the respective obligation utilizing the straight-line method, which approximates the effective interest method. Bond discounts and premiums are also amortized over the terms of the outstanding obligations using the straight-line method. Amortization and write-off of bond issue costs, discounts, and premiums are included as components of depreciation and amortization in the accompanying consolidated financial statements.

Goodwill — Effective October 1, 2010, McLeod Health adopted the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-805 *Business Combinations*, relating to goodwill. Prior to the adoption of ASC 958-805, goodwill of $8,272,000 associated with the purchase of McLeod Medical Center — Dillon was amortized over a 20-year period using a straight-line method. Beginning October 1, 2010, and upon adoption of ASC 958-805, the goodwill associated with the purchase of McLeod Medical Center — Dillon is no longer amortized. Accumulated amortization of the goodwill as of September 30, 2010, amounted to approximately $5,010,000. The remaining unamortized balance of goodwill of approximately $3,262,000 is now subject to at least an annual assessment for impairment or more frequently if events or circumstances indicate that assets might be impaired by applying a fair-value based test. There was no impairment of goodwill during the year ended September 30, 2011.

Interest Rate Swap Agreement — In May 2005, MMP entered into a nine-year interest rate swap agreement related to its note payable. The notional amount of the agreement at September 30, 2011 and 2010, was $11,586,947 and $11,936,498, respectively. The agreement requires MMP to pay the counterparty a 4.645% fixed rate of interest on the notional amount. In return, the counterparty will pay MMP interest at a variable rate based on the published London InterBank Offered Rate (LIBOR) index in accordance with the swap agreement. MMP did not designate the derivative as a hedge instrument. The net settlement between the fixed and variable rates is included as a component of interest expense in the accompanying consolidated statements of operations. The fair value of this derivative of $(1,190,016) and $(1,519,840) as of September 30, 2011 and 2010, respectively, is reported in the accompanying consolidated balance sheet as a component of accrued expenses and other liabilities, and changes in the fair value are reflected in other revenues (expenses) in the accompanying consolidated statements of operations.

Noncontrolling Interest — Noncontrolling interest represents the minority stockholders' proportionate share of the net assets of MMP. Revenues in excess of expenses are allocated to the noncontrolling interest of MMP in proportion to their ownership percentage and are reflected as income attributable to noncontrolling interest on the consolidated statements of operations.

Temporarily and Permanently Restricted Net Assets — Temporarily restricted net assets are those assets whose use has been limited by a donor to a specific time period or purpose. Temporarily restricted net assets at September 30, 2011 and 2010, of $5,274,028 and $2,953,480, respectively, are available for scholarships, continuing education, and various other health-related programs. Temporarily restricted net assets are transferred to unrestricted net assets when the donor restrictions as to time or purpose have been met and are reflected as net assets released from restrictions in the accompanying consolidated financial statements. Net assets released from restrictions in fiscal years 2011 and 2010 of $1,584,016 and $1,121,920, respectively, included $746,948 and $789,666 for the purchase of property and equipment, respectively, and $837,068 and $332,254 for operating activities, respectively.

Permanently restricted net assets of $716,973 at both September 30, 2011 and 2010, have been restricted by the donors to be maintained by McLeod Health in perpetuity. The income from permanently restricted net assets is recorded as temporarily restricted net assets, and is expendable for scholarships, continuing education, and various other health-related programs.

Net Patient Service Revenues — Net patient service revenues are reported at the estimated net realizable amounts received, or to be received, from patients, third-party payors, and others for the specific services and supplies rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, and are adjusted in future periods as estimates change or final settlements are determined.

Charity Care — McLeod Health provides care without charge, or at amounts less than its established rates, to patients who meet certain criteria under its charity care policy. Because McLeod Health does not pursue collection of patient accounts determined to qualify as charity care, they are not reported as net patient service revenues.

Contributions — Unconditional promises by donors to give cash or other assets are reported at fair value at the date the promises are received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gifts are received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor restrictions that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated financial statements as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year that they are received are reported as unrestricted contributions in the accompanying consolidated financial statements. Contributions of property and equipment are recorded as unrestricted support in the absence of donor stipulations regarding how long the assets are to be used.

Income Taxes — McLeod Health and its not-for-profit subsidiaries have been recognized by the Internal Revenue Service as tax exempt under IRC Section 501(c)(3). Accordingly, no provision for income taxes has been recorded in the accompanying consolidated financial statements.

Excess of Revenues over Expenses — The accompanying consolidated financial statements reflect an excess of revenues over expenses. Changes in unrestricted net assets resulting from permanent transfers of assets to and from affiliates for other than goods and services and contributions of long-lived assets (including assets acquired using contributions which, by donor restriction, were to be used for the purposes of acquiring such assets) are excluded from excess of revenues over expenses.

Subsequent Events — McLeod Health has evaluated events and transactions occurring after September 30, 2011, for potential recognition or disclosure in its financial statements through the date that the consolidated financial statements were issued. See further discussion of subsequent events in footnote 17.

