MOUNTAIN STATES HEALTH ALLIANCE

Audited Consolidated Financial Statements
(and Supplemental Schedules)

Years Ended June 30, 2010 and 2009

MOUNTAIN STATES HEALTH ALLIANCE

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Years Ended June 30, 2010 and 2009

Audited Consolidated Financial Statements

Supplemental Schedules

PYA
Pershing Yoakley & Associates
CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Mountain States Health Alliance:

We have audited the accompanying consolidated balance sheets of Mountain States Health Alliance and subsidiaries (the Alliance) as of June 30, 2010 and 2009 and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Alliance'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 consolidated 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 the Alliance's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mountain States Health Alliance and subsidiaries as of June 30, 2010 and 2009 and the results of their operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplemental schedules, as listed in the accompanying index, are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Pershing Yoakley & Associates, P.C.

Knoxville, Tennessee
October 25, 2010

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Balance Sheets
(Dollars in Thousands)

	June 30, 2010	June 30, 2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ **234,526**	$ 239,836
Current portion of investments	**28,467**	27,317
Patient accounts receivable, less estimated allowances for uncollectible accounts of $45,941 in 2010 and $42,587 in 2009	**125,580**	128,812
Other receivables, net	**17,926**	16,108
Inventories and prepaid expenses	**29,163**	27,135
TOTAL CURRENT ASSETS	**435,662**	439,208
INVESTMENTS, less amounts required to meet current obligations	**586,756**	597,440
PROPERTY, PLANT AND EQUIPMENT, net	**695,598**	590,569
OTHER ASSETS		
Goodwill, net of accumulated amortization of $95,760 in 2010 and $84,687 in 2009	**151,352**	162,620
Net deferred financing, acquisition costs and other charges, less current portion	**30,819**	31,473
Other assets	**29,313**	34,765
TOTAL OTHER ASSETS	**211,484**	228,858
	$ **1,929,500**	$ 1,856,075

		June 30,		
		2010		2009
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES				
Accrued interest payable	$	**16,039**	$	12,050
Current portion of long-term debt and capital lease obligations		**28,131**		31,306
Current portion of estimated fair value of derivatives		**10,740**		10,921
Accounts payable and accrued expenses		**99,227**		94,712
Accrued salaries, compensated absences and amounts withheld		**47,280**		49,569
Estimated amounts due to third-party payors, net		**10,155**		6,398
TOTAL CURRENT LIABILITIES		**211,572**		204,956
OTHER LIABILITIES				
Long-term debt and capital lease obligations, less current portion		**1,054,842**		1,040,944
Estimated fair value of derivatives, less current portion		**123,560**		115,296
Deferred revenue		**20,445**		21,078
Estimated professional liability self-insurance		**9,541**		10,012
Other long-term liabilities		**12,628**		13,885
TOTAL LIABILITIES		**1,432,588**		1,406,171
MINORITY INTERESTS		**168,410**		165,500
COMMITMENTS AND CONTINGENCIES - Notes D, F, G, and N				
NET ASSETS				
Unrestricted net assets		**317,434**		272,049
Temporarily restricted net assets		**10,941**		12,178
Permanently restricted net assets		**127**		177
TOTAL NET ASSETS		**328,502**		284,404
	$	**1,929,500**	$	1,856,075

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Operations and Changes in Net Assets
(Dollars in Thousands)

	Year Ended June 30, 2010	2009
CHANGES IN UNRESTRICTED NET ASSETS:		
Revenue, gains and support:		
Net patient service revenue	$ **928,270**	$ 822,898
Other operating revenue	**16,009**	17,046
TOTAL REVENUE, GAINS AND SUPPORT	**944,279**	839,944
Expenses:		
Salaries and wages	**325,663**	296,073
Physician salaries and wages	**54,489**	38,240
Contract labor	**6,546**	16,899
Employee benefits	**68,362**	61,134
Fees	**82,542**	71,896
Supplies	**175,469**	156,418
Utilities	**16,193**	15,548
Other	**67,640**	57,974
Depreciation	**68,436**	56,373
Amortization	**13,123**	12,150
Estimated provision for bad debts	**7,961**	5,011
Interest and taxes	**42,264**	45,225
TOTAL EXPENSES	**928,688**	832,941
OPERATING INCOME	**15,591**	7,003
Nonoperating gains (losses):		
Interest and dividend income	**17,298**	19,105
Net realized gains (losses) on the sale of securities	**2,385**	(6,552)
Net unrealized gains (losses) on securities	**15,018**	(62,582)
Derivative related income	**4,394**	4,772
Loss on termination of derivatives - Note D	**-**	(2,785)
Loss on early extinguishment of debt - Note F	**(3,029)**	-
Change in estimated fair value of derivatives	**(8,607)**	(42,128)
Other nonoperating gains (losses)	**512**	(306)
Net assets released from restrictions used for operations	**1,113**	793
NET NONOPERATING GAINS (LOSSES)	**29,084**	(89,683)

	Year Ended June 30, 2010	2009
EXCESS (DEFICIT) OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES, BEFORE DISCONTINUED OPERATIONS AND MINORITY INTERESTS	**44,675**	(82,680)
Gain on sale of and deficit of revenue, gains and support over expenses and losses from discontinued operations	**-**	2,519
EXCESS (DEFICIT) OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES BEFORE MINORITY INTERESTS	**44,675**	(80,161)
Minority interest in consolidated subsidiaries' net (gain) loss	**(3,162)**	546
EXCESS (DEFICIT) OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	**41,513**	(79,615)
Other changes in unrestricted net assets:		
Pension and other defined benefit plan adjustments	**1,589**	(512)
Net assets released from restrictions used for the purchase of property, plant and equipment	**2,283**	3,095
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	**45,385**	(77,032)
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS:		
Restricted grants and contributions	**2,159**	3,929
Net assets released from restrictions	**(3,396)**	(3,888)
(DECREASE) INCREASE IN TEMPORARILY RESTRICTED NET ASSETS	**(1,237)**	41
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS:		
Net assets released from restrictions by donor	**(50)**	-
INCREASE (DECREASE) IN TOTAL NET ASSETS	**44,098**	(76,991)
NET ASSETS, BEGINNING OF YEAR	**284,404**	361,395
NET ASSETS, END OF YEAR	**$ 328,502**	$ 284,404

See notes to consolidated financial statements.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Cash Flows
(Dollars in Thousands)

	Year Ended June 30, 2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase (decrease) in net assets	$ **44,098**	$ (76,991)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Provision for depreciation and amortization	**81,982**	68,967
Loss on early extinguishment of debt	**3,029**	-
Loss on termination of derivatives	-	3,245
Change in estimated fair value of derivatives	**8,607**	42,128
Equity in net income of joint ventures	**(1,117)**	(723)
Gain on sale of assets held for resale and disposal of assets	**(548)**	(568)
Amounts received on interest rate swap settlements	**(4,394)**	(4,772)
Minority interest in consolidated subsidiaries' net (gain) loss	**3,162**	(546)
Income recognized through forward sale agreements	**(864)**	(796)
Capital Appreciation Bond accretion and other	**2,071**	1,678
Restricted contributions	**(2,159)**	(3,929)
Pension and other defined benefit plan adjustments	**598**	512
Increase (decrease) in cash due to change in:		
Net patient accounts receivable	**3,232**	724
Other receivables, net	**(1,246)**	(4,107)
Inventories and prepaid expenses	**(4,640)**	1,843
Trading securities	**(13,368)**	183,450
Other assets	**(1,159)**	(4,144)
Accrued interest payable	**3,989**	1,900
Accounts payable and accrued expenses	**(855)**	8,551
Accrued salaries, compensated absences and amounts withheld	**(2,289)**	3,500
Estimated amounts due from/to third-party payors, net	**3,757**	6,492
Other long-term liabilities	**(201)**	(1,363)
Estimated professional liability self-insurance	**(471)**	(610)
Total adjustments	**77,116**	301,432
NET CASH PROVIDED BY OPERATING ACTIVITIES	**121,214**	224,441
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment, property held for resale and property held for expansion, net	**(172,240)**	(119,741)
Additions to goodwill	-	(16,097)
Net decrease (increase) in assets limited as to use	**50,362**	(28,152)
Purchases of held-to-maturity securities	**(28,175)**	-
Net sale or distribution from joint ventures and unconsolidated affiliates	**1,162**	384

	Year Ended June 30, 2010	2009
Proceeds from sale of property, plant and equipment and property held for resale	9,565	2,056
NET CASH USED IN INVESTING ACTIVITIES	(139,326)	(161,550)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt and capital lease obligations, including deposits to escrow	(226,315)	(36,820)
Payment of acquisition and financing costs	(3,565)	(3,214)
Proceeds from issuance of long-term debt and other financing arrangements	235,158	135,780
Net amounts received on interest rate swap settlements	4,394	4,772
Restricted contributions received	3,382	5,767
Distribution to minority shareholders and other	(252)	(158)
NET CASH PROVIDED BY FINANCING ACTIVITIES	12,802	106,127
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(5,310)	169,018
CASH AND CASH EQUIVALENTS, beginning of year	239,836	70,818
CASH AND CASH EQUIVALENTS, end of year	$ 234,526	$ 239,836

SUPPLEMENTAL INFORMATION AND NON-CASH TRANSACTIONS:

Cash paid for interest	$ 38,666	$ 45,218
Cash paid for federal and state income taxes	$ 446	$ 664
Construction related payables in accounts payable and accrued expenses	$ 14,847	$ 9,246
Increase in receivable from sale of property	$ 1,483	$ -
Decrease in land held for expansion related to property exchange transaction	$ 3,432	$ -

During the years ended June 30, 2010 and 2009, the Alliance refinanced previously issued debt of $184,050 and $9,445, respectively.

As discussed in Note A, the Alliance acquired a 50.1% interest in Johnston Memorial Hospital, Inc. (JMH) in fiscal year 2009. JMH is consolidated within the accompanying financial statements as of the acquisition date, April 1, 2009. The consolidated cash flows include JMH's cash flows since the acquisition date.

(Dollars in Thousands)

NOTE A--ORGANIZATION AND OPERATIONS

Mountain States Health Alliance (the Alliance) is a tax-exempt entity with operations primarily located in Washington, Sullivan, and Carter counties of Tennessee and Smyth, Wise, Dickenson, Russell and Washington counties of Virginia. The initial funds for the establishment of the Alliance in 1945 were provided by individuals and various institutions. Membership of the Alliance consists of individuals and institutions who have contributed at least $100 to the capital fund of the Alliance and are entitled to vote at the annual election of the Board of Directors.

The primary operations of the Alliance consist of eleven acute and specialty care hospitals, as follows:

- Johnson City Medical Center (JCMC) - licensed for 645 beds
- Indian Path Medical Center (IPMC) - licensed for 322 beds
- Smyth County Community Hospital (SCCH) - licensed for 279 beds
- Johnston Memorial Hospital (JMH) - licensed for 135 beds
- Norton Community Hospital (NCH) - licensed for 129 beds
- Sycamore Shoals Hospital (SSH) - licensed for 121 beds
- North Side Hospital (NSH) - licensed for 91 beds
- Russell County Medical Center (RCMC) - licensed for 78 beds
- Johnson City Specialty Hospital (JCSH) - licensed for 23 beds
- Dickenson Community Hospital (DCH) - licensed for 25 beds
- Johnson County Community Hospital (JCCH) - licensed for 2 beds

Effective April 1, 2009, the Alliance acquired an interest in Johnston Memorial Hospital, Inc. (JMH), a 135 bed general acute care hospital located in Abingdon, Virginia. JMH is also the sole member of Abingdon Physician Partners (APP), a non-taxable corporation that owns and manages physician practices. The Alliance acquired a 50.1% interest in JMH by providing $132,000 to JMH (designated for capital). Johnston Memorial Healthcare Foundation, Inc. (JMHF), a hospital supporting organization, retained a 49.9% interest in JMH. The assets and liabilities of JMH at April 1, 2009 have been consolidated by the Alliance at their carrying value as of that date. The following is condensed, unaudited financial information related to JMH as of March 31, 2009:

Current Assets	$	23,516
Other Assets		139,576
Total	$	163,092
Liabilities	$	47,440
Net Assets (initial membership interest of JMHF)		115,652
	$	163,092

NOTE A--ORGANIZATION AND OPERATIONS - Continued

The activities and accounts of JMH since April 1, 2009 are included in the accompanying consolidated financial statements.

The Alliance has a 50.1% interest in NCH. NCH is also the sole member or shareholder of DCH and Norton Community Physician Services, LLC (NCPS), a taxable corporation that consists of physician practices and a pharmacy and; Community Home Care (CHC), a taxable corporation that provides home medical equipment. The activities and accounts of NCH are included in the accompanying consolidated financial statements.

The Alliance also has an 80% interest in SCCH. SCCH is the sole shareholder of Southwest Community Health Services, Inc. (SWCH), a taxable entity that operates a pharmacy and provides other health services. The activities and accounts of SCCH are included in the accompanying consolidated financial statements.

The Alliance is the sole shareholder of Blue Ridge Medical Management Corporation (BRMM), a for-profit entity that owns and manages physician practices and provides other healthcare services to patients in Tennessee and Virginia. BRMM also operates as a medical office real estate developer by owning, selling and leasing real estate to physician practices and other entities. BRMM is either the sole shareholder, a significant shareholder, or member of the following organizations:

Blue Ridge Physician Group, Inc. (BRPG): A company that contracts with physicians to provide services to BRMM physician practices.

Mountain States Properties, Inc. (MSPI): An entity that owns and manages certain real estate (primarily medical office buildings) and provides rehabilitation and fitness services. In addition, MSPI is a counter-party to various financing transactions, including interest rate swaps.

Mediserve Medical Equipment of Kingsport, Inc. (Mediserve): A company that provides durable medical equipment services.

Kingsport Ambulatory Surgery Center (KASC) (d.b.a. Kingsport Day Surgery): A joint venture operating as an outpatient surgery center which performs procedures primarily in otolaryngology, orthopedics, ophthalmology, and general surgery. BRMM has a 43% ownership of KASC at June 30, 2010 and 2009; however, BRMM maintains control over KASC. As such, the accounts and activities of KASC are included in the accompanying consolidated financial statements.

NOTE A--ORGANIZATION AND OPERATIONS - Continued

Piney Flats Urgent Care (PFUC): A for-profit entity that provides urgent care patient services.

The Alliance is the primary beneficiary of the activities of Mountain States Foundation, Inc. (MSF), a not-for-profit foundation formed to coordinate fundraising and development activities of the Alliance. The Alliance is also the beneficiary of Mountain States Health Alliance Auxiliary (Auxiliary), a not-for-profit organization formed to coordinate volunteer activities of the Alliance. The activities and accounts of MSF and the Auxiliary are included in the accompanying consolidated financial statements.

Prior to 2010, the Alliance was a majority shareholder of PHP of Tri-Cities, LLC (PHPT). PHPT's primary purpose was to hold an equity interest in another organization engaged in and related to the financing and/or delivery of healthcare services. During 2009, PHPT's equity interest in this other entity was reacquired by that entity (PHP Companies, Inc. (PHP)). PHPT sold the interest to PHP for a net gain of $2,519. The activities of PHPT and gain on sale are included in the accompanying 2009 consolidated financial statements as "discontinued operations". During 2009, PHPT was reorganized under the business name of Integrated Solutions Health Network, LLC (ISHN). Concurrent with the reorganization, the Alliance purchased the remaining ownership interest of Health Alliance PHO, Inc. (PHO), an entity in which the Alliance previously held a minority interest. The net assets of the PHO were merged into ISHN on June 30, 2009. The primary function of ISHN is to establish, operate and administer a provider-sponsored health care delivery network.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Alliance and its subsidiaries after elimination of all significant intercompany accounts and transactions. The Alliance classifies those activities directly associated with its mission of providing healthcare services, as well as other activities deemed significant to its operations, as operating activities.

A minority interest is recorded to recognize the ownership or membership interests of third parties with respect to JMH, NCH, SCCH, KASC, PFUC and ISHN.

In 2011, the Alliance will adopt recently issued accounting standards, which change the accounting for, and the financial statement presentation of, noncontrolling interests in a subsidiary within consolidated financial statements. This new standard requires that a noncontrolling interest in the equity of a subsidiary be accounted for and reported as equity, provides revised guidance on the treatment of net income and losses attributable to the noncontrolling interest and changes in ownership interests in a subsidiary and requires additional disclosures that identify and distinguish between the interests of the controlling and noncontrolling owners. Management of the

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Alliance is currently assessing the potential impact of the adoption of this new guidance on the consolidated financial statements.

Use of Estimates: The preparation of the 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 as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Accounting Standards Codification: In June 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (GAAP) - a Replacement of FASB Statement No. 162.* This Statement modifies the GAAP hierarchy by establishing only two levels of GAAP, authoritative and nonauthoritative literature. Effective September 2009, the FASB Accounting Standards Codification (ASC), also known collectively as the "Codification," is considered the single source of authoritative U.S. accounting and reporting standards. FASB ASC 105-10, Generally Accepted Accounting Principles, became applicable during fiscal year 2010. All accounting references have been updated, and therefore SFAS references have been replaced with ASC references. The adoption of the ASC did not have an impact on the consolidated financial statements.

Cash and Cash Equivalents: Cash and cash equivalents include all highly liquid investments with a maturity of three months or less when purchased. Cash and cash equivalents designated as assets limited as to use or uninvested amounts included in investment portfolios are not included as cash and cash equivalents on the Consolidated Balance Sheets.

Investments: Investments as reported in the Consolidated Balance Sheets includes trading securities, held-to-maturity securities and assets limited as to use (Note C). FASB ASC 958-320, *Investments – Debt and Equity Securities*, allows not-for-profit organizations to report in a manner similar to business entities by identifying securities as available-for-sale or held-to-maturity and to exclude the unrealized gains and losses on those securities from the Performance Indicator (as defined below). Investments which the Alliance has the positive intent and ability to hold to maturity are considered as held-to-maturity. Substantially all other investments (including assets limited as to use) are considered as trading securities. Management annually evaluates the held-to-maturity investment portfolio and recognizes any "other-than-temporary" losses as deductions from the Performance Indicator. Management's evaluation considers the amount of decline in fair value, as well as the time period of any such decline. Management does not believe any investment classified as held-to-maturity is other-than-temporarily impaired at June 30, 2010.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Within the trading securities portfolio, all debt securities and marketable equity securities with readily determinable fair values are reported at fair value based on quoted market prices. Investments without readily determinable fair values are reported at fair market value pursuant to FASB ASC 825, *Financial Instruments*. Guaranteed investment contracts are reported at contract value.

Realized gains and losses on trading securities and assets limited as to use are computed using the specific identification method for cost determination. Interest and dividend income is reported net of related investment fees.

Investments in joint ventures are reported under the equity method of accounting, which approximates the Alliance's equity in the underlying net book value, unless the ownership structure requires consolidation. Other assets include investments in joint ventures of $2,418 and $2,463 at June 30, 2010 and 2009, respectively.

Inventories: Inventories, consisting primarily of medical supplies, are stated at the lower of cost or market.

Property, Plant and Equipment: Property, plant and equipment is stated on the basis of cost, or if donated, at the fair value at the date of gift. Generally, depreciation is computed by the straight-line method over the estimated useful life of the asset. Equipment held under capital lease obligations is amortized under the straight-line method over the shorter of the lease term or estimated useful life. Amortization of equipment held under capital lease is shown as a part of depreciation expense and accumulated depreciation in the accompanying consolidated financial statements.

Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

The Alliance reviews capital assets for indications of potential impairment when there are changes in circumstances related to a specific asset. If this review indicates that the carrying value of these assets may not be recoverable, the Alliance estimates future cash flows from operations and the eventual disposition of such assets. If the sum of these undiscounted future cash flows is less than the carrying amount of the asset, a write-down to estimated fair value is recorded. The Alliance did not recognize any impairment losses during 2010 and 2009.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Property held for resale and property held for expansion primarily represent land contributed to, or purchased by, the Alliance plus costs incurred to develop the infrastructure of such land. Other assets include property held for resale and property held for expansion of $9,135 and $12,542, respectively, at June 30, 2010 and 2009. Management annually evaluates its investment and records non-temporary declines in value when it is determined the ultimate net realizable value is less than the recorded amount. No such declines were identified in 2010 and 2009.

Goodwill: Goodwill represents the difference between the acquisition cost of assets and the estimated fair value of net tangible and any separately identified intangible assets. The Alliance amortizes goodwill associated with its not-for-profit subsidiaries under the straight-line method over various estimated useful lives. For goodwill acquired by its for-profit subsidiaries, the Alliance does not amortize the goodwill and annually performs impairment testing in accordance with FASB ASC 350, *Intangibles – Goodwill and Other.* At June 30, 2010, management does not believe any goodwill so tested to be impaired.

FASB ASC 350, *Intangibles - Goodwill and Other,* will require, among other things, that goodwill associated with not-for-profit entities be evaluated annually for impairment, including a transitional impairment test upon adoption, and that such goodwill no longer be amortized. The Alliance will be required to adopt this standard in 2011 and will perform such transitional testing as of July 1, 2010 prior to December 31, 2010. While the Alliance is evaluating the potential impact of the adoption of this standard, including the transitional impairment testing, it is currently not possible to determine the effects, if any, the adoption of this standard will have on the consolidated financial statements.

Deferred Financing, Acquisition Costs and Other Charges: Deferred financing costs are amortized over the life of the respective bond issue principally using the average bonds outstanding method. Other intangible assets include licenses and similar assets and are being amortized over the intangible's estimated useful life under the straight-line method.

Prior to 2009, the Alliance routinely financed interest rate swap and other derivative transaction issuance costs through modification of future settlement terms. As such, the unamortized issuance costs of these derivatives are included as deferred financing costs in the accompanying Consolidated Balance Sheets and are being amortized over the term of the respective derivative instrument. The unpaid issuance costs are included as a part of the estimated fair value of derivatives in the accompanying Consolidated Balance Sheets. Beginning in 2009, interest rate swap and derivative transaction issuance costs are expensed as incurred, in accordance with FASB ASC 820, *Fair Value Measurements and Disclosures* (FASB ASC 820). No such costs were incurred in 2010 and 2009.

Derivative Financial Instruments: As further described in Note D, the Alliance is a party to interest rate swap and other derivative agreements. These financial instruments are not designated as hedges

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

and have been presented at estimated fair market value in the accompanying Consolidated Balance Sheets. These fair values are based on the estimated amount the Alliance would receive, or be required to pay, to enter into equivalent agreements at the valuation date. Due to the nature of these financial instruments, such estimates are subject to significant change in the near term.

Estimated Professional Liability Self-Insurance and Other Long-Term Liabilities: Self-insurance liabilities include estimated reserves for reported and unreported professional liability claims (Note G) and are recorded at the estimated net present value of such claims. Other long-term liabilities include contributions payable and obligations under deferred compensation arrangements, a defined benefit pension plan, a post-retirement employee benefit plan as well as other liabilities which management estimates are not payable within one year.

Net Patient Service Revenue/Receivables: Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts, 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 adjusted in future periods as final settlements are determined. The Alliance's revenue recognition policies related to self-pay and other types of payors emphasize revenue recognition only when collections are reasonably assured.

Patient accounts receivable are reported net of both an estimated allowance for uncollectible accounts and an estimated allowance for contractual adjustments. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, TennCare and other third-party payment programs. Current operations include a provision for bad debts in the Consolidated Statements of Operations and Changes in Net Assets estimated based upon the age of the patient accounts receivable, prior experience and any unusual circumstances (such as local, regional or national economic conditions) which affect the collectibility of receivables, including management's assumptions about conditions it expects to exist and courses of action it expects to take.

The Alliance's policy does not require collateral or other security for patient accounts receivable. The Alliance routinely accepts assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans or policies.

Charity Care: The Alliance accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the Alliance and various guidelines outlined by the Federal Government. These policies define charity as those services for

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

which no payment is anticipated and, as such, charges at established rates are not included in net patient service revenue.

In addition to the charity care services described above, the Alliance provides a number of other services to benefit the poor for which little or no payment is received. Medicare, TennCare and State indigent programs do not cover the full cost of providing care to beneficiaries of those programs. The Alliance also provides services to the community at large for which it receives little or no payment.

Excess (Deficit) of Revenue, Gains and Support Over Expenses and Losses: The Consolidated Statements of Operations and Changes in Net Assets includes the caption *Excess (Deficit) of Revenue, Gains and Support Over Expenses and Losses* (the Performance Indicator). Changes in unrestricted net assets which are excluded from the Performance Indicator, consistent with industry practice, include transfers of assets to and from affiliates and contributions of long-lived assets or amounts restricted to the purchase of long-lived assets, as well as pension and related adjustments.

Income Taxes: The Alliance is classified as an organization exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. As such, no provision for income taxes has been made in the accompanying consolidated financial statements for the Alliance and its tax-exempt subsidiaries. Taxable entities account for income taxes in accordance with FASB ASC 740, *Income Taxes* (Note L). The Alliance has no significant uncertain tax positions at June 30, 2010 and 2009.

Temporarily and Permanently Restricted Net Assets: Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. When a donor or time restriction expires; that is, when a stipulated time restriction ends or purpose restriction is fulfilled, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the Statements of Operations and Changes in Net Assets as net assets released from restrictions. Permanently restricted net assets have been restricted by donors to be maintained by the Alliance in perpetuity.

Fair Value Measurement: In 2009, the Hospital adopted FASB ASC 820, *Fair Value Measurements and Disclosures,* which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements. There was no significant impact on the consolidated financial statements as a result of adopting this standard (Note Q).

(Dollars in Thousands)

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 requires new disclosures regarding significant transfers in and out of Levels 1 and 2, as well as information about activity in Level 3 fair value measurements, including presenting information about purchases, sales, issuances and settlements on a gross versus a net basis in the Level 3 activity roll forward. In addition, ASU 2010-06 clarifies existing disclosures regarding input and valuation techniques, as well as the level of disaggregation for each class of assets and liabilities. The Alliance will adopt ASU 2010-06 in 2011, except for the disclosures related to purchases, sales, issuance and settlements, which will be effective for the Alliance beginning July 1, 2012. The adoption of ASU 2010-06 is not expected to have an impact on the Alliance's consolidated financial statements.

Subsequent Events: The Alliance evaluated all events or transactions that occurred after June 30, 2010, through October 25, 2010, the issuance date of the consolidated financial statements. During this period management did not note any material recognizable subsequent events that required recognition or disclosure in the June 30, 2010 consolidated financial statements, other than as discussed in Note D and in Note F.

Reclassifications: Certain 2009 amounts have been reclassified to conform with the 2010 presentation in the accompanying consolidated financial statements.

NOTE C--INVESTMENTS

Assets limited as to use are summarized by designation or restriction as follows at June 30:

	2010	2009
Designated or restricted:		
Under safekeeping agreements	$ 52,050	$ 40,604
Under guarantee agreements	89,486	86,364
By Board for capital improvements	2,776	-
Under bond indenture agreements:		
For debt service and interest payments	78,612	60,828
For capital acquisitions	76,241	161,731
	299,165	349,527
Less: amount required to meet current obligations	(25,092)	(22,492)
	$ 274,073	$ 327,035

(Dollars in Thousands)

NOTE C--INVESTMENTS- Continued

Assets limited as to use consist of the following at June 30:

	2010	2009
Cash, cash equivalents and money market funds	$ 170,897	$ 173,859
U.S. Government securities	1,795	1,795
U.S. Agency securities	12,319	18,827
Guaranteed investment contracts	114,154	155,046
	$ 299,165	$ 349,527

Trading securities consist of the following at June 30:

	2010	2009
Cash, cash equivalents and money market funds	$ 4,799	$ 14,622
U.S. Government securities	3,137	-
U.S. Agency securities	13,760	16,013
Corporate and foreign bonds	15,063	10,014
Municipal obligations	1,461	3,101
U.S. equity securities	142,816	161,284
Other	28,608	30,031
	209,644	235,065
Less: amount classified as current	(3,375)	(4,825)
	$ 206,269	$ 230,240

Held-to-Maturity securities consist of the following at June 30:

	2010	2009
Cash, cash equivalents and money market funds	$ 1,131	$ 452
Corporate and foreign bonds	103,968	39,504
Municipal obligations	1,315	209
	$ 106,414	$ 40,165

Held-to-maturity securities had gross unrealized gains and losses of $5,525 and $607, respectively, at June 30, 2010 and $831 and $110, respectively at June 30, 2009. At June 30, 2010, the Alliance held one security within the held-to-maturity portfolio with a fair value and unrealized loss of $591

NOTE C--INVESTMENTS- Continued

and $166, respectively, which had been at an unrealized loss position for over one year. At June 30, 2009, no securities held in the held-to-maturity portfolio had been in an unrealized loss position for over one year. At June 30, 2010, the contractual maturities of held-to-maturity securities were $13,389 due in one year or less, $48,447 due from one to five years and $44,578 due after five years. At June 30, 2009, the contractual maturities of held-to-maturity securities were $733 due in one year or less, $21,190 due from one to five years and $18,242 due after five years.

At June 30, 2010 and 2009, the Alliance held investments in certain limited partnerships and hedge funds of $28,608 and $30,031, respectively, that have a wide range of investment strategies with various levels of risk. These funds are included within trading securities and do not have readily determinable fair values. The funds are reported at fair market value pursuant to FASB ASC 825, *Financial Instruments.*

The Alliance has investments in several joint ventures and corporations which are accounted for under the equity method of accounting.

As a part of the acquisition of membership interests in JMH, SCCH and NCH, the Alliance has committed to invest $132,000, $48,100, and $45,000, respectively. Cumulative amounts expended at June 30, 2010 under these commitments are approximately $73,600.

NOTE D--DERIVATIVE TRANSACTIONS

The Alliance is a party to a number of derivative transactions. These derivatives have not been designated as hedges and, as such, are valued at estimated fair value in the accompanying Consolidated Balance Sheets. Management's primary objective in holding such derivatives is to introduce a variable rate component into its fixed rate debt structure. Under the terms of these agreements, changes in the interest rate environment could have a significant effect on the Alliance.

These derivative agreements require that the Alliance post additional collateral for the derivatives' fair market value deficits above specified levels. Such investments are included as assets limited as to use. As of June 30, 2010, management believes the Alliance was fully collateralized with respect to the derivative agreements and management does not believe such collateral is exposed to third-party credit risk. Further, certain of the agreements contain requirements regarding maintenance of financial and liquidity ratios. Management has represented the Alliance is in compliance with all such covenants at June 30, 2010.

Interest Rate Swaps: The Alliance is a party to six interest rate swap agreements with Merrill Lynch as the counterparty. A liability, representing the estimated fair value of these swaps, of $33,910 and $37,274 was recognized by the Alliance as of June 30, 2010 and 2009, respectively.

(Dollars in Thousands)

NOTE D--DERIVATIVE TRANSACTIONS - Continued

The following is a summary of five of these interest rate swap agreements at June 30, 2010:

Swap	Notional Amount	Term	Payments by: Counterparty	Payments by: Alliance
A	$ 170,000	4/2008-4/2026	0.51% through April 2011, then 71.10% of USD-ISDA Swap Rate	0.00% through April 2011, then USD-SIFMA Municipal Swap Index
B	95,000	4/2008-4/2026	0.52% through April 2011, then 71.18% of USD-ISDA Swap Rate	0.00% through April 2011, then USD-SIFMA Municipal Swap Index
C	173,030	4/2008-4/2034	0.53% through April 2011, then 72.35% of USD-ISDA Swap Rate	0.00% through April 2011, then USD-SIFMA Municipal Swap Index
D	82,055	12/2007-7/2033	USD-LIBOR-BBA through June 2012, then 67.00% USD-LIBOR-BBA	4.411% through June 2012, then 3.805%
E	50,000	2/2008-7/2038	67.00% of USD-LIBOR-BBA less 0.07%	3.41%

Deferred financing and acquisition costs, net of amortization, include $6,823 and $7,167 at June 30, 2010 and 2009, respectively, related to these swaps.

In addition to the swaps described above, the Alliance and Merrill Lynch are also parties to a total return swap in the notional amount of $23,900. No deferred financing and acquisition costs were recorded as a result of this transaction. The agreement consists of the following:

- An agreement that requires the Alliance to pay a variable rate of USD-SIFMA Municipal Swap Index through July 1, 2012 (or termination of the swap) on a notional amount equal to the outstanding 2001A Hospital Revenue and Improvement Bonds (the 2001A Reference Bonds). The Alliance receives a fixed rate of 6.25% on the outstanding 2001A Reference Bonds.

- A "total return provision" under which the Alliance will pay (or receive) an amount equal to the product of the outstanding 2001A Reference Bonds multiplied by the difference between the outstanding 2001A Reference Bonds and the 2001A Reference Bonds' market price at termination, as defined in the agreement. In the event the swap does not terminate prior to July 1, 2012, there would be no settlement of this component as there would be no outstanding 2001A Reference Bonds.

NOTE D--DERIVATIVE TRANSACTIONS - Continued

During 2009, the Alliance terminated an interest rate swap with a notional amount of $318,315 to which Merrill Lynch was the counterparty. As a result of the termination, the Alliance wrote-off deferred financing and issuance costs of $3,220 and recognized a gain on termination of $3,054, which are included in loss on termination of derivatives in the accompanying 2009 Consolidated Statement of Operations and Changes in Net Assets.

The Alliance is party to a total return swap with Lehman Brothers as the counterparty. Lehman Brothers filed for bankruptcy in September 2008. The Alliance subsequently received notification from Lehman Brothers Special Financing, Inc. indicating the intent of the counterparty to terminate this agreement effective January 1, 2009. As of October 25, 2010, the Alliance and Lehman Brothers Special Financing, Inc. have been unable to reach a settlement agreement. In September 2010, the Alliance was issued a subpoena to furnish certain documentation related to the transaction. A protocol has been put into place by the bankruptcy court whereby the parties are to undergo alternate dispute resolution. If a settlement is not reached through the alternate dispute resolution process, the matter will be subject to non-binding arbitration. Legal counsel has advised management that the court ordered process may take several years.

The fair value of these swaps is undeterminable at January 1, 2009, as prior to the termination date Lehman Brothers liquidated the underlying referenced securities, making a valuation not commercially viable. An estimated liability of $10,740 and $10,921 was recognized by the Alliance as of June 30, 2010 and 2009, respectively. Management believes that the liability as recorded at June 30, 2010 is sufficient to cover any exposure arising from litigation in this matter. However, it is reasonably possible management's estimate may change in the near term, although the amount of any change cannot be estimated. Due to the termination of this agreement, the estimated liability is included as a current liability in the accompanying Consolidated Balance Sheets.