New Accounting Pronouncements — Effective October 1, 2010, McLeod Health adopted the provisions of ASC 958-810, *Not-for-Profit Entities — Consolidation*. ASC 958-810 amended FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, to make their provisions applicable to not-for-profit entities. The provisions of ASC 958-810 are to be applied prospectively, except for presentation and disclosure requirements related to noncontrolling interests, which are to be applied retrospectively. ASC 958-810 requires the noncontrolling interests to be presented as a separate component of the appropriate class of net assets. ASC 958-810 also requires the excess of revenues over expenses attributable to noncontrolling interests to be presented separately on the consolidated statements of operations. These provisions have been reflected in the consolidated balance sheets, statements of operations, statements of changes in net assets, and consolidated statements of cash flows as of and for the years ended September 30, 2011 and 2010.

Effective October 1, 2010, McLeod Health adopted the provisions of ASC 958-805, *Business Combinations*, relating to goodwill. Prior to the adoption of ASC 958-805, goodwill was amortized on a straight-line basis. Beginning October 1, 2010, and upon the adoption of ASC 958-805, goodwill is no longer amortized and is now subject to at least an annual assessment for impairment by applying a fair-value based test.

In September 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Assets Value per Share*. The amendments of this ASU permit, as a practical expedient, a reporting entity to measure fair value of an investment that is within the scope of the amendments of ASU No. 2009-12 on the basis of the net asset value per share of the investment (or its equivalent) if the net asset value of the investment is calculated in a manner consistent with the measurement principles of ASU Topic No. 946 as of the reporting entity's measurement date, including measurement of all or substantially all of the underlying investments of the investee in accordance with Topic 820. The amendments of this update are effective for reporting periods after December 15, 2009, with early adoption permitted. The adoption of this standard did not have a material effect on the consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 adds additional disclosure requirements related to transfers of Level 1 and Level 2 fair value measurements as well as additional disclosure around activity in Level 3 fair value measurements. The ASU also provides amendments to existing disclosures by adding clarification around the level of disaggregation and disclosures about inputs and valuation techniques. The disclosure requirements in ASU 2010-06 are effective for reporting periods beginning after December 15, 2009, except for the requirement to present the Level 3 rollforward on a gross basis, which is effective for reporting periods beginning after December 15, 2010. The adoption of this guidance was limited to the form and content of disclosures, and did not have a material effect on the consolidated financial statements.

In August 2010, the FASB issued ASU No. 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries.* The objective of this ASU is to address the current diversity in practice related to the accounting by health care entities for medical malpractice claims and similar liabilities and their related anticipated insurance recoveries. The amendments of this ASU clarify that a health care entity should not net insurance recoveries against a related claim liability. The amendments in this ASU are effective for fiscal years beginning after December 15, 2010. McLeod Health is currently evaluating the provisions of this update and their impact on its consolidated financial statements.

In August 2010, the FASB issued ASU No. 2010-23, *Health Care Entities (Topic 954): Measuring Charity Care for Disclosure*. This ASU provides amendments to require that cost be used as the measurement basis for charity care disclosure purposes and that cost be identified as the direct and indirect costs of providing charity care. This update also requires disclosure of the methodology used to determine such costs. This ASU is effective for fiscal years beginning after December 15, 2010. McLeod Health is currently evaluating the provisions of this update and their impact on its consolidated financial statements.

In July 2011, the FASB issued ASU No. 2011-07, *Health Care Entities (Topic 954): Presentation and Disclosure of Patient Services Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. ASU No. 2011-07 requires certain health care entities to change the presentation of their statements of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, those health care entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. ASU No. 2011-07 also requires disclosures of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. ASU No. 2011-07 is effective for nonpublic entities for fiscal years ending after December 15, 2012, with early adoption permitted. McLeod Health is currently evaluating the provisions of this update and their impact on its consolidated financial statements.

2. NET PATIENT SERVICE REVENUES

McLeod Health has agreements with third-party payors that provide for payments to McLeod Health at amounts different from its established rates. A summary of the payment arrangements with certain third-party payors is as follows:

Medicare — Inpatient acute care services rendered to Medicare program beneficiaries are generally paid at prospectively determined rates per discharge, which vary according to a patient classification system based on clinical, diagnostic, and other factors. McLeod Health's classification of Medicare patients and the appropriateness of their admissions are subject to review by a Medicare contracted independent organization. Most outpatient services are also reimbursed at prospectively determined rates. However, final Medicare reimbursement is determined based upon the submission of annual cost reports by McLeod Health and audits thereof by the Medicare Audit Contractor (MAC).

McLeod Health's Medicare cost reports have been audited by Palmetto GBA, the MAC, through September 30, 2009. However, final settlements and net patient revenues for all acute-care hospitals have been delayed by the Centers for Medicare and Medicaid Services (CMS) for fiscal years ending on or after September 30, 2007. The delay is due to unresolved issues with the data used by CMS to compute the SSI fraction, a key component in the calculation of Medicare Disproportionate Share reimbursement.

Since final determination of amounts due from or to the Medicare and Medicaid programs is subject to audit and subsequent reopenings, changes resulting from final determinations are reflected as changes in estimates, generally in the year of determination. In the opinion of management, adequate provision has been made for adjustments, if any, that may result from such reviews. Net patient service revenue decreased approximately $1.8 million for the year ended September 30, 2011, due to increases in estimated third-party settlement reserves for fiscal years ended September 30, 2005 through September 30, 2011.