A third party holds collateral with a fair market value of approximately $13,570 and $13,252, respectively, at June 30, 2010 and 2009, with respect to these derivative agreements. Such collateral is included as current assets limited as to use. Additionally, during 2009 the Alliance wrote-off deferred financing and issuance costs related to these swaps of $2,619 which is included in loss on termination of derivatives in the accompanying 2009 Consolidated Statement of Operations and Changes in Net Assets.

The arrangement consists of nine agreements each with three separate components (described below) with notional values of $23,600, $8,000, and $8,750 each. The swaps generally consist of the following:

NOTE D--DERIVATIVE TRANSACTIONS - Continued

- An arrangement that calls for the Alliance to pay a variable rate (SIFMA Municipal Swap Index) plus certain fixed payment amounts and receive a payment equal to the interest paid by the Alliance on a portion of its early extinguished, but still outstanding, 2000A and 2000B Hospital Mortgage Revenue Refunding Bonds (the Reference Bonds) (whose fixed rates range from 7.50% to 7.75%).

- An arrangement that requires the Alliance to pay a fixed rate of 4.211% through either July 1, 2025, 2029 or 2033 (or termination of the swap) on the outstanding Reference Bonds and receive a variable rate of 67% of USD-LIBOR-BBA on the outstanding Reference Bonds; and

- A "total return provision" under which the Alliance will pay (or receive) the difference between the outstanding Reference Bonds, multiplied by 132%, less the fair value of the Reference Bonds on the date of termination and any fixed interest payments made under the arrangements described above. In the event the swaps do not terminate prior to their stated termination dates (2025, 2029 or 2033), there would be no settlement of this component as there would be no outstanding Reference Bonds.

The swap also contains an agreement that consists of two separate components:

- An arrangement that requires the Alliance to pay a fixed rate of 2.98% through July 1, 2016 (or termination of the swap) on the outstanding, but previously defeased, 1991 Hospital Revenue and Improvement Bonds (the 1991 Reference Bonds) and receive a variable rate of 67% of USD-LIBOR-BBA on the outstanding 1991 Reference Bonds; and

- A "fixed payor provision" under which the Alliance will pay (or receive) the difference between the outstanding 1991 Reference Bonds multiplied by 100% and any fixed interest payments made as required under the agreement minus the outstanding 1991 Reference Bonds multiplied by the average market price at termination. In the event the swaps do not terminate prior to their stated termination date (2016), there would be no settlement of this component as there would be no outstanding 1991 Reference Bonds.

Interest Rate Swap Option: In June 2004, the Alliance entered into an agreement with Bear Stearns (acquired by JP Morgan) whereby Bear Stearns has purchased from the Alliance an option to enter into an interest rate swap agreement (swaption) with the Alliance on July 1, 2011, which is an optional redemption date related to the Alliance's early extinguished 2000A and 2000B Bonds (Note F). The purpose of this agreement was to effectively sell the call features related to the early extinguished Series 2000A and 2000B Bonds. As consideration under this agreement, the Alliance

(Dollars in Thousands)

NOTE D--DERIVATIVE TRANSACTIONS - Continued

received a total of $42,500 in upfront payments as the swaption premium. Such amounts were initially recorded as estimated fair value of derivatives in the Consolidated Balance Sheets. Beginning 30 calendar days prior to July 1, 2011 and terminating 30 calendar days prior to July 1, 2015, the counterparty has the periodic right to exercise the swaption.

The underlying interest rate swap transactions to which the swaption transaction relates have the following terms:

	Notional		*Payments by:*	
Swap	*Amount*	*Term*	*Counterparty*	*Alliance*
2000A	Ranging from $148,170 through July 1, 2018 to $23,000 through July 2033	30 days following the exercise date through July 2033	64% of USD-LIBOR-BBA	Fixed amounts ranging from 7.13% upon execution to 7.50% through July 2033, based on notional amount
2000B	Ranging from $76,240 through July 1, 2021 to $8,800 through July 2033	30 days following the exercise date through July 2033	64% of USD-LIBOR-BBA	Fixed amounts ranging from 7.54% upon execution to 8.00% through July 2033, based on notional amount

Management anticipates the swaption will be settled by a payment of cash and not by the execution of an actual interest rate swap transaction, should the counterparty not elect to terminate.

The Alliance retains the right to terminate the swaption at any time prior to May 17, 2011 at its fair market value. A liability of $89,650 and $78,022, representing the estimated fair value of the swaption at June 30, 2010 and 2009, respectively, is included in estimated fair value of derivatives in the accompanying Consolidated Balance Sheets. As a derivative financial instrument, this swaption is extremely sensitive to changes in long-term interest rates and other elements in the financial marketplace. As such, estimates of fair value are subject to significant changes in the near term.

Deferred financing and acquisition costs include $434 and $868 at June 30, 2010 and 2009, respectively, related to the costs of this transaction. The change in estimated fair value of derivatives in the accompanying Statement of Operations and Changes in Net Assets for 2010 and 2009 includes an unrealized loss of $11,628 and $9,195, respectively, related to this derivative.

Forward Sale Agreements: In June 2004, the Alliance entered into two related forward sale agreements with the counterparty to the swaption agreements and the Master Trustee of the Series 2000 Bonds. The forward sale agreements originally related to the Debt Service Reserve Fund and to the Debt Service Fund, respectively, (collectively, the "Funds"), as established under provisions

NOTE D--DERIVATIVE TRANSACTIONS - Continued

of the Master Trust Indenture related to the issuance of the Series 2000 Bonds. In consideration of the future earnings on the Funds, the counterparty paid the Master Trustee a total of $30,000 during 2005, to be held on behalf of the Alliance. In June 2006, one of these agreements was amended to also relate to the Series 2000C, 2000D, 2006A and 2006B Bonds, and to remove the Series 2000A Bonds from consideration under the agreement. As the original intent of these Funds was to secure debt service payments under the above referenced Bonds, the agreement requires these funds to be held under a guaranty agreement as further described below.

In connection with the issuance of the Series 2007 Bonds and the derecognition of a portion of the Series 2000A Bonds, all of the outstanding Series 2000B Bonds, and all of the outstanding 2006B Bonds (Note F), one of these agreements as it relates to the Series 2000A and 2000B Bonds was partially terminated. As such, during 2008 the Alliance reduced its liability with respect to the portion related to the Series 2000A and 2000B Bonds, and paid the counterparty $6,186 under the terms of the agreement. Management has represented that the other agreement will be amended in fiscal year 2011 to include the Series 2010A Bonds and to remove the Series 2000B and 2006B Bonds. As such, the Alliance has not reduced its liability for the portion related to the Series 2000B or 2006B Bonds under this agreement.

A liability of $19,864 and $20,728 representing the unamortized payments from the counterparty is included as part of deferred revenue in the accompanying Consolidated Balance Sheets as of June 30, 2010 and 2009, respectively. Amounts are being recognized as investment income over the life of the agreements.

Pursuant to these agreements, the counterparty required that the Alliance's obligations under the swaption and forward sale agreements be collateralized under a guarantee agreement in favor of the counterparty. Due to various requirements of the Master Trust Indenture, the Alliance transferred to MSF a total of $42,500 that was in turn deposited with the counterparty as collateral in a Guaranteed Investment Contract (GIC). Amounts received under the forward sale agreements were also deposited into the GIC. All GIC deposits earn interest compounded at 4.14% for the first year, and at 3.5% thereafter through July 1, 2011. The GIC deposits as of June 30, 2010 and 2009 totaled $89,486 and $86,364, respectively.

In the event the counterparty does not exercise the swaption, the Alliance will realize the swaption premium, forward sale amounts, and earnings on the GIC when the swaption expires on July 1, 2015. In the event the Alliance settles with the counterparty, the Alliance would in effect lose the earnings on these funds.

(Dollars in Thousands)

NOTE E--PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following at June 30:

	2010	2009
Land	$ 60,351	$ 51,484
Buildings and leasehold improvements	404,790	407,063
Property and improvements held for leasing	84,421	96,457
Equipment	479,523	424,738
Equipment held under capital lease	22,679	25,032
	1,051,764	1,004,774
Less: Allowances for depreciation and amortization	(569,913)	(505,600)
	481,851	499,174
Construction in progress (Note N)	213,747	91,395
	$ 695,598	$ 590,569

Accumulated depreciation and amortization on property and improvements held for leasing purposes is $21,543 and $21,829 at June 30, 2010 and 2009, respectively. Net interest capitalized was $11,117 and $3,744 for the years ended June 30, 2010 and 2009, respectively.

The Alliance is constructing two new hospital facilities, including Franklin Woods Community Hospital (FWCH) in Washington County, Tennessee and a replacement facility for JMH and has plans to construct a replacement facility at SCCH which will commence in 2011. The Alliance is also performing various renovations on existing hospital facilities. These projects may have a significant impact on the remaining useful life of the existing hospital facilities. Where commitments to construct new facilities have been finalized, management has adjusted the estimated useful lives of existing hospital facilities.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS

Long-term debt and capital lease obligations consist of the following at June 30:

Description	Maturities	Rates	Outstanding Balance 2010	Outstanding Balance 2009
2010A Hospital Refunding Revenue Bonds, net of unamortized premium of $1,096 at June 30, 2010	$38,660 uninsured serially, through 2020	3.00% to 5.00%	$ 169,176	$ -
	$14,985 uninsured term bonds, due July 1, 2025	5.38%		
	$19,385 uninsured term bonds, due July 1, 2030	5.63%		
	$39,570 uninsured term bonds, due July 1, 2038	6.50%		
	$55,480 uninsured term bonds, due July 1, 2038	6.00%		
2010B Hospital Refunding Revenue Bonds, net of unamortized premium of $753 at June 30, 2010	$27,330 uninsured serially, through 2020	2.50% to 5.00%	36,688	-
	$4,355 uninsured term bonds, due July 1, 2023	5.00%		
	$4,250 uninsured term bonds, due July 1, 2028	5.50%		

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Description	Maturities	Rates	Outstanding Balance 2010	Outstanding Balance 2009
2009A Hospital Revenue Bonds, net of unamortized discount of $126 and $129 at June 30, 2010 and 2009, respectively	$725 uninsured term bonds, due July 1, 2019 $1,730 uninsured term bonds, due July 1, 2029 $3,105 uninsured term bonds, due July 1, 2038	7.25% 7.50% 7.75%	5,434	5,431
2009B Hospital Revenue Bonds	$5,535 uninsured term bonds, due July 1, 2038	8.00%	5,535	5,535
2009C Hospital Revenue Bonds, net of unamortized discount of $2,508 and $2,595 at June 30, 2010 and 2009, respectively	$21,100 uninsured term bonds, due July 1, 2019 $20,000 uninsured term bonds, due July 1, 2029 $74,855 uninsured term bonds, due July 1, 2038	7.25% 7.50% 7.75%	113,447	113,360
2008A Hospital Revenue Bonds	$13,245 uninsured term bonds, due July 1, 2038, subject to early redemption or tender	Variable, 0.91% at June 30, 2010	13,245	72,770
2008B Hospital Revenue Bonds	$54,050 uninsured term bonds, due July 1, 2038, subject to early redemption or tender	Variable, 0.91% at June 30, 2010	54,050	54,230
2007A Hospital Revenue Bonds	$4,305 uninsured term bonds, due July 1, 2038, subject to early redemption or tender	Variable, 0.91% at June 30, 2010	4,305	100,220
2007B Taxable Hospital Revenue Bonds	$314,190 uninsured term bonds, due July 1, 2033, subject to early redemption or tender	Variable, 2.42% at June 30, 2010	314,190	320,170
2007C Hospital Revenue Bonds	$1,900 uninsured term bonds, due July 1, 2032, subject to early redemption or tender	Variable, 0.91% at June 30, 2010	1,900	36,575
2006A Hospital First Mortgage Revenue Bonds, net of unamortized premium of $153 and $159 at June 30, 2010 and 2009, respectively	$7,265 uninsured serially, through 2019 $7,375 uninsured term bonds, due July 1, 2026 $20,505 uninsured term bonds, due July 1, 2031 $135,175 uninsured term bonds, due July 1, 2036	4.50% to 5.00% 5.25% 5.50% 5.50%	170,473	171,149
2001A Hospital First Mortgage Revenue Bonds	$23,900 term bonds, due July 1, 2026, subject to early redemption or tender	6.85%	23,900	24,600
2001 Hospital Refunding and Improvement Revenue Bonds (NCH), net of unamortized discount of $43 and $38 at June 30, 2010 and 2009, respectively	$675 insured term bonds, due December 1, 2010 $1,465 insured term bonds, due December 1, 2012 $1,635 insured term bonds, due December 1, 2014 $8,815 insured term bonds, due December 1, 2022	5.13% 5.75% 6.00% 6.00%	12,547	13,183
2000A Hospital First Mortgage Revenue Refunding Bonds	$28,417 insured Capital Appreciation Bonds, interest and principal due July 1, 2026 through 2030	6.63%	28,417	26,601
2000C Hospital First Mortgage Revenue Taxable Bonds	$35,335 insured term bonds, due July 1, 2026	8.50%	35,335	36,270
2000D First Mortgage Taxable Bonds	$15,225 insured term bonds, due July 1, 2026	8.50%	15,225	15,630
1998 Hospital Refunding and Improvement Revenue Bonds (JMH)	$1,125 uninsured serially, through 2011 $6,495 uninsured term bonds, due July 1, 2016 $7,620 uninsured term bonds, due July 1, 2028	5.00% 5.25% 5.38%	15,240	16,310
Capitalized lease obligations secured by buildings and equipment	Maturing through 2027	3.18% to 13.01%	16,715	17,211
Note payable secured by assets of Kingsport Ambulatory Surgery Center	Monthly principal and interest payments maturing through June 2010	5.50%	-	334
Note payable secured by property	Monthly principal and interest payments of $7 beginning March 2007 maturing February 2012. Note was paid-off in 2010	LIBOR + 1.25%	-	204
$7,500 promissory note secured by assets of Mediserve Medical Equipment of Kingsport, Inc.	Monthly principal and interest payments of $56 beginning February 2007 maturing December 2011; remaining principal of $6,473 due January 2012	LIBOR + 1.10%	6,064	6,647
Capitalized lease obligations secured by equipment	Various monthly payments of monthly principal and interest	Various	1,325	1,526
$7,482 promissory note secured by property and unsecured letter of credit	Monthly interest-only payments through maturity on December 31, 2010; paid off in 2010	$32 interest per month	-	7,450
Master installment payment agreement	$2,194 due August 1, 2010	Unspecified	2,194	3,140
$1,409 unsecured promissory note	Monthly principal and interest payments of $23 beginning July 2008 through September 2013; remaining principal and accrued interest due October 2014	LIBOR + 1.25%	920	1,202

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Description	Maturities	Rates	Outstanding Balance 2010	2009
$1,800 note payable secured by property	Monthly interest-only payments through maturity in July 2009	3.74%	-	1,800
$10,221 note payable secured by property	Various annual principal and interest payments through April 2013	6.25%	7,836	10,221
$5,000 line of credit secured by investments	Payable on demand	LIBOR + 1.25%	-	5,039
$4,600 note payable secured by property	Monthly principal and interest payments of $50 beginning February 2009 maturing December 2013; remaining principal due January 2014. Note was paid-off in 2010	5.47%	-	4,377
$1,065 note payable secured by land	Monthly interest-only payments through April 2011; remaining principal and accrued interest due May 2011	5.50%	1,065	1,065
$6,332 promissory note secured by substantially all assets of the Alliance	Monthly principal payments of $35 plus accrued interest beginning July 2010 maturing June 2015; remaining principal due July 2015	LIBOR + 2.00%	6,332	-
$3,955 note payable secured by property	Monthly principal and interest payments of $27 beginning July 2010 maturing May 2015; remaining principal due June 2015	3.00%	3,955	-
Note payable under Master Financing Agreement, secured by Equipment	Monthly principal and interest payments of $166 beginning July 2010 maturing June 2017	4.62%	11,900	-
Note payable under Master Financing Agreement, secured by Equipment	Monthly principal and interest payments of $56 beginning July 2010 maturing June 2017	3.75%	4,100	-
$4,926 convertible construction loan secured by property and assigned rents	Monthly interest-only payments through January 2011 followed by monthly principal and interest payments of $25 maturing December 2014; remaining principal and accrued interest due January 2015	Prime (stated minimum and maximum interest rates of 3.75% and 6.75%, respectively)	1,195	-
$1,885 line of credit secured by property	Monthly interest-only payments through March 2011 followed by monthly principal and interest payments of $9 maturing February 2015; remaining principal and accrued interest due March 2015	Prime - 0.50% (stated minimum and maximum interest rates of 3.50% and 6.25%, respectively)	265	-
			1,082,973	1,072,250
	Less current portion		(28,131)	(31,306)
			$ 1,054,842	$ 1,040,944

Series 2010 Bonds: In April 2010, the Alliance issued $168,080 (Series 2010A) and $35,935 Series 2010B fixed rate Hospital Refunding Revenue Bonds (collectively, the Series 2010 Bonds). Proceeds of the Series 2010A and the Series 2010B Bonds were used to refinance outstanding indebtedness, specifically related to the Alliance's facilities in Tennessee and in Virginia, respectively, fund debt service reserve funds and pay costs of issuance. The Alliance recognized a $3,029 loss on early extinguishment of debt representing the write off of previously deferred and unamortized financing costs related to the refinanced Series 2008A and the Series 2007A and 2007C debt issues discussed below.

Series 2009 Bonds

In March 2009, the Alliance issued $5,560 (Series 2009A), $5,535 (Series 2009B) and $115,955 (Series 2009C) fixed rate Hospital Revenue Bonds (collectively, the Series 2009 Bonds). The proceeds of Series 2009 Bonds were used to refinance a portion of the outstanding Series 2006C

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Taxable Notes, which were originally issued to finance a capital commitment to SCCH and purchase certain leased assets, finance the acquisition of a majority ownership in JMH, fund a debt service reserve fund and pay costs of issuance. The portion of the 2006C taxable notes which were not refinanced with the Series 2009 Bonds were repaid with cash on hand.

In connection with its acquisition of a majority ownership in JMH, the Alliance assumed the then outstanding long-term debt of JMH, totaling $33,906, including the JMH Series 1998 Hospital Refunding and Improvement Revenue Bonds as further described in the table above.

Series 2008 Bonds

In February 2008, the Alliance issued $72,770 (Series 2008A) and $54,230 (Series 2008B) variable rate Hospital Revenue Bonds (collectively, the Series 2008 Bonds). The proceeds of Series 2008 Bonds were primarily used to finance certain future capital projects for the Alliance's hospital facilities and for the repayment of previously issued 2008 Taxable Notes used for the acquisition of RCMC. The payment of principal and interest on the Series 2008 Bonds and the purchase price of any tendered bonds on each series are secured by a separate, irrevocable, transferable, direct-pay letter of credit (the Letters of Credit). The Letters of Credit entitle the Master Trustee to draw amounts equal to the principal amounts of the Series 2008 Bonds outstanding and up to 35 days interest at a rate of 12%. The Letters of Credit expire on December 14, 2012 unless renewed or replaced. A portion ($59,525) of the Series 2008A Bonds were repaid from proceeds of the Series 2010 Bonds.

The variable rate of interest on the Series 2008 Bonds is determined weekly by the Remarketing Agent (Merrill Lynch), as the rate equal to the lowest rate which, in regard to general financial conditions and other special conditions bearing on the rate, would produce as nearly as possible a par bid for the Series 2008 Bonds in the secondary market. In no event shall the variable rate on the Series 2008 Bonds during any period where interest is calculated weekly exceed the lesser of 12% annually or the maximum contract rate of interest permitted by the State of Tennessee for the Series 2008A Bonds or the Commonwealth of Virginia for the Series 2008B Bonds. The Alliance has the option, upon written approval of the holder of the Letters of Credit, the Remarketing Agent and others, to convert to a medium-term rate period or to a fixed rate.

The Series 2008 Bonds are subject to optional and mandatory tender for purchase prior to maturity at the option of the holder, upon conversion to a fixed rate, upon conversion to a medium-term rate period, prior to the effective date of any substitute letter of credit, or upon the termination of the Letters of Credit. The optional and mandatory tender provisions generally call for the Master Trustee to purchase the outstanding Series 2008 Bonds at a purchase price equal to the principal amount thereof plus accrued interest upon a stated date as described in the tender notice delivered to the bond holders.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Series 2007 Bonds

In December 2007, the Alliance issued $104,355 (Series 2007A), $327,170 (Series 2007B taxable) and $36,575 (Series 2007C) variable rate Hospital Revenue Bonds (collectively, the Series 2007 Bonds). The proceeds of Series 2007 Bonds were primarily used to early extinguish a portion of the outstanding Series 2000A Bonds, all of the outstanding 2000B Bonds, all of the outstanding Series 1994 Bonds, and all of the outstanding Series 2006B Bonds; to finance the acquisition of a majority ownership in NCH, and to finance certain capital improvements and equipment acquisitions for the Alliance's hospital facilities. The payment of principal and interest on the Series 2007 Bonds and the purchase price of any tendered bonds on each series are secured by a separate, irrevocable, transferable, direct-pay letter of credit (the Letters of Credit). The Letters of Credit entitle the Master Trustee to draw amounts equal to the principal amounts of the Series 2007 Bonds outstanding and up to 35 days interest at a rate of 12%. The Letters of Credit expire on December 14, 2012 unless renewed or replaced. A portion of the outstanding Series 2007A ($91,685) and Series 2007C ($32,840) Bonds were repaid from proceeds of the Series 2010 Bonds.

The variable rate of interest on the Series 2007 Bonds is determined weekly in the same manner as described above for the Series 2008 Bonds. In no event shall the variable rate on the Series 2007 Bonds during any period where interest is calculated weekly exceed the lesser of 12% annually or the maximum contract rate of interest permitted by the State of Tennessee for the Series 2007A and 2007B Bonds or the Commonwealth of Virginia for the 2007C Bonds. The Alliance has the option, upon written approval of the holder of the Letters of Credit, the Remarketing Agent and others, to convert to a medium-term rate period or to a fixed rate. Upon such conversion, the Series 2007 Bonds become subject to mandatory tender for purchase.

The Series 2007 Bonds are subject to optional and mandatory tender in the same manner as described above for the Series 2008 Bonds. In addition, the Series 2007B Bonds are subject to a special mandatory tender with respect to its conversion from taxable debt to tax-exempt debt.

Series 2006 Bonds

During 2006, the Alliance issued $173,030 Hospital First Mortgage Revenue Bonds (Series 2006A) and $66,500 Hospital First Mortgage Variable Rate Revenue Bonds (Series 2006B). The proceeds from the sale of the Series 2006A Bonds were used to finance certain future and prior capital projects for the Alliance's hospital facilities and to refund certain existing indebtedness, specifically the Series 2001B Bonds (discussed below) and certain existing short and intermediate term loans and leases, as well as fund a debt service reserve fund. The Series 2006B Bond proceeds were substantially used to refund the remaining outstanding principal of the Series 2001B Bonds and establish a debt service reserve fund.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Series 2001 Bonds

During 2001, the Alliance issued $26,000 Hospital First Mortgage Revenue Bonds (Series 2001A) and $60,175 Hospital First Mortgage Revenue Bonds (Series 2001B). The Series 2001A Bonds were subject to optional tender by Bond holders. Effective July 1, 2007, the Alliance entered into an agreement whereby the beneficial owners of the Series 2001A Bonds have irrevocably waived their rights to tender the Bonds under the provisions of the respective Bond Indenture. The waiver will continue in effect through the maturity of the 2001A Bonds. The Series 2001B Bonds were refunded and redeemed in 2006.

Series 2000 Bonds

The Hospital First Mortgage Revenue Refunding (Series 2000A Bonds) and First Mortgage Revenue Refunding Bonds (Series 2000B Bonds), were used to advance refund previously existing indebtedness as well as fund a required debt service reserve fund. The Hospital First Mortgage Revenue Bonds (Series 2000C Taxable Bonds) were intended to refinance certain mortgage indebtedness of BRMM, and to refund other previously existing indebtedness. The proceeds from the sale of the First Mortgage Bonds (Series 2000D Taxable Bonds) were used primarily to fund working capital for the Alliance.

The Series 2000A Bonds included at issue date $14,680 of insured Capital Appreciation Bonds. Such bonds bear a 0% coupon rate and have a yield of 6.625% annually. The Alliance recognizes interest expense and increases the amount of outstanding debt each year based upon this yield. Total principal and interest due at maturity (2026 through 2030) is $93,675.

The advance refunding of previously issued debt requires funds to be placed in irrevocable trusts in order to satisfy remaining scheduled principal and interest payments. Management, upon advice of legal counsel, believes the amounts deposited in such irrevocable trust accounts have contractually relieved the Alliance of any future obligations with respect to this debt, and the debt and escrowed securities are not considered liabilities or assets of the Alliance. Therefore, such debt has been derecognized.

Debt outstanding and not recognized in the Consolidated Balance Sheet at June 30, 2010 due to previous advance refundings of the Series 2000A Bonds, Series 2000B Bonds, Series 1998C Bonds, and Series 1991 Bonds, totaled approximately $585,960.

The assets placed in the irrevocable trust accounts are also not recognized as assets of the Alliance. These assets consist primarily of various investments, as permitted by bond indentures and other

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

documents, including United States Treasury obligations, an investment contract with MBIA Insurance Corporation (MBIA) in the amount of $54,300, as well as the Series 2000C and 2000D Bonds which were purchased with the proceeds of the 2000A and 2000B Bonds specifically for the purpose of utilizing the Series 2000C and 2000D Bonds in the irrevocable trust. Therefore, certain of the assets held in the irrevocable trust accounts have future income streams contingent upon payments by the Alliance.

Essentially all of the Alliance's bonds are subject to redemption prior to maturity, including optional, mandatory sinking fund and extraordinary redemption, at various dates and prices as described in the respective Bond indentures and other documents.

Other Bonds, Notes Payable and Financing Arrangements

The Alliance has granted a deed of trust on JCMC and SSH to secure the payment of the outstanding bonds. The bonds are also secured by the Alliance's receivables, inventories and other assets as well as certain funds held under the documents pursuant to which the bonds were issued.

The NCH Series 2001 Hospital Refunding and Improvement Revenue Bonds are secured by revenues and a lien on certain real and personal property of NCH. The JMH Series 1998 Hospital Refunding and Improvement Revenue Bonds are secured by pledged gross receipts of JMH, as defined in the Master Trust indenture.

The scheduled maturities and mandatory sinking fund payments of the long-term debt and capital lease obligations (excluding interest), exclusive of net unamortized original issue discount and premium, at June 30, 2010 are as follows:

Year Ending June 30,		
2011		$ 28,131
2012		35,002
2013		30,312
2014		28,035
2015		31,898
Thereafter		930,227
		1,083,605
	Net discount	(632)
		$ 1,082,973

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

The Alliance, NCH and JMH are each members of separate Obligated Groups. The bond indentures, master trust indentures, letter of credit agreements and loan agreements related to the various bond issues and notes payable contain covenants with which the respective Obligated Groups must comply. These requirements include maintenance of certain financial and liquidity ratios, deposits to trustee funds, permitted indebtedness, use of facilities and disposals of property. These covenants also require that failure to meet certain debt service coverage tests will require the deposit of all daily cash receipts of the Alliance into a trust fund. Management has represented the Alliance, NCH and JMH are in compliance with all such covenants at June 30, 2010.

In connection with the tax-exempt bonds, the Alliance is required every five years, and at maturity, to remit to the Internal Revenue Service amounts which are due related to positive arbitrage on the borrowed funds. The Alliance performs such computations when required and recognizes any liability at that time. Management does not believe there are any significant arbitrage liabilities at June 30, 2010 or 2009.

In September 2010, in order to reduce credit risk and expenses, the Alliance replaced the existing letters of credit related to the Series 2007B, Series 2008A and Series 2008B Bonds with letters of credit held by several different financial institutions. The term of the letter of credit facility is for three years. As a part of this restructuring, the existing Bonds in these series were repaid through a remarketing of sub-series of each respective bond issue created per the mandatory tender and letter of credit substitution provisions.

NOTE G--SELF-INSURANCE PROGRAMS

The Alliance is self-insured for professional and general liability claims and related expenses. The Alliance maintains a $25,000 umbrella liability policy that attaches over the self-insurance limits of $10,000 per claim and a $15,000 annual aggregate retention. The Alliance also provides professional liability coverage for certain affiliates and joint ventures.

The Alliance is self-insured for workers' compensation claims in the State of Tennessee and has established estimated liabilities for both reported and unreported claims. The Alliance maintains a stop-loss policy that attaches over the self-insurance limits of $1,000 per occurrence and $1,000 annual aggregate retention. In the State of Virginia, the Alliance is not self-insured and maintains workers' compensation insurance through commercial carriers.

At June 30, 2010, the Alliance is involved in litigation relating to medical malpractice and workers' compensation and other claims arising in the ordinary course of business. There are also known incidents occurring through June 30, 2010 that may result in the assertion of additional claims, and other unreported claims may be asserted arising from services provided in the past. Alliance

(Dollars in Thousands)

NOTE G--SELF-INSURANCE PROGRAMS - Continued

management has estimated and accrued for the cost of these unreported claims based on historical data and actuarial projections. The estimated net present value of malpractice and workers' compensation claims, both reported and unreported, as of June 30, 2010 and 2009 was $12,601 and $12,887, respectively. The discount rate utilized was 5% at June 30, 2010 and 2009.

Additionally, the Alliance is self-insured for employee health claims and recognizes expense each year based upon actual claims paid and an estimate of claims incurred but not yet paid, including a catastrophic claims reserve based on historical claims in excess of $75.

NOTE H--NET PATIENT SERVICE REVENUE

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the accompanying Consolidated Statements of Operations and Changes in Net Assets is as follows for the years ended June 30:

	2010	*2009*
Inpatient service charges	$ 1,848,590	$ 1,630,110
Outpatient service charges	1,669,705	1,253,097
Gross patient service charges	3,518,295	2,883,207
Less:		
Estimated contractual adjustments and other discounts	2,417,082	1,929,061
Estimated uncollectible self-pay - Note B	111,565	86,760
Charity care	61,378	44,488
	2,590,025	2,060,309
Net patient service revenue	$ 928,270	$ 822,898

NOTE I--THIRD-PARTY REIMBURSEMENT

The Alliance renders services to patients under contractual arrangements with Medicare, Medicaid, TennCare, Blue Cross and various other commercial payors. The Medicare program pays for inpatient services on a prospective basis. Payments are based upon diagnosis related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. The Alliance also receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid and other low income patients. Most Medicare outpatient services are reimbursed on a prospectively determined payment methodology. The

NOTE I--THIRD-PARTY REIMBURSEMENT - Continued

Medicare program also reimburses certain other services on the basis of reasonable cost, subject to various prescribed limitations and reductions.

Reimbursement under the State of Tennessee's Medicaid waiver program (TennCare) for inpatient and outpatient services is administered by various managed care organizations (MCOs) and is based on diagnosis related group assignments, a negotiated per diem or fee schedule basis. The Alliance also receives additional supplemental payments from the State of Tennessee. The amount recognized totaled $8,700 and $11,137 for the years ended June 30, 2010 and 2009, respectively. Such payments are not guaranteed in future periods.

The Virginia Medicaid program reimbursement for inpatient hospital services is based on a prospective payment system using both a per case and per diem methodology. Additional payments are made for the allowable costs of capital. Payments for outpatient services are based on Medicare cost reimbursement principles and settled through the filing of an annual Medicaid cost report.

Amounts earned under the contractual agreements with the Medicare and Medicaid programs are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Activity with respect to audits and reviews of the governmental programs in the healthcare industry has increased and is expected to increase in the future. No additional specific reserves or allowances have been established with regard to these increased audits and reviews as management is not able to estimate such amounts. Management believes that any adjustments from these increased audits and reviews will not have a material adverse impact on the consolidated financial statements. However, due to uncertainties in the estimation, it is at least reasonably possible that management's estimate will change in 2011, although the amount of any change cannot be estimated. The impact of final settlements of cost reports or changes in estimates decreased net patient service revenue by $3,540 in 2009. The impact of final settlements of cost reports or changes in estimates were not significant in 2010.

Participation in the Medicare program subjects the Alliance to significant rules and regulations; failure to adhere to such could result in fines, penalties or expulsion from the program. Management believes that adequate provision has been made for any adjustments, fines or penalties which may result from final settlements or violations of other rules or regulations. Management has represented that the Alliance is in substantial compliance with these rules and regulations as of June 30, 2010.

The Alliance has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations and employer groups. The basis

NOTE I--THIRD-PARTY REIMBURSEMENT - Continued

for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

NOTE J--EMPLOYEE BENEFIT PLANS

The Alliance sponsors a retirement plan (the Plan) which covers substantially all employees. The Plan is a defined contribution plan which consists mainly of employer-funded contributions. During 2010 and 2009, the Alliance made contributions to the Plan under a stratified system, whereby the Alliance's contribution percentage is based on each employee's years of service. In addition, the Alliance sponsors a 403(b) plan which is funded solely by employees' contributions. The Alliance does not make any discretionary or matching contributions into the 403(b) plan. Employees of certain other subsidiaries are covered by other plans, although such plans are not significant. The total expense related to defined contribution plans for the years ended June 30, 2010 and 2009 was $13,311 and $10,590, respectively.

NCH maintains a defined benefit pension plan and a post-retirement employee benefit plan. The accrued unfunded pension liability was $1,942 and $1,972, and the accrued unfunded post-retirement liability was $3,843 and $4,821 at June 30, 2010 and 2009, respectively.

The Alliance sponsors a secured executive benefit program (SEBP) for certain key executives. Contributions to the plan by the Alliance are based on an annual amount of funding necessary to produce a target benefit for the participants at their retirement date, although the Alliance does not guarantee any level of benefit will be achieved. The Alliance contributed $1,303 and $1,716 to the plan during 2010 and 2009, respectively. Other assets at June 30, 2010 and 2009 include $7,077 and $5,827, respectively, related to the Alliance's portion of the benefits which are recoverable upon the death of the participant. In addition, the Alliance sponsors a Section 457(f) plan for certain key executives. The benefits for substantially all employees previously participating in the SEBP plan have been transferred into the 457(f) plan.

NOTE K--CONCENTRATIONS OF RISK

The Alliance has locations primarily in upper East Tennessee and Southwest Virginia which is considered a geographic concentration. The Alliance grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. Net patient service revenue from Washington County, Tennessee operations were approximately 54% and 59% of total net patient service revenue for 2010 and 2009, respectively.

The mix of receivables from patients and third-party payors based on charges at established rates is as follows as of June 30:

(Dollars in Thousands)

NOTE K--CONCENTRATIONS OF RISK - Continued

	2010	*2009*
Medicare	42%	40%
Tenncare/Medicaid	15%	17%
Commercial	25%	31%
Other third-party payors	10%	5%
Patients	8%	7%
	100%	100%

Approximately 98% of the consolidated total revenue, gains and support were related to the provision of healthcare services during 2010 and 2009. Admitting physicians are primarily practitioners in the regional area.