Medicaid — Inpatient and outpatient Medicaid services are reimbursed on a reasonable cost basis. Interim payments are made by the state based on each facility's historical costs trended forward. Tentative settlements are made based on actual costs reported on hospital cost reports, but these are subject to further adjustment based on subsequent audits. Although Medicaid cost report audits have been initiated on several fiscal years, no final settlements have been determined by the state, as of September 30, 2011. Management has estimated potential settlements and established reserves for fiscal years 2004–2011.

In the state of South Carolina, providers are assessed a quarterly tax and receive periodic Medicaid disproportionate share and upper payment limit funds from the state of South Carolina. The tax assessment was $12,745,473 and $13,298,635 for the years ended September 30, 2011 and 2010, respectively, and is recorded as an operating expense in the accompanying consolidated statements of operations. McLeod Health received approximately $23,799,251 and $24,617,106 of disproportionate share funds from the state for the years ended September 30, 2011 and 2010, respectively, and recorded the funds as net patient service revenue in the accompanying consolidated statements of operations.

Effective January 1, 2003, funds received under the upper payment limit program may be subject to a retroactive settlement process. McLeod Health continues to evaluate the settlement process related to the upper payment limit payment program and believes that it has recorded adequate provisions as of September 30, 2011 and 2010, in estimated third-party settlements in the accompanying consolidated balance sheets. Funds received under these programs may be subject to a retroactive settlement process and future receipts of funds are not guaranteed. Beginning in fiscal year 2011, states are required to perform audits of hospital disproportionate share data and make adjustments to payments if over or underpayments have occurred based on the results of these audits.

3. INVESTMENTS

Investments as of September 30, 2011 and 2010, are composed of investments held by the Foundation and are recorded as follows:

	2011	2010
Investments held by the Foundation	$ 3,936,232	$ 3,947,598
Less amounts included in assets limited to use	(2,088,833)	(2,066,775)
Certificates of deposit and money market funds	$ 1,847,399	$ 1,880,823

McLeod Health has segregated assets limited as to use maintained by the Foundation into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value as of September 30, 2011 and 2010, in the tables below:

	Fair Value Measurement as of September 30, 2011			
	September 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Common stocks	$ 1,204,675	$ 1,204,675	$ -	$ -
Mutual funds	108,878	108,878		
Corporate bond funds	529,647	529,647		
Government bonds	217,400		217,400	
Other	28,233		28,233	
Total	$ 2,088,833	$ 1,843,200	$ 245,633	$ -

	Fair Value Measurement as of September 30, 2010			
	September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Common stocks	$ 1,328,606	$ 1,328,606	$ -	$ -
Mutual funds	109,374	109,374		
Corporate bond funds	483,581	483,581		
Government bonds	118,396		118,396	
Other	26,818		26,818	
Total	$ 2,066,775	$ 1,921,561	$ 145,214	$ -

4. ASSETS LIMITED AS TO USE

McLeod Health combines its investments in a system-wide investment pool, which includes investments and assets whose use is limited. Assets whose use is limited primarily include assets held by trustees under a master trust indenture agreement and assets designated 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.

Assets limited as to use are stated at fair value as of September 30, 2011 and 2010, and have been designated as set forth in the table below:

	2011	2010
By the Board of Trustees for future expansion, purchase of property and equipment, and repayment of debt	$ 480,639,471	$ 456,612,805
Held by trustee for construction and purchase of property and equipment	42,203,820	87,991,037
Held by trustee for debt service reserve	7,539,092	7,924,435
Held by the Foundation	2,088,833	2,066,775
Total	$ 532,471,216	$ 554,595,052

McLeod Health has segregated its investments and assets limited as to use into the most appropriate level within the fair value hierarchy based on the inputs used to determine the fair value as of September 30, 2011 and 2010, in the tables below:

	Fair Value Measurement as of September 30, 2011			
	September 30, 2011	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Cash, cash equivalents, and money market funds	$ 59,479,162	$ 59,479,162	$ -	$ -
Mutual funds	76,217,959	76,217,959		
Domestic equities	57,440,591	57,440,591		
Fixed income:				
Government bonds and government-backed securities	57,814,686		57,814,686	
Corporate bonds	23,784,472		23,784,472	
Mortgage-backed securities	6,234,288		6,234,288	
Other	7,594,969		7,594,969	
Large Cap Commingled Funds:				
State Street Global Advisors S&P 500 Index Funds	42,418,639		42,418,639	
JPMorgan U.S. Large Cap 130/30 Fund LLC	45,795,791		45,795,791	
International Equity Commingled Funds:				
Blackrock Global Investors Fund	54,425,790		54,425,790	
Alliance Institutional International Equity Fund	23,475,119		23,475,119	
Bernstein International Value Fund	28,400,339		28,400,339	
Alternative investment — Blackstone Partners Offshore Fund Ltd.	47,300,578			47,300,578
Investments held by the Foundation (Note 3)	2,088,833	1,843,200	245,633	
Total	$ 532,471,216	$ 194,980,912	$ 290,189,726	$ 47,300,578

	Fair Value Measurement as of September 30, 2010			
	September 30, 2010	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Cash, cash equivalents, and money market funds	$ 102,085,568	$ 102,085,568	$ -	$ -
Mutual funds	67,869,212	67,869,212		
Domestic equities	60,056,621	60,056,621		
Fixed income:				
Government bonds and government-backed securities	44,125,881		44,125,881	
Corporate bonds	34,589,631		34,589,631	
Mortgage-backed securities	9,718,966		9,718,966	
Other	2,741,096		2,741,096	
Large Cap Commingled Funds:				
State Street Global Advisors S&P 500 Index Funds	41,951,183		41,951,183	
JPMorgan U.S. Large Cap 130/30 Fund LLC	46,802,951		46,802,951	
International Equity Commingled Funds:				
Blackrock Global Investors Fund	47,539,080		47,539,080	
Alliance Institutional International Equity Fund	29,574,692		29,574,692	
Bernstein International Value Fund	29,017,120		29,017,120	
Alternative investment — Blackstone Partners Offshore Fund Ltd.	36,456,276			36,456,276
Investments held by the Foundation (Note 3)	2,066,775	1,921,561	145,214	
Total	$ 554,595,052	$ 231,932,962	$ 286,205,814	$ 36,456,276

The fair value of fixed income securities shown in Level 2 above are measured using inputs other than quoted prices that are observable for the assets, including the stated interest rate, maturity and credit risk.

McLeod Health's commingled funds and alternative investments include the following funds that do not have readily determinable market values:

State Street Global Advisors S&P 500 Index Funds — privately held funds that invest primarily in equity securities that trade on national stock exchanges and seeks to gain exposure to large capitalization U.S. companies by replicating the returns and characteristics of the S&P 500 Index. There are no redemption restrictions on this fund.

JPMorgan U.S. Large Cap 130/30 Fund, LLC — a privately held fund that invests primarily in equity securities that trade on a national stock exchange and utilizes active stock selection with a systematic valuation process and seeks to invest in a diversified portfolio of U.S. large cap equities with a target average exposure of 130% long and 30% short. There are no redemption restrictions on this fund.

Blackrock Global Investors Fund (formerly Barclay's) — a privately held fund that invests primarily in international equity securities that trade on global stock exchanges. There are no redemption restrictions on this fund.

Alliance Institutional International Equity Fund — a privately held fund that invests primarily in equity securities of non-U.S. companies actively traded on foreign exchanges. The portfolio generally will be broadly diversified at the country level, with no more than 5% of any class of securities of any single issuer. The notification periods required for redemption or other limits on redemption as of September 30, 2011 are four business days for partial withdrawals and ten business days for full redemptions.

Bernstein International Value Fund — A nonpublicly traded fund that invests primarily in equity securities of non-U.S. companies actively traded on foreign exchanges located in the countries comprising the Morgan Stanley Capital International All Country World Index. The notification periods required for redemption or other limits on redemption as of September 30, 2011 are four business days for partial withdrawals and ten business days for full redemptions.

Blackstone Partners Offshore Fund Ltd. — A nonpublicly traded fund that invests primarily in other funds that are not publicly traded and is a fund of funds constructed through a multimanager framework of strategies that collectively are not highly correlated to traditional asset classes. This fund provides for redemptions on a semiannual basis with 95 days prior written notice. The change in the fair value of the fund for September 30, 2011 and 2010, is a result of the following:

Balance September 30, 2009	$26,234,783
Unrealized gains	2,221,493
Capital contribution	8,000,000
Balance September 30, 2010	36,456,276
Unrealized gains	844,302
Capital contribution	10,000,000
Balance September 30, 2011	$47,300,578

The commingled funds and alternative investments may contain elements of both credit and market risk. Such risks could include, but are not limited to, limited liquidity, absence of oversight, dependence upon key individuals, emphasis on speculative investments (both derivatives and nonmarketable investments), and nondisclosure of portfolio composition. McLeod Health reviews and evaluates the values provided by the investment managers for commingled funds and alternative investments and agrees with the valuation methods and assumptions used in determining the fair value of commingled finds and alternative investments. Financial instruments, which involve varying degrees of off-balance-sheet risk for the various limited partnerships, limited liability corporations, and offshore investment funds included within alternative investments, may result in a loss due to changes in the market (market risk).

The estimated fair value of certain alternative investments is based on valuations performed prior to the balance sheet date by the external investment managers and adjusted for cash receipts, cash disbursements, and securities distributions through September 30, 2011. Because alternative investments are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed. Such differences could be material.

5. PROPERTY AND EQUIPMENT

Property and equipment as of September 30, 2011 and 2010, consists of the following:

	2011	2010
Land and land improvements	$ 59,263,402	$ 59,737,862
Buildings	452,073,020	405,604,667
Fixed and moveable equipment	233,657,313	221,634,181
Leasehold improvements	2,431,031	2,326,174
Construction in progress	48,889,940	24,868,413
	796,314,706	714,171,297
Less accumulated depreciation	(422,891,570)	(393,080,754)
Total	$ 373,423,136	$ 321,090,543

6. SHORT-TERM BORROWINGS

McLeod Health has a $20,000,000 unsecured line of credit with a local financial institution. The line of credit bears interest at LIBOR, plus 1.25% (LIBOR was 0.24% at September 30, 2011). Interest is assessed at a variable interest rate adjusted daily and is payable monthly. There were no outstanding borrowings at September 30, 2011 and 2010.