Two of the Alliance's Virginia hospitals' employees are covered under collective bargaining agreements. These agreements expire in January 2011.

The Alliance routinely invests in investment vehicles as listed in Note C. The Alliance's investment portfolio is managed by outside investment management companies. Investments in corporate and foreign bonds and notes, municipal obligations, money market funds, equities and other vehicles that are held by safekeeping agents are not insured or guaranteed by the U.S. government.

NOTE L--INCOME TAXES

BRMM and its subsidiaries file a consolidated federal tax return and separate state tax returns. As of June 30, 2010 and 2009, BRMM and its subsidiaries had net operating loss carryforwards for consolidated federal purposes of $32,447 and $35,448, respectively, related to operating losses which expire through 2025. BRMM had state net operating loss carryforwards of $59,860 and $58,771, respectively, which expire through 2025. The net operating loss carryforwards may be offset against future taxable income to the extent permitted by the Internal Revenue Code and Tennessee Code Annotated.

At June 30, 2010 and 2009, SWCH had federal and state net operating loss carryforwards of $4,376 and $3,923, respectively, which expire through 2029. CHC files separate federal and state tax returns. CHC had a net deferred tax liability of $58 at June 30, 2010 and a net deferred tax asset of $55 at June 30, 2009; the differences are due primarily to temporary timing differences related to depreciation and net operating loss carryforwards. The net operating loss carryforwards may be offset against future taxable income to the extent permitted by the Internal Revenue Code and tax codes of the Commonwealth of Virginia.

NOTE L--INCOME TAXES - Continued

Net deferred tax assets related to these carryforwards and other deferred tax assets have been substantially offset through valuation allowances equal to these amounts. Income taxes paid relate primarily to state taxes for certain subsidiaries and federal alternative minimum tax.

NOTE M--RELATED PARTY TRANSACTIONS

The Alliance enters into transactions with entities affiliated with certain members of the Board of Directors including transactions to construct Alliance facilities and provide professional services to the Alliance. Board members refrain from discussion and abstain from voting on transactions with entities with which they are related.

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES

Construction in Progress: Construction in progress at June 30, 2010 represents costs incurred related to various hospital and medical office building facility renovations and additions. The Alliance has outstanding contracts and other commitments related to the completion of these projects, and the cost to complete these projects is estimated to be approximately $223,847 at June 30, 2010. The Alliance does not expect any significant costs to be incurred for infrastructure improvements to assets held for resale.

Physician Contracts: BRMM employs physicians to provide services to BRMM's physician practices through employment agreements which provide annual compensation, plus incentives based upon specified productivity levels. These contracts have various terms.

In addition, the Alliance has entered into contractual relationships with non-employed physicians to provide services in Upper East Tennessee and Southwest Virginia. These contracts guarantee certain base payments and allowable expenses and have terms of varying lengths. Upon completion of the respective guarantee period, amounts drawn and outstanding under each agreement are treated as a loan bearing interest at various rates and are subject to repayment over a specified period. The physician note may also be amortized by virtue of the physician's continued practice in the specified community during the repayment period. A net receivable of $1,818 and $2,770 related to these agreements is included in the accompanying Consolidated Balance Sheets at June 30, 2010 and 2009, respectively.

Employee Scholarships: The Alliance offers scholarships to certain individuals which require that the recipients return to the Alliance to work for a specified period of time after they complete their degree. Amounts due are then forgiven over a specific period of time as provided in the individual contracts. If the recipient does not return and work the required period of time, the funds disbursed on their behalf become due immediately and interest is charged until the funds are repaid. Other receivables June 30, 2010 and 2009 includes $5,571 and $3,880, respectively, related to students in

(Dollars in Thousands)

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES - Continued

school, graduates working at the Alliance and amounts due from others who are no longer in the scholarship program.

Promises to Give: The Alliance has recorded certain unconditional promises to give to unrelated organizations. At June 30, 2010, $1,768 is due within one year, and an additional $644 is due within five years and is included in other long-term liabilities.

Operating Leases and Maintenance Contracts: Total lease expense for the years ended June 30, 2010 and 2009 was $10,216 and $9,412, respectively. Future minimum lease payments for each of the next five years and in the aggregate for the Alliance's noncancellable operating leases with remaining lease terms in excess of one year are as follows:

Year Ending June 30,		
2011	$	1,686
2012		1,560
2013		1,345
2014		1,000
2015		835
Thereafter		3,808
	$	10,234

Estimated future minimum payments under various noncancellable maintenance contracts with remaining terms in excess of one year at June 30, 2010 total in the aggregate $3,720 through 2015.

Asset Retirement Obligation: The Alliance has identified asbestos in certain facilities and is required by law to dispose of it in a special manner if the facility undergoes major renovations or is demolished; otherwise, the Alliance is not required to remove the asbestos from the facility. The Alliance has complied with regulations by treating the asbestos so that it presents no known immediate or future safety concerns. An asset retirement obligation has been established to the extent that sufficient information exists upon which to estimate the liability.

Other: During 2007, the Alliance received a Certificate of Need (CON) application to build a new 80-bed hospital in Washington County, Tennessee. When this new facility (FWCH) is opened in 2011, acute care services are planned to be discontinued or reduced at both NSH and JCSH. Management anticipates that the NSH and JCSH facilities will continue to be fully utilized by the

(Dollars in Thousands)

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES - Continued

Alliance in its operations and, therefore, no change to their estimated useful lives is anticipated. However, it is reasonably possible management's estimates related to the continuing use of these facilities could change in the near term. The carrying value of buildings and improvements related to these facilities is $12,493 at June 30, 2010.

During 2007, the Alliance filed a Certificate of Public Need (COPN) application to build a new 57-bed hospital in Smyth County, Virginia. The COPN has been approved by the applicable Commonwealth of Virginia agencies. Construction is expected to begin in 2011 and total costs are expected to be $68,216.

The Alliance is a party to various transactions and agreements in the normal course of business, which include purchase and re-purchase agreements, put arrangements and other commitments, which may bind the Alliance to undertake additional transactions or activities in the future.

NOTE O--RENTAL INCOME UNDER OPERATING LEASES

The Alliance leases rental properties to third parties, most of whom are physician practices, for various terms, generally five years. The following is a schedule by year and in the aggregate of minimum future rental income due under noncancellable operating leases at June 30, 2010:

Year Ending June 30,		
2011	$	1,648
2012		1,545
2013		995
2014		730
2015		615
Thereafter		858
Total minimum future rentals	$	6,391

NOTE P--FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments has been estimated by the Alliance using available market information as of June 30, 2010 and 2009, and valuation methodologies considered appropriate. The estimates presented are not necessarily indicative of amounts the Alliance could realize in a current market exchange. The carrying value of substantially all financial instruments approximates fair value due to the nature or term of the instruments, except as described below.

NOTE P--FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

Investment in Joint Ventures: It is not practical to estimate the fair market value of the investments in joint ventures.

Other Long-Term Liabilities: Estimates of reported and unreported professional liability claims, pension and post-retirement liabilities are discounted to approximate their estimated fair value. It is not practical to estimate the fair market value of other long-term liabilities due to uncertainty of when these amounts may be paid. Other long-term liabilities are not discounted.

Long-Term Debt and Capital Leases: The fair value of long-term debt is estimated based upon quotes obtained from brokers for bonds and discounted future cash flows using current market rates for other debt. For long-term debt with variable interest rates, the carrying value approximates fair value.

The Alliance's significant capital leases and vendor contracts were negotiated with various entities and are considered unique. It is not practicable to estimate the fair value of these obligations under current conditions. Other capital lease obligations are not significant.

The estimated fair value of the Alliance's financial instruments that have carrying values different from fair value is as follows at June 30:

	2010		*2009*	
	Carrying Value	*Estimated Fair Value*	*Carrying Value*	*Estimated Fair Value*
FINANCIAL LIABILITIES:				
Long-term debt	$ 1,082,973	$ 1,105,778	$ 1,072,250	$ 988,263

NOTE Q--FAIR VALUE MEASUREMENT

FASB ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.

- Level 2 - Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

(Dollars in Thousands)

NOTE Q--FAIR VALUE MEASUREMENT - Continued

- Level 3 - Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes values determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Alliance's own assumptions.

In instances where the determination of the fair value hierarchy measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Alliance's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following table sets forth, by level within the fair value hierarchy, the financial assets and liabilities recorded at fair value on a recurring basis as of June 30, 2010 and 2009:

	June 30, 2010	*Level 1*	*Level 2*	*Level 3*
Trading securities	$ 209,644	$ 164,510	$ 16,526	$ 28,608
Assets whose use is limited	177,180	177,180	-	-
Total assets	$ 386,824	$ 341,690	$ 16,526	$ 28,608
Fair value of derivative agreements	$ (134,300)	$ -	$ -	$ (134,300)

	June 30, 2009	*Level 1*	*Level 2*	*Level 3*
Trading securities	$ 235,065	$ 191,918	$ 13,116	$ 30,031
Assets whose use is limited	186,414	186,414	-	-
Total assets	$ 421,479	$ 378,332	$ 13,116	$ 30,031
Fair value of derivative agreements	$ (126,217)	$ -	$ -	$ (126,217)

The valuation of the Alliance's derivative agreements is determined using market valuation techniques, including discounted cash flow analysis on the expected cash flows of each agreement. This analysis reflects the contractual terms of the agreement, including the period to maturity, and uses observable market-based inputs, including forward interest rate curves. The fair values of interest rate swap agreements are determined by netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The variable cash receipts (or payments) are based on the expectation of future interest rates based on observable market forward interest rate curves and the underlying notional amount. The Alliance also

(Dollars in Thousands)

NOTE Q--FAIR VALUE MEASUREMENT - Continued

incorporates credit valuation adjustments (CVAs) to appropriately reflect both its own nonperformance or credit risk and the respective counterparty's nonperformance or credit risk in the fair value measurements. The CVA on the Alliance's interest rate swap agreements at June 30, 2010 and 2009 resulted in a decrease in the fair value of the related liability of $10,085 and $7,914, respectively.

A certain portion of the inputs used to value its interest rate swap agreements, including the forward interest rate curves and market perceptions of the Alliance's credit risk used in the CVAs, are unobservable inputs available to a market participant. As a result, the Alliance has determined that the interest rate swap valuations are classified in Level 3 of the fair value hierarchy.

The following tables provide a summary of changes in the fair value of the Alliance's Level 3 financial assets and liabilities during the fiscal years ended June 30, 2010 and 2009:

	Trading Securities	*Derivatives, Net*
July 1, 2008	$ 32,187	$ (87,295)
Total unrealized/realized losses in the performance indicator, net	(9,298)	(42,128)
Purchases, issuance and settlements and other, net	1,015	3,206
Transfers in (out), net	6,127	-
June 30, 2009	30,031	(126,217)
Total unrealized/realized losses in the performance indicator, net	(1,546)	(8,607)
Purchases, issuance and settlements and other, net	1,446	524
Transfers in (out), net	(1,323)	-
June 30, 2010	$ 28,608	$ (134,300)
Net losses included in the performance indicator which are attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2009	$ (9,298)	$ (43,172)
Net losses included in the performance indicator which are attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2010	$ (1,920)	$ (27,116)

On July 1, 2009, the Alliance adopted the provisions of FASB ASC 820 related to non-financial assets and liabilities recognized or disclosed at fair value on a non-recurring basis. The Alliance does not have any non-financial liabilities recognized or disclosed at fair value on a non-recurring basis. Assets subject to this guidance primarily include certain goodwill, property and equipment

(Dollars in Thousands)

NOTE Q--FAIR VALUE MEASUREMENT - Continued

and investments in unconsolidated affiliates. There were no significant assets or liabilities that were re-measured at fair value on a non-recurring basis during the fiscal year ended June 30, 2010.

NOTE R--OPERATING EXPENSES BY FUNCTIONAL CLASSIFICATION

Direct expenses by functional classification are as follows for the years ended June 30:

	2010	*2009*
Healthcare services	$ 795,725	$ 686,779
Administrative and general	124,338	135,994
Other	8,625	10,168
	$ 928,688	$ 832,941

Supplemental Schedules

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Balance Sheet
(Dollars in Thousands)

June 30, 2010

	Blue Ridge Medical Management *	Other Obligated Group Members	Eliminations	Total Obligated Group	Mountain States Properties	Other Entities	Eliminations	Total
ASSETS								
CURRENT ASSETS								
Cash and cash equivalents	$ 1,043	$ 204,966	$ -	$ 206,009	$ 7,566	$ 20,951	$ -	$ 234,526
Current portion of investments	-	9,588	-	9,588	14,120	4,759	-	28,467
Patient accounts receivable, less estimated allowances for contractual adjustments and uncollectible accounts	4,457	84,416	-	88,873	-	36,707	-	125,580
Other receivables, net	352	10,277	-	10,629	788	6,509	-	17,926
Inventories and prepaid expenses	192	18,977	-	19,169	183	9,811	-	29,163
TOTAL CURRENT ASSETS	6,044	328,224	-	334,268	22,657	78,737	-	435,662
INVESTMENTS, less amounts required to meet current obligations	17,166	266,104	-	283,270	18,765	284,721	-	586,756
PROPERTY, PLANT AND EQUIPMENT, net	9,152	463,652	-	472,804	66,295	156,499	-	695,598
EQUITY IN AFFILIATES	138,930	391,644	(160,670)	369,904	-	-	(369,904)	-
OTHER ASSETS								
Goodwill, net of accumulated amortization	6,246	143,276	-	149,522	-	1,830	-	151,352
Net deferred financing, acquisition costs and other charges, less current portion	176	28,458	-	28,634	1,540	645	-	30,819
Other assets	10,695	8,087	-	18,782	3,608	6,923	-	29,313
TOTAL OTHER ASSETS	17,117	179,821	-	196,938	5,148	9,398	-	211,484
	$ 188,409	$ 1,629,445	$ (160,670)	$ 1,657,184	$ 112,865	$ 529,355	$ (369,904)	$ 1,929,500

* Management Services Organization only

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Balance Sheet - Continued
(Dollars in Thousands)

June 30, 2010

	*Blue Ridge Medical Management **	*Other Obligated Group Members*	*Eliminations*	*Total Obligated Group*	*Mountain States Properties*	*Other Entities*	*Eliminations*	*Total*
LIABILITIES AND NET ASSETS								
CURRENT LIABILITIES								
Accrued interest payable	$ -	$ 15,550	$ -	$ 15,550	$ 4	$ 485	$ -	$ 16,039
Current portion of long-term debt and capital lease obligations	550	23,743	-	24,293	50	3,788	-	28,131
Current portion of estimated fair value of derivatives	-	-	-	-	10,740	-	-	10,740
Accounts payable and accrued expenses	2,159	76,098	-	78,257	1,317	19,653	-	99,227
Accrued salaries, compensated absences and amounts withheld	2,695	31,604	-	34,299	-	12,981	-	47,280
Payables to (receivables from) affiliates, net	9,392	(10,146)	-	(754)	(33,334)	34,088	-	-
Estimated amounts due to third-party payors, net	-	7,983	-	7,983	-	2,172	-	10,155
TOTAL CURRENT LIABILITIES	14,796	144,832	-	159,628	(21,223)	73,167	-	211,572
OTHER LIABILITIES								
Long-term debt and capital lease obligations, less current portion	5,515	1,006,038	-	1,011,553	1,144	42,145	-	1,054,842
Estimated fair value of derivatives, less current portion	-	123,308	-	123,308	252	-	-	123,560
Deferred revenue	-	20,092	-	20,092	-	353	-	20,445
Estimated professional liability self-insurance	2,229	5,075	-	7,304	-	2,237	-	9,541
Other long-term liabilities	5,199	1,598	-	6,797	-	5,831	-	12,628
TOTAL LIABILITIES	27,739	1,300,943	-	1,328,682	(19,827)	123,733	-	1,432,588
MINORITY INTERESTS	-	-	-	-	-	168,410	-	168,410
NET ASSETS								
Unrestricted net assets	160,670	317,434	(160,670)	317,434	132,692	226,356	(359,048)	317,434
Temporarily restricted net assets	-	10,941	-	10,941	-	10,729	(10,729)	10,941
Permanently restricted net assets	-	127	-	127	-	127	(127)	127
TOTAL NET ASSETS	160,670	328,502	(160,670)	328,502	132,692	237,212	(369,904)	328,502
	$ 188,409	$ 1,629,445	$ (160,670)	$ 1,657,184	$ 112,865	$ 529,355	$ (369,904)	$ 1,929,500

*Management Services Organization only.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Statement of Operations and Changes in Net Assets (Dollars in Thousands)

Year Ended June 30, 2010

	*Blue Ridge Medical Management **	*Other Obligated Group Members*	*Eliminations*	*Total Obligated Group*	*Mountain States Properties*	*Other Entities*	*Eliminations*	*Total*
CHANGES IN UNRESTRICTED NET ASSETS:								
Revenue, gains and support:								
Net patient service revenue	$ 32,979	$ 657,122	$ (1,556)	$ 688,545	$ -	$ 239,921	$ (196)	$ 928,270
Other operating revenue	24,046	3,914	(18,087)	9,873	7,430	32,519	(33,813)	16,009
Equity in net gain of affiliates	6,702	4,959	(5,460)	6,201	-	15	(6,216)	-
TOTAL REVENUE, GAINS AND SUPPORT	63,727	665,995	(25,103)	704,619	7,430	272,455	(40,225)	944,279
Expenses:								
Salaries and wages	15,053	225,269	-	240,322	139	87,975	(2,773)	325,663
Physician salaries and wages	28,752	1,133	-	29,885	-	49,009	(24,405)	54,489
Contract labor	873	3,460	-	4,333	-	2,499	(286)	6,546
Employee benefits	5,152	43,758	(1,615)	47,295	39	22,587	(1,559)	68,362
Fees	2,206	76,192	(18,018)	60,380	830	21,867	(535)	82,542
Supplies	2,200	132,563	-	134,763	1	40,898	(193)	175,469
Utilities	510	10,078	-	10,588	1,010	4,595	-	16,193
Other	4,024	39,787	(11)	43,800	2,611	25,482	(4,253)	67,640
Depreciation	1,059	42,890	-	43,949	2,585	21,902	-	68,436
Amortization	266	12,711	-	12,977	-	146	-	13,123
Estimated provision for bad debts	1,522	3,822	-	5,344	-	2,617	-	7,961
Interest and taxes	(1,279)	41,601	-	40,322	1,409	4,787	(4,254)	42,264
TOTAL EXPENSES	60,338	633,264	(19,644)	673,958	8,624	284,364	(38,258)	928,688
OPERATING INCOME	3,389	32,731	(5,459)	30,661	(1,194)	(11,909)	(1,967)	15,591
Nonoperating gains (losses):								
Interest and dividend income	546	10,904	-	11,450	791	9,311	(4,254)	17,298
Net realized gains on the sale of securities	128	1,543	-	1,671	-	714	-	2,385
Net unrealized gains on securities	596	8,083	-	8,679	1,312	5,027	-	15,018
Derivative related income	-	2,622	-	2,622	1,772	-	-	4,394
Loss on early extinguishment of debt	-	(3,029)	-	(3,029)	-	-	-	(3,029)
Change in estimated fair value of derivatives	-	(10,865)	-	(10,865)	2,258	-	-	(8,607)
Other nonoperating gains (losses)	800	2,502	-	3,302	533	(3,323)	-	512
Net assets released from restrictions used for operations	-	-	-	-	-	1,113	-	1,113
NET NONOPERATING GAINS	2,070	11,760	-	13,830	6,666	12,842	(4,254)	29,084
EXCESS OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES, BEFORE MINORITY INTERESTS	5,459	44,491	(5,459)	44,491	5,472	933	(6,221)	44,675

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Statement of Operations and Changes in Net Assets - Continued (Dollars in Thousands)

Year Ended June 30, 2010

	Blue Ridge Medical Management *	Other Obligated Group Members	Eliminations	Total Obligated Group	Mountain States Properties	Other Entities	Eliminations	Total
Minority interest in consolidated subsidiaries' net gain	-	-	-	-	-	(3,162)	-	(3,162)
EXCESS OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	5,459	44,491	(5,459)	44,491	5,472	(2,229)	(6,221)	41,513
Other changes in unrestricted net assets:								
Pension and other defined benefit plan adjustments	-	-	-	-	-	1,589	-	1,589
Net assets released from restrictions used for the purchase of property, plant and equipment	-	-	-	-	-	2,283	-	2,283
INCREASE IN UNRESTRICTED NET ASSETS	5,459	44,491	(5,459)	44,491	5,472	1,643	(6,221)	45,385
DECREASE IN TEMPORARILY RESTRICTED NET ASSETS	-	(393)	-	(393)	-	(844)	-	(1,237)
DECREASE IN PERMANENTLY RESTRICTED NET ASSETS	-	-	-	-	-	(50)	-	(50)
INCREASE IN TOTAL NET ASSETS	5,459	44,098	(5,459)	44,098	5,472	749	(6,221)	44,098
NET ASSETS, BEGINNING OF YEAR	155,211	284,404	(155,211)	284,404	127,220	236,463	(363,683)	284,404
NET ASSETS, END OF YEAR	$ 160,670	$ 328,502	$ (160,670)	$ 328,502	$ 132,692	$ 237,212	$ (369,904)	$ 328,502

*Management Services Organization only.

NOTE A--OBLIGATED GROUP MEMBERS

As described in Note F to the consolidated financial statements, the Alliance has granted a deed of trust on JCMC and SSH to secure the payment of the outstanding bonds. The bonds are also secured by the Alliance's receivables, inventories and other assets as well as certain funds held under the documents pursuant to which the bonds were issued. In accordance with Article Six, Section 6.6 of the Amended and Restated Master Trust Indenture between Mountain States Health Alliance and the Bank of New York Trust Company, NA as Master Trustee, those members pledged include Johnson City Medical Center Hospital, Indian Path Medical Center and Pavilion, North Side Hospital, Sycamore Shoals Hospital, Johnson City Specialty Hospital, Johnson County Community Hospital, Russell County Medical Center and Blue Ridge Medical Management Corporation (parent company only), collectively defined as the Obligated Group (Obligated Group).

The supplemental consolidating schedules include the accounts of the members of the Obligated Group after elimination of all significant intergroup accounts and transactions. Certain other subsidiaries of the Alliance, Mountain States Properties, Inc. (MSP) and all other affiliates (Other Entities), are not pledged to secure the payment of the outstanding bonds as they are not part of the Obligated Group. These affiliates have been accounted for within the Obligated Group based upon the Alliance's original and subsequent investments, as adjusted for the Alliance's pro rata share of income or losses and any distributions, and are included as a part of equity in affiliates in the supplemental consolidating balance sheet.

MOUNTAIN STATES HEALTH ALLIANCE

Audited Consolidated Financial Statements
(and Supplemental Schedules)

Years Ended June 30, 2011 and 2010

PYA

MOUNTAIN STATES HEALTH ALLIANCE

Audited Consolidated Financial Statements and Supplemental Schedules

Years Ended June 30, 2011 and 2010

PERSHING YOAKLEY & ASSOCIATES

PERSHING YOAKLEY & ASSOCIATES, P.C.
Certified Public Accountants
One Cherokee Mills, 2220 Sutherland Avenue
Knoxville, TN 37919

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Mountain States Health Alliance:

We have audited the accompanying consolidated balance sheets of Mountain States Health Alliance and subsidiaries (the Alliance) as of June 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 the Alliance'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 consolidated 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 the Alliance's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mountain States Health Alliance and subsidiaries as of June 30, 2011 and 2010 and the results of their operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplemental schedules, as listed in the accompanying index, are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

As discussed in Note B, the Alliance adopted Financial Accounting Standards Board Accounting Standards Codification 958-10, *Consolidation,* and applicable portions of 958-805, *Not-for-Profit Entities*, during 2011.

Pershing Yoakley & Associates, PC

Knoxville, Tennessee
October 26, 2011

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Balance Sheets
(Dollars in Thousands)

	June 30, 2011	June 30, 2010
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ **112,768**	$ 234,526
Current portion of investments	**116,175**	25,092
Patient accounts receivable, less estimated allowances for uncollectible accounts of $53,366 in 2011 and $45,941 in 2010	**134,611**	125,580
Other receivables, net	**19,614**	17,926
Inventories and prepaid expenses	**28,965**	29,163
TOTAL CURRENT ASSETS	**412,133**	432,287
INVESTMENTS, less amounts required to meet current obligations	**581,376**	590,131
PROPERTY, PLANT AND EQUIPMENT, net	**797,418**	695,598
OTHER ASSETS		
Goodwill - Note B	**148,666**	151,352
Net deferred financing, acquisition costs and other charges, less current portion	**29,844**	30,819
Other assets	**28,448**	29,313
TOTAL OTHER ASSETS	**206,958**	211,484
	$ **1,997,885**	$ 1,929,500

		June 30,		
		2011		2010
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES				
Accrued interest payable	$	**20,047**	$	16,039
Current portion of long-term debt and capital lease obligations		**28,162**		28,131
Current portion of estimated fair value of derivatives		**102,609**		10,740
Accounts payable and accrued expenses		**98,819**		99,227
Accrued salaries, compensated absences and amounts withheld		**57,800**		47,280
Estimated amounts due to third-party payors, net		**14,813**		10,155
TOTAL CURRENT LIABILITIES		**322,250**		211,572
OTHER LIABILITIES				
Long-term debt and capital lease obligations, less current portion		**1,040,923**		1,054,842
Estimated fair value of derivatives, less current portion		**8,123**		123,560
Deferred revenue		**19,267**		20,445
Estimated professional liability self-insurance		**9,692**		9,541
Other long-term liabilities		**14,352**		12,628
TOTAL LIABILITIES		**1,414,607**		1,432,588
COMMITMENTS AND CONTINGENCIES - Notes D, F, G, and N				
NET ASSETS				
Unrestricted net assets				
Mountain States Health Alliance		**400,395**		317,485
Noncontrolling interests in subsidiaries - Note B		**171,984**		168,359
TOTAL UNRESTRICTED NET ASSETS		**572,379**		485,844
Temporarily restricted net assets				
Mountain States Health Alliance		**10,715**		10,890
Noncontrolling interests in subsidiaries - Note B		**57**		51
TOTAL TEMPORARILY RESTRICTED NET ASSETS		**10,772**		10,941
Permanently restricted net assets		**127**		127
TOTAL NET ASSETS		**583,278**		496,912
	$	**1,997,885**	$	1,929,500

See notes to consolidated financial statements.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Operations
(Dollars in Thousands)

	Year Ended June 30, 2011	2010
Revenue, gains and support:		
Net patient service revenue	$ **960,254**	$ 928,270
Other operating revenue	**15,871**	16,009
TOTAL REVENUE, GAINS AND SUPPORT	**976,125**	944,279
Expenses:		
Salaries and wages	**342,208**	325,663
Physician salaries and wages	**59,249**	54,489
Contract labor	**5,964**	6,546
Employee benefits	**67,139**	68,362
Fees	**85,919**	82,542
Supplies	**169,362**	175,469
Utilities	**17,300**	16,193
Other	**69,647**	69,154
Depreciation	**87,499**	68,436
Amortization - Note B	**2,559**	13,123
Estimated provision for bad debts	**6,174**	7,961
Interest and taxes	**44,153**	42,264
TOTAL EXPENSES	**957,173**	930,202
OPERATING INCOME	**18,952**	14,077
Nonoperating gains (losses):		
Interest and dividend income	**16,224**	17,298
Net realized gains on the sale of securities	**1,957**	2,385
Net unrealized gains on securities	**22,168**	15,018
Derivative related income	**5,072**	4,394
Loss on early extinguishment of debt - Note F	**-**	(3,029)
Change in estimated fair value of derivatives	**23,049**	(8,607)
Other nonoperating gains (losses)	**(2,653)**	512
Net assets released from restrictions used for operations	**1,893**	2,627
NET NONOPERATING GAINS	**67,710**	30,598
EXCESS OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	$ **86,662**	$ 44,675

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Changes in Net Assets
(Dollars in Thousands)

Year Ended June 30, 2011

	Mountain States Health Alliance	*Noncontrolling Interests*	*Total*
UNRESTRICTED NET ASSETS:			
Excess of Revenue, Gains and Support over Expenses and Losses	$ 83,269	$ 3,393	$ 86,662
Pension and other defined benefit plan adjustments	620	617	1,237
Cumulative effect of a change in accounting principle - Note B	(2,965)	-	(2,965)
Net assets released from restrictions used for the purchase of property, plant and equipment	1,946	-	1,946
Distributions to noncontrolling interests	-	(270)	(270)
Repurchases of noncontrolling interests and other	40	(115)	(75)
INCREASE IN UNRESTRICTED NET ASSETS	82,910	3,625	86,535
TEMPORARILY RESTRICTED NET ASSETS:			
Restricted grants and contributions	3,612	58	3,670
Net assets released from restrictions	(3,787)	(52)	(3,839)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	(175)	6	(169)
INCREASE IN TOTAL NET ASSETS	82,735	3,631	86,366
NET ASSETS, BEGINNING OF YEAR	328,502	168,410	496,912
NET ASSETS, END OF YEAR	$ 411,237	$ 172,041	$ 583,278

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Changes in Net Assets - Continued
(Dollars in Thousands)

Year Ended June 30, 2010

	Mountain States Health Alliance	*Noncontrolling Interests*	*Total*
UNRESTRICTED NET ASSETS:			
Excess of Revenue, Gains and Support over Expenses and Losses	$ 42,372	$ 2,303	$ 44,675
Pension and other defined benefit plan adjustments	796	793	1,589
Net assets released from restrictions used for the purchase of property, plant and equipment	2,283	-	2,283
Distributions to noncontrolling interests	-	(151)	(151)
Repurchases of noncontrolling interests and other	(63)	(38)	(101)
INCREASE IN UNRESTRICTED NET ASSETS	45,388	2,907	48,295
TEMPORARILY RESTRICTED NET ASSETS:			
Restricted grants and contributions	3,585	88	3,673
Net assets released from restrictions	(4,825)	(85)	(4,910)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	(1,240)	3	(1,237)
PERMANENTLY RESTRICTED NET ASSETS:			
Net assets released from restrictions by donor	(50)	-	(50)
INCREASE IN TOTAL NET ASSETS	44,098	2,910	47,008
NET ASSETS, BEGINNING OF YEAR	284,404	165,500	449,904
NET ASSETS, END OF YEAR	$ 328,502	$ 168,410	$ 496,912

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Cash Flows
(Dollars in Thousands)

		Year Ended June 30, 2011		2010
CASH FLOWS FROM OPERATING ACTIVITIES:				
Increase in net assets	$	**86,366**	$	47,008
Adjustments to reconcile increase in net assets to net cash provided by operating activities:				
Provision for depreciation and amortization		**90,472**		81,982
Loss on early extinguishment of debt		**-**		3,029
Cumulative effect of a change in accounting principle		**2,965**		-
Change in estimated fair value of derivatives		**(23,049)**		8,607
Equity in net income of joint ventures, net		**(898)**		(1,117)
Gain on sale of assets held for resale and disposal of assets		**(367)**		(548)
Amounts received on interest rate swap settlements		**(5,072)**		(4,394)
Income recognized through forward sale agreements		**(864)**		(864)
Capital Appreciation Bond accretion and other		**2,738**		2,071
Restricted contributions		**(3,670)**		(2,159)
Pension and other defined benefit plan adjustments		**(1,237)**		598
Increase (decrease) in cash due to change in:				
Net patient accounts receivable		**(9,031)**		3,232
Other receivables		**(2,802)**		(1,246)
Inventories and prepaid expenses		**(643)**		(4,640)
Trading securities		**(123,966)**		(13,368)
Other assets		**(3,632)**		(1,159)
Accrued interest payable		**4,008**		3,989
Accounts payable and accrued expenses		**2,741**		(855)
Accrued salaries, compensated absences and amounts withheld		**11,361**		(2,289)
Estimated amounts due from/to third-party payors, net		**4,658**		3,757
Other long-term liabilities		**2,961**		(201)
Estimated professional liability self-insurance		**151**		(471)
Total adjustments		**(53,176)**		73,954
NET CASH PROVIDED BY OPERATING ACTIVITIES		**33,190**		120,962
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchases of property, plant and equipment, property held for resale and property held for expansion, net		**(172,786)**		(172,240)
Additions to goodwill		**(279)**		-
Net decrease in assets limited as to use		**81,383**		50,362
Purchases of held-to-maturity securities		**(41,060)**		(28,175)
Net distribution from joint ventures and unconsolidated affiliates		**1,057**		1,162
Proceeds from sale of property, plant and equipment and property held for resale		**812**		9,565
NET CASH USED IN INVESTING ACTIVITIES		**(130,873)**		(139,326)

	Year Ended June 30, 2011	2010
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt and capital lease obligations, including deposits to escrow	**(37,735)**	(226,315)
Payment of acquisition and financing costs	**(1,716)**	(3,565)
Proceeds from issuance of long-term debt and other financing arrangements	**5,954**	235,158
Net amounts received on interest rate swap settlements	**5,072**	4,394
Restricted contributions received	**4,350**	3,382
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	**(24,075)**	13,054
NET DECREASE IN CASH AND CASH EQUIVALENTS	**(121,758)**	(5,310)
CASH AND CASH EQUIVALENTS, beginning of year	**234,526**	239,836
CASH AND CASH EQUIVALENTS, end of year	**$ 112,768**	$ 234,526

SUPPLEMENTAL INFORMATION AND NON-CASH TRANSACTIONS:		
Cash paid for interest	**$ 39,507**	$ 38,666
Cash paid for federal and state income taxes	**$ 739**	$ 446
Construction related payables in accounts payable and accrued expenses	**$ 11,384**	$ 14,847
Property purchased through capital lease arrangement	**$ 15,951**	$ -
Increase in receivable from sale of property	**$ -**	$ 1,483
Decrease in land held for expansion related to property exchange transaction	**$ -**	$ 3,432
Land held for expansion placed in use	**$ 4,904**	$ -

During the year ended June 30, 2010, the Alliance refinanced previously issued debt of $184,050.

NOTE A--ORGANIZATION AND OPERATIONS

Mountain States Health Alliance (the Alliance) is a tax-exempt entity with operations primarily located in Washington, Sullivan, and Carter counties of Tennessee and Smyth, Wise, Dickenson, Russell and Washington counties of Virginia. The initial funds for the establishment of the Alliance in 1945 were provided by individuals and various institutions. Membership of the Alliance consists of individuals and institutions who have contributed at least $100 to the capital fund of the Alliance and are entitled to vote at the annual election of the Board of Directors.