7. LONG-TERM DEBT

Long-term debt as of September 30, 2011 and 2010, consists of the following:

	2011	2010
1998 Series A Bonds, less unamortized bond discount, due in various installments of $2,795,000 to $3,415,000, beginning November 1, 2010. Interest is paid semiannually at rates ranging from 4.75% to 5.25%	$ 20,565,901	$ 23,341,163
2004 Series A Bonds, plus unamortized premium, due in various installments ranging from $805,000 to $26,275,000 through 2034. Interest is paid semiannually at rates ranging from 4.10% to 5.25%	76,166,968	76,223,512
2010 Series A Bonds, plus unamortized premium, due in various installments ranging from $2,420,000 to $15,215,000, beginning in 2011 and extending to 2037. Interest is paid semiannually at rates ranging from 1.50% to 5.00%	123,058,304	123,059,283
2010 Series B Bonds, plus unamortized premium, due in annual installments of $15,375,000 to $15,805,000, beginning in 2038 and extending to 2040. Interest is paid monthly based on a variable rate (0.20% at September 30, 2011)	46,770,000	46,770,000
Note payable, due in monthly principal installments of $159,236, with the outstanding balance to be paid in August 2016. Interest is paid monthly at LIBOR (0.24% at September 30, 2011) plus 0.75%. Collateralized by a portion of assets	9,713,344	11,624,176
Note payable, due in monthly installments of approximately $30,000 with the remaining outstanding balance of $10.6 million to be paid in April 2014. Interest is paid monthly according to a swap agreement described in Note 1. Collateralized by MMP's land and buildings	11,586,947	11,936,498
Note payable, paid off in March 2011		101,458
Other	930,501	135,571
	288,791,965	293,191,661
Less current portion of long-term debt	(5,247,427)	(5,306,583)
Total	$ 283,544,537	$ 287,885,078

In 2010, McLeod Health issued Series 2010A and 2010B bonds. A portion of the proceeds from the issuance of the Series 2010A and 2010B bonds was used to refund the entire $33,000,000 outstanding principal balance of the Series 2004B bonds, as well as a partial refunding of $37,120,000 of the Series 1998A bonds. As a result of the refunding, McLeod Health recorded a loss on extinguishment of approximately $2.8 million (primarily attributed to the write-off of unamortized bond issuance costs related to retired debt), which is recorded as a component of depreciation and amortization expense in the accompanying consolidated financial statements. Approximately $1.7 million of new bond issuance costs have been capitalized related to various costs of issuing the bonds. The remaining proceeds from the Series 2010A and 2010B bond issuance will be used to acquire, construct, and equip certain hospital facilities.

McLeod Health's Series 2010A and 2010B, Series 2004A, and Series 1998A bonds were issued through the governmental municipality of Florence County, South Carolina. Each member of the Obligated Group is jointly and severally liable for the repayment of the principal and interest as they become due on the bonds under a master indenture agreement. All accounts receivable of McLeod Health, now owned or hereafter acquired, and all proceeds thereof are pledged as collateral for the bonds. Additionally, under the master indenture agreement, the bonds are secured by the mortgage, as described in footnote 10, on McLeod Health's land and all personal property and fixtures located thereon. Upon payment or defeasance of the Series 2004A and Series 1998A bonds, the master trustee has agreed to cancel the mortgage, and upon such cancellation, the Series 2010A and 2010B bonds will no longer be secured by the mortgage. Also under the master indenture agreement, McLeod Health is subject to various restrictions as a part of debt covenants for the bonds and other debt. At September 30, 2011, McLeod Health was in compliance with its restrictive debt covenants.

Future aggregate annual principal payments applicable to long-term debt are as follows:

Years Ending September 30	
2012	$ 5,247,427
2013	5,481,605
2014	15,184,270
2015	4,693,618
2016	4,728,618
Thereafter	253,456,427
Total	$ 288,791,965

8. EMPLOYEE BENEFIT PLANS

McLeod Health maintains a defined contribution plan covering a limited number of employees who were hired prior to January 1, 2001. McLeod Health contributes 3% of each eligible participant's compensation. Such contributions amounted to $1,979,240 and $1,942,447 in fiscal years 2011 and 2010, respectively.

McLeod Health sponsors a 401(k) plan covering substantially all employees of McLeod Health. Annual contributions are based upon a matching of the participant's elective deferrals and amounted to $4,436,172 and $4,143,533 in fiscal years 2011 and 2010, respectively.

9. CONCENTRATIONS OF CREDIT RISK

McLeod Health provides acute and nonacute health care services to residents of the Pee Dee region of South Carolina. While the majority of patient receivables are due from the Medicare and Medicaid programs and various insurance companies, the collectability of receivable balances is affected by the economic stability of the area. Accordingly, receivables are reflected on the balance sheet net of valuation allowances based on the anticipated collectability of the related gross receivables.

The mix of gross receivables from patients and third-party payors as of September 30, 2011 and 2010, is as follows:

	2011	2010
Medicare	34 %	37 %
Medicaid	12	11
Managed care and other commercial insurers	30	29
Self-pay patients	24	23
Total	100 %	100 %

10. COMMITMENTS AND CONTINGENCIES

McLeod Health has leased a portion of its land for its physical plant through 2076, at which time McLeod Health has the option to purchase the property for a nominal cost. McLeod Health is also contingently responsible for any debt service cost of the landlord, plus any expenses incurred by the landlord in connection with the ownership of the premises. For the years ended September 30, 2011 and 2010, the landlord had incurred no debt service costs or other expenses in connection with the land.

During 2008, McLeod Health maintained occurrence-basis professional liability insurance to cover medical malpractice claims in accordance with state-mandated limits for both hospital operations and its physicians. In July 2009, McLeod Health changed to a claims-made insurance policy for its physicians. In October 2009, McLeod Health changed to a claims-made insurance policy for hospital operations. It should also be noted that the South Carolina Charitable Immunity Statute allows for recovery against a charitable organization only the actual damages sustained, in an amount not exceeding the limitations of liability imposed in the South Carolina Tort Claims Act (the “Tort Claims Act”). The Tort Claims Act provides that no person shall recover in any action or claim brought hereunder a sum exceeding $300,000 per person, per occurrence or a total of $600,000 per occurrence, except that both the per-person and per-occurrence amounts are raised to $1.2 million for the tort of a licensed physician or dentist employed by such facility. No award for damages under the Tort Claims Act shall include punitive or exemplary damages or interest prior to judgment.

McLeod Health is self-insured with respect to employee health benefits and workers’ compensation.

McLeod Health is involved in various litigation, regulatory matters, and administrative proceedings arising in the ordinary course of business, including personnel and employment related matters. While any litigation contains an element of uncertainty, management believes that the outcome of any pending lawsuit or claim is covered by insurance and/or has been adequately reflected as accrued expenses and other liabilities in the accompanying consolidated financial statements.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient care services, and Medicare and Medicaid fraud and abuse. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

The health care industry continues to attract much legislative interest and public attention. In March of 2010, the President signed into law H.R. 3590, *The Patient Protection and Affordable Care Act*, and companion bill H.R. 4872, *The Health Care and Education Affordability Reconciliation Act of 2010.* The reform will be effective over a 10-year period through 2020, and contains an individual insurance mandate, low-income subsidies, an expansion of Medicaid, insurance reforms, and the creation of state-based health insurance exchanges. It is unclear at this time what the net impact of this legislation will be on McLeod Health. Such effects may include material and adverse changes to the amounts of reimbursement received by our facilities.

McLeod Health has committed to contracts with outside parties for various construction projects and equipment purchases that still have approximately $57,400,000 due to be paid subsequent to September 30, 2011.

Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the consolidated financial statements.

11. RELATED-PARTY TRANSACTIONS

Total expenditures for related-party transactions during fiscal years 2011 and 2010 were approximately $2,101,000 and $890,000, respectively. Such transactions primarily consist of trauma call pay to Florence Neurosurgery and Spine, of which a member of the community board practices neurosurgery, payments to Pee Dee Pathology where a member of the Foundation Board practices, as well as medical director and chief of staff fees for several members of the Board of Trustees and community board. In addition, a Board of Trustees member and a community board member are key employees of an anesthesiology group that has an exclusive arrangement with McLeod Health for provision of anesthesiology services.

In fiscal years 2011 and 2010, McLeod Health purchased insurance coverage from third-party insurance companies involving premiums totaling approximately $2,230,000 and $2,020,000, respectively. This coverage was placed by an insurance broker who serves on the Board of Trustees of the Foundation.

12. OPERATING LEASES

McLeod Health leases office space to outside parties under lease agreements with varying expiration dates through fiscal year 2028. Portions of the buildings below are used by McLeod Health, accordingly, no rental income is recognized for that space. The cost and carrying amounts of property covered by these leases as of September 30, 2011, are as follows:

Buildings	$ 33,594,054
Less accumulated depreciation	(13,264,070)
Total	$ 20,329,984

Aggregate annual rental income during the remaining terms of these agreements as of September 30, 2011, is as follows:

Years Ending September 30	
2012	$ 2,236,266
2013	2,105,893
2014	1,638,018
2015	739,881
2016	171,505
Thereafter	3,959,126
Total	$ 10,850,689

Rental income for the years ended September 30, 2011 and 2010, totaled $2,979,410 and $3,249,727, respectively.

McLeod Health leases certain equipment and office space used in its operations. Generally, the leases provide for renewal for various periods at stipulated rates. Aggregate future minimum lease payments under noncancelable operating leases as of September 30, 2011, are as follows:

Years Ending September 30	
2012	$ 1,157,797
2013	1,157,797
2014	1,106,023
2015	962,038
2016	388,139
Thereafter	5,323
Total	$ 4,777,117

Rent expense related to office space for the years ended September 30, 2011 and 2010, was $527,000 and $302,000, respectively. Rent expense related to equipment for the years ended September 30, 2011 and 2010, was $3,741,000 and $4,232,000, respectively.