The primary operations of the Alliance consist of ten acute and specialty care hospitals, as follows:

- Johnson City Medical Center (JCMC) - licensed for 658 beds
- Smyth County Community Hospital (SCCH) - licensed for 279 beds
- Indian Path Medical Center (IPMC) - licensed for 261 beds
- Norton Community Hospital (NCH) - licensed for 129 beds
- Sycamore Shoals Hospital (SSH) - licensed for 121 beds
- Johnston Memorial Hospital (JMH) - licensed for 116 beds
- Franklin Woods Community Hospital (FWCH) - licensed for 80 beds
- Russell County Medical Center (RCMC) - licensed for 78 beds
- Dickenson Community Hospital (DCH) - licensed for 25 beds
- Johnson County Community Hospital (JCCH) - licensed for 2 beds

FWCH opened in July 2010, replacing operations at North Side Hospital (NSH) and Johnson City Specialty Hospital (JCSH). NSH and JCSH were licensed for 91 beds and 23 beds, respectively, prior to the opening of FWCH and a total of 64 beds were transferred within the Alliance.

The Alliance has a 50.1% interest in JMH. JMH is also the sole member of Abingdon Physician Partners (APP), a non-taxable corporation that owns and manages physician practices.

The Alliance has a 50.1% interest in NCH. NCH is also the sole member or shareholder of DCH and Norton Community Physician Services, LLC (NCPS), a taxable corporation that consists of physician practices and a pharmacy and; Community Home Care (CHC), a taxable corporation that provides home medical equipment.

The Alliance has an 80% interest in SCCH. SCCH is the sole shareholder of Southwest Community Health Services, Inc. (SWCH), a taxable entity that operates a pharmacy and provides other health services.

The activities and accounts of JMH, NCH and SCCH are included in the accompanying consolidated financial statements.

NOTE A--ORGANIZATION AND OPERATIONS - Continued

The Alliance is the sole shareholder of Blue Ridge Medical Management Corporation (BRMM), a for-profit entity that owns and manages physician practices and provides other healthcare services to patients in Tennessee and Virginia. BRMM also operates as a medical office real estate developer by owning, selling and leasing real estate to physician practices and other entities. BRMM is either the sole shareholder, a significant shareholder, or member of the following organizations:

Mountain States Physician Group, Inc. (MSPG): A company that contracts with physicians to provide services to BRMM physician practices.

Mountain States Properties, Inc. (MSPI): An entity that owns and manages certain real estate (primarily medical office buildings) and provides rehabilitation and fitness services. In addition, MSPI is a counter-party to various financing transactions, including interest rate swaps.

Mediserve Medical Equipment of Kingsport, Inc. (Mediserve): A company that provides durable medical equipment services.

Synergy Health Group LLC: An affiliation of member hospitals that work together to maximize cost savings opportunities through aggregated buying power.

Kingsport Ambulatory Surgery Center (KASC) (d.b.a. Kingsport Day Surgery): A joint venture operating as an outpatient surgery center which performs procedures primarily in otolaryngology, orthopedics, ophthalmology, and general surgery. BRMM has a 43% ownership of KASC at June 30, 2011 and 2010; however, BRMM maintains control over KASC through a management agreement. As such, the accounts and activities of KASC are included in the accompanying consolidated financial statements.

Piney Flats Urgent Care (PFUC): A for-profit entity that provides urgent care patient services. BRMM has a 75% ownership of PFUC. The accounts and activities of PFUC are included in the accompanying consolidated financial statements.

The Alliance is the primary beneficiary of the activities of Mountain States Foundation, Inc. (MSF), a not-for-profit foundation formed to coordinate fundraising and development activities of the Alliance. The Alliance is also the beneficiary of the Mountain States Health Alliance Auxiliary (Auxiliary), a not-for-profit organization formed to coordinate volunteer activities of the Alliance. The activities and accounts of MSF and the Auxiliary are included in the accompanying consolidated financial statements.

The Alliance is a majority shareholder of Integrated Solutions Health Network, LLC (ISHN). The primary function of ISHN is to establish, operate and administer a provider-sponsored health care

NOTE A--ORGANIZATION AND OPERATIONS - Continued

delivery network. The accounts and activities of ISHN are included in the accompanying consolidated financial statements.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Alliance and its subsidiaries after elimination of all significant intercompany accounts and transactions. The Alliance classifies those activities directly associated with its mission of providing healthcare services, as well as other activities deemed significant to its operations, as operating activities.

Noncontrolling Interests in Subsidiaries: Noncontrolling interests represent the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent organization. Effective July 1, 2010, the Alliance adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-810, *Consolidation.* ASC 958-810 amends the accounting for, and the financial statement presentation of, noncontrolling interests in a subsidiary within consolidated financial statements. ASC 958-810 requires that a noncontrolling interest in the net assets of a subsidiary be accounted for and reported as net assets and provides revised guidance on the treatment of income and losses attributable to the noncontrolling interest and changes in ownership interests in a subsidiary.

The Alliance adopted ASC 958-810 during 2011 and reclassified $168,410 of noncontrolling interests from minority interest to net assets as of June 30, 2010. These amounts are reflected net of distributions and pension and other defined benefit plan adjustments within net assets in the Consolidated Balance Sheets. The Alliance attributed an Excess of Revenue, Gains and Support over Expenses and Losses of $3,393 and $2,303 for the years ending June 30, 2011 and 2010, respectively, to the noncontrolling interests in JMH, NCH, SCCH, KASC, PFUC and ISHN based on the noncontrolling interests' respective ownership percentage. None of the noncontrolling interests include redemption features.

Use of Estimates: The preparation of the 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 as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents: Cash and cash equivalents include all highly liquid investments with a maturity of three months or less when purchased. Cash and cash equivalents designated as assets

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

limited as to use or uninvested amounts included in investment portfolios are not included as cash and cash equivalents on the Consolidated Balance Sheets.

Investments: Investments as reported in the Consolidated Balance Sheets include trading securities, held-to-maturity securities and assets limited as to use (Note C). FASB ASC 958-320, *Investments – Debt and Equity Securities*, allows not-for-profit organizations to report in a manner similar to business entities by identifying securities as available-for-sale or held-to-maturity and to exclude the unrealized gains and losses on those securities from the Performance Indicator (as defined below). Investments which the Alliance has the positive intent and ability to hold to maturity are considered as held-to-maturity. Substantially all other investments (including assets limited as to use) are considered as trading securities. Management annually evaluates the held-to-maturity investment portfolio and recognizes any "other-than-temporary" losses as deductions from the Performance Indicator. Management's evaluation considers the amount of decline in fair value, as well as the time period of any such decline. Management does not believe any investment classified as held-to-maturity is other-than-temporarily impaired at June 30, 2011.

Within the trading securities portfolio, all debt securities and marketable equity securities with readily determinable fair values are reported at fair value based on quoted market prices. Investments without readily determinable fair values are reported at estimated fair market value pursuant to FASB ASC 825, *Financial Instruments*. Guaranteed investment contracts are reported at contract value.

Realized gains and losses on trading securities and assets limited as to use are computed using the specific identification method for cost determination. Interest and dividend income is reported net of related investment fees.

Investments in joint ventures are reported under the equity method of accounting, which approximates the Alliance's equity in the underlying net book value, unless the ownership structure requires consolidation. Other assets include investments in joint ventures of $2,367 and $2,418 at June 30, 2011 and 2010, respectively.

Inventories: Inventories, consisting primarily of medical supplies, are stated at the lower of cost or market.

Property, Plant and Equipment: Property, plant and equipment is stated on the basis of cost, or if donated, at the fair value at the date of gift. Generally, depreciation is computed by the straight-line method over the estimated useful life of the asset. Equipment held under capital lease obligations is amortized under the straight-line method over the shorter of the lease term or estimated useful life.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Amortization of building and equipment held under capital lease is shown as a part of depreciation expense and accumulated depreciation in the accompanying consolidated financial statements.

Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

The Alliance reviews capital assets for indications of potential impairment when there are changes in circumstances related to a specific asset. If this review indicates that the carrying value of these assets may not be recoverable, the Alliance estimates future cash flows from operations and the eventual disposition of such assets. If the sum of these undiscounted future cash flows is less than the carrying amount of the asset, a write-down to estimated fair value is recorded. The Alliance did not recognize any impairment losses during 2011 and 2010.

Other assets include property held for resale and property held for expansion of $4,230 and $9,135, respectively, at June 30, 2011 and 2010. During 2011, property held for expansion totaling approximately $4,905 was transferred to property, plant and equipment in conjunction with the construction of FWCH. Property held for resale and property held for expansion primarily represent land contributed to, or purchased by, the Alliance plus costs incurred to develop the infrastructure of such land. Management annually evaluates its investment and records non-temporary declines in value when it is determined the ultimate net realizable value is less than the recorded amount. No such declines were identified in 2011 and 2010.

Goodwill: Goodwill represents the difference between the acquisition cost of assets and the estimated fair value of net tangible and any separately identified intangible assets. Prior to July 1, 2010, the Alliance amortized goodwill associated with its not-for-profit subsidiaries under the straight-line method over various estimated useful lives ranging from 10 to 25 years. However, effective July 1, 2010, ASC 958-805, *Not-for-Profit Entities*, requires the not-for-profit entities within the Alliance to cease amortization of goodwill, perform a transitional impairment test and perform annual impairment testing in the future.

As a result of its transitional impairment testing as of July 1, 2010, management determined that approximately $2,965 of goodwill associated with one of its reporting units was impaired, and such impairment has been reflected as the Cumulative Effect of a Change in Accounting Principle in the 2011 Consolidated Statement of Changes in Net Assets. Based upon this transitional testing, management does not believe any remaining goodwill acquired by its not-for-profit entities to be

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

impaired. The reporting unit for evaluation of substantially all such goodwill is the Alliance's aggregate acute-care operations.

For goodwill acquired by its for-profit subsidiaries, the Alliance does not amortize goodwill and annually performs impairment testing. Based upon this annual impairment testing, management has determined that there is no impairment related to goodwill associated with its for-profit subsidiaries.

Deferred Financing, Acquisition Costs and Other Charges: Other assets, including deferred financing, acquisition costs and other charges, total $29,844 and $30,819 at June 30, 2011 and 2010, respectively. Deferred financing costs are amortized over the life of the respective bond issue principally using the average bonds outstanding method. Other intangible assets include licenses and similar assets and are being amortized over the intangible's estimated useful life under the straight-line method.

Prior to 2009, the Alliance routinely financed interest rate swap and other derivative transaction issuance costs through modification of future settlement terms. As such, the unamortized issuance costs of these derivatives are included as deferred financing costs in the accompanying Consolidated Balance Sheets and are being amortized over the term of the respective derivative instrument. The unpaid issuance costs are included as a part of the estimated fair value of derivatives in the accompanying Consolidated Balance Sheets. Beginning in 2009, interest rate swap and derivative transaction issuance costs are expensed as incurred.

Derivative Financial Instruments: As further described in Note D, the Alliance is a party to interest rate swap and other derivative agreements. These financial instruments are not designated as hedges and have been presented at estimated fair market value in the accompanying Consolidated Balance Sheets as either current or long-term liabilities, based upon the remaining term of the instrument. Changes in the estimated fair value of these derivatives are included in the Consolidated Statements of Operations as part of nonoperating gains (losses). Net settlements and other related income of derivatives are also reflected as a part of the Performance Indicator (described below).

These fair values are based on the estimated amount the Alliance would receive, or be required to pay, to enter into equivalent agreements at the valuation date. The fair value of various derivatives are netted on the Consolidated Balance Sheets based on management's evaluation of the settlement provisions in the master contract. Gross positions of these derivatives are disclosed in Note D. Due to the nature of these financial instruments, such estimates of fair value are subject to significant change in the near term.

Estimated Professional Liability Self-Insurance and Other Long-Term Liabilities: Self-insurance liabilities include estimated reserves for reported and unreported professional liability claims (Note G) and are recorded at the estimated net present value of such claims. Other long-term liabilities include contributions payable and obligations under deferred compensation arrangements, a defined

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

benefit pension plan, a post-retirement employee benefit plan as well as other liabilities which management estimates are not payable within one year.

Net Patient Service Revenue/Receivables: Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts, 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 adjusted in future periods as final settlements are determined. The Alliance's revenue recognition policies related to self-pay and other types of payors emphasize revenue recognition only when collections are reasonably assured.

Patient accounts receivable are reported net of both an estimated allowance for uncollectible accounts and an estimated allowance for contractual adjustments. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, Medicaid, TennCare and other third-party payment programs. Current operations include a provision for bad debts in the Consolidated Statements of Operations estimated based upon the age of the patient accounts receivable, prior experience and any unusual circumstances (such as local, regional or national economic conditions) which affect the collectibility of receivables, including management's assumptions about conditions it expects to exist and courses of action it expects to take.

The Alliance's policy does not require collateral or other security for patient accounts receivable. The Alliance routinely accepts assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans or policies.

Charity Care: The Alliance accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the Alliance and various guidelines outlined by the Federal Government. These policies define charity as those services for which no payment is anticipated and, as such, charges at established rates are not included in net patient service revenue.

In addition to the charity care services described above, the Alliance provides a number of other services to benefit the poor for which little or no payment is received. Medicare, Medicaid, TennCare and State indigent programs do not cover the full cost of providing care to beneficiaries of those programs. The Alliance also provides services to the community at large for which it receives little or no payment.

Excess of Revenue, Gains and Support Over Expenses and Losses: The Consolidated Statements of Operations and the Consolidated Statements of Changes in Net Assets includes the caption *Excess of*

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Revenue, Gains and Support Over Expenses and Losses (the Performance Indicator). Changes in unrestricted net assets which are excluded from the Performance Indicator, consistent with industry practice, include contributions of long-lived assets or amounts restricted to the purchase of long-lived assets, pension and related adjustments, and distributions to, or contributions from, owners and transactions with noncontrolling interests.

Income Taxes: The Alliance is classified as an organization exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. As such, no provision for income taxes has been made in the accompanying consolidated financial statements for the Alliance and its tax-exempt subsidiaries. Taxable entities account for income taxes in accordance with FASB ASC 740, *Income Taxes* (Note L). The Alliance has no significant uncertain tax positions at June 30, 2011 and 2010.

Temporarily and Permanently Restricted Net Assets: Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. When a donor or time restriction expires; that is, when a stipulated time restriction ends or purpose restriction is fulfilled, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the Consolidated Statements of Operations and Consolidated Statements of Changes in Net Assets as net assets released from restrictions. Permanently restricted net assets have been restricted by donors to be maintained by the Alliance in perpetuity.

Fair Value Measurement: The Alliance had previously adopted FASB ASC 820, *Fair Value Measurements and Disclosures,* which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements.

In January 2010, the FASB issued ASU 2010-06, *Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 requires new disclosures regarding significant transfers in and out of Levels 1 and 2, as well as information about activity in Level 3 fair value measurements, including presenting information about purchases, sales, issuances and settlements on a gross versus a net basis in the Level 3 activity roll forward. In addition, ASU 2010-06 clarifies existing disclosures regarding input and valuation techniques, as well as the level of disaggregation for each class of assets and liabilities. The Alliance adopted ASU 2010-06 in 2011, except for the disclosures related to purchases, sales, issuance and settlements, which will be effective for the Alliance beginning July 1, 2012. The adoption of ASU 2010-06 did not, and is not expected to, have an impact on the Alliance's consolidated financial statements.

Subsequent Events: The Alliance evaluated all events or transactions that occurred after June 30, 2011, through October 26, 2011, the date the consolidated financial statements were available to be

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

issued. During this period management did not note any material recognizable subsequent events that required recognition or disclosure in the June 30, 2011 consolidated financial statements, other than as discussed in Notes D, F and S.

New Accounting Pronouncements: In August 2010, the FASB issued Accounting Standards Update (ASU) 2010-23, *Health Care Entities – Measuring Charity Care for Disclosure.* ASU 2010-23 is intended to reduce the diversity in practice regarding the measurement basis used in the disclosure of charity care. ASU 2010-23 requires that cost, identified as the direct and indirect costs of providing the charity care, be used as the measurement basis for disclosure purposes. ASU 2010-23 also requires disclosure of the method used to identify or determine such costs. The Hospital will adopt ASU 2010-23 in fiscal year 2012. Management does not expect the adoption of ASU 2010-23 to have a material impact on the consolidated financial statements.

In August 2010, the FASB issued ASU 2010-24, *Health Care Entities – Presentation of Insurance Claims and Related Insurance Recoveries.* The amendments in the ASU clarify that a health care entity may not net insurance recoveries against related claim liabilities. In addition, the amount of the claim liability must be determined without consideration of insurance recoveries. ASU 2010-24 is effective for the Alliance beginning July 1, 2011 and management is currently evaluating the impact of this ASU on the consolidated financial statements.

In July 2011, the FASB issued ASU 2011-07, *Healthcare Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and Allowance for Doubtful Accounts for Certain Healthcare Entities*, which will require certain healthcare entities to reclassify the provision for bad debts associated with providing patient care from an operating expense to a deduction from net patient service revenue in the Consolidated Statements of Operations. Additionally, ASU 2011-07 requires enhanced disclosures about an entity's policies for recognizing revenue and assessing bad debts and qualitative and quantitative information about changes in the allowance for doubtful accounts. The Alliance intends to adopt ASU 2011-07 in fiscal year 2013. Management does not expect the adoption of ASU 2011-07 to have a material impact on the consolidated financial statements.

Reclassifications: Certain 2010 amounts have been reclassified to conform with the 2011 presentation in the accompanying consolidated financial statements.

NOTE C--INVESTMENTS

Assets limited as to use are summarized by designation or restriction as follows at June 30:

(Dollars in Thousands)

NOTE C--INVESTMENTS - Continued

	2011	2010
Designated or restricted:		
Under safekeeping agreements	$ 28,349	$ 52,050
Under guarantee agreements	92,720	89,486
By Board for capital improvements	4	2,776
Under bond indenture agreements:		
For debt service and interest payments	67,874	78,612
For capital acquisitions	28,835	76,241
	217,782	299,165
Less: amount required to meet current obligations	(116,175)	(25,092)
	$ 101,607	$ 274,073

Assets limited as to use consist of the following at June 30:

	2011	2010
Cash, cash equivalents and money market funds	$ 115,579	$ 170,897
U.S. Government securities	1,795	1,795
U.S. Agency securities	7,688	12,319
Guaranteed investment contracts	92,720	114,154
	$ 217,782	$ 299,165

Trading securities consist of the following at June 30:

	2011	2010
Cash, cash equivalents and money market funds	$ 29,159	$ 4,799
U.S. Government securities	9,409	3,137
U.S. Agency securities	31,551	13,760
Corporate and foreign bonds	126,543	11,688
Municipal obligations	451	1,461
Preferred and asset backed securities	8,945	7,023
U.S. equity securities	94,834	139,168
Other	32,718	28,608
	$ 333,610	$ 209,644

(Dollars in Thousands)

NOTE C--INVESTMENTS - Continued

Held-to-Maturity securities are carried at amortized cost and consist of the following at June 30:

	2011	2010
Cash, cash equivalents and money market funds	$ 753	$ 1,131
Corporate and foreign bonds	135,745	103,968
Municipal obligations	9,661	1,315
	$ 146,159	$ 106,414

Held-to-maturity securities had gross unrealized gains and losses of $6,838 and $276, respectively, at June 30, 2011 and $5,525 and $607, respectively at June 30, 2010. At June 30, 2011, the Alliance held nine securities within the held-to-maturity portfolio with a fair value and unrealized loss of $549 and $44, respectively, which had been at an unrealized loss position for over one year. At June 30, 2010, the Alliance held one security within the held-to-maturity portfolio with a fair value and unrealized loss of $591 and $166, respectively, which had been at an unrealized loss position for over one year. At June 30, 2011, the contractual maturities of held-to-maturity securities were $13,816 due in one year or less, $55,563 due from one to five years and $76,780 due after five years. At June 30, 2010, the contractual maturities of held-to-maturity securities were $13,389 due in one year or less, $48,447 due from one to five years and $44,578 due after five years.

At June 30, 2011 and 2010, the Alliance held investments in certain limited partnerships and hedge funds of $32,718 and $28,608, respectively, that have a wide range of investment strategies with various levels of risk. These funds are included within trading securities and do not have readily determinable fair values. The funds are reported at estimated fair market value pursuant to FASB ASC 825, *Financial Instruments.*

The Alliance has investments in several joint ventures and corporations which are accounted for under the equity method of accounting.

As a part of the acquisition of membership interests in JMH, SCCH and NCH, the Alliance has committed to invest $132,000, $48,100, and $45,000, respectively. Cumulative amounts expended at June 30, 2011 under these commitments are approximately $150,184.

NOTE D--DERIVATIVE TRANSACTIONS

The Alliance is a party to a number of derivative transactions. These derivatives have not been designated as hedges and are valued at estimated fair value in the accompanying Consolidated Balance Sheets. Management's primary objective in holding such derivatives is to introduce a variable rate component into its fixed rate debt structure. Under the terms of these agreements, changes in the interest rate environment could have a significant effect on the Alliance.

(Dollars in Thousands)

NOTE D--DERIVATIVE TRANSACTIONS - Continued

These derivative agreements require that the Alliance post additional collateral for the derivatives' fair market value deficits above specified levels. Such investments are included as assets limited as to use. As of June 30, 2011, management believes the Alliance was fully collateralized with respect to the derivative agreements and management does not believe such collateral is exposed to third-party credit risk. Further, certain of the agreements contain requirements regarding maintenance of financial and liquidity ratios. Management has represented the Alliance is in compliance with all such covenants at June 30, 2011.

Interest Rate Swaps: The Alliance is a party to six interest rate swap agreements with Merrill Lynch as the counterparty. The terms of five of these agreements were modified without settlement during 2011 and no gain or loss was realized. However, such modifications did impact the estimated fair value of these interest rate swaps. A liability, representing the estimated net fair value of these swaps, of $8,123 and $33,910 was recognized by the Alliance as of June 30, 2011 and 2010, respectively.

The following is a summary of five of these interest rate swap agreements at June 30, 2011:

			Payments by:		
Swap	*Notional Amount*	*Term*	*Counterparty*	*Alliance*	*Estimated Fair Value*
A	$ 170,000	4/2008-4/2026	1.265% through April 2013; 1.07% through April 2014; then 71.10% of USD-ISDA Swap Rate	0.00% through April 2014, then USD-SIFMA Municipal Swap Index	$ 3,028
B	95,000	4/2008-4/2026	1.265% through April 2013; 1.08% through April 2014; then 71.18% of USD-ISDA Swap Rate	0.00% through April 2014, then USD-SIFMA Municipal Swap Index	1,729
C	173,030	4/2008-4/2034	1.315% through April 2013; 1.12% through April 2014; then 72.35% of USD-ISDA Swap Rate	0.00% through April 2014, then USD-SIFMA Municipal Swap Index	741
D	82,055	12/2007-7/2033	1) 3.493% through July 2012; then 0% 2) USD-LIBOR-BBA through July 2012, then 67% USD-LIBOR-BBA	1) 4.41% through July 2012; then .312% 2) USD-SIFMA	(9,363)
E	50,000	2/2008-7/2038	67.00% of USD-LIBOR-BBA plus .145%	USD-SIFMA	(3,918)

Deferred financing and acquisition costs, net of amortization, include $6,480 and $6,823 at June 30, 2011 and 2010, respectively, related to these swaps.

NOTE D--DERIVATIVE TRANSACTIONS - Continued

In addition to the swaps described above, the Alliance and Merrill Lynch are also parties to a total return swap in the notional amount of $23,100 which has an estimated fair value of $(340) and $(252) at June 30, 2011 and 2010, respectively . The agreement consists of the following:

- An agreement that requires the Alliance to pay a variable rate of USD-SIFMA Municipal Swap Index through July 1, 2012 (or termination of the swap) on a notional amount equal to the outstanding 2001A Hospital Revenue and Improvement Bonds (the 2001A Reference Bonds). The Alliance receives a fixed rate of 6.25% of the outstanding 2001A Reference Bonds.

- A "total return provision" under which the Alliance will pay (or receive) an amount equal to the product of the outstanding 2001A Reference Bonds multiplied by the difference between the outstanding 2001A Reference Bonds and the 2001A Reference Bonds' market price at termination, as defined in the agreement. In the event the swap does not terminate prior to July 1, 2012, there would be no settlement of this component as there would be no outstanding 2001A Reference Bonds.

The Alliance is also party to a total return swap with Lehman Brothers as the counterparty. Lehman Brothers filed for bankruptcy in September 2008. The Alliance subsequently received notification from Lehman Brothers Special Financing, Inc. indicating the intent of the counterparty to terminate this agreement effective January 1, 2009. The Alliance and Lehman Brothers Special Financing, Inc. have been unable to reach a settlement agreement. In September 2010, the Alliance was issued a subpoena to furnish certain documentation related to the transaction. A protocol has been put into place by the bankruptcy court whereby the parties are to undergo alternate dispute resolution, including non-binding arbitration, which management anticipates will occur in 2012.

The fair value of these swaps is undeterminable at January 1, 2009, as prior to the termination date Lehman Brothers liquidated the underlying referenced securities, making a valuation not commercially viable. An estimated liability of $10,565 and $10,740 was recognized by the Alliance as of June 30, 2011 and 2010, respectively. Management believes that the liability as recorded at June 30, 2011 is sufficient to cover any exposure arising from litigation in this matter. However, it is reasonably possible management's estimate may change in the near term, although the amount of any change cannot be estimated. Due to the termination of this agreement, the estimated liability is included as a current liability in the accompanying Consolidated Balance Sheets.

A third party holds collateral with a fair market value of approximately $13,381 and $13,570, respectively, at June 30, 2011 and 2010, with respect to these Lehman derivative agreements. Such collateral is included as current assets limited as to use.

NOTE D--DERIVATIVE TRANSACTIONS - Continued

The arrangement consists of nine agreements each with three separate components (described below) with notional values of $23,600, $8,000, and $8,750 each. The swaps generally consist of the following:

- An arrangement that calls for the Alliance to pay a variable rate (SIFMA Municipal Swap Index) plus certain fixed payment amounts and receive a payment equal to the interest paid by the Alliance on a portion of its early extinguished, but still outstanding, 2000A and 2000B Hospital Mortgage Revenue Refunding Bonds (the Reference Bonds) (whose fixed rates range from 7.50% to 7.75%).

- An arrangement that requires the Alliance to pay a fixed rate of 4.211% through either July 1, 2025, 2029 or 2033 (or termination of the swap) on the outstanding Reference Bonds and receive a variable rate of 67% of USD-LIBOR-BBA on the outstanding Reference Bonds; and

- A "total return provision" under which the Alliance will pay (or receive) the difference between the outstanding Reference Bonds, multiplied by 132%, less the fair value of the Reference Bonds on the date of termination and any fixed interest payments made under the arrangements described above. In the event the swaps do not terminate prior to their stated termination dates (2025, 2029 or 2033), there would be no settlement of this component as there would be no outstanding Reference Bonds.

The swap also contains an agreement that consists of two separate components:

- An arrangement that requires the Alliance to pay a fixed rate of 2.98% through July 1, 2016 (or termination of the swap) on the outstanding, but previously defeased, 1991 Hospital Revenue and Improvement Bonds (the 1991 Reference Bonds) and receive a variable rate of 67% of USD-LIBOR-BBA on the outstanding 1991 Reference Bonds; and

- A "fixed payor provision" under which the Alliance will pay (or receive) the difference between the outstanding 1991 Reference Bonds multiplied by 100% and any fixed interest payments made as required under the agreement minus the outstanding 1991 Reference Bonds multiplied by the average market price at termination. In the event the swaps do not terminate prior to their stated termination date (2016), there would be no settlement of this component as there would be no outstanding 1991 Reference Bonds.

Interest Rate Swap Option: In June 2004, the Alliance entered into an agreement with Bear Stearns (acquired by JP Morgan) whereby Bear Stearns has purchased from the Alliance an option to enter

(Dollars in Thousands)

NOTE D--DERIVATIVE TRANSACTIONS - Continued

into an interest rate swap agreement (swaption) with the Alliance on July 1, 2011, which is an optional redemption date related to the Alliance's early extinguished 2000A and 2000B Bonds (Note F). The purpose of this agreement was to effectively sell the call features related to the early extinguished Series 2000A and 2000B Bonds. As consideration under this agreement, the Alliance received a total of $42,500 in upfront payments as the swaption premium. Such amounts were initially recorded as estimated fair value of derivatives in the Consolidated Balance Sheets. Beginning 30 calendar days prior to July 1, 2011 and terminating 30 calendar days prior to July 1, 2015, the counterparty has the periodic right to exercise the swaption.

The underlying interest rate swap transactions to which the swaption transaction relates have the following terms:

	Notional		*Payments by:*	
Swap	*Amount*	*Term*	*Counterparty*	*Alliance*
2000A	Ranging from $148,170 through July 1, 2018 to $23,000 through July 2033	30 days following the exercise date through July 2033	64% of USD-LIBOR-BBA	Fixed amounts ranging from 7.13% upon execution to 7.50% through July 2033, based on notional amount
2000B	Ranging from $76,240 through July 1, 2021 to $8,800 through July 2033	30 days following the exercise date through July 2033	64% of USD-LIBOR-BBA	Fixed amounts ranging from 7.54% upon execution to 8.00% through July 2033, based on notional amount

The Alliance retained the right to terminate the swaption at any time prior to May 17, 2011 at its fair market value. A liability of $92,044 and $89,650, representing the estimated fair value of the swaption at June 30, 2011 and 2010, respectively, is included in estimated fair value of derivatives in the accompanying Consolidated Balance Sheets. As a derivative financial instrument, this swaption is extremely sensitive to changes in long-term interest rates and other elements in the financial marketplace. As such, estimates of fair value are subject to significant changes in the near term.

Deferred financing and acquisition costs include $0 and $434 at June 30, 2011 and 2010, respectively, related to the costs of this transaction. The change in estimated fair value of derivatives in the accompanying Statements of Operations for 2011 and 2010 includes an unrealized loss of $2,394 and $11,628, respectively, related to this derivative.

The interest rate swap option, described above, was terminated on October 13, 2011. To effectuate this termination, the Alliance transferred a portion of a Guaranteed Investment Contract (GIC), described below, to the third party as a termination payment. A gain of approximately $3,000 was recognized on this termination.

NOTE D--DERIVATIVE TRANSACTIONS - Continued

Forward Sale Agreements: In June 2004, the Alliance entered into two related forward sale agreements with the counterparty to the swaption agreements and the Master Trustee of the Series 2000 Bonds. The forward sale agreements originally related to the Debt Service Reserve Fund and to the Debt Service Fund, respectively, (collectively, the "Funds"), as established under provisions of the Master Trust Indenture related to the issuance of the Series 2000 Bonds. In consideration of the future earnings on the Funds, the counterparty paid the Master Trustee a total of $30,000 during 2005, to be held on behalf of the Alliance. In June 2006, one of these agreements was amended to also relate to the Series 2000C, 2000D, 2006A and 2006B Bonds, and to remove the Series 2000A Bonds from consideration under the agreement. As the original intent of these Funds was to secure debt service payments under the above referenced Bonds, the agreement requires these funds to be held under a guaranty agreement as further described below.

In connection with the issuance of the Series 2007 Bonds and the derecognition of a portion of the Series 2000A Bonds, all of the outstanding Series 2000B Bonds, and all of the outstanding 2006B Bonds (Note F), one of these agreements as it relates to the Series 2000A and 2000B Bonds was partially terminated. As such, during 2008 the Alliance reduced its liability with respect to the portion related to the Series 2000A and 2000B Bonds, and paid the counterparty $6,186 under the terms of the agreement. The agreement was amended in fiscal year 2011 to include the Series 2010A Bonds and to remove the Series 2000B and 2006B Bonds.

A liability of $19,001 and $19,864 representing the unamortized payments from the counterparty is included as part of deferred revenue in the accompanying Consolidated Balance Sheets as of June 30, 2011 and 2010, respectively. Amounts are being recognized as investment income over the life of the agreements.

Pursuant to these agreements, the counterparty required that the Alliance's obligations under the swaption and forward sale agreements be collateralized under a guarantee agreement in favor of the counterparty. Due to various requirements of the Master Trust Indenture, the Alliance transferred to MSF a total of $42,500 that was in turn deposited with the counterparty as collateral in a GIC. Amounts received under the forward sale agreements were also deposited into the GIC. All GIC deposits earn interest compounded at 4.14% for the first year, and at 3.5% thereafter through July 1, 2011. The GIC deposits as of June 30, 2011 and 2010 totaled $92,720 and $89,486, respectively. The GIC was substantially utilized on October 13, 2011 to terminate the interest rate swap option agreement discussed above and, as such, is included in the current portion of assets whose use is limited in the Consolidated Balance Sheet at June 30, 2011.

NOTE E--PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following at June 30:

(Dollars in Thousands)

NOTE E--PROPERTY, PLANT AND EQUIPMENT - Continued

	2011	2010
Land	$ 63,749	$ 58,037
Buildings and leasehold improvements	454,852	407,104
Property and improvements held for leasing	80,568	84,421
Equipment	532,767	479,523
Buildings and equipment held under capital lease	42,720	22,679
	1,174,656	1,051,764
Less: Allowances for depreciation and amortization	(586,471)	(569,913)
	588,185	481,851
Construction in progress (Note N)	209,233	213,747
	$ 797,418	$ 695,598

Accumulated depreciation and amortization on property and improvements held for leasing purposes is $23,348 and $21,543 at June 30, 2011 and 2010, respectively. Net interest capitalized was $10,640 and $11,117 for the years ended June 30, 2011 and 2010, respectively.

The Alliance is constructing replacement facilities for SCCH and JMH and is also performing various renovations on existing hospital facilities. During 2011 and 2010, management of the Alliance assessed the planned current and future use of the existing NSH, SCCH and JMH facilities as well as certain other facilities, and adjusted their estimated useful lives accordingly.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS

Long-term debt and capital lease obligations consist of the following at June 30:

Description	Maturities	Rates	Outstanding Balance 2011	Outstanding Balance 2010
2010A Hospital Revenue Bonds, net of unamortized premium of $1,056 and $1,096 at June 30, 2011 and 2010, respectively	$38,660 uninsured serially, through 2020	3.00% to 5.00%	$ 169,137	$ 169,176
	$14,985 uninsured term bonds, due July 1, 2025	5.38%		
	$19,385 uninsured term bonds, due July 1, 2030	5.63%		
	$39,570 uninsured term bonds, due July 1, 2038	6.50%		
	$55,480 uninsured term bonds, due July 1, 2038	6.00%		
2010B Hospital Revenue Bonds, net of unamortized premium of $711 and $753 at June 30, 2011 and 2010, respectively	$27,330 uninsured serially, through 2020	2.50% to 5.00%	36,646	36,688
	$4,355 uninsured term bonds, due July 1, 2023	5.00%		
	$4,250 uninsured term bonds, due July 1, 2028	5.50%		
2009A Hospital Revenue Bonds, net of unamortized discount of $121 and $126 at June 30, 2011 and 2010, respectively	$725 uninsured term bonds, due July 1, 2019	7.25%	5,439	5,434
	$1,730 uninsured term bonds, due July 1, 2029	7.50%		
	$3,105 uninsured term bonds, due July 1, 2038	7.75%		

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Description	Maturities	Rates	Outstanding Balance 2011	Outstanding Balance 2010
2009B Hospital Revenue Bonds	$5,535 uninsured term bonds, due July 1, 2038	8.00%	5,535	5,535
2009C Hospital Revenue Bonds, net of unamortized discount of $2,421 and $2,508 at June 30, 2011 and 2010, respectively	$21,100 uninsured term bonds, due July 1, 2019 $20,000 uninsured term bonds, due July 1, 2029 $74,855 uninsured term bonds, due July 1, 2038	7.25% 7.50% 7.75%	113,534	113,447
2008A Hospital Revenue Bonds	$13,245 uninsured term bonds, due July 1, 2038, subject to early redemption or tender	Variable, 0.07% at June 30, 2011	13,245	13,245
2008B Hospital Revenue Bonds	$53,855 uninsured term bonds, due July 1, 2038, subject to early redemption or tender	Variable, 0.07% at June 30, 2011	53,855	54,050
2007A Hospital Revenue Bonds	Uninsured term bonds, due July 1, 2038, redeemed in 2011	NA	-	4,305
2007B Taxable Hospital Revenue Bonds, bifurcated into sub-series B-1, B-2 and B-3 during 2011	$307,900 uninsured term bonds, due July 1, 2033, subject to early redemption or tender	Variable, 0.11% to 0.16% at June 30, 2011	307,900	314,190
2007C Hospital Revenue Bonds	Uninsured term bonds, due July 1, 2032, redeemed in 2011	NA	-	1,900
2006A Hospital First Mortgage Revenue Bonds, net of unamortized premium of $147 and $153 at June 30, 2011 and 2010, respectively	$6,580 uninsured serially, through 2019 $7,375 uninsured term bonds, due July 1, 2026 $20,505 uninsured term bonds, due July 1, 2031 $135,175 uninsured term bonds, due July 1, 2036	5.00% 5.25% 5.50% 5.50%	169,782	170,473
2001A Hospital First Mortgage Revenue Bonds	$23,100 term bonds, due July 1, 2026, subject to early redemption or tender	6.85%	23,100	23,900
2001 Hospital Refunding and Improvement Revenue Bonds (NCH), net of unamortized discount of $34 and $38 at June 30, 2011 and 2010, respectively	$1,465 insured term bonds, due December 1, 2012 $1,635 insured term bonds, due December 1, 2014 $8,815 insured term bonds, due December 1, 2022	5.75% 6.00% 6.00%	11,876	12,547
2000A Hospital First Mortgage Revenue Refunding Bonds	$30,358 insured Capital Appreciation Bonds, interest and principal due July 1, 2026 through 2030	6.63%	30,358	28,417
2000C Hospital First Mortgage Revenue Bonds	$34,325 insured term bonds, due July 1, 2026	8.50%	34,325	35,335
2000D First Mortgage Taxable Bonds	$14,790 insured term bonds, due July 1, 2026	8.50%	14,790	15,225
1998 Hospital Refunding and Improvement Revenue Bonds (JMH)	$6,495 uninsured term bonds, due July 1, 2016 $7,620 uninsured term bonds, due July 1, 2028	5.25% 5.38%	14,115	15,240
Capitalized lease obligations secured by buildings and equipment	Maturing through 2027	3.18% to 13.01%	16,153	16,715
$7,500 promissory note secured by assets of Mediserve Medical Equipment of Kingsport, Inc.	Monthly principal and interest payments of $56 beginning February 2007 maturing December 2011; remaining principal due January 2012	LIBOR + 1.10%	5,473	6,064
Capitalized lease obligations secured by equipment	Various monthly payments of monthly principal and interest	Various	587	1,325
Master installment payment agreement	Paid-off in 2011	Unspecified	-	2,194
$1,409 unsecured promissory note	Monthly principal and interest payments of $23 beginning July 2008 through September 2013; remaining principal and accrued interest due October 2014; note was paid-off in 2011	LIBOR + 1.25%	-	920
$10,221 note payable secured by property	Various annual principal and interest payments through April 2013; note was paid-off in 2011	6.25%	-	7,836
$1,065 note payable secured by land	Monthly interest-only payments through October 2011; remaining principal and accrued interest due November 2011	5.50%	572	1,065
$6,332 promissory note secured by substantially all assets of the Alliance	Monthly principal payments of $35 plus accrued interest beginning July 2010 maturing June 2015; remaining principal due July 2015	LIBOR + 2.00%	5,945	6,332
$3,955 note payable secured by property	Monthly principal and interest payments of $27 beginning July 2010 maturing May 2015; remaining principal due June 2015	3.00%	3,743	3,955

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

			Outstanding Balance	
Description	Maturities	Rates	2011	2010
Note payable under Master Financing Agreement, secured by Equipment	Monthly principal and interest payments of $166 beginning July 2010 maturing June 2017	4.62%	10,431	11,900
Note payable under Master Financing Agreement, secured by Equipment	Monthly principal and interest payments of $56 beginning July 2010 maturing June 2017	3.75%	3,580	4,100
$4,926 convertible construction loan secured by property and assigned rents	Monthly interest-only payments through January 2011 followed by monthly principal and interest payments of $25 maturing December 2014; remaining principal and accrued interest due January 2015; note was paid-off in 2011	Prime (stated minimum and maximum interest rates of 3.75% and 6.75%, respectively)	-	1,195
$1,885 line of credit secured by property	Monthly interest-only payments through March 2011 followed by monthly principal and interest payments of $9 maturing February 2015; remaining principal and accrued interest due March 2015	Prime - 0.50% (stated minimum and maximum interest rates of 3.50% and 6.25%, respectively)	1,873	265
$1,593 note payable, secured by equipment	Various annual principal payments through July 2014	Unspecified	1,593	-
Capitalized lease obligation secured by medical office building (JMH)	Maturing through 2026	9.72%	15,498	-
			1,069,085	1,082,973
	Less current portion		(28,162)	(28,131)
			$ 1,040,923	$ 1,054,842

In September 2010, in order to reduce credit risk and expenses, the Alliance replaced the existing letters of credit related to the Series 2007B, Series 2008A and Series 2008B Bonds with letters of credit held by several different financial institutions. The substitute letters of credit entitle the Master Trustee to draw amounts equal to the principal amounts of the respective series of Bonds outstanding and up to 37 days interest at a rate of 12%. The substitute letters of credit expire on September 29, 2013 unless renewed or replaced.

Series 2010 Bonds: In April 2010, the Alliance issued $168,080 (Series 2010A) and $35,935 Series 2010B fixed rate Hospital Refunding Revenue Bonds (collectively, the Series 2010 Bonds). Proceeds of the Series 2010A and the Series 2010B Bonds were used to refinance outstanding indebtedness, specifically related to the Alliance's facilities in Tennessee and in Virginia, respectively, fund debt service reserve funds and pay costs of issuance. The Alliance recognized a $3,029 loss on early extinguishment of debt representing the write off of previously deferred and unamortized financing costs related to the refinanced Series 2008A and the Series 2007A and 2007C debt issues discussed below.

Series 2009 Bonds

In March 2009, the Alliance issued $5,560 (Series 2009A), $5,535 (Series 2009B) and $115,955 (Series 2009C) fixed rate Hospital Revenue Bonds (collectively, the Series 2009 Bonds). The proceeds of Series 2009 Bonds were used to refinance a portion of the outstanding Series 2006C Taxable Notes, which were originally issued to finance a capital commitment to SCCH and purchase certain leased assets, finance the acquisition of a majority ownership in JMH, fund a debt service

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

reserve fund and pay costs of issuance. The portion of the 2006C taxable notes which were not refinanced with the Series 2009 Bonds were repaid with cash on hand.

In connection with its acquisition of a majority ownership in JMH, the Alliance assumed the then outstanding long-term debt of JMH, totaling $33,906, including the JMH Series 1998 Hospital Refunding and Improvement Revenue Bonds as further described in the table above.

Series 2008 Bonds

In February 2008, the Alliance issued $72,770 (Series 2008A) and $54,230 (Series 2008B) variable rate Hospital Revenue Bonds (collectively, the Series 2008 Bonds). The proceeds of Series 2008 Bonds were primarily used to finance certain future capital projects for the Alliance's hospital facilities and for the repayment of previously issued 2008 Taxable Notes used for the acquisition of RCMC. As discussed above, the payment of principal and interest on the Series 2008 Bonds and the purchase price of any tendered bonds on each series are secured by a separate, irrevocable, transferable, direct-pay letter of credit. A portion ($59,525) of the Series 2008A Bonds were repaid from proceeds of the Series 2010 Bonds.

The variable rate of interest on the Series 2008 Bonds is determined weekly by the Remarketing Agent (Merrill Lynch), as the rate equal to the lowest rate which, in regard to general financial conditions and other special conditions bearing on the rate, would produce as nearly as possible a par bid for the Series 2008 Bonds in the secondary market. In no event shall the variable rate on the Series 2008 Bonds during any period where interest is calculated weekly exceed the lesser of 12% annually or the maximum contract rate of interest permitted by the State of Tennessee for the Series 2008A Bonds or the Commonwealth of Virginia for the Series 2008B Bonds. The Alliance has the option, upon written approval of the holder of the letters of credit, the Remarketing Agent and others, to convert to a medium-term rate period or to a fixed rate.

The Series 2008 Bonds are subject to optional and mandatory tender for purchase prior to maturity at the option of the holder, upon conversion to a fixed rate, upon conversion to a medium-term rate period, prior to the effective date of any substitute letter of credit, or upon the termination of the letters of credit. The optional and mandatory tender provisions generally call for the Master Trustee to purchase the outstanding Series 2008 Bonds at a purchase price equal to the principal amount thereof plus accrued interest upon a stated date as described in the tender notice delivered to the bond holders.

Series 2007 Bonds

In December 2007, the Alliance issued $104,355 (Series 2007A), $327,170 (Series 2007B taxable) and $36,575 (Series 2007C) variable rate Hospital Revenue Bonds (collectively, the Series 2007 Bonds). The proceeds of Series 2007 Bonds were primarily used to early extinguish a portion of the

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

outstanding Series 2000A Bonds, all of the outstanding 2000B Bonds, all of the outstanding Series 1994 Bonds, and all of the outstanding Series 2006B Bonds; to finance the acquisition of a majority ownership in NCH, and to finance certain capital improvements and equipment acquisitions for the Alliance's hospital facilities. A portion of the outstanding Series 2007A ($91,685) and Series 2007C ($32,840) Bonds were repaid from proceeds of the Series 2010 Bonds. The remaining outstanding Series 2007A and Series 2007C Bonds were redeemed in 2011.

In 2011 during the letter of credit restructuring, the existing 2007B Bonds were repaid through a remarketing of Sub-Series 2007B-1, 2007B-2 and 2007B-3 (collectively, the Sub-Series 2007B Bonds), created per the mandatory tender and letter of credit substitution provisions. As discussed above, the payment of principal and interest on the Sub-Series 2007B Bonds and the purchase price of any tendered bonds on each series are secured by a separate, irrevocable, transferable, direct-pay letter of credit.

The variable rate of interest on the Series 2007 Bonds is determined weekly in the same manner as described above for the Series 2008 Bonds. In no event shall the variable rate on the bonds during any period where interest is calculated weekly exceed the lesser of 12% annually or the maximum contract rate of interest permitted by the State of Tennessee. The Alliance has the option, upon written approval of the holder of the letters of credit, the Remarketing Agent and others, to convert to a medium-term rate period or to a fixed rate. Upon such conversion, the bonds become subject to mandatory tender for purchase.

The Sub-Series 2007 Bonds are subject to optional and mandatory tender in the same manner as described above for the Series 2008 Bonds. In addition, the Sub-Series 2007B Bonds are subject to a special mandatory tender with respect to its conversion from taxable debt to tax-exempt debt. As discussed in Note S, certain of the Sub-Series 2007B Bonds were redeemed subsequent to year end.

Series 2006 Bonds

During 2006, the Alliance issued $173,030 Hospital First Mortgage Revenue Bonds (Series 2006A) and $66,500 Hospital First Mortgage Variable Rate Revenue Bonds (Series 2006B). The proceeds from the sale of the Series 2006A Bonds were used to finance certain future and prior capital projects for the Alliance's hospital facilities and to refund certain existing indebtedness, specifically the Series 2001B Bonds (discussed below) and certain existing short and intermediate term loans and leases, as well as fund a debt service reserve fund. The Series 2006B Bond proceeds were substantially used to refund the remaining outstanding principal of the Series 2001B Bonds and establish a debt service reserve fund.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Series 2001 Bonds

During 2001, the Alliance issued $26,000 Hospital First Mortgage Revenue Bonds (Series 2001A) and $60,175 Hospital First Mortgage Revenue Bonds (Series 2001B). The Series 2001A Bonds were subject to optional tender by Bond holders. Effective July 1, 2007, the Alliance entered into an agreement whereby the beneficial owners of the Series 2001A Bonds have irrevocably waived their rights to tender the Bonds under the provisions of the respective Bond Indenture. The waiver will continue in effect through the maturity of the 2001A Bonds. The Series 2001B Bonds were refunded and redeemed in 2006.

Series 2000 Bonds

The Hospital First Mortgage Revenue Refunding (Series 2000A Bonds) and First Mortgage Revenue Refunding Bonds (Series 2000B Bonds), were used to advance refund previously existing indebtedness as well as fund a required debt service reserve fund. The Hospital First Mortgage Revenue Bonds (Series 2000C Taxable Bonds) were intended to refinance certain mortgage indebtedness of BRMM, and to refund other previously existing indebtedness. The proceeds from the sale of the First Mortgage Bonds (Series 2000D Taxable Bonds) were used primarily to fund working capital for the Alliance.

The Series 2000A Bonds included at issue date $14,680 of insured Capital Appreciation Bonds. Such bonds bear a 0% coupon rate and have a yield of 6.625% annually. The Alliance recognizes interest expense and increases the amount of outstanding debt each year based upon this yield. Total principal and interest due at maturity (2026 through 2030) is $93,675.

The advance refunding of previously issued debt requires funds to be placed in irrevocable trusts in order to satisfy remaining scheduled principal and interest payments. Management, upon advice of legal counsel, believes the amounts deposited in such irrevocable trust accounts have contractually relieved the Alliance of any future obligations with respect to this debt, and the debt and escrowed securities are not considered liabilities or assets of the Alliance. Therefore, such debt has been derecognized.

Debt outstanding and not recognized in the Consolidated Balance Sheet at June 30, 2011 due to previous advance refundings of the Series 2000A Bonds, Series 2000B Bonds, Series 1998C Bonds, and Series 1991 Bonds, totaled approximately $525,025.

The assets placed in the irrevocable trust accounts are also not recognized as assets of the Alliance. These assets consist primarily of various investments, as permitted by bond indentures and other

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

documents, including United States Treasury obligations, an investment contract with MBIA Insurance Corporation (MBIA) in the original amount of $54,300, as well as the Series 2000C and 2000D Bonds which were purchased with the proceeds of the 2000A and 2000B Bonds specifically for the purpose of utilizing the Series 2000C and 2000D Bonds in the irrevocable trust. Therefore, certain of the assets held in the irrevocable trust accounts have future income streams contingent upon payments by the Alliance.

Essentially all of the Alliance's bonds are subject to redemption prior to maturity, including optional, mandatory sinking fund and extraordinary redemption, at various dates and prices as described in the respective Bond indentures and other documents.

Other Bonds, Notes Payable and Financing Arrangements

The Alliance has granted a deed of trust on JCMC and SSH to secure the payment of the outstanding bonds. The bonds are also secured by the Alliance's receivables, inventories and other assets as well as certain funds held under the documents pursuant to which the bonds were issued. The NCH Series 2001 Hospital Refunding and Improvement Revenue Bonds are secured by revenues and a lien on certain real and personal property of NCH. The JMH Series 1998 Hospital Refunding and Improvement Revenue Bonds are secured by pledged gross receipts of JMH, as defined in the Master Trust indenture.

The scheduled maturities and mandatory sinking fund payments of the long-term debt and capital lease obligations (excluding interest), exclusive of net unamortized original issue discount and premium, at June 30, 2011 are as follows:

Year Ending June 30,		
2012		$ 28,162
2013		32,230
2014		28,706
2015		34,504
2016		33,585
Thereafter		912,560
		1,069,747
	Net discount	(662)
		$ 1,069,085

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

The Alliance, NCH and JMH are each members of separate Obligated Groups. The bond indentures, master trust indentures, letter of credit agreements and loan agreements related to the various bond issues and notes payable contain covenants with which the respective Obligated Groups must comply. These requirements include maintenance of certain financial and liquidity ratios, deposits to trustee funds, permitted indebtedness, use of facilities and disposals of property. These covenants also require that failure to meet certain debt service coverage tests will require the deposit of all daily cash receipts of the Alliance into a trust fund. Management has represented the Alliance, NCH and JMH are in compliance with all such covenants at June 30, 2011.

In connection with the tax-exempt bonds, the Alliance is required every five years, and at maturity, to remit to the Internal Revenue Service amounts which are due related to positive arbitrage on the borrowed funds. The Alliance performs such computations when required and recognizes any liability at that time. Management does not believe there are any significant arbitrage liabilities at June 30, 2011 or 2010.

NOTE G--SELF-INSURANCE PROGRAMS

The Alliance is substantially self-insured for professional and general liability claims and related expenses. The Alliance maintains a $25,000 umbrella liability policy that attaches over the self-insurance limits of $10,000 per claim and a $15,000 annual aggregate retention. The Alliance's insurance program also provides professional liability coverage for certain affiliates and joint ventures.

The Alliance is also substantially self-insured for workers' compensation claims in the State of Tennessee and has established estimated liabilities for both reported and unreported claims. The Alliance maintains a stop-loss policy that attaches over the self-insurance limits of $1,000 per occurrence and $1,000 annual aggregate retention. In the State of Virginia, the Alliance is not self-insured and maintains workers' compensation insurance through commercial carriers.

At June 30, 2011, the Alliance is involved in litigation relating to medical malpractice and workers' compensation and other claims arising in the ordinary course of business. There are also known incidents occurring through June 30, 2011 that may result in the assertion of additional claims, and other unreported claims may be asserted arising from services provided in the past. Alliance management has estimated and accrued for the cost of these unreported claims based on historical data and actuarial projections. The estimated net present value of malpractice and workers' compensation claims, both reported and unreported, as of June 30, 2011 and 2010 was $13,531 and $12,601, respectively. The discount rate utilized was 5% at June 30, 2011 and 2010.

(Dollars in Thousands)

NOTE G--SELF-INSURANCE PROGRAMS - Continued

Additionally, the Alliance is self-insured for employee health claims and recognizes expense each year based upon actual claims paid and an estimate of claims incurred but not yet paid, including a catastrophic claims reserve based on historical claims in excess of $75.

NOTE H--NET PATIENT SERVICE REVENUE

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the accompanying Consolidated Statements of Operations is as follows for the years ended June 30:

	2011	2010
Inpatient service charges	$ 1,983,340	$ 1,848,590
Outpatient service charges	1,807,247	1,669,705
Gross patient service charges	3,790,587	3,518,295
Less:		
Estimated contractual adjustments and other discounts	2,647,514	2,417,082
Estimated uncollectible self-pay	110,387	111,565
Charity care	72,432	61,378
	2,830,333	2,590,025
Net patient service revenue	$ 960,254	$ 928,270

NOTE I--THIRD-PARTY REIMBURSEMENT

The Alliance renders services to patients under contractual arrangements with Medicare, Medicaid, TennCare, Blue Cross and various other commercial payors. The Medicare program pays for inpatient services on a prospective basis. Payments are based upon diagnosis related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. The Alliance also receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid and other low income patients. Most Medicare outpatient services are reimbursed on a prospectively determined payment methodology. The Medicare program also reimburses certain other services on the basis of reasonable cost, subject to various prescribed limitations and reductions.

Reimbursement under the State of Tennessee's Medicaid waiver program (TennCare) for inpatient and outpatient services is administered by various managed care organizations (MCOs) and is based on diagnosis related group assignments, a negotiated per diem or fee schedule basis. The Alliance

NOTE I--THIRD-PARTY REIMBURSEMENT - Continued

also receives additional supplemental payments from the State of Tennessee. The amount recognized totaled $11,480 and $7,811 for the years ended June 30, 2011 and 2010, respectively. Such payments are not guaranteed in future periods.

The Virginia Medicaid program reimbursement for inpatient hospital services is based on a prospective payment system using both a per case and per diem methodology. Additional payments are made for the allowable costs of capital. Payments for outpatient services are based on Medicare cost reimbursement principles and settled through the filing of an annual Medicaid cost report.

Amounts earned under the contractual agreements with the Medicare and Medicaid programs are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Activity with respect to audits and reviews of the governmental programs in the healthcare industry has increased and is expected to increase in the future. No additional specific reserves or allowances have been established with regard to these increased audits and reviews as management is not able to estimate such amounts. Management believes that any adjustments from these increased audits and reviews will not have a material adverse impact on the consolidated financial statements. However, due to uncertainties in the estimation, it is at least reasonably possible that management's estimate will change in 2012, although the amount of any change cannot be estimated. The impact of final settlements of cost reports or changes in estimates decreased net patient service revenue by $4,570 in 2011. The impact of final settlements of cost reports or changes in estimates were not significant in 2010.

Participation in the Medicare program subjects the Alliance to significant rules and regulations; failure to adhere to such could result in fines, penalties or expulsion from the program. Management believes that adequate provision has been made for any adjustments, fines or penalties which may result from final settlements or violations of other rules or regulations. Management has represented that the Alliance is in substantial compliance with these rules and regulations as of June 30, 2011.

The Alliance has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations and employer groups. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

NOTE J--EMPLOYEE BENEFIT PLANS

The Alliance sponsors a retirement plan (the Plan) which covers substantially all employees. The Plan is a defined contribution plan which consists mainly of employer-funded contributions. During

NOTE J--EMPLOYEE BENEFIT PLANS - Continued

2011 and 2010, the Alliance made contributions to the Plan under a stratified system, whereby the Alliance's contribution percentage is based on each employee's years of service. In addition, the Alliance sponsors a 403(b) plan which is funded solely by employees' contributions. The Alliance does not make any discretionary or matching contributions into the 403(b) plan. Employees of certain other subsidiaries are covered by other plans, although such plans are not significant. The total expense related to defined contribution plans for the years ended June 30, 2011 and 2010 was $12,682 and $13,311, respectively.

NCH maintains a defined benefit pension plan and a post-retirement employee benefit plan. The accrued unfunded pension liability was $1,313 and $1,942, and the accrued unfunded post-retirement liability was $3,761 and $3,843 at June 30, 2011 and 2010, respectively.

The Alliance sponsors a secured executive benefit program (SEBP) for certain key executives. Contributions to the plan by the Alliance are based on an annual amount of funding necessary to produce a target benefit for the participants at their retirement date, although the Alliance does not guarantee any level of benefit will be achieved. The Alliance contributed $929 and $1,303 to the plan during 2011 and 2010, respectively. Other assets at June 30, 2011 and 2010 include $7,888 and $7,077, respectively, related to the Alliance's portion of the benefits which are recoverable upon the death of the participant. In addition, the Alliance sponsors a Section 457(f) plan for certain key executives. The benefits for substantially all employees previously participating in the SEBP plan have been transferred into the 457(f) plan.

NOTE K--CONCENTRATIONS OF RISK

The Alliance has locations primarily in upper East Tennessee and Southwest Virginia which is considered a geographic concentration. The Alliance grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. Net patient service revenue from Washington County, Tennessee operations were approximately 54% of total net patient service revenue for each of the years 2011 and 2010.

The mix of receivables from patients and third-party payors based on charges at established rates is as follows as of June 30:

(Dollars in Thousands)

NOTE K--CONCENTRATIONS OF RISK - Continued

	2011	*2010*
Medicare	40%	42%
Tenncare/Medicaid	12%	15%
Commercial	27%	25%
Other third-party payors	9%	10%
Patients	12%	8%
	100%	100%

Approximately 98% of the consolidated total revenue, gains and support were related to the provision of healthcare services during 2011 and 2010. Admitting physicians are primarily practitioners in the regional area.

Two of the Alliance's Virginia hospitals' employees are covered under collective bargaining agreements which extend through February 2, 2014.

The Alliance routinely invests in investment vehicles as listed in Note C. The Alliance's investment portfolio is managed by outside investment management companies. Investments in corporate and foreign bonds and notes, municipal obligations, money market funds, equities and other vehicles that are held by safekeeping agents are not insured or guaranteed by the U.S. government. At June 30, 2011, the Alliance also had deposits in financial institutions significantly in excess of the Federal Deposit Insurance Corporation's limits.

NOTE L--INCOME TAXES

BRMM and its subsidiaries file a consolidated federal tax return and separate state tax returns. As of June 30, 2011 and 2010, BRMM and its subsidiaries had net operating loss carryforwards for consolidated federal purposes of $34,822 and $32,447, respectively, related to operating losses which expire through 2030. At June 30, 2011 and 2010, BRMM had state net operating loss carryforwards of $65,979 and $59,860, respectively, which expire through 2025. The net operating loss carryforwards may be offset against future taxable income to the extent permitted by the Internal Revenue Code and Tennessee Code Annotated.

At June 30, 2011 and 2010, SWCH had federal and state net operating loss carryforwards of $4,875 and $4,376, respectively, which expire through 2030. CHC files separate federal and state tax returns. At June 30, 2011 and 2010, CHC had a net deferred tax liability of $69 and $58, respectively, due primarily to temporary timing differences related to depreciation. The net operating loss carryforwards may be off-set against future taxable income to the extent permitted by the Internal Revenue Code and tax codes of the Commonwealth of Virginia.

NOTE L--INCOME TAXES - Continued

Net deferred tax assets related to these carryforwards and other deferred tax assets have been substantially offset through valuation allowances equal to these amounts. Income taxes paid relate primarily to state taxes for certain subsidiaries and federal alternative minimum tax.

NOTE M--RELATED PARTY TRANSACTIONS

The Alliance enters into transactions with entities affiliated with certain members of the Board of Directors including transactions to construct Alliance facilities and provide professional services to the Alliance. Board members refrain from discussion and abstain from voting on transactions with entities with which they are related.

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES

Construction in Progress: Construction in progress at June 30, 2011 represents costs incurred related to various hospital and medical office building facility renovations and additions. The Alliance has outstanding contracts and other commitments related to the completion of these projects, and the cost to complete these projects is estimated to be approximately $98,721 at June 30, 2011. The Alliance does not expect any significant costs to be incurred for infrastructure improvements to assets held for resale.

Physician Contracts: BRMM employs physicians to provide services to BRMM's physician practices through employment agreements which provide annual compensation, plus incentives based upon specified productivity levels. These contracts have various terms.

In addition, the Alliance has entered into contractual relationships with non-employed physicians to provide services in Upper East Tennessee and Southwest Virginia. These contracts guarantee certain base payments and allowable expenses and have terms of varying lengths. Upon completion of the respective guarantee period, amounts drawn and outstanding under each agreement are treated as a loan bearing interest at various rates and are subject to repayment over a specified period. The physician note may also be amortized by virtue of the physician's continued practice in the specified community during the repayment period. A net receivable of $1,407 and $1,818 related to these agreements is included in the accompanying Consolidated Balance Sheets at June 30, 2011 and 2010, respectively.

Employee Scholarships: The Alliance offers scholarships to certain individuals which require that the recipients return to the Alliance to work for a specified period of time after they complete their degree. Amounts due are then forgiven over a specific period of time as provided in the individual contracts. If the recipient does not return and work the required period of time, the funds disbursed on their behalf become due immediately and interest is charged until the funds are repaid. Other receivables June 30, 2011 and 2010 includes $7,250 and $5,571, respectively, related to students in

(Dollars in Thousands)

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES - Continued

school, graduates working at the Alliance and amounts due from others who are no longer in the scholarship program.

Promises to Give: The Alliance has recorded certain unconditional promises to give to unrelated organizations. At June 30, 2011, $1,568 is due within one year, and an additional $180 is due within five years and is included in other long-term liabilities.

Operating Leases and Maintenance Contracts: Total lease expense for the years ended June 30, 2011 and 2010 was $9,362 and $10,216, respectively. Future minimum lease payments for each of the next five years and in the aggregate for the Alliance's noncancellable operating leases with remaining lease terms in excess of one year are as follows:

Year Ending June 30,		
2012	$	2,846
2013		2,631
2014		2,286
2015		2,121
2016		1,285
Thereafter		9,914
	$	21,083

Estimated future minimum payments under various noncancellable maintenance contracts with remaining terms in excess of one year at June 30, 2011 total in the aggregate $1,422 through 2016.

Asset Retirement Obligation: The Alliance has identified asbestos in certain facilities and is required by law to dispose of it in a special manner if the facility undergoes major renovations or is demolished; otherwise, the Alliance is not required to remove the asbestos from the facility. The Alliance has complied with regulations by treating the asbestos so that it presents no known immediate or future safety concerns. An asset retirement obligation has been established to the extent that sufficient information exists upon which to estimate the liability.

Other: The Alliance is a party to various transactions and agreements in the normal course of business, which include purchase and re-purchase agreements, put arrangements and other commitments, which may bind the Alliance to undertake additional transactions or activities in the future. In addition, the Alliance has agreed to guarantee a portion of the outstanding indebtedness of a joint venture. Management estimates that the fair value of the guarantee of this debt is immaterial as of June 30, 2011.

(Dollars in Thousands)

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES - Continued

Healthcare Industry: Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

In March 2010, Congress adopted comprehensive health care insurance legislation, *Patient Care Protection and Affordable Care Act* and *Health Care and Education Reconciliation Act*. The legislation, among other matters, is designated to expand access to coverage to substantively all citizens by 2019 through a combination of public program expansion and private industry health insurance. Changes to existing TennCare and Medicaid coverage and payments are also expected to occur as a result of this legislation. Implementing regulations are generally required for these legislative acts, which are to be adopted over a period of years and, accordingly, the specific impact of any future regulations is not determinable.

NOTE O--RENTAL INCOME UNDER OPERATING LEASES

The Alliance leases rental properties to third parties, most of whom are physician practices, for various terms, generally five years. The following is a schedule by year and in the aggregate of minimum future rental income due under noncancellable operating leases at June 30, 2011:

Year Ending June 30,		
2012	$	1,742
2013		1,219
2014		958
2015		796
2016		397
Total minimum future rentals	$	5,112

NOTE P--FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments has been estimated by the Alliance using available market information as of June 30, 2011 and 2010, and valuation methodologies considered appropriate. The estimates presented are not necessarily indicative of amounts the Alliance could realize in a current market exchange. The carrying value of substantially all financial instruments approximates fair value due to the nature or term of the instruments, except as described below.

NOTE P--FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

Investment in Joint Ventures: It is not practical to estimate the fair market value of the investments in joint ventures.

Other Long-Term Liabilities: Estimates of reported and unreported professional liability claims, pension and post-retirement liabilities are discounted to approximate their estimated fair value. It is not practical to estimate the fair market value of other long-term liabilities due to uncertainty of when these amounts may be paid. Other long-term liabilities are not discounted.

Long-Term Debt and Capital Leases: The fair value of long-term debt is estimated based upon quotes obtained from brokers for bonds and discounted future cash flows using current market rates for other debt. For long-term debt with variable interest rates, the carrying value approximates fair value.

The Alliance's significant capital leases and vendor contracts were negotiated with various entities and are considered unique. It is not practicable to estimate the fair value of these obligations under current conditions. Other capital lease obligations are not significant.

The estimated fair value of the Alliance's financial instruments that have carrying values different from fair value is as follows at June 30:

	2011		*2010*	
	Carrying Value	*Estimated Fair Value*	*Carrying Value*	*Estimated Fair Value*
FINANCIAL LIABILITIES:				
Long-term debt	$ 1,069,085	$ 1,046,675	$ 1,082,973	$ 1,105,778

NOTE Q--FAIR VALUE MEASUREMENT

FASB ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 - Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.
- Level 2 - Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar

(Dollars in Thousands)

NOTE Q--FAIR VALUE MEASUREMENT - Continued

assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. The Alliance's Level 2 investments are valued primarily using the market valuation approach.

- Level 3 - Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes values determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Alliance's own assumptions.

In instances where the determination of the fair value hierarchy measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Alliance's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following table sets forth, by level within the fair value hierarchy, the financial assets and liabilities recorded at fair value on a recurring basis as of June 30, 2011 and 2010:

	June 30, 2011	*Level 1*	*Level 2*	*Level 3*
Trading securities	$ 333,610	$ 164,953	$ 135,939	$ 32,718
Assets whose use is limited	117,170	117,170	-	-
Total assets	$ 450,780	$ 282,123	$ 135,939	$ 32,718
Fair value of derivative agreements - Note D	$ (110,732)	$ -	$ -	$ (110,732)

	June 30, 2010	*Level 1*	*Level 2*	*Level 3*
Trading securities	$ 209,644	$ 164,510	$ 16,526	$ 28,608
Assets whose use is limited	177,180	177,180	-	-
Total assets	$ 386,824	$ 341,690	$ 16,526	$ 28,608
Fair value of derivative agreements - Note D	$ (134,300)	$ -	$ -	$ (134,300)

The valuation of the Alliance's derivative agreements is determined using market valuation techniques, including discounted cash flow analysis on the expected cash flows of each agreement. This analysis reflects the contractual terms of the agreement, including the period to maturity, and uses observable market-based inputs, including forward interest rate curves. The fair values of interest rate swap agreements are determined by netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The variable cash receipts (or payments) are based on the expectation of future interest rates based on observable

(Dollars in Thousands)

NOTE Q--FAIR VALUE MEASUREMENT - Continued

market forward interest rate curves and the underlying notional amount. The Alliance also incorporates credit valuation adjustments (CVAs) to appropriately reflect both its own nonperformance or credit risk and the respective counterparty's nonperformance or credit risk in the fair value measurements. The CVA on the Alliance's interest rate swap agreements at June 30, 2011 and 2010 resulted in a decrease in the fair value of the related liability of $7,940 and $10,085, respectively.

A certain portion of the inputs used to value its interest rate swap agreements, including the forward interest rate curves and market perceptions of the Alliance's credit risk used in the CVAs, are unobservable inputs available to a market participant. As a result, the Alliance has determined that the interest rate swap valuations are classified in Level 3 of the fair value hierarchy.