13. FUNCTIONAL EXPENSES

McLeod Health primarily provides various health care services to its patients. Expenses related to providing these services during fiscal years 2011 and 2010, are summarized as follows:

	2011	**2010**
Health care services	$ 626,545,752	$ 615,330,795
General and administrative	55,727,333	55,262,164
Total	$ 682,273,085	$ 670,592,959

14. CHARITY CARE

McLeod Health maintains records to identify and monitor the levels of charity care that it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. McLeod Health provided charity care in the amount of $104,177,000 and $96,008,000 in 2011 and 2010, respectively.

15. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

Investments and Assets Limited as to Use — The carrying amounts reported in the accompanying consolidated balance sheets are based on quoted market prices, if available, or estimated using quoted market prices for similar securities. (See Notes 3 and 4 for additional information.)

Receivables — The carrying amounts reported in the accompanying consolidated balance sheets for receivables approximate their fair value.

Accounts Payable and Accrued Expenses and Other Liabilities — The carrying amounts reported in the accompanying consolidated balance sheets for accounts payable and accrued expenses and other liabilities approximate their fair value. This includes the interest rate swap agreement in which the carrying amount reported in the accompanying consolidated balance sheets is based on the present value of estimated future net cash flows related to the settlement of the agreement.

Estimated Third-Party Settlements — The carrying amount reported in the accompanying consolidated balance sheets for estimated third-party settlements approximates its fair value.

Long-Term Debt — The fair value of McLeod Health's long-term debt was approximately $297,684,000 at September 30, 2011, and was determined based on quoted market prices for bonds and the carrying amounts of notes payable with variable interest rates. The carrying amount of McLeod Health's long-term debt approximated fair value at September 30, 2010.

16. ENDOWMENT FUNDS

McLeod Health's endowment funds consist of donor-restricted funds and internally designated funds established primarily for scholarship purposes.

Management has interpreted FASB Issues Staff Position FAS 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (ASC Topic 958) as requiring the preservation of the fair value of original gifts and subsequent contributions as of the gift date of donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result, the Foundation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent contributions to the permanent endowment, and (c) other accumulations to the permanent endowment as required by donor gift instruments. The remaining portion of donor-restricted endowment funds that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation consistent with the donor's wishes. Losses on the investments of donor-restricted endowment funds are recorded as a reduction of temporarily restricted net assets to the extent that donor-imposed temporary restrictions on net appreciation of the fund have not been met before the loss occurs. Any remaining losses reduce unrestricted net assets. Investment (losses) gains on donor-restricted endowment funds totaling $(3,775) and $22,574 as of September 30, 2011 and 2010, respectively, have been recorded as changes in the temporarily restricted net assets of the endowment funds.

The Foundation has developed an investment policy for all its investable assets whose general purpose is to preserve the capital and purchasing power of the endowments and to produce sufficient investment earnings for current and future spending needs. The Foundation has adopted a spending policy that limits the amount of funds available for distribution each year to four percent (4%) of a 12-quarter trailing average market value of each portfolio computed as of the prior September 30, fiscal year end. Depending on investment conditions, the Board may approve a spending policy of no less than 3.5% and no more than 5% of the 12-quarter trailing average market value of the fund. With this policy, the annual dollar amount available for spending will be known at the beginning of the year. If necessary, quarterly transfers of approximately one percent (1%) of the earnings of the endowment will be scheduled to be transferred to the main cash account from the endowment funds. In establishing this policy, the Foundation considered the long-term expected return on its investments and the objective to preserve purchasing power.

As of September 30, 2011 and 2010, McLeod Health's total endowment net assets were $840,010 and $841,424, respectively. Changes in endowment net assets for the years ended September 30, 2011 and 2010, consisted of the following:

	Unrestricted	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Endowment net assets — beginning of year October 1, 2009	$ -	$ 99,312	$ 716,973	$ 816,285
Investment gain		22,574		22,574
Additions		3,565		3,565
Expenses		(1,000)		(1,000)
Endowment net assets — end of year September 30, 2010	-	124,451	716,973	841,424
Investment loss		(3,775)		(3,775)
Additions		3,361		3,361
Expenses		(1,000)		(1,000)
Endowment net assets — end of year September 30, 2011	$ -	$ 123,037	$ 716,973	$ 840,010

17. SUBSEQUENT EVENTS

On November 9, 2011, McLeod Health entered into an affiliation agreement with the Loris Healthcare System (Loris). Subject to approval by the U.S. Department of Housing and Urban Development (HUD), effective January 1st, 2012, McLeod Health will assume all assets and liabilities of Loris, and Loris will become a part of McLeod Health. This will include the assumption of an FHA-insured note and mortgage liability that had a balance of $70 million at September 30, 2011. Loris provides care for residents of northern Horry County in South Carolina and southern Brunswick and Columbus Counties in North Carolina. Loris currently operates Loris Community Hospital which has 105 licensed in-patient beds, Seacoast Medical Center which has 50 licensed in-patient beds, and a network of physician practices.