The following tables provide a summary of changes in the fair value of the Alliance's Level 3 financial assets and liabilities during the fiscal years ended June 30, 2011 and 2010:

	Trading Securities	*Derivatives, Net*
July 1, 2009	$ 30,031	$ (126,217)
Total unrealized/realized losses in the Performance Indicator, net	(1,546)	(8,607)
Purchases, issuance and settlements and other, net	1,446	524
Transfers in (out), net	(1,323)	-
June 30, 2010	28,608	(134,300)
Total unrealized/realized gains in the Performance Indicator, net	2,847	23,049
Purchases, issuance and settlements and other, net	1,263	519
June 30, 2011	$ 32,718	$ (110,732)

There were no changes in valuation techniques in 2011 or 2010. During 2011, as part of the transitional test of goodwill impairment, the Alliance recognized goodwill impairment of $2,965 based primarily on the fair value of the reporting unit, utilizing the income approach. Remaining goodwill determined not to be impaired, for this specific reporting unit, is included in the Consolidated Balance Sheet at $2,900. There were no significant assets or liabilities that were re-measured at fair value on a non-recurring basis during the fiscal year ended June 30, 2010.

NOTE R--OPERATING EXPENSES BY FUNCTIONAL CLASSIFICATION

Direct expenses by functional classification are as follows for the years ended June 30:

(Dollars in Thousands)

NOTE R--OPERATING EXPENSES BY FUNCTIONAL CLASSIFICATION - Continued

	2011	2010
Healthcare services	$ 817,397	$ 795,725
Administrative and general	130,543	125,852
Other	9,233	8,625
	$ 957,173	$ 930,202

NOTE S--SUBSEQUENT EVENTS

Acquisition: Subsequent to June 30, 2011, the Alliance purchased the stock of a pharmacy provider for approximately $6,700. The Alliance has not completed an allocation of the purchase price although it is anticipated significant intangible assets will be recognized upon such allocation.

Debt: In October 2011, the Alliance (along with BRMMC, NCH and SCCH) issued $85,260 of Series 2011 Tax-exempt Hospital Revenue Bonds through The Health and Educational Facilities Board of the City of Johnson City, Tennessee (the Tennessee Bonds) and $110,580 through the Industrial Development Authority of Smyth, Virginia (the Virginia Bonds). Such bonds were issued on parity with the outstanding bond indebtedness of the Alliance as of June 30, 2011. The Bonds bear interest at a variable rate determined by a remarketing agent based upon a weekly rate period. Additionally, the Alliance issued $15,960 of Series 2011 Taxable Bonds. NCH and SCCH were also admitted as members of the Alliance Obligated Group.

The proceeds from the Tennessee Bonds will be issued to finance certain capital acquisitions in the State of Tennessee and pay issuance costs related to these Bonds. The proceeds from the Virginia Bonds will be used to refinance $11,200 of 2001 NCH Hospital Refunding and Improvement Revenue Bonds, finance capital acquisitions for NCH, JMH and SCCH and to pay issuance costs associated with these Bonds. The Series 2011 Taxable Bonds proceeds will be used to finance capital acquisitions of SCCH and BRMMC and pay issuance costs. The timely payment of the Tennessee and the Virginia Bonds is secured by a letter of credit which expires October 19, 2014. The Alliance also redeemed $115,135 of the Series 2007B-1 Revenue Bonds and $29,405 of the Series 2007B-3 Revenue Bonds.

Management further anticipates issuance of an additional $25,000 of tax-exempt bonds for the benefit of JMH. JMH is not a member of the Mountain States Health Alliance Obligated Group.

Subsequent to June 30, 2011, JMH exercised their right to purchase a facility previously held under a capital lease for total consideration of $16,051. $2,093 was paid directly to the third party and the remaining $13,958 was by assumption of a promissory note with payments through 2013. The promissory note bears interest at a variable rate of LIBOR plus 1.5%. Additionally, JMH assumed an interest rate swap in the notional amount of $13,940. JMH pays a fixed rate of 7.46%

NOTE S--SUBSEQUENT EVENTS - Continued

and receives a variable rate of LIBOR plus 1.5%. The interest rate swap has a termination date of August 15, 2012.

Supplemental Schedules

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Balance Sheet
(Dollars in Thousands)

June 30, 2011

	Blue Ridge Medical Management *	Other Obligated Group Members	Eliminations	Total Obligated Group	Other Entities	Mountain States Properties	Eliminations	Total
ASSETS								
CURRENT ASSETS								
Cash and cash equivalents	$ 450	$ 85,976	$ -	$ 86,426	$ 17,023	$ 9,319	$ -	$ 112,768
Current portion of investments	-	7,629	-	7,629	94,775	13,771	-	116,175
Patient accounts receivable, less estimated allowances for uncollectible accounts	4,476	96,083	-	100,559	34,052	-	-	134,611
Other receivables, net	848	13,434	-	14,282	4,552	780	-	19,614
Inventories and prepaid expenses	553	18,783	-	19,336	9,477	152	-	28,965
TOTAL CURRENT ASSETS	6,327	221,905	-	228,232	159,879	24,022	-	412,133
INVESTMENTS, less amounts required to meet current obligations	19,193	337,367	-	356,560	190,937	33,879	-	581,376
EQUITY IN AFFILIATES	139,582	387,825	(155,611)	371,796	-	-	(371,795)	-
PROPERTY, PLANT AND EQUIPMENT, net	10,696	469,613	-	480,309	258,342	58,766	-	797,418
OTHER ASSETS								
Goodwill	3,281	143,276	-	146,557	2,109	-	-	148,666
Net deferred financing, acquisition costs and	-	-	-	-	-	-	-	-
other charges, less current portion	168	27,991	-	28,159	568	1,117	-	29,844
Other assets	8,467	10,154	-	18,621	7,265	2,562	-	28,448
TOTAL OTHER ASSETS	11,916	181,421	-	193,337	9,942	3,679	-	206,958
	$ 187,714	$ 1,598,131	$ (155,611)	$ 1,630,234	$ 619,100	$ 120,346	$ (371,795)	$ 1,997,885

* Management Services Organization only

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Balance Sheet - Continued (Dollars in Thousands)

June 30, 2011

	Blue Ridge Medical Management *	*Other Obligated Group Members*	*Eliminations*	*Total Obligated Group*	*Other Entities*	*Mountain States Properties*	*Eliminations*	*Total*
LIABILITIES AND NET ASSETS								
CURRENT LIABILITIES								
Accrued interest payable	$ -	$ 19,607	$ -	$ 19,607	$ 440	$ -	$ -	$ 20,047
Current portion of long-term debt and capital lease obligations	550	23,724	-	24,274	3,888	-	-	28,162
Current portion of estimated fair value of derivatives	-	92,044	-	92,044	-	10,565	-	102,609
Accounts payable and accrued expenses	3,463	66,494	-	69,957	27,645	1,217	-	98,819
Accrued salaries, compensated absences and amounts withheld	3,093	40,177	-	43,270	14,530	-	-	57,800
Payables to (receivables from) affiliates, net	11,094	(81,319)	-	(70,225)	94,632	(24,407)	-	-
Estimated amounts due to third-party payors, net	-	12,547	-	12,547	2,266	-	-	14,813
TOTAL CURRENT LIABILITIES	18,200	173,274	-	191,474	143,401	(12,625)	-	322,250
OTHER LIABILITIES								
Long-term debt and capital lease obligations, less current portion	4,923	979,774	-	984,697	56,226	-	-	1,040,923
Estimated fair value of derivatives, less current portion	-	7,783	-	7,783	-	340	-	8,123
Deferred revenue	-	19,167	-	19,167	100	-	-	19,267
Estimated professional liability self-insurance	2,285	4,494	-	6,779	2,913	-	-	9,692
Other long-term liabilities	6,695	2,402	-	9,097	5,255	-	-	14,352
TOTAL LIABILITIES	32,103	1,186,894	-	1,218,997	207,895	(12,285)	-	1,414,607
NET ASSETS								
UNRESTRICTED NET ASSETS								
Unrestricted net assets								
Mountain States Health Alliance	155,478	400,395	(155,478)	400,395	228,554	132,631	(361,185)	400,395
Noncontrolling interests in subsidiaries	-	-	-	-	171,984	-	-	171,984
TOTAL UNRESTRICTED NET ASSETS	155,478	400,395	(155,478)	400,395	400,538	132,631	(361,185)	572,379
Temporarily restricted net assets								
Mountain States Health Alliance	133	10,715	(133)	10,715	10,483	-	(10,483)	10,715
Noncontrolling interests in subsidiaries	-	-	-	-	57	-	-	57
TOTAL TEMPORARILY RESTRICTED NET ASSETS	133	10,715	(133)	10,715	10,540	-	(10,483)	10,772
Permanently restricted net assets	-	127	-	127	127		(127)	127
TOTAL NET ASSETS	155,611	411,237	(155,611)	411,237	411,205	132,631	(371,795)	583,278
	$ 187,714	$ 1,598,131	$ (155,611)	$ 1,630,234	$ 619,100	$ 120,346	$ (371,795)	$ 1,997,885

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Statement of Operations (Dollars in Thousands)

Year Ended June 30, 2011

	Blue Ridge Medical Management *	Other Obligated Group Members	Eliminations	Total Obligated Group	Other Entities	Mountain States Properties	Eliminations	Total
Revenue, gains and support:								
Net patient service revenue	$ 35,353	$ 683,224	$ (1,702)	$ 716,875	$ 243,487	$ -	$ (108)	$ 960,254
Other operating revenue	26,855	3,657	(20,748)	9,764	39,423	7,807	(41,123)	15,871
Equity in net gain (loss) of affiliates	974	(3,283)	2,051	(258)	-	-	258	-
TOTAL REVENUE, GAINS AND SUPPORT	63,182	683,598	(20,399)	726,381	282,910	7,807	(40,973)	976,125
Expenses:								
Salaries and wages	17,287	235,564	-	252,851	92,108	150	(2,901)	342,208
Physician salaries and wages	32,631	1,010	-	33,641	55,417	-	(29,809)	59,249
Contract labor	866	3,234	-	4,100	2,123	-	(259)	5,964
Employee benefits	4,874	45,591	(1,743)	48,722	20,414	35	(2,032)	67,139
Fees	3,544	81,194	(20,612)	64,126	22,251	713	(1,171)	85,919
Supplies	1,745	129,126	-	130,871	38,594	2	(105)	169,362
Utilities	455	11,386	-	11,841	4,452	1,007	-	17,300
Other	4,778	38,479	(95)	43,162	28,206	3,230	(4,951)	69,647
Depreciation	1,476	59,635	-	61,111	23,666	2,722	-	87,499
Amortization	23	2,188	-	2,211	348	-	-	2,559
Estimated provision for bad debts	353	4,097	-	4,450	1,724	-	-	6,174
Interest and taxes	(1,228)	42,204	-	40,976	3,248	1,374	(1,445)	44,153
TOTAL EXPENSES	66,804	653,708	(22,450)	698,062	292,551	9,233	(42,673)	957,173
OPERATING INCOME (LOSS)	(3,622)	29,890	2,051	28,319	(9,641)	(1,426)	1,700	18,952
Nonoperating gains (losses):								
Interest and dividend income	662	9,810	-	10,472	6,552	645	(1,445)	16,224
Net realized gains on the sale of securities	73	1,449	-	1,522	435	-	-	1,957
Net unrealized gains on securities	1,311	13,664	-	14,975	7,949	(756)	-	22,168
Derivative related income	-	3,512	-	3,512	-	1,560	-	5,072
Change in estimated fair value of derivatives	-	23,137	-	23,137	-	(88)	-	23,049
Other nonoperating gains (losses)	(475)	1,245	-	770	(3,430)	4	3	(2,653)
Net assets released from restrictions used for operations	-	562	-	562	1,331	-	-	1,893
NET NONOPERATING GAINS	1,571	53,379	-	54,950	12,837	1,365	(1,442)	67,710
EXCESS (DEFICIT) OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	$ (2,051)	$ 83,269	$ 2,051	$ 83,269	$ 3,196	$ (61)	$ 258	$ 86,662

*Management Services Organization only.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Statement of Changes in Net Assets (Dollars in Thousands)

Year Ended June 30, 2011

	Blue Ridge Medical Management *	Other Obligated Group Members	Eliminations	Total Obligated Group	Other Entities: Mountain States Health Alliance	Other Entities: Noncontrolling Interests	Total Other Entities	Mountain States Properties	Eliminations	Total
UNRESTRICTED NET ASSETS:										
Excess of Revenue, Gains and Support over Expenses and Losses	$ (2,051)	$ 83,269	$ 2,051	$ 83,269	$ (197)	$ 3,393	$ 3,196	$ (61)	$ 258	$ 86,662
Pension and other defined benefit plan adjustments	-	620	-	620	620	617	1,237	-	(620)	1,237
Cumulative effect of a change in accounting principle	(2,965)	(2,965)	2,965	(2,965)	-	-	-			(2,965)
Net assets released from restrictions used for the purchase of property, plant and equipment	-	1,946	-	1,946	1,946	-	1,946	-	(1,946)	1,946
Distributions to noncontrolling interests	-	-	-	-	-	(270)	(270)	-	-	(270)
Repurchases of noncontrolling interests and other	(43)	40	43	40	(182)	(115)	(297)	-	182	(75)
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	(5,059)	82,910	5,059	82,910	2,187	3,625	5,812	(61)	(2,126)	86,535
TEMPORARILY RESTRICTED NET ASSETS:										
Restricted grants and contributions	-	3,612	-	3,612	2,990	58	3,048	-	(2,990)	3,670
Net assets released from restrictions	-	(3,787)	-	(3,787)	(3,225)	(52)	(3,277)	-	3,225	(3,839)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	-	(175)	-	(175)	(235)	6	(229)	-	235	(169)
INCREASE (DECREASE) IN TOTAL NET ASSETS	(5,059)	82,735	5,059	82,735	1,952	3,631	5,583	(61)	(1,891)	86,366
NET ASSETS, BEGINNING OF YEAR	160,670	328,502	(160,670)	328,502	237,212	168,410	405,622	132,692	(369,904)	496,912
NET ASSETS, END OF YEAR	$ 155,611	$ 411,237	$ (155,611)	$ 411,237	$ 239,164	$ 172,041	$ 411,205	$ 132,631	$ (371,795)	$ 583,278

*Management Services Organization only.

NOTE A--OBLIGATED GROUP MEMBERS

As described in Note F to the consolidated financial statements, the Alliance has granted a deed of trust on JCMC and SSH to secure the payment of the outstanding bonds. The bonds are also secured by the Alliance's receivables, inventories and other assets as well as certain funds held under the documents pursuant to which the bonds were issued. In accordance with Article Six, Section 6.6 of the Amended and Restated Master Trust Indenture between Mountain States Health Alliance and the Bank of New York Trust Company, NA as Master Trustee, those members pledged include Johnson City Medical Center Hospital, Indian Path Medical Center, Franklin Woods Community Hospital, Sycamore Shoals Hospital, Johnson County Community Hospital, Russell County Medical Center and Blue Ridge Medical Management Corporation (parent company only), collectively defined as the Obligated Group (Obligated Group).

The supplemental consolidating schedules include the accounts of the members of the Obligated Group after elimination of all significant intergroup accounts and transactions. Certain other subsidiaries of the Alliance, Mountain States Properties, Inc. (MSP) and all other affiliates (Other Entities), are not pledged to secure the payment of the outstanding bonds as they are not part of the Obligated Group. These affiliates have been accounted for within the Obligated Group based upon the Alliance's original and subsequent investments, as adjusted for the Alliance's pro rata share of income or losses and any distributions, and are included as a part of equity in affiliates in the supplemental consolidating balance sheet.

MOUNTAIN STATES HEALTH ALLIANCE

Audited Consolidated Financial Statements
(and Supplemental Schedules)

Years Ended June 30, 2012 and 2011

PYA

Certified Public Accountants

MOUNTAIN STATES HEALTH ALLIANCE

Audited Consolidated Financial Statements (and Supplemental Schedules)

Years Ended June 30, 2012 and 2011

PYA
Certified Public Accountants

PERSHING YOAKLEY & ASSOCIATES, P.C.
One Cherokee Mills, 2220 Sutherland Aver
Knoxville, TN 37
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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Mountain States Health Alliance:

We have audited the accompanying consolidated balance sheets of Mountain States Health Alliance and subsidiaries (the Alliance) as of June 30, 2012 and 2011 and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Alliance'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 consolidated 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 the Alliance's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mountain States Health Alliance and subsidiaries as of June 30, 2012 and 2011 and the results of their operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental information as listed in the accompanying index is presented for purposes:of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated 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 consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Pershing Yoakley & Associates PC

Knoxville, Tennessee
October 26, 2012

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Balance Sheets
(Dollars in Thousands)

	June 30, 2012	June 30, 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ **65,107**	$ 112,768
Current portion of investments - Note C	**36,557**	116,175
Patient accounts receivable, less estimated allowances for uncollectible accounts of $52,911 in 2012 and $53,366 in 2011	**150,690**	134,611
Other receivables, net	**23,008**	19,614
Inventories and prepaid expenses	**28,810**	28,965
TOTAL CURRENT ASSETS	**304,172**	412,133
INVESTMENTS, less amounts required to meet current obligations	**560,697**	581,376
PROPERTY, PLANT AND EQUIPMENT, net	**865,456**	797,418
OTHER ASSETS		
Goodwill	**154,391**	148,666
Net deferred financing, acquisition costs and other charges	**28,187**	29,844
Other assets	**28,144**	28,448
TOTAL OTHER ASSETS	**210,722**	206,958
	$ **1,941,047**	$ 1,997,885

	June 30, 2012	2011
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accrued interest payable	$ 18,525	$ 20,047
Current portion of long-term debt and capital lease obligations	32,477	28,162
Current portion of estimated fair value of derivatives - Note D	10,395	102,609
Accounts payable and accrued expenses	108,870	98,819
Accrued salaries, compensated absences and amounts withheld	55,589	57,800
Estimated amounts due to third-party payors, net	18,060	14,813
TOTAL CURRENT LIABILITIES	243,916	322,250
OTHER LIABILITIES		
Long-term debt and capital lease obligations, less current portion	1,048,098	1,040,923
Estimated fair value of derivatives, less current portion	8,986	8,123
Deferred revenue	3,134	19,267
Estimated professional liability self-insurance	9,344	9,692
Other long-term liabilities	16,822	14,352
TOTAL LIABILITIES	1,330,300	1,414,607
COMMITMENTS AND CONTINGENCIES - Notes D, F, G, and N		
NET ASSETS		
Unrestricted net assets		
Mountain States Health Alliance	436,388	400,395
Noncontrolling interests in subsidiaries	162,959	171,984
TOTAL UNRESTRICTED NET ASSETS	599,347	572,379
Temporarily restricted net assets		
Mountain States Health Alliance	11,223	10,715
Noncontrolling interests in subsidiaries	50	57
TOTAL TEMPORARILY RESTRICTED NET ASSETS	11,273	10,772
Permanently restricted net assets	127	127
TOTAL NET ASSETS	610,747	583,278
	$ 1,941,047	$ 1,997,885

See notes to consolidated financial statements.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Operations
(Dollars in Thousands)

	Year Ended June 30, 2012	Year Ended June 30, 2011
Revenue, gains and support:		
Patient service revenue, net of contractual allowances and discounts	$ 1,075,050	$ 1,062,123
Provision for bad debts	(122,917)	(116,248)
Net patient service revenue	952,133	945,875
Other operating revenue	39,407	24,868
TOTAL REVENUE, GAINS AND SUPPORT	991,540	970,743
Expenses:		
Salaries and wages	358,607	342,208
Physician salaries and wages	65,706	59,249
Contract labor	6,375	5,964
Employee benefits	69,600	67,139
Fees	97,959	85,919
Supplies	170,186	168,261
Utilities	17,289	17,300
Other	76,285	69,647
Depreciation	73,060	87,499
Amortization	2,245	2,559
Interest and taxes	45,903	44,153
TOTAL EXPENSES	983,215	949,898
OPERATING INCOME	8,325	20,845
Nonoperating gains (losses):		
Interest and dividend income	15,213	16,224
Net realized gains (losses) on the sale of securities	(2,595)	1,957
Change in net unrealized gains on securities	(2,884)	22,168
Derivative related income	7,515	5,072
Loss on early extinguishment of debt - Note F	(2,636)	-
Change in estimated fair value of derivatives	(6,198)	23,049
Other nonoperating gains (losses)	11,236	(2,653)
NET NONOPERATING GAINS	19,651	65,817
EXCESS OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	$ 27,976	$ 86,662

See notes to consolidated financial statements.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Changes in Net Assets
(Dollars in Thousands)

Year Ended June 30, 2012

	Mountain States Health Alliance	*Noncontrolling Interests*	*Total*
UNRESTRICTED NET ASSETS:			
Excess (Deficit) of Revenue, Gains and Support over Expenses and Losses	$ 31,702	$ (3,726)	$ 27,976
Pension and other defined benefit plan adjustments	(1,119)	(1,115)	(2,234)
Net assets released from restrictions used for the purchase of property, plant and equipment	1,550	-	1,550
Distributions to noncontrolling interests	-	(324)	(324)
Repurchases of noncontrolling interests	3,860	(3,860)	-
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	35,993	(9,025)	26,968
TEMPORARILY RESTRICTED NET ASSETS:			
Restricted grants and contributions	3,860	39	3,899
Net assets released from restrictions	(3,352)	(46)	(3,398)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	508	(7)	501
INCREASE (DECREASE) IN TOTAL NET ASSETS	36,501	(9,032)	27,469
NET ASSETS, BEGINNING OF YEAR	411,237	172,041	583,278
NET ASSETS, END OF YEAR	$ 447,738	$ 163,009	$ 610,747

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Changes in Net Assets - Continued
(Dollars in Thousands)

Year Ended June 30, 2011

	Mountain States Health Alliance	*Noncontrolling Interests*	*Total*
UNRESTRICTED NET ASSETS:			
Excess of Revenue, Gains and Support over Expenses and Losses	$ 83,269	$ 3,393	$ 86,662
Pension and other defined benefit plan adjustments	620	617	1,237
Cumulative effect of a change in accounting principle - Note B	(2,965)	-	(2,965)
Net assets released from restrictions used for the purchase of property, plant and equipment	1,946	-	1,946
Distributions to noncontrolling interests	-	(270)	(270)
Repurchases of noncontrolling interests and other	40	(115)	(75)
INCREASE IN UNRESTRICTED NET ASSETS	82,910	3,625	86,535
TEMPORARILY RESTRICTED NET ASSETS:			
Restricted grants and contributions	3,612	58	3,670
Net assets released from restrictions	(3,787)	(52)	(3,839)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	(175)	6	(169)
INCREASE IN TOTAL NET ASSETS	82,735	3,631	86,366
NET ASSETS, BEGINNING OF YEAR	328,502	168,410	496,912
NET ASSETS, END OF YEAR	$ 411,237	$ 172,041	$ 583,278

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Cash Flows
(Dollars in Thousands)

	Year Ended June 30, 2012	Year Ended June 30, 2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	$ 27,469	$ 86,366
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Provision for depreciation and amortization	75,777	90,472
Loss on early extinguishment of debt	2,636	-
Cumulative effect of a change in accounting principle	-	2,965
Change in estimated fair value of derivatives	6,198	(23,049)
Equity in net income of joint ventures, net	(979)	(898)
Loss (gain) on disposal of assets	446	(367)
Amounts received on interest rate swap settlements	(7,515)	(5,072)
Gain on escrow restructuring - Note F	(5,337)	-
Income recognized through forward sale agreements	(864)	(864)
Gain on termination of swaption and forward sale agreements - Note D	(7,766)	-
Capital Appreciation Bond accretion and other	3,159	2,738
Restricted contributions	(3,899)	(3,670)
Pension and other defined benefit plan adjustments	2,234	(1,237)
Increase (decrease) in cash due to change in:		
Patient accounts receivable	(16,079)	(9,031)
Other receivables, net	(3,501)	(2,802)
Inventories and prepaid expenses	155	(643)
Trading securities	21,646	(123,966)
Other assets	(2,733)	(3,632)
Accrued interest payable	(1,522)	4,008
Accounts payable and accrued expenses	4,131	2,741
Accrued salaries, compensated absences and amounts withheld	(2,211)	11,361
Estimated amounts due to third-party payors, net	3,247	4,658
Other long-term liabilities	236	2,961
Estimated professional liability self-insurance	(348)	151
Total adjustments	67,111	(53,176)
NET CASH PROVIDED BY OPERATING ACTIVITIES	94,580	33,190
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(132,890)	(172,786)
Additions to goodwill	(5,725)	(279)
Net decrease in assets limited as to use	85,947	81,383
Purchases of held-to-maturity securities	(9,516)	(41,060)
Net distribution from joint ventures and unconsolidated affiliates	882	1,057
Proceeds from sale of property, plant and equipment	1,881	812
NET CASH USED IN INVESTING ACTIVITIES	(59,421)	(130,873)

	Year Ended June 30,	
	2012	***2011***
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt and capital lease obligations, including deposits to escrow	**(71,997)**	(37,735)
Payment of acquisition and financing costs	**(2,742)**	(1,716)
Proceeds from issuance of long-term debt and other financing arrangements	**67,451**	5,954
Payment on termination of swaption	**(93,353)**	-
Gain on escrow restructuring	**5,337**	-
Net amounts received on interest rate swap settlements	**7,515**	5,072
Restricted contributions received	**4,969**	4,350
NET CASH USED IN FINANCING ACTIVITIES	**(82,820)**	(24,075)
NET DECREASE IN CASH AND CASH EQUIVALENTS	**(47,661)**	(121,758)
CASH AND CASH EQUIVALENTS, beginning of year	**112,768**	234,526
CASH AND CASH EQUIVALENTS, end of year	**$ 65,107**	$ 112,768
SUPPLEMENTAL INFORMATION AND NON-CASH TRANSACTIONS:		
Cash paid for interest	**$ 41,168**	$ 39,507
Cash paid for federal and state income taxes	**$ 336**	$ 739
Construction related payables in accounts payable and accrued expenses	**$ 6,821**	$ 11,384
Property acquired through capital lease arrangement	**$ 13,959**	$ 15,951
Payable on termination of forward sale agreements in accounts payable and accrued expenses	**$ 13,429**	$ -
Land held for expansion placed in use	**$ 1,610**	$ 4,904

During the year ended June 30, 2012, the Alliance refinanced previously issued debt of $174,547.

NOTE A--ORGANIZATION AND OPERATIONS

Mountain States Health Alliance (the Alliance) is a tax-exempt entity with operations primarily located in Washington, Sullivan, and Carter counties of Tennessee and Smyth, Wise, Dickenson, Russell and Washington counties of Virginia. The initial funds for the establishment of the Alliance in 1945 were provided by individuals and various institutions. Membership of the Alliance consists of individuals and institutions who have contributed at least $100 to the capital fund of the Alliance and are entitled to vote at the annual election of the Board of Directors.

The primary operations of the Alliance consist of ten acute and specialty care hospitals, as follows:

- Johnson City Medical Center (JCMC) - licensed for 658 beds
- Indian Path Medical Center (IPMC) - licensed for 261 beds
- Smyth County Community Hospital (SCCH) - licensed for 153 beds
- Norton Community Hospital (NCH) - licensed for 129 beds
- Sycamore Shoals Hospital (SSH) - licensed for 121 beds
- Johnston Memorial Hospital (JMH) - licensed for 116 beds
- Franklin Woods Community Hospital (FWCH) - licensed for 80 beds
- Russell County Medical Center (RCMC) - licensed for 78 beds
- Dickenson Community Hospital (DCH) - licensed for 25 beds
- Johnson County Community Hospital (JCCH) - licensed for 2 beds

The Alliance has a 50.1% interest in JMH. JMH is also the sole member of Abingdon Physician Partners (APP), a non-taxable corporation that owns and manages physician practices.

The Alliance has a 50.1% interest in NCH. NCH is also the sole member or shareholder of DCH and Norton Community Physician Services, LLC (NCPS), a taxable corporation that consists of physician practices and a pharmacy and; Community Home Care (CHC), a taxable corporation that provides home medical equipment.

The Alliance has an 80% interest in SCCH. SCCH is the sole shareholder of Southwest Community Health Services, Inc. (SWCH), a taxable entity that operates a pharmacy and provides other health services.

The activities and accounts of JMH, NCH and SCCH are included in the accompanying consolidated financial statements.

The Alliance is the sole shareholder of Blue Ridge Medical Management Corporation (BRMM), a for-profit entity that owns and manages physician practices and provides other healthcare services to patients in Tennessee and Virginia. BRMM also operates as a medical office real estate developer by

NOTE A--ORGANIZATION AND OPERATIONS - Continued

owning, selling and leasing real estate to physician practices and other entities. BRMM is either the sole shareholder, a significant shareholder, or member of the following organizations:

Mountain States Physician Group, Inc. (MSPG): A company that contracts with physicians to provide services to BRMM physician practices.

Mountain States Properties, Inc. (MSPI): An entity that owns and manages certain real estate (primarily medical office buildings) and provides rehabilitation and fitness services. In addition, MSPI is counter-party to an interest rate swap.

Mediserve Medical Equipment of Kingsport, Inc. (Mediserve): A company that provides durable medical equipment services.

Kingsport Ambulatory Surgery Center (KASC) (d.b.a. Kingsport Day Surgery): A joint venture operating as an outpatient surgery center which performs procedures primarily in otolaryngology, orthopedics, ophthalmology, and general surgery. BRMM has a 43% ownership of KASC and maintains control over KASC through a management agreement. The accounts and activities of KASC are included in the accompanying consolidated financial statements.

Piney Flats Urgent Care (PFUC): A for-profit entity that provides urgent care patient services. BRMM has a 75% ownership of PFUC. The accounts and activities of PFUC are included in the accompanying consolidated financial statements.

Wilson Pharmacy, Inc. (Wilson): In August 2012, BRMM acquired Wilson, a Company that owns and operates retail pharmacies. BRMM purchased 100% of the total issued and outstanding capital stock of Wilson for $8,114 and recognized goodwill of $5,725.

The Alliance is the primary beneficiary of the activities of Mountain States Foundation, Inc. (MSF), a not-for-profit foundation formed to coordinate fundraising and development activities of the Alliance. The Alliance is also the beneficiary of the Mountain States Health Alliance Auxiliary (Auxiliary), a not-for-profit organization formed to coordinate volunteer activities of the Alliance. The activities and accounts of MSF and the Auxiliary are included in the accompanying consolidated financial statements.

The Alliance is a majority shareholder of Integrated Solutions Health Network, LLC (ISHN). The primary function of ISHN is to establish, operate and administer a provider-sponsored health care delivery network. The accounts and activities of ISHN are included in the accompanying consolidated financial statements.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Alliance and its subsidiaries after elimination of all significant intercompany accounts and transactions. The Alliance classifies those activities directly associated with its mission of providing healthcare services, as well as other activities deemed significant to its operations, as operating activities.

Noncontrolling Interests in Subsidiaries: The Alliance's accompanying consolidated financial statements include all assets, liabilities, revenues, expenses, and changes in net assets, including amounts attributable to the noncontrolling interest. Noncontrolling interests represent the portion of equity (net assets) into a subsidiary not attributable, directly or indirectly, to the Alliance. For the years ending June 30, 2012 and 2011, the Alliance attributed an Excess (Deficit) of Revenue, Gains and Support over Expenses and Losses of ($3,726) and $3,393, respectively, to the noncontrolling interests in JMH, NCH, SCCH, KASC, PFUC and ISHN based on the noncontrolling interests' respective ownership percentage.

Use of Estimates: The preparation of the 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 as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents: Cash and cash equivalents include all highly liquid investments with a maturity of three months or less when purchased. Cash and cash equivalents designated as assets limited as to use or uninvested amounts included in investment portfolios are not included as cash and cash equivalents on the Consolidated Balance Sheets.

Investments: Investments as reported in the Consolidated Balance Sheets include trading securities, held-to-maturity securities and assets limited as to use (Note C). The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-320, *Investments – Debt and Equity Securities*, allows not-for-profit organizations to report in a manner similar to business entities by identifying securities as available-for-sale or held-to-maturity and to exclude the unrealized gains and losses on those securities from the Performance Indicator (as defined below). Investments which the Alliance has the positive intent and ability to hold to maturity are considered as held-to-maturity. Substantially all other investments are considered as trading securities. Management annually evaluates the held-to-maturity investment portfolio and recognizes any "other-than-temporary" losses as deductions from the Performance Indicator. Management's evaluation considers the amount of decline in fair value, as well as the time period of any such decline.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Management does not believe any investment classified as held-to-maturity is other-than-temporarily impaired at June 30, 2012.

Within the trading securities portfolio, all debt securities and marketable equity securities with readily determinable fair values are reported at fair value based on quoted market prices. Investments without readily determinable fair values are reported at estimated fair market value pursuant to FASB ASC 825, *Financial Instruments*. Guaranteed investment contracts are reported at contract value.

Realized gains and losses on trading securities and assets limited as to use are computed using the specific identification method for cost determination. Interest and dividend income is reported net of related investment fees.

Investments in joint ventures are reported under the equity method of accounting, which approximates the Alliance's equity in the underlying net book value, unless the ownership structure requires consolidation. Other assets include investments in joint ventures of $2,153 and $2,367 at June 30, 2012 and 2011, respectively.

Inventories: Inventories, consisting primarily of medical supplies, are stated at the lower of cost or market.

Property, Plant and Equipment: Property, plant and equipment is stated on the basis of cost, or if donated, at the fair value at the date of gift. Generally, depreciation is computed by the straight-line method over the estimated useful life of the asset. Equipment held under capital lease obligations is amortized under the straight-line method over the shorter of the lease term or estimated useful life. Amortization of buildings and equipment held under capital leases is shown as a part of depreciation expense and accumulated depreciation in the accompanying consolidated financial statements. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets.

The Alliance reviews capital assets for indications of potential impairment when there are changes in circumstances related to a specific asset. If this review indicates that the carrying value of these assets may not be recoverable, the Alliance estimates future cash flows from operations and the eventual disposition of such assets. If the sum of these undiscounted future cash flows is less than

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

the carrying amount of the asset, a write-down to estimated fair value is recorded. The Alliance did not recognize any impairment losses during 2012 and 2011.

Other assets include property held for resale and property held for expansion of $2,620 and $4,230, respectively, at June 30, 2012 and 2011. During 2012, property held for expansion totaling approximately $1,610 was transferred to property, plant and equipment in conjunction with the construction of a replacement facility for SCCH. During 2011, property held for expansion totaling approximately $4,904 was transferred to property, plant and equipment in conjunction with the construction of FWCH. Property held for resale and property held for expansion primarily represent land contributed to, or purchased by, the Alliance plus costs incurred to develop the infrastructure of such land. Management annually evaluates its investment and records non-temporary declines in value when it is determined the ultimate net realizable value is less than the recorded amount. No such declines were identified in 2012 and 2011.