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SUPPLEMENTAL CONSOLIDATING INFORMATION

MCLEOD HEALTH

SUPPLEMENTAL CONSOLIDATING BALANCE SHEET INFORMATION — OBLIGATED AND NONOBLIGATED GROUP
AS OF SEPTEMBER 30, 2011

	Obligated Group	Nonobligated Group	Eliminations	Total
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	$ 18,415,840	$ 2,641,399	$ -	$ 21,057,239
Investments		1,847,399		1,847,399
Net patient receivables	69,652,166			69,652,166
Due from (to) affiliates and other receivables	1,947,574	192,116	(273,714)	1,865,976
Inventories	3,505,261			3,505,261
Prepaid expenses	7,481,989	37,247		7,519,236
Total current assets	101,002,830	4,718,161	(273,714)	105,447,277
INVESTMENT IN SUBSIDIARIES	6,876,326		(6,876,326)	-
ASSETS LIMITED AS TO USE	530,382,383	2,088,833		532,471,216
PROPERTY AND EQUIPMENT — Net	357,761,644	15,661,492		373,423,136
BOND ISSUE COSTS — Net	5,984,186			5,984,186
GOODWILL	3,261,544			3,261,544
OTHER ASSETS	5,625,099	2,874,016		8,499,115
TOTAL	$ 1,010,894,012	$ 25,342,502	$ (7,150,040)	$ 1,029,086,474
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES:				
Current portion of long-term debt	$ 4,875,208	$ 372,219	$	$ 5,247,427
Accounts payable	22,389,318	310,537	(273,714)	22,426,141
Accrued expenses and other liabilities	30,925,773	1,468,256		32,394,029
Estimated third-party settlements	36,858,605			36,858,605
Total current liabilities	95,048,904	2,151,012	(273,714)	96,926,202
LONG-TERM DEBT — Net of current portion	272,329,809	11,214,728		283,544,537
Total liabilities	367,378,713	13,365,740	(273,714)	380,470,739
NET ASSETS:				
Noncontrolling interest		1,838,339		1,838,339
McLeod Health	643,515,299	10,138,423	(6,876,326)	646,777,396
TOTAL	$ 1,010,894,012	$ 25,342,502	$ (7,150,040)	$ 1,029,086,474

MCLEOD HEALTH

SUPPLEMENTAL CONSOLIDATING STATEMENT OF OPERATIONS INFORMATION — OBLIGATED AND NONOBLIGATED GROUP
FOR THE YEAR ENDED SEPTEMBER 30, 2011

	Obligated Group	Nonobligated Group	Eliminations	Total
REVENUES, GAINS, AND OTHER SUPPORT:				
Net patient service revenues	$ 710,092,620	$ -	$ -	$ 710,092,620
Other operating revenues	15,885,069	6,794,532	(5,623,800)	17,055,801
Net assets released from restrictions	837,068			837,068
Total revenues, gains, and other support	726,814,757	6,794,532	(5,623,800)	727,985,489
EXPENSES:				
Personnel	311,452,879	376,771		311,829,650
Professional fees	16,290,370	500,402		16,790,772
Supplies	122,377,669	289,802		122,667,471
Purchased services	28,958,278	2,479,118	(955,192)	30,482,204
Facility-related costs	16,281,954	566,851	(3,557,850)	13,290,955
Insurance	3,457,833	40,794		3,498,627
Other	21,651,640	768,349	(1,110,758)	21,309,231
Interest	10,797,706	688,245		11,485,951
Depreciation and amortization	32,527,034	548,891		33,075,925
Loss on disposal of property	549,791			549,791
Provision for uncollectible accounts — net	117,292,509			117,292,509
Total expenses	681,637,663	6,259,223	(5,623,800)	682,273,086
INCOME FROM OPERATIONS	45,177,094	535,309	-	45,712,403
OTHER (EXPENSES) REVENUES	(21,202,334)	342,234		(20,860,100)
SUBSIDIARIES' INCOME — Net	436,908		(436,908)	-
EXCESS OF REVENUES OVER EXPENSES	24,411,668	877,543	(436,908)	24,852,303
LESS INCOME ATTRIBUTABLE TO NONCONTROLLING INTEREST		(440,635)		(440,635)
EXCESS OF REVENUES OVER EXPENSES ATTRIBUTABLE TO MCLEOD HEALTH	24,411,668	436,908	(436,908)	24,411,668
MMP DISTRIBUTIONS	440,235	(440,235)		-
NET ASSETS RELEASED FROM RESTRICTIONS FOR PURCHASES OF PROPERTY AND EQUIPMENT	746,948			746,948
CHANGE IN NET ASSETS ATTRIBUTABLE TO MCLEOD HEALTH:				
Unrestricted	25,598,851	(3,327)	(436,908)	25,158,616
Temporarily restricted		2,320,548		2,320,548
Permanently restricted				-
TOTAL CHANGE IN NET ASSETS ATTRIBUTABLE TO MCLEOD HEALTH	$ 25,598,851	$ 2,317,221	$ (436,908)	$ 27,479,164