Goodwill: Goodwill represents the difference between the acquisition cost of assets and the estimated fair value of net tangible and any separately identified intangible assets. Effective July 1, 2010, the Alliance adopted ASC 350, *Intangibles – Goodwill and Other*, which requires goodwill to be evaluated for impairment at least annually. Upon adoption of ASC 350, the Alliance was required to perform a transitional impairment test. As a result of this testing, management determined that as of July 1, 2010 approximately $2,965 of goodwill associated with one of its reporting units was impaired, and such impairment has been reflected as the Cumulative Effect of a Change in Accounting Principle in the 2011 Consolidated Statement of Changes in Net Assets.

In September 2011, the FASB issued Accounting Standards Update (ASU) 2011-08 which allows entities to use a qualitative approach to determine whether the fair value of a reporting unit is more likely than not impaired. The Alliance early adopted the provisions of this ASU and, based upon this qualitative analysis, management does not believe it is more likely than not that goodwill associated with any of its reporting units is impaired as of June 30, 2012. The reporting unit for evaluation of substantially all such goodwill is the Alliance's aggregate acute-care operations.

Deferred Financing, Acquisition Costs and Other Charges: Other assets, including deferred financing, acquisition costs and other charges, total $28,187 and $29,844 at June 30, 2012 and 2011, respectively. Deferred financing costs are amortized over the life of the respective bond issue principally using the average bonds outstanding method. Other intangible assets include licenses and similar assets and are being amortized over the intangible's estimated useful life under the straight-line method.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Prior to 2009, the Alliance routinely financed interest rate swap and other derivative transaction issuance costs through modification of future settlement terms. As such, the unamortized issuance costs of these derivatives are included as deferred financing costs in the accompanying Consolidated Balance Sheets and are being amortized over the term of the respective derivative instrument. The unpaid issuance costs are included as a part of the estimated fair value of derivatives in the accompanying Consolidated Balance Sheets. Subsequent to 2009, interest rate swap and derivative transaction issuance costs were expensed as incurred.

Derivative Financial Instruments: As further described in Note D, the Alliance is a party to interest rate swap and other derivative agreements. These financial instruments are not designated as hedges and have been presented at estimated fair market value in the accompanying Consolidated Balance Sheets as either current or long-term liabilities, based upon the remaining term of the instrument. Changes in the estimated fair value of these derivatives are included in the Consolidated Statements of Operations as part of nonoperating gains (losses). Net settlements and other related income of derivatives are also reflected as a part of the Performance Indicator (described below).

These fair values are based on the estimated amount the Alliance would receive, or be required to pay, to enter into equivalent agreements at the valuation date and include an estimated credit value adjustment. The fair value of various derivatives are netted on the Consolidated Balance Sheets based on management's evaluation of the settlement provisions in the master contract. Gross positions of these derivatives are disclosed in Note D. Due to the nature of these financial instruments, such estimates of fair value are subject to significant change in the near term.

Estimated Professional Liability Self-Insurance and Other Long-Term Liabilities: Self-insurance liabilities include estimated reserves for reported and unreported professional liability claims (Note G) and are recorded at the estimated net present value of such claims. Other long-term liabilities include contributions payable and obligations under deferred compensation arrangements, a defined benefit pension plan, a post-retirement employee benefit plan as well as other liabilities which management estimates are not payable within one year.

Net Patient Service Revenue/Receivables: Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts, 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 adjusted in future periods as final settlements are determined. The Alliance's revenue recognition policies related to self-pay and other types of payors emphasize revenue recognition only when collections are reasonably assured.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Patient accounts receivable are reported net of both an estimated allowance for uncollectible accounts and an estimated allowance for contractual adjustments. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, Medicaid, TennCare and other third-party payment programs. Current operations include a provision for bad debts in the Consolidated Statements of Operations estimated based upon the age of the patient accounts receivable, historical writeoffs and recoveries and any unusual circumstances (such as local, regional or national economic conditions) which affect the collectibility of receivables, including management's assumptions about conditions it expects to exist and courses of action it expects to take. Additions to the allowance for uncollectible accounts result from the provision for bad debts. Patient accounts written off as uncollectible are deducted from the allowance for uncollectible accounts.

For uninsured patients that do not qualify for charity care, the Alliance recognizes revenue on the basis of discounted rates under the Alliance's self-pay patient policy. Under the policy, a patient who has no insurance and is ineligible for any government assistance program has his or her bill reduced to the amount which generally would be billed to a commercially insured patient.

The Alliance's policy does not require collateral or other security for patient accounts receivable. The Alliance routinely accepts assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans or policies.

Charity Care: The Alliance accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the Alliance and various guidelines outlined by the Federal Government. These policies define charity as those services for which no payment is anticipated and, as such, charges at established rates are not included in net patient service revenue. The estimated direct and indirect cost of providing these services totaled approximately $24,709 and $18,158 in 2012 and 2011, respectively. Such costs are determined using a ratio of cost to charges analysis with indirect cost allocated under a reasonable and systematic approach.

In addition to the charity care services described above, the Alliance provides a number of other services to benefit the poor for which little or no payment is received. Medicare, Medicaid, TennCare and State indigent programs do not cover the full cost of providing care to beneficiaries of those programs. The Alliance also provides services to the community at large for which it receives little or no payment.

Excess (Deficit) of Revenue, Gains and Support Over Expenses and Losses: The Consolidated Statements of Operations and the Consolidated Statements of Changes in Net Assets includes the

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

caption *Excess (Deficit) of Revenue, Gains and Support Over Expenses and Losses* (the Performance Indicator). Changes in unrestricted net assets which are excluded from the Performance Indicator, consistent with industry practice, include contributions of long-lived assets or amounts restricted to the purchase of long-lived assets, pension and related adjustments, and distributions to, or contributions from, owners and transactions with noncontrolling interests.

Income Taxes: The Alliance is classified as an organization exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. As such, no provision for income taxes has been made in the accompanying consolidated financial statements for the Alliance and its tax-exempt subsidiaries. Taxable entities account for income taxes in accordance with FASB ASC 740, *Income Taxes* (Note L). The Alliance has no significant uncertain tax positions at June 30, 2012 and 2011.

Temporarily and Permanently Restricted Net Assets: Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. When a donor or time restriction expires; that is, when a stipulated time restriction ends or purpose restriction is fulfilled, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the Consolidated Statements of Operations and Consolidated Statements of Changes in Net Assets as net assets released from restrictions. The Alliance's policy is to net contribution and grant revenues against related expenses and present such amounts as a part of other nonoperating gains (losses) in the Consolidated Statements of Operations. Permanently restricted net assets have been restricted by donors to be maintained by the Alliance in perpetuity.

Fair Value Measurement: The Alliance had previously adopted FASB ASC 820, *Fair Value Measurements and Disclosures,* which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements.

Subsequent Events: The Alliance evaluated all events or transactions that occurred after June 30, 2012, through October 26, 2012, the date the consolidated financial statements were available to be issued. During this period management did not note any material recognizable subsequent events that required recognition or disclosure in the June 30, 2012 consolidated financial statements, other than as discussed in Notes D and S.

New Accounting Pronouncements: In July 2011, the FASB issued ASU 2011-07, *Healthcare Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and Allowance for Doubtful Accounts for Certain Healthcare Entities*, which requires certain healthcare entities reclassify the provision for bad debts associated with providing patient care from an operating expense to a deduction from net patient service revenue in the Consolidated

(Dollars in Thousands)

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Statements of Operations. Additionally, ASU 2011-07 requires enhanced disclosures about an entity's policies for recognizing revenue and assessing bad debts and qualitative and quantitative information about changes in the allowance for doubtful accounts. The Alliance retroactively adopted ASU 2011-07 in fiscal year 2012. The adoption of ASU 2011-07 did not have a material impact on the 2012 or 2011 consolidated financial statements.

In August 2010, the FASB issued ASU 2010-24, *Health Care Entities – Presentation of Insurance Claims and Related Insurance Recoveries* (ASU 2010-24). The amendments in ASU 2010-24 clarify that a healthcare entity may not net insurance recoveries against related claim liabilities. In addition, the amount of the claim liability must be determined without consideration of insurance recoveries. The Alliance adopted ASU 2010-24 prospectively during 2012. The adoption of ASU 2010-24 did not have a material impact on the consolidated financial statements.

In August 2010, the FASB issued ASU 2010-23, *Health Care Entities – Measuring Charity Care for Disclosure.* ASU 2010-23 is intended to reduce the diversity in practice regarding the measurement basis used in the disclosure of charity care. ASU 2010-23 requires that cost, identified as the direct and indirect costs of providing the charity care, be used as the measurement basis for disclosure purposes. ASU 2010-23 also requires disclosure of the method used to identify or determine such costs. The Alliance adopted ASU 2010-23 in 2012. The adoption of ASU 2010-23 did not have a material impact on the consolidated financial statements.

Reclassifications: Certain 2011 amounts have been reclassified to conform with the 2012 presentation in the accompanying consolidated financial statements.

NOTE C--INVESTMENTS

Assets limited as to use are summarized by designation or restriction as follows at June 30:

	2012	***2011***
Designated or restricted:		
Under safekeeping agreements and other	$ 24,026	$ 28,349
Under guarantee agreements	-	92,720
By Board for capital improvements	4	4

(Dollars in Thousands)

NOTE C--INVESTMENTS - Continued

	2012	2011
Under bond indenture agreements:		
For debt service and interest payments	77,602	67,874
For capital acquisitions	29,578	28,835
	131,210	217,782
Less: amount required to meet current obligations	(36,557)	(116,175)
	$ 94,653	$ 101,607

Assets limited as to use consist of the following at June 30:

	2012	2011
Cash, cash equivalents and money market funds	$ 80,304	$ 115,579
U.S. Government securities	8,582	1,795
U.S. Agency securities	40,398	7,688
Municipal obligations	1,926	-
Guaranteed investment contract	-	92,720
	$ 131,210	$ 217,782

Trading securities consist of the following at June 30:

	2012	2011
Cash, cash equivalents and money market funds	$ 5,186	$ 29,159
U.S. Government securities	10,697	9,409
U.S. Agency securities	26,165	31,551
Corporate and foreign bonds	52,581	32,895
Municipal obligations	961	451
Preferred and asset backed securities	11,183	8,945
U.S. equity securities	28,344	21,774
Mutual funds	141,968	166,708
Other	34,880	32,718
	$ 311,965	$ 333,610

Held-to-maturity securities (other than assets limited as to use) are carried at amortized cost and consist of the following at June 30:

(Dollars in Thousands)

NOTE C--INVESTMENTS - Continued

	2012	2011
Cash, cash equivalents and money market funds	$ 298	$ 753
Corporate and foreign bonds	138,232	135,745
Municipal obligations	15,549	9,661
	$ 154,079	$ 146,159

Held-to-maturity securities had gross unrealized gains and losses of $11,432 and $33, respectively, at June 30, 2012 and $6,838 and $276, respectively at June 30, 2011. At June 30, 2012, the Alliance held no securities within the held-to-maturity portfolio which had been at an unrealized loss position for over one year. At June 30, 2011, the Alliance held nine securities within the held-to-maturity portfolio with a fair value and unrealized loss of $549 and $44, respectively, which had been at an unrealized loss position for over one year. At June 30, 2012, the contractual maturities of held-to-maturity securities were $11,225 due in one year or less, $67,532 due from one to five years and $75,322 due after five years. At June 30, 2011, the contractual maturities of held-to-maturity securities were $13,816 due in one year or less, $55,563 due from one to five years and $76,780 due after five years.

At June 30, 2012 and 2011, the Alliance held investments in certain limited partnerships and hedge funds of $34,880 and $32,718, respectively, that have a wide range of investment strategies with various levels of risk. These funds are included within trading securities and do not have readily determinable fair values. The funds are reported at estimated fair market value pursuant to FASB ASC 825, *Financial Instruments*.

NOTE D--DERIVATIVE TRANSACTIONS

The Alliance is a party to a number of derivative transactions. These derivatives have not been designated as hedges and are valued at estimated fair value in the accompanying Consolidated Balance Sheets. Management's primary objective in holding such derivatives is to introduce a variable rate component into its fixed rate debt structure. Under the terms of these agreements, changes in the interest rate environment could have a significant effect on the Alliance.

These derivative agreements require that the Alliance post additional collateral for the derivatives' fair market value deficits above specified levels. Such investments are included as assets limited as to use. As of June 30, 2012, management believes the Alliance was fully collateralized with respect to the derivative agreements and management does not believe such collateral is exposed to third-party credit risk.

(Dollars in Thousands)

NOTE D--DERIVATIVE TRANSACTIONS - Continued

Interest Rate Swaps: The Alliance is a party to six interest rate swap agreements with Bank of America, Merrill Lynch as the counterparty. The terms of five of these agreements were modified without settlement during 2011. No gain or loss was realized as a result of the modifications although such modifications did impact the estimated fair value of the interest rate swaps. A liability, representing the estimated net fair value of these swaps, of $8,765 and $8,123 was recognized by the Alliance as of June 30, 2012 and 2011, respectively.

The following is a summary of five of these interest rate swap agreements at June 30, 2012:

			Payments by:		
Swap	*Notional Amount*	*Term*	*Counterparty*	*Alliance*	*Estimated Fair Value*
A	$ 170,000	4/2008-4/2026	1.265% through April 2013; 1.07% through April 2014; then 71.10% of USD-ISDA Swap Rate	0.00% through April 2014, then USD-SIFMA	$ 3,500
B	95,000	4/2008-4/2026	1.265% through April 2013; 1.08% through April 2014; then 71.18% of USD-ISDA Swap Rate	0.00% through April 2014, then USD-SIFMA	1,983
C	173,030	4/2008-4/2034	1.315% through April 2013; 1.12% through April 2014; then 72.35% of USD-ISDA Swap Rate	0.00% through April 2014, then USD-SIFMA	(513)
D	82,055	12/2007-7/2033	3.493% through July 2012; then 0% USD-LIBOR-BBA through July 2012, then 67% USD-LIBOR-BBA	4.41% through July 2012; then .312% USD-SIFMA	(9,520)
E	50,000	2/2008-7/2038	67.00% of USD-LIBOR-BBA plus .145%	USD-SIFMA	(3,895)

Deferred financing and acquisition costs, net of amortization, include $6,135 and $6,480 at June 30, 2012 and 2011, respectively, related to these swaps.

In addition to the interest rate swaps described above, the Alliance and Bank of America, Merrill Lynch are also parties to a total return swap. The notional amount of the total return swap is equal to the outstanding 2001A Hospital Revenue and Improvement Bonds which was $22,300 at June 30, 2012. The estimated fair value of the total return swap was $(320) and $(340) at June 30, 2012 and 2011, respectively. The terms of the swap were modified without settlement during 2012. No gain or loss was realized as a result of the modifications although such modifications did impact the swap's estimated fair value. The payment terms, as amended consist of the following:

NOTE D--DERIVATIVE TRANSACTIONS - Continued

- Beginning July 1, 2012, the Alliance will pay a variable rate of USD-SIFMA plus basis points ranging from 65 to 400, depending on the Alliance's bond rating as set forth by Standard and Poor's Ratings Service and Moody's Investors Service. The Alliance will receive a fixed rate of 4.50% and settlements will be made semi-annually through July 1, 2015.

- A "total return provision" under which the Alliance will pay (or receive) an amount equal to the product of the outstanding 2001A Reference Bonds multiplied by the difference between the outstanding 2001A Reference Bonds and the 2001A Reference Bonds' market price at termination, as defined in the agreement.

In addition to the six interest rate swaps discussed above, the Alliance is also a party to an interest rate swap with Regions Bank (the Regions swap) and an interest rate swap with First Tennessee Bank National Association (the FTB swap). The Regions swap was entered into in July 2011 and terminates in August 2012. The FTB swap was entered into in June 2010 and terminates in July 2015. The notional amounts of the Regions swap and FTB swap were $13,727 and $5,524, respectively, at June 30, 2012. A liability, representing the estimated net fair value of these swaps, of $221 was recognized by the Alliance as of June 30, 2012. The estimated fair value of the FTB swap was not significant at June 30, 2011.

The Alliance was previously a party to a total return swap with Lehman Brothers as the counterparty. Lehman Brothers filed for bankruptcy in September 2008. The Alliance subsequently received notification from Lehman Brothers Special Financing, Inc. indicating the intent of the counterparty to terminate this agreement effective January 1, 2009. The Alliance and Lehman Brothers Special Financing, Inc. were unable to reach a settlement agreement at the time the swap was terminated.

An estimated liability related to the agreement of $10,395 and $10,565 was recognized by the Alliance at June 30, 2012 and 2011. In addition, a third party holds investments with a fair market value of approximately $13,809 and $13,381, respectively, at June 30, 2012 and 2011 as collateral. The collateral and estimated liability related to this agreement are classified as current in the accompanying Consolidated Balance Sheets.

At June 30, 2012, the parties were undergoing alternate dispute resolution, including non-binding arbitration. Subsequent to year end, the parties reached a tentative settlement agreement. In full settlement of the liability, the Alliance will pay the counterparty $7,375 from the funds held as collateral and the remaining collateral will be returned to the Alliance.

NOTE D--DERIVATIVE TRANSACTIONS - Continued

Interest Rate Swap Option: In June 2004, the Alliance entered into an agreement with Bear Stearns (acquired by JP Morgan) whereby Bear Stearns purchased from the Alliance an option to enter into an interest rate swap agreement (swaption) with the Alliance beginning July 1, 2011, which is an optional redemption date related to the Alliance's early extinguished 2000A and 2000B Bonds (Note F). The purpose of this agreement was to effectively sell the call features related to the early extinguished Series 2000A and 2000B Bonds. As consideration under this agreement, the Alliance received a total of $42,500 in upfront payments as the swaption premium. Such amounts were initially recorded as estimated fair value of derivatives in the Consolidated Balance Sheets.

During 2012, the counterparty expressed their intent to exercise the swaption on January 1, 2012 and the Alliance exercised its right to terminate the swaption at its fair market value. The swaption was terminated on October 13, 2011. To effectuate the termination, the Alliance transferred $93,353 of a Guaranteed Investment Contract (GIC), described below, to the third party as a termination payment. A gain of $3,058 was recognized on the termination, which is included within other nonoperating gains (losses) in the accompanying 2012 Consolidated Statement of Operations.

A liability of $92,044, representing the estimated fair value of the swaption at June 30, 2011, respectively, is included in estimated fair value of derivatives in the accompanying 2011 Consolidated Balance Sheet. The change in estimated fair value of derivatives in the accompanying Consolidated Statements of Operations for 2012 and 2011 includes an unrealized loss of $4,676 and $2,394, respectively, related to this derivative, prior to termination.

Forward Sale Agreements: In June 2004, the Alliance entered into two related forward sale agreements with the counterparty to the swaption agreements and the Master Trustee of the Series 2000 Bonds. The forward sale agreements originally related to the Debt Service Reserve Fund and to the Debt Service Fund, respectively, (collectively, the "Funds"), as established under provisions of the Master Trust Indenture related to the issuance of the Series 2000 Bonds. In consideration of the future earnings on the Funds, the counterparty paid the Master Trustee a total of $30,000 during 2005, to be held on behalf of the Alliance. As the original intent of these Funds was to secure debt service payments under the above referenced Bonds, the agreement requires these funds to be held under a guaranty agreement as further described below.

In June 2006, one of these agreements was amended to also relate to the Series 2000C, 2000D, 2006A and 2006B Bonds, and to remove the Series 2000A Bonds from consideration under the agreement. In connection with the issuance of the Series 2007 Bonds and the derecognition of a portion of the Series 2000A Bonds, all of the outstanding Series 2000B Bonds, and all of the outstanding 2006B Bonds (Note F), one of these agreements as it relates to the Series 2000A and 2000B Bonds was partially terminated. As such, during 2008 the Alliance reduced its liability with respect to the portion related to the Series 2000A and 2000B Bonds, and paid the counterparty

(Dollars in Thousands)

NOTE D--DERIVATIVE TRANSACTIONS - Continued

$6,186 under the terms of the agreement. The agreement was amended in fiscal year 2011 to include the Series 2010A Bonds and to remove the Series 2000B and 2006B Bonds.

Amounts were being recognized as investment income over the life of the agreements. A liability of $19,001 representing the unamortized payments from the counterparty at June 30, 2011 is included as part of deferred revenue in the accompanying 2011 Consolidated Balance Sheet.

In June 2012, the Alliance and the counterparty terminated the two forward sale agreements. To effectuate the termination, the Alliance agreed to pay $13,429 to the counterparty. At June 30, 2012, the termination payable was included in accounts payable and accrued expenses in the accompanying 2012 Consolidated Balance Sheet. The Alliance recognized a gain of $4,708 on the termination of these agreements, which is included within other nonoperating gains (losses) in the accompanying 2012 Consolidated Statement of Operations.

Pursuant to these agreements, the counterparty required that the Alliance's obligations under the swaption and forward sale agreements be collateralized under a guarantee agreement in favor of the counterparty. Due to various requirements of the Master Trust Indenture, the Alliance had previously transferred to MSF a total of $42,500 that was in turn deposited with the counterparty as collateral in a GIC. Amounts received under the forward sale agreements were also deposited into the GIC. All GIC deposits earn interest compounded at 4.14% for the first year, and at 3.5% thereafter through July 1, 2011. The GIC deposits as of June 30, 2011 totaled $92,720. The GIC was substantially utilized on October 13, 2011 to terminate the swaption discussed above and, as such, is included in the current portion of assets whose use is limited in the 2011 Consolidated Balance Sheet.

NOTE E--PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following at June 30:

	2012	2011
Land	$ 69,356	$ 63,749
Buildings and leasehold improvements	661,146	454,852
Property and improvements held for leasing	74,914	80,568
Equipment	571,774	532,767
Buildings and equipment held under capital lease	20,540	42,720
	1,397,730	1,174,656

(Dollars in Thousands)

NOTE E--PROPERTY, PLANT AND EQUIPMENT - Continued

	2012	*2011*
Less: Allowances for depreciation and amortization	(626,552)	(586,471)
	771,178	588,185
Construction in progress (Note N)	94,278	209,233
	$ 865,456	$ 797,418

Accumulated depreciation and amortization on property and improvements held for leasing purposes is $22,951 and $23,348 at June 30, 2012 and 2011, respectively. Net interest capitalized was $3,110 and $10,640 for the years ended June 30, 2012 and 2011, respectively.

During 2012, the Alliance executed an Amendment and Mutual Release Agreement with a vendor whereby the Alliance waived its right to take any action with respect to prior contracts in exchange for professional services in future periods, primarily related to accelerated deployment of information systems. The Alliance recognized approximately $3,200 in 2012 as additions to property, plant and equipment with an offsetting gain related to the agreed-upon value of such professional services. The Alliance anticipates recognition of additional amounts in future periods as such services are provided.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS

Long-term debt and capital lease obligations consist of the following at June 30:

			Outstanding Balance	
Description	*Maturities*	*Rates*	*2012*	*2011*
2011A Hospital Revenue Bonds	$65,260 uninsured term bonds, due July 1, 2033, subject to early redemption or tender	Variable, 0.19% at June 30, 2012	$ 65,260	$ -
2011B Hospital Revenue Bonds	$20,000 uninsured term bonds, due July 1, 2033, subject to early redemption or tender	Variable, 0.19% at June 30, 2012	20,000	-
2011C Hospital Revenue Bonds	$49,875 uninsured term bonds, due July 1, 2031, subject to early redemption or tender	Variable, 0.16% at June 30, 2012	49,875	-
2011D Hospital Revenue Bonds	$60,705 uninsured term bonds, due July 1, 2031, subject to early redemption or tender	Variable, 0.19% at June 30, 2012	60,705	-
2011E Taxable Bonds	$15,960 uninsured term bonds, due July 1, 2026, subject to early redemption or tender	Variable, 0.24% at June 30, 2012	15,960	-
2011 Hospital Facility Revenue Refunding and Improvement Bonds (JMH)	$24,870 uninsured term bonds, due July 1, 2033, subject to early redemption or tender	Variable, 1.2% at June 30, 2012	24,870	-
2010A Hospital Revenue Bonds, net of unamortized premium of $1,017 and $1,056 at June 30, 2012 and 2011, respectively	$32,515 uninsured serially, through 2020 $14,985 uninsured term bonds, due July 1, 2025 $19,385 uninsured term bonds, due July 1, 2030 $39,570 uninsured term bonds, due July 1, 2038 $55,480 uninsured term bonds, due July 1, 2038	3.00% to 5.00% 5.38% 5.63% 6.50% 6.00%	162,952	169,137

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Description	Maturities	Rates	Outstanding Balance 2012	2011
2010B Hospital Revenue Bonds, net of unamortized premium of $669 and $711 at June 30, 2012 and 2011, respectively	$23,855 uninsured serially, through 2020 $4,355 uninsured term bonds, due July 1, 2023 $4,250 uninsured term bonds, due July 1, 2028	2.50% to 5.00% 5.00% 5.50%	33,129	36,646
2009A Hospital Revenue Bonds, net of unamortized discount of $117 and $121 at June 30, 2012 and 2011, respectively	$725 uninsured term bonds, due July 1, 2019 $1,730 uninsured term bonds, due July 1, 2029 $3,105 uninsured term bonds, due July 1, 2038	7.25% 7.50% 7.75%	5,443	5,439
2009B Hospital Revenue Bonds	$5,535 uninsured term bonds, due July 1, 2038	8.00%	5,535	5,535
2009C Hospital Revenue Bonds, net of unamortized discount of $2,334 and $2,421 at June 30, 2012 and 2011, respectively	$21,100 uninsured term bonds, due July 1, 2019 $20,000 uninsured term bonds, due July 1, 2029 $74,855 uninsured term bonds, due July 1, 2038	7.25% 7.50% 7.75%	113,621	113,534
2008A Hospital Revenue Bonds	$13,245 uninsured term bonds, due July 1, 2038, subject to early redemption or tender	Variable, 0.19% at June 30, 2012	13,245	13,245
2008B Hospital Revenue Bonds	$52,930 uninsured term bonds, due July 1, 2038, subject to early redemption or tender	Variable, 0.19% at June 30, 2012	52,930	53,855
2007B Taxable Hospital Revenue Bonds, bifurcated into sub-series B-1, B-2 and B-3 during 2011	$156,760 uninsured term bonds, due July 1, 2033, subject to early redemption or tender	Variable, 0.20% to 0.23% at June 30, 2012	156,760	307,900
2006A Hospital First Mortgage Revenue Bonds, net of unamortized premium of $141 and $147 at June 30, 2012 and 2011, respectively	$5,940 uninsured serially, through 2019 $7,375 uninsured term bonds, due July 1, 2026 $20,505 uninsured term bonds, due July 1, 2031 $135,175 uninsured term bonds, due July 1, 2036	5.00% 5.25% 5.50% 5.50%	169,136	169,782
2001A Hospital First Mortgage Revenue Bonds, re-issued in 2012	$22,300 term bonds, due July 1, 2026, subject to early redemption or tender	4.50% as re-issued	22,300	23,100
2001 Hospital Refunding and Improvement Revenue Bonds (NCH), net of unamortized discount of $34 June 30, 2011	Redeemed in 2012	N/A	-	11,876
2000A Hospital First Mortgage Revenue Refunding Bonds	$32,431 insured Capital Appreciation Bonds, interest and principal due July 1, 2026 through 2030	6.63%	32,431	30,358
2000C Hospital First Mortgage Revenue Bonds	$33,230 insured term bonds, due July 1, 2026	8.50%	33,230	34,325
2000D First Mortgage Taxable Bonds	$14,315 insured term bonds, due July 1, 2026	8.50%	14,315	14,790
1998 Hospital Refunding and Improvement Revenue Bonds (JMH)	Redeemed in 2012	N/A	-	14,115
Capitalized lease obligation	Lease paid-off in 2012	N/A	-	13,656
$7,500 promissory note	Note paid-off in 2012	N/A	-	5,473
Capitalized lease obligations secured by equipment	Various monthly payments of monthly principal and interest	Various	1,645	2,518
$1,065 note payable	Note paid-off in 2012	N/A	-	572
$6,332 promissory note	Promissory note paid-off in 2012	N/A	-	5,945
$3,955 note payable	Note paid-off in 2012	N/A	-	3,743
Notes payable under Master Financing Agreement	Notes paid-off in 2012	N/A	-	14,011
$1,885 line of credit	Line of credit paid-off in 2012	N/A	-	1,873
$1,593 note payable, secured by equipment	Various annual principal payments through July 2014	Unspecified	1,343	1,593
Capitalized lease obligation secured by medical office building (JMH)	Maturing through 2026 - Note S	9.72%	15,498	15,952
Master installment payment agreement	Various quarterly payments through May 2014	Unspecified	4,438	112

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Description	*Maturities*	*Rates*	*Outstanding Balance* 2012	*Outstanding Balance* 2011
Master installment payment agreement, secured by equipment	Various quarterly payments through May 2014	Unspecified	3,032	-
$1,870 note payable, secured by land	Monthly principal payments of $10 through maturity in July 2015	Unspecified	1,870	-
$1,052 in promissory notes secured by assets of Emmaus Community Healthcare, LLC	Various monthly principal and interest payments through 2019	3.00% - 3.75%	1,052	-
			1,080,575	1,069,085
	Less current portion		(32,477)	(28,162)
			$ 1,048,098	$ 1,040,923

Series 2011 Bonds: In October 2011, the Alliance issued $65,260 (Series 2011A) and $20,000 (Series 2011B) variable rate tax-exempt Hospital Revenue Bonds through The Health and Educational Facilities Board of the City of Johnson City, Tennessee, $49,875 (Series 2011C) and $60,705 (Series 2011D) variable rate tax-exempt Hospital Revenue Bonds through the Industrial Development Authority of Smyth, Virginia and $15,960 (Series 2011E) variable rate Taxable Bonds (collectively, the Series 2011 Bonds). The Series 2011 Bonds bear interest at a variable rate determined by a remarketing agent based upon a weekly rate period. The proceeds from the Series 2011A and Series 2011B Bonds were used to finance certain capital acquisitions in the State of Tennessee and pay issuance costs related to these Bonds. The proceeds from the Series 2011C and 2011D Bonds were used to refinance the 2001 NCH Hospital Refunding and Improvement Revenue Bonds, finance capital acquisitions for NCH, JMH and SCCH and to pay issuance costs associated with these Bonds. The Series 2011E Bond proceeds were used to refinance certain capital acquisitions of SCCH and BRMMC and pay issuance costs. The timely payment of the Series 2011 Bonds is secured by a letter of credit which expires October 19, 2014.

In November 2011, JMH issued $24,870 (JMH Series 2011) variable rate tax-exempt Hospital Facility Revenue Refunding and Improvement Bonds through the Industrial Development Authority of Smyth County. The JMH Series 2011 Bonds bear interest at a variable rate determined by a remarketing agent based upon a weekly rate period. The proceeds from the JMH Series 2011 Bonds were used to refinance the 1998 Hospital Refunding and Improvement Revenue Bonds, refinance existing indebtedness incurred to finance capital acquisitions and to pay issuance costs associated with the Bonds.

Series 2010 Bonds: In April 2010, the Alliance issued $168,080 (Series 2010A) and $35,935 (Series 2010B) fixed rate Hospital Refunding Revenue Bonds (collectively, the Series 2010 Bonds). Proceeds of the Series 2010A and the Series 2010B Bonds were used to refinance outstanding indebtedness, specifically related to the Alliance's facilities in Tennessee and in Virginia, respectively, fund debt service reserve funds and pay costs of issuance.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Series 2009 Bonds: In March 2009, the Alliance issued $5,560 (Series 2009A), $5,535 (Series 2009B) and $115,955 (Series 2009C) fixed rate Hospital Revenue Bonds (collectively, the Series 2009 Bonds). The proceeds of Series 2009 Bonds were used to refinance a portion of the outstanding Series 2006C Taxable Notes, which were originally issued to finance a capital commitment to SCCH and purchase certain leased assets, finance the acquisition of a majority ownership in JMH, fund a debt service reserve fund and pay costs of issuance. The portion of the 2006C taxable notes which were not refinanced with the Series 2009 Bonds were repaid with cash on hand.

Series 2008 Bonds: In February 2008, the Alliance issued $72,770 (Series 2008A) and $54,230 (Series 2008B) variable rate Hospital Revenue Bonds (collectively, the Series 2008 Bonds). The proceeds of Series 2008 Bonds were primarily used to finance certain future capital projects for the Alliance's hospital facilities and for the repayment of previously issued 2008 Taxable Notes used for the acquisition of RCMC. The payment of principal and interest on the Series 2008 Bonds and the purchase price of any tendered bonds on each series are secured by a separate, irrevocable, transferable, direct-pay letter of credit. A portion ($59,525) of the Series 2008A Bonds were repaid from proceeds of the Series 2010 Bonds.

Series 2007 Bonds: In December 2007, the Alliance issued $104,355 (Series 2007A), $327,170 (Series 2007B taxable) and $36,575 (Series 2007C) variable rate Hospital Revenue Bonds (collectively, the Series 2007 Bonds). The proceeds of Series 2007 Bonds were primarily used to early extinguish a portion of the outstanding Series 2000A Bonds, all of the outstanding 2000B Bonds, all of the outstanding Series 1994 Bonds, and all of the outstanding Series 2006B Bonds; to finance the acquisition of a majority ownership in NCH, and to finance certain capital improvements and equipment acquisitions for the Alliance's hospital facilities. A portion of the outstanding Series 2007A ($91,685) and Series 2007C ($32,840) Bonds were repaid from proceeds of the Series 2010 Bonds.

During 2011, the remaining outstanding Series 2007A and Series 2007C Bonds were redeemed and the existing 2007B Bonds were repaid through a remarketing of Sub-Series 2007B-1, 2007B-2 and 2007B-3 (collectively, the Sub-Series 2007B Bonds), created per the mandatory tender and letter of credit substitution provisions. The payment of principal and interest on the Sub-Series 2007B Bonds and the purchase price of any tendered bonds on each series are secured by a separate, irrevocable, transferable, direct-pay letter of credit.

During 2012, the Alliance redeemed $115,135 of the Series 2007B-1 Bonds and $29,405 of the Series 2007B-3 Bonds.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Series 2006 Bonds: During 2006, the Alliance issued $173,030 Hospital First Mortgage Revenue Bonds (Series 2006A) and $66,500 Hospital First Mortgage Variable Rate Revenue Bonds (Series 2006B). The proceeds from the sale of the Series 2006A Bonds were used to finance certain future and prior capital projects for the Alliance's hospital facilities and to refund certain existing indebtedness, specifically the Series 2001B Bonds (discussed below) and certain existing short and intermediate term loans and leases, as well as fund a debt service reserve fund. The Series 2006B Bond proceeds were substantially used to refund the remaining outstanding principal of the Series 2001B Bonds and establish a debt service reserve fund.

Series 2001 Bonds: During 2001, the Alliance issued $26,000 Hospital First Mortgage Revenue Bonds (Series 2001A) and $60,175 Hospital First Mortgage Revenue Bonds (Series 2001B). The Series 2001A Bonds were subject to optional tender by Bond holders. The Series 2001B Bonds were refunded and redeemed in 2006. The Alliance redeemed the 2001A Bonds and released a new Series 2001A to Bank of America Merrill Lynch during 2012.

Series 2000 Bonds: The Hospital First Mortgage Revenue Refunding (Series 2000A Bonds) and First Mortgage Revenue Refunding Bonds (Series 2000B Bonds), were used to advance refund previously existing indebtedness as well as fund a required debt service reserve fund. The Hospital First Mortgage Revenue Bonds (Series 2000C Taxable Bonds) were used to refinance certain mortgage indebtedness of BRMM, and to refund other previously existing indebtedness. The proceeds from the sale of the First Mortgage Bonds (Series 2000D Taxable Bonds) were used primarily to fund working capital for the Alliance.

The Series 2000A Bonds included at issue date $14,680 of insured Capital Appreciation Bonds. Such bonds bear a 0% coupon rate and have a yield of 6.625% annually. The Alliance recognizes interest expense and increases the amount of outstanding debt each year based upon this yield. Total principal and interest due at maturity (2026 through 2030) is $93,675.

Derecognized Bonds: The advance refunding of previously issued debt requires funds to be placed in irrevocable trusts in order to satisfy remaining scheduled principal and interest payments. Management, upon advice of legal counsel, believes the amounts deposited in such irrevocable trust accounts have contractually relieved the Alliance of any future obligations with respect to this debt, and the debt and escrowed securities are not considered liabilities or assets of the Alliance. Therefore, such debt has been derecognized.

Debt outstanding and not recognized in the Consolidated Balance Sheet at June 30, 2012 due to previous advance refundings of the Series 2000A Bonds, Series 2000B Bonds, Series 1998C Bonds, and Series 1991 Bonds, totaled approximately $483,625.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

The assets placed in the irrevocable trust accounts are also not recognized as assets of the Alliance. These assets consist primarily of various investments, as permitted by bond indentures and other documents, including United States Treasury obligations, an investment contract with MBIA Insurance Corporation (MBIA) in the original amount of $54,300, as well as the Series 2000C and 2000D Bonds which were purchased with the proceeds of the 2000A and 2000B Bonds specifically for the purpose of utilizing the Series 2000C and 2000D Bonds in the irrevocable trust. Therefore, certain of the assets held in the irrevocable trust accounts have future income streams contingent upon payments by the Alliance.

During 2012, the Alliance instructed the trustee of the 1998C Bonds to liquidate certain investments held in the related irrevocable trust account and to redeem a portion of the 1998C Bonds with the proceeds from the liquidation. The fair value of the liquidated assets exceeded the payment necessary to redeem the 1998C Bonds and the excess was paid to the Alliance. As a result of this transaction, the Alliance recognized a gain of $5,337, net of fees, which is included in other nonoperating gains (losses) in the accompanying 2012 Consolidated Statement of Operations.

Variable Rate Issuances: The variable rate of interest on the Series 2011, Series 2008 and Series 2007 Bonds is determined weekly by the Remarketing Agent, as the rate equal to the lowest rate which, in regard to general financial conditions and other special conditions bearing on the rate, would produce as nearly as possible a par bid for the Bonds in the secondary market. In no event shall the variable rate on the Bonds during any period where interest is calculated weekly exceed the lesser of 12% annually or the maximum contract rate of interest permitted by the applicable State of issue. The Alliance has the option, upon written approval of the holder of the letters of credit, the Remarketing Agent and others, to convert to a medium-term rate period or to a fixed rate.

Early Redemption: Essentially all of the Alliance's bonds are subject to redemption prior to maturity, including optional, mandatory sinking fund and extraordinary redemption, at various dates and prices as described in the respective Bond indentures and other documents.

Other Bonds, Notes Payable and Financing Arrangements: The Alliance has granted a deed of trust on JCMC and SSH to secure the payment of the outstanding Bonds. The Bonds are also secured by the Alliance's receivables, inventories and other assets as well as certain funds held under the documents pursuant to which the bonds were issued. The JMH Series 2011 Hospital Refunding and Improvement Revenue Bonds are secured by pledged revenues of JMH, as defined in the Credit Agreement.

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

The scheduled maturities and mandatory sinking fund payments of the long-term debt and capital lease obligations (excluding interest), exclusive of net unamortized original issue discount and premium, at June 30, 2012 are as follows:

Year Ending June 30,			
2013		$	32,477
2014			33,414
2015			29,932
2016			31,315
2017			31,006
Thereafter			923,055
			1,081,199
	Net discount		(624)
		$	1,080,575

The Alliance and JMH are each members of separate Obligated Groups. The bond indentures, master trust indentures, letter of credit agreements and loan agreements related to the various bond issues and notes payable contain covenants with which the respective Obligated Groups must comply. These requirements include maintenance of certain financial and liquidity ratios, deposits to trustee funds, permitted indebtedness, use of facilities and disposals of property. These covenants also require that failure to meet certain debt service coverage tests will require the deposit of all daily cash receipts of the Alliance into a trust fund. Management has represented the Alliance and JMH are in compliance with all such covenants at June 30, 2012.

In connection with the tax-exempt bonds, the Alliance is required every five years, and at maturity, to remit to the Internal Revenue Service amounts which are due related to positive arbitrage on the borrowed funds. The Alliance performs such computations when required and recognizes any liability at that time. Management does not believe there are any significant arbitrage liabilities at June 30, 2012 or 2011.

During 2012, the Alliance recognized a $2,636 loss on early extinguishment of debt representing the write off of previously deferred and unamortized financing costs generally related to the refinanced or otherwise redeemed portion of the Series 2007B Bonds, Series 1998 JMH Bonds and the Series 2001 NCH Bonds.

(Dollars in Thousands)

NOTE G--SELF-INSURANCE PROGRAMS

The Alliance is substantially self-insured for professional and general liability claims and related expenses. The Alliance maintains a $25,000 umbrella liability policy that attaches over the self-insurance limits of $10,000 per claim and a $15,000 annual aggregate retention. The Alliance's insurance program also provides professional liability coverage for certain affiliates and joint ventures.

The Alliance is also substantially self-insured for workers' compensation claims in the State of Tennessee and has established estimated liabilities for both reported and unreported claims. The Alliance maintains a stop-loss policy that attaches over the self-insurance limits of $1,000 per occurrence and $1,000 annual aggregate retention. In the State of Virginia, the Alliance is not self-insured and maintains workers' compensation insurance through commercial carriers.

At June 30, 2012, the Alliance is involved in litigation relating to medical malpractice and workers' compensation and other claims arising in the ordinary course of business. There are also known incidents occurring through June 30, 2012 that may result in the assertion of additional claims, and other unreported claims may be asserted arising from services provided in the past. Alliance management has estimated and accrued for the cost of these unreported claims based on historical data and actuarial projections. The estimated net present value of malpractice and workers' compensation claims, both reported and unreported, as of June 30, 2012 and 2011 was $12,896 and $13,531, respectively. The discount rate utilized was 5% at June 30, 2012 and 2011.

Additionally, the Alliance is self-insured for employee health claims and recognizes expense each year based upon actual claims paid and an estimate of claims incurred but not yet paid, including a catastrophic claims reserve based on historical claims in excess of $75.

NOTE H--NET PATIENT SERVICE REVENUE

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the accompanying Consolidated Statements of Operations is as follows for the years ended June 30:

	2012	*2011*
Inpatient service charges	$ 2,095,036	$ 1,983,340
Outpatient service charges	1,982,154	1,791,858
Gross patient service charges	4,077,190	3,775,198

(Dollars in Thousands)

NOTE H--NET PATIENT SERVICE REVENUE - Continued

	2012	2011
Less:		
Estimated contractual adjustments and other discounts	2,899,678	2,640,909
Charity care	102,462	72,166
Provision for bad debts	122,917	116,248
	3,125,057	2,829,323
Net patient service revenue	$ 952,133	$ 945,875

Net patient service revenue by major payor source for the years ended June 30, 2012 and 2011, net of contractual allowances and self-pay discounts (before the provision for bad debts), is as follows:

	2012	2011
Third-party payors	$ 968,101	$ 957,828
Self-pay	106,949	104,295
Patient service revenue	$ 1,075,050	$ 1,062,123

Deductibles and copayments under third-party payment programs, which are included within the third-party payor amounts above, are the patient's responsibility and the Alliance considers these amounts in its determination of the provision for bad debts based on prior collection experience. Accounts receivable are also reduced by an allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, the Alliance analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the Alliance analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary, for expected uncollectible deductibles and copayments or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely. For receivables associated with self-pay patients, which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill, the Alliance records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between discounted rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged against the allowance for doubtful accounts.

NOTE H--NET PATIENT SERVICE REVENUE - Continued

The Alliance's allowance for doubtful accounts totaled $52,911 and $53,366 at June 30, 2012 and 2011, respectively. The allowance for doubtful accounts decreased from 28% of patient accounts receivable, net of contractual allowances, at June 30, 2011 to 26% of patient accounts receivable, net of contractual allowances, as of June 30, 2012. Write-offs, net of recoveries, for the years ending June 30, 2012 and 2011 were $123,373 and $108,823, respectively, and relate primarily to self-pay patients. Write-offs of third-party payor accounts were not significant in the years ending June 30, 2012 and 2011. The Alliance has not experienced significant changes in write-off trends and has not changed its charity care policy for the year ended June 30, 2012. The provision for bad debts associated with the Alliance's ancillary service lines are not significant.

NOTE I--THIRD-PARTY REIMBURSEMENT

The Alliance renders services to patients under contractual arrangements with Medicare, Medicaid, TennCare, Blue Cross and various other commercial payors. The Medicare program pays for inpatient services on a prospective basis. Payments are based upon diagnosis related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. The Alliance also receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid and other low income patients. Most Medicare outpatient services are reimbursed on a prospectively determined payment methodology. The Medicare program also reimburses certain other services on the basis of reasonable cost, subject to various prescribed limitations and reductions.

Reimbursement under the State of Tennessee's Medicaid waiver program (TennCare) for inpatient and outpatient services is administered by various managed care organizations (MCOs) and is based on diagnosis related group assignments, a negotiated per diem or fee schedule basis. The Alliance also receives additional supplemental payments from the State of Tennessee. The amount recognized totaled $11,300 and $11,480 for the years ended June 30, 2012 and 2011, respectively. In addition, during 2012 the Alliance recognized $4,894 from TennCare related to the implementation and meaningful use of electronic medical records as provided by the Health Information Technology for Economics and Clinical Health (HITECH) Act. Such payments are included within other operating revenue in the accompanying 2012 Consolidated Statement of Operations and are not guaranteed in future periods.

The Virginia Medicaid program reimbursement for inpatient hospital services is based on a prospective payment system using both a per case and per diem methodology. Additional payments are made for the allowable costs of capital. Payments for outpatient services are based on Medicare cost reimbursement principles and settled through the filing of an annual Medicaid cost report.

NOTE I--THIRD-PARTY REIMBURSEMENT - Continued

Amounts earned under the contractual agreements with the Medicare and Medicaid programs are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Activity with respect to audits and reviews of the governmental programs in the healthcare industry has increased and is expected to increase in the future. No additional specific reserves or allowances have been established with regard to these increased audits and reviews as management is not able to estimate such amounts. Management believes that any adjustments from these increased audits and reviews will not have a material adverse impact on the consolidated financial statements. However, due to uncertainties in the estimation, it is at least reasonably possible that management's estimate will change in 2013, although the amount of any change cannot be estimated. The impact of final settlements of cost reports or changes in estimates decreased net patient service revenue by $1,556 and $4,570 in 2012 and 2011, respectively.

Participation in the Medicare program subjects the Alliance to significant rules and regulations; failure to adhere to such could result in fines, penalties or expulsion from the program. Management believes that adequate provision has been made for any adjustments, fines or penalties which may result from final settlements or violations of other rules or regulations. Management has represented that the Alliance is in substantial compliance with these rules and regulations as of June 30, 2012.

The Alliance has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations and employer groups. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

NOTE J--EMPLOYEE BENEFIT PLANS

The Alliance sponsors a retirement plan (the Plan) which covers substantially all employees. The Plan is a defined contribution plan which consists mainly of employer-funded contributions. During 2012 and 2011, the Alliance made contributions to the Plan under a stratified system, whereby the Alliance's contribution percentage is based on each employee's years of service. Employees of certain other subsidiaries are covered by other plans, although such plans are not significant. The total expense related to defined contribution plans for the years ended June 30, 2012 and 2011 was $15,072 and $12,682, respectively.

NCH maintains a defined benefit pension plan and a post-retirement employee benefit plan. The accrued unfunded pension liability was $2,560 and $1,313, and the accrued unfunded post-retirement liability was $4,554 and $3,761 at June 30, 2012 and 2011, respectively.

(Dollars in Thousands)

NOTE J--EMPLOYEE BENEFIT PLANS - Continued

The Alliance sponsors a secured executive benefit program (SEBP) for certain key executives. Contributions to the plan by the Alliance are based on an annual amount of funding necessary to produce a target benefit for the participants at their retirement date, although the Alliance does not guarantee any level of benefit will be achieved. The Alliance contributed \$1,734 and \$929 to the plan during 2012 and 2011, respectively. Other assets at June 30, 2012 and 2011 include \$9,675 and \$7,888, respectively, related to the Alliance's portion of the benefits which are recoverable upon the death of the participant. In addition, the Alliance sponsors a Section 457(f) plan for certain key executives.

NOTE K--CONCENTRATIONS OF RISK

The Alliance has locations primarily in upper East Tennessee and Southwest Virginia which is considered a geographic concentration. The Alliance grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. Net patient service revenue from Washington County, Tennessee operations were approximately 53% and 53% of total net patient service revenue for 2012 and 2011, respectively.

The mix of receivables from patients and third-party payors based on charges at established rates is as follows as of June 30:

	2012	*2011*
Medicare	36%	40%
Tenncare/Medicaid	14%	12%
Commercial	26%	27%
Other third-party payors	13%	9%
Patients	11%	12%
	100%	100%

Approximately 96% and 96% of the consolidated total revenue, gains and support were related to the provision of healthcare services during 2012 and 2011, respectively. Admitting physicians are primarily practitioners in the regional area.

Two of the Alliance's Virginia hospitals' employees are covered under collective bargaining agreements which extend through February 2014 and January 2015, respectively.

The Alliance routinely invests in investment vehicles as listed in Note C. The Alliance's investment portfolio is managed by outside investment management companies. Investments in corporate and

NOTE K--CONCENTRATIONS OF RISK - Continued

foreign bonds, municipal obligations, money market funds, equities and other vehicles that are held by safekeeping agents are not insured or guaranteed by the U.S. government. At June 30, 2012, the Alliance also had deposits in financial institutions significantly in excess of the Federal Deposit Insurance Corporation's limits.

NOTE L--INCOME TAXES

BRMM and its subsidiaries file a consolidated federal tax return and separate state tax returns. As of June 30, 2012 and 2011, BRMM and its subsidiaries had net operating loss carryforwards for consolidated federal purposes of $38,888 and $34,822, respectively, related to operating loss carryforwards which expire through 2031. At June 30, 2012 and 2011, BRMM had state net operating loss carryforwards of $69,999 and $65,979, respectively, which expire through 2026. The net operating loss carryforwards may be offset against future taxable income to the extent permitted by the Internal Revenue Code and Tennessee Code Annotated.

At June 30, 2012 and 2011, SWCH had federal and state net operating loss carryforwards of $5,614 and $4,875, respectively, which expire through 2031. The net operating loss carryforwards may be off-set against future taxable income to the extent permitted by the Internal Revenue Code and tax codes of the Commonwealth of Virginia.

Net deferred tax assets related to these carryforwards and other deferred tax assets have been substantially offset through valuation allowances equal to these amounts. Income taxes paid relate primarily to state taxes for certain subsidiaries and federal alternative minimum tax.

NOTE M--RELATED PARTY TRANSACTIONS

The Alliance enters into transactions with entities affiliated with certain members of the Board of Directors including transactions to construct Alliance facilities and provide professional services to the Alliance. Board members refrain from discussion and abstain from voting on transactions with entities with which they are related.

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES

Construction in Progress: Construction in progress at June 30, 2012 represents costs incurred related to various hospital and medical office building facility renovations and additions. The Alliance has outstanding contracts and other commitments related to the completion of these

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES - Continued

projects, and the cost to complete these projects is estimated to be approximately $100,312 at June 30, 2012. The Alliance does not expect any significant costs to be incurred for infrastructure improvements to assets held for resale.

Physician Contracts: BRMM employs physicians to provide services to BRMM's physician practices through employment agreements which provide annual compensation, plus incentives based upon specified productivity levels. These contracts have various terms.

In addition, the Alliance has entered into contractual relationships with non-employed physicians to provide services in Upper East Tennessee and Southwest Virginia. These contracts guarantee certain base payments and allowable expenses and have terms of varying lengths. Amounts drawn and outstanding under each agreement are treated as a loan bearing interest at various rates and are subject to repayment over a specified period. The physician notes may also be amortized by virtue of the physician's continued practice in the specified community during the repayment period. A net receivable of $1,436 and $1,407 related to these agreements is included in the accompanying Consolidated Balance Sheets at June 30, 2012 and 2011, respectively.

Employee Scholarships: The Alliance offers scholarships to certain individuals which require that the recipients return to the Alliance to work for a specified period of time after they complete their degree. Amounts due are then forgiven over a specific period of time as provided in the individual contracts. If the recipient does not return and work the required period of time, the funds disbursed on their behalf become due immediately and interest is charged until the funds are repaid. Other receivables at June 30, 2012 and 2011 include $8,005 and $7,250, respectively, related to students in school, graduates working at the Alliance and amounts due from others who are no longer in the scholarship program, net of allowance.

Promises to Give: The Alliance has recorded certain unconditional promises to give to unrelated organizations. At June 30, 2012, $1,354 is due within one year, and an additional $100 is due within five years and is included in other long-term liabilities.

Operating Leases and Maintenance Contracts: Total lease expense for the years ended June 30, 2012 and 2011 was $8,823 and $9,362, respectively. Future minimum lease payments for each of the next five years and in the aggregate for the Alliance's noncancellable operating leases with remaining lease terms in excess of one year are as follows:

(Dollars in Thousands)

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES - Continued

Year Ending June 30,		
2013	$	4,661
2014		4,476
2015		4,253
2016		3,997
2017		2,332
Thereafter		8,008
	$	27,727

Asset Retirement Obligation: The Alliance has identified asbestos in certain facilities and is required by law to dispose of it in a special manner if the facility undergoes major renovations or is demolished; otherwise, the Alliance is not required to remove the asbestos from the facility. The Alliance has complied with regulations by treating the asbestos so that it presents no known immediate or future safety concerns. An asset retirement obligation has been established to the extent that sufficient information exists upon which to estimate the liability.

Other: The Alliance is a party to various transactions and agreements in the normal course of business, which include purchase and re-purchase agreements, put arrangements and other commitments, which may bind the Alliance to undertake additional transactions or activities in the future. In addition, the Alliance has agreed to guarantee a portion of the outstanding indebtedness of a joint venture. Management estimates that the fair value of the guarantee of this debt is immaterial as of June 30, 2012.

Healthcare Industry: Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

In March 2010, Congress adopted comprehensive health care insurance legislation, *Patient Care Protection and Affordable Care Act* and *Health Care and Education Reconciliation Act*. The legislation, among other matters, is designated to expand access to coverage to substantively all citizens by 2019 through a combination of public program expansion and private industry health insurance. Changes to existing TennCare and Medicaid coverage and payments are also expected to occur as a result of this legislation. Implementing regulations are generally required for these legislative acts, which are to be adopted over a period of years and, accordingly, the specific impact of any future regulations is not determinable.

(Dollars in Thousands)

NOTE O--RENTAL INCOME UNDER OPERATING LEASES

The Alliance leases rental properties to third parties, most of whom are physician practices, for various terms, generally five years. The following is a schedule by year and in the aggregate of minimum future rental income due under noncancellable operating leases at June 30, 2012:

Year Ending June 30,		
2013	$	1,574
2014		1,454
2015		1,339
2016		762
2017		405
Thereafter		116
Total minimum future rentals	$	5,650

NOTE P--FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments has been estimated by the Alliance using available market information as of June 30, 2012 and 2011, and valuation methodologies considered appropriate. The estimates presented are not necessarily indicative of amounts the Alliance could realize in a current market exchange. The carrying value of substantially all financial instruments approximates fair value due to the nature or term of the instruments, except as described below.

Investment in Joint Ventures: It is not practical to estimate the fair market value of the investments in joint ventures.

Other Long-Term Liabilities: Estimates of reported and unreported professional liability claims, pension and post-retirement liabilities are discounted to approximate their estimated fair value. It is not practical to estimate the fair market value of other long-term liabilities due to uncertainty of when these amounts may be paid. Other long-term liabilities are not discounted.

Long-Term Debt and Capital Leases: The fair value of long-term debt is estimated based upon quotes obtained from brokers for bonds and discounted future cash flows using current market rates for other debt. For long-term debt with variable interest rates, the carrying value approximates fair value.

The Alliance's significant capital leases and vendor contracts were negotiated with various entities and are considered unique. It is not practicable to estimate the fair value of these obligations under current conditions. Other capital lease obligations are not significant.

(Dollars in Thousands)

NOTE P--FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

The estimated fair value of the Alliance's financial instruments that have carrying values different from fair value is as follows at June 30:

	2012		2011	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
FINANCIAL LIABILITIES:				
Long-term debt	$ 1,080,575	$ 1,150,201	$ 1,069,085	$ 1,046,675

NOTE Q--FAIR VALUE MEASUREMENT

FASB ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 - Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.

  Level 2 - Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. The Alliance's Level 2 investments are valued primarily using the market valuation approach.

- Level 3 - Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes values determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Alliance's own assumptions.

In instances where the determination of the fair value hierarchy measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Alliance's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following table sets forth, by level within the fair value hierarchy, the financial assets and liabilities recorded at fair value on a recurring basis as of June 30, 2012 and 2011:

(Dollars in Thousands)

NOTE Q--FAIR VALUE MEASUREMENT - Continued

	Total	Level 1	Level 2	Level 3
June 30, 2012				
Cash, cash equivalents and money market funds	$ 85,017	$ 85,017	$ -	$ -
U.S. Government securities	15,693	15,693	-	-
U.S. Agency securities	62,437	62,437	-	-
Corporate and foreign bonds	52,581	-	52,581	-
Municipal obligations	961	-	961	-
Preferred and asset backed securities	11,183	-	11,183	-
U.S. equity securities	28,344	28,344	-	-
Mutual funds	141,968	97,600	44,368	
Other	34,880	-	-	34,880
Total assets	$ 433,064	$ 289,091	$ 109,093	$ 34,880
Fair value of derivative agreements - Note D	$ (19,381)	$ -	$ -	$ (19,381)
June 30, 2011				
Cash, cash equivalents and money market funds	$ 142,031	$ 142,031	$ -	$ -
U.S. Government securities	11,204	11,204	-	-
U.S. Agency securities	34,054	34,054	-	-
Corporate and foreign bonds	32,895	-	32,895	-
Municipal obligations	451	-	451	-
Preferred and asset backed securities	8,945	-	8,945	-
U.S. equity securities	21,774	21,774	-	-
Mutual funds	166,708	73,060	93,648	-
Other	32,718	-	-	32,718
Total assets	$ 450,780	$ 282,123	$ 135,939	$ 32,718
Fair value of derivative agreements - Note D	$ (110,732)	$ -	$ -	$ (110,732)

The valuation of the Alliance's derivative agreements is determined using market valuation techniques, including discounted cash flow analysis on the expected cash flows of each agreement. This analysis reflects the contractual terms of the agreement, including the period to maturity, and uses certain observable market-based inputs. The fair values of interest rate agreements are determined by netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The variable cash receipts (or payments) are based on the expectation of future interest rates and the underlying notional amount. The Alliance also incorporates credit valuation adjustments (CVAs) to appropriately reflect both its own nonperformance or credit risk and the respective counterparty's nonperformance or credit risk in the fair value measurements. The CVA on the Alliance's interest rate swap agreements at June 30, 2012 and 2011 resulted in a decrease in the fair value of the related liability of $5,726 and $7,940, respectively.

(Dollars in Thousands)

NOTE Q--FAIR VALUE MEASUREMENT - Continued

A certain portion of the inputs used to value its interest rate swap agreements, including the forward interest rate curves and market perceptions of the Alliance's credit risk used in the CVAs, are unobservable inputs available to a market participant. As a result, the Alliance has determined that the interest rate swap valuations are classified in Level 3 of the fair value hierarchy.

The following tables provide a summary of changes in the fair value of the Alliance's Level 3 financial assets and liabilities during the fiscal years ended June 30, 2012 and 2011:

	Trading Securities	*Derivatives, Net*
July 1, 2010	$ 28,608	$ (134,300)
Total unrealized/realized gains in the Performance Indicator, net	2,847	23,049
Net investment income	1,263	519
June 30, 2011	32,718	(110,732)
Total unrealized/realized gains in the Performance Indicator, net	1,466	(6,198)
Net investment income	1,221	515
Purchases	5,107	-
Settlements	-	97,034
Distributions	(5,632)	-
June 30, 2012	$ 34,880	$ (19,381)

There were no changes in valuation techniques in 2012 or 2011. During 2011, as part of the transitional test of goodwill impairment, the Alliance recognized goodwill impairment of $2,965 based primarily on the fair value of the reporting unit, utilizing the income approach. Remaining goodwill determined not to be impaired, for this specific reporting unit, is included in the Consolidated Balance Sheets at $2,900.

NOTE R--OPERATING EXPENSES BY FUNCTIONAL CLASSIFICATION

The Alliance does not present expense information by functional classification because its resources and activities are primarily related to providing healthcare services. Further, since the Alliance receives substantially all of its resources from providing healthcare services in a manner similar to business enterprise, other indicators contained in these consolidated financial statements are considered important in evaluating how well management has discharged their stewardship responsibilities.

NOTE S--SUBSEQUENT EVENTS

In September 2012, the Alliance issued $55,000 (Series 2012A) fixed rate and $28,095 (Series 2012B) variable rate tax-exempt Hospital Revenue Bonds through The Health and Educational Facilities Board of the City of Johnson City, Tennessee, and $9,785 (Series 2012C) variable rate tax-exempt Hospital Revenue Bonds through the Industrial Development Authority of Wise, Virginia (collectively, the Series 2012 Bonds). The proceeds from the Series 2012A Bonds will be used to finance a surgery center project at JCMC and pay issuance costs related to these Bonds. The proceeds from the Series 2012B and 2012C Bonds will be used to finance or refinance capital improvements and equipment acquisitions and to pay issuance costs associated with these Bonds. The timely payment of the Series 2012B and Series 2012C Bonds is secured by irrevocable transferable direct-pay letters of credit.

In July 2012, the Trustee of the previously derecognized 1998C Bonds liquidated certain investments held in the related irrevocable trust account and redeemed a portion of the 1998C Bonds with the proceeds from the liquidation. The fair value of the liquidated assets exceeded the payment necessary to redeem the 1998C Bonds and the excess was paid to the Alliance. As a result of this transaction, the Alliance recognized a gain of $13,847, net of fees.

Subsequent to June 30, 2012, JMH exercised their purchase option related to a medical office building previously held under a capital lease. The purchase price was $17,529 which was financed through a taxable private placement bond issuance.

Supplemental Schedules

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Balance Sheet
(Dollars in Thousands)

June 30, 2012

	*Blue Ridge Medical Management **	*Other Obligated Group Members*	*Eliminations*	*Total Obligated Group*	*Other Entities*	*Mountain States Properties*	*Eliminations*	*Total*
ASSETS								
CURRENT ASSETS								
Cash and cash equivalents	$ 1,482	$ 36,881	$ -	$ 38,363	$ 22,006	$ 4,738	$ -	$ 65,107
Current portion of investments	-	22,745	-	22,745	3	13,809	-	36,557
Patient accounts receivable, less estimated allowances for uncollectible accounts	5,051	116,629	-	121,680	29,010	-	-	150,690
Other receivables, net	1,624	18,852	-	20,476	3,120	412	(1,000)	23,008
Inventories and prepaid expenses	832	20,951	-	21,783	6,924	103	-	28,810
TOTAL CURRENT ASSETS	8,989	216,058	-	225,047	61,063	19,062	(1,000)	304,172
INVESTMENTS, less amounts required to meet current obligations	19,348	395,778	-	415,126	100,811	44,760	-	560,697
EQUITY IN AFFILIATES	143,050	318,231	(157,099)	304,182	-	-	(304,182)	-
PROPERTY, PLANT AND EQUIPMENT, net	13,559	598,415	-	611,974	199,990	53,492	-	865,456
OTHER ASSETS								
Goodwill	9,007	143,276	-	152,283	2,108	-	-	154,391
Net deferred financing, acquisition costs and other charges	302	26,776	-	27,078	602	507	-	28,187
Other assets	8,887	12,145	-	21,032	4,550	2,562	-	28,144
TOTAL OTHER ASSETS	18,196	182,197	-	200,393	7,260	3,069	-	210,722
	$ 203,142	$ 1,710,679	$ (157,099)	$ 1,756,722	$ 369,124	$ 120,383	$ (305,182)	$ 1,941,047

* Management Services Organization only

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Balance Sheet - Continued (Dollars in Thousands)

June 30, 2012

	*Blue Ridge Medical Management **	*Other Obligated Group Members*	*Eliminations*	*Total Obligated Group*	*Other Entities*	*Mountain States Properties*	*Eliminations*	*Total*
LIABILITIES AND NET ASSETS								
CURRENT LIABILITIES								
Accrued interest payable	$ 46	$ 18,455	$ -	$ 18,501	$ 24	$ -	$ -	$ 18,525
Current portion of long-term debt and capital lease obligations	-	29,824	-	29,824	2,653	-	-	32,477
Current portion of estimated fair value of derivatives	-	-	-	-	-	10,395	-	10,395
Accounts payable and accrued expenses	4,191	94,352	-	98,543	9,297	1,030	-	108,870
Accrued salaries, compensated absences and amounts withheld	3,704	40,121	-	43,825	11,764	-	-	55,589
Payables to (receivables from) affiliates, net	15,321	3,118	-	18,439	8,365	(26,804)	-	-
Estimated amounts due to third-party payors, net	-	16,607	-	16,607	1,453	-	-	18,060
TOTAL CURRENT LIABILITIES	23,262	202,477	-	225,739	33,556	(15,379)	-	243,916
OTHER LIABILITIES								
Long-term debt and capital lease obligations, less current portion	13,676	994,014	-	1,007,690	41,408	-	(1,000)	1,048,098
Estimated fair value of derivatives, less current portion	-	8,534	-	8,534	133	319	-	8,986
Deferred revenue	-	2,929	-	2,929	205	-	-	3,134
Estimated professional liability self-insurance	2,268	5,975	-	8,243	1,101	-	-	9,344
Other long-term liabilities	6,837	9,839	-	16,676	146	-	-	16,822
TOTAL LIABILITIES	46,043	1,223,768	-	1,269,811	76,549	(15,060)	(1,000)	1,330,300
NET ASSETS								
Unrestricted net assets								
Mountain States Health Alliance	157,099	436,388	(157,099)	436,388	164,117	135,443	(299,560)	436,388
Noncontrolling interests in subsidiaries	-	39,123	-	39,123	117,377	-	6,459	162,959
TOTAL UNRESTRICTED NET ASSETS	157,099	475,511	(157,099)	475,511	281,494	135,443	(293,101)	599,347
Temporarily restricted net assets								
Mountain States Health Alliance	-	11,223	-	11,223	10,955	-	(10,955)	11,223
Noncontrolling interests in subsidiaries	-	50	-	50	(1)	-	1	50
TOTAL TEMPORARILY RESTRICTED NET ASSETS	-	11,273	-	11,273	10,954	-	(10,954)	11,273
Permanently restricted net assets	-	127	-	127	127		(127)	127
TOTAL NET ASSETS	157,099	486,911	(157,099)	486,911	292,575	135,443	(304,182)	610,747
	$ 203,142	$ 1,710,679	$ (157,099)	$ 1,756,722	$ 369,124	$ 120,383	$ (305,182)	$ 1,941,047

*Management Services Organization only.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Statement of Operations (Dollars in Thousands)

Year Ended June 30, 2012

	*Blue Ridge Medical Management **	*Other Obligated Group Members*	*Eliminations*	*Total Obligated Group*	*Other Entities*	*Mountain States Properties*	*Eliminations*	*Total*
Revenue, gains and support:								
Patient service revenue, net of contractual allowances and discounts	$ 50,213	$ 824,899	$ (2,165)	$ 872,947	$ 202,108	$ -	$ (5)	$ 1,075,050
Provision for bad debts	(4,397)	(95,440)	-	(99,837)	(23,080)	-	-	(122,917)
Net patient service revenue	45,816	729,459	(2,165)	773,110	179,028	-	(5)	952,133
Other operating revenue	39,451	15,163	(29,595)	25,019	67,543	8,398	(61,553)	39,407
Equity in net gain (loss) of affiliates	3,332	(17,848)	(1,488)	(16,004)	-	-	16,004	-
TOTAL REVENUE, GAINS AND SUPPORT	88,599	726,774	(33,248)	782,125	246,571	8,398	(45,554)	991,540
Expenses:								
Salaries and wages	21,613	268,799	-	290,412	72,358	451	(4,614)	358,607
Physician salaries and wages	43,468	1,162	-	44,630	62,704	-	(41,628)	65,706
Contract labor	777	3,864	-	4,641	2,382	9	(657)	6,375
Employee benefits	7,416	51,007	(2,236)	56,187	17,510	85	(4,182)	69,600
Fees	4,025	100,938	(29,034)	75,929	25,946	517	(4,433)	97,959
Supplies	2,454	135,733	-	138,187	32,124	40	(165)	170,186
Utilities	626	12,222	-	12,848	3,476	965	-	17,289
Other	7,538	47,568	(490)	54,616	23,471	4,077	(5,879)	76,285
Depreciation	1,395	49,959	-	51,354	19,458	2,248	-	73,060
Amortization	30	2,161	-	2,191	54	-	-	2,245
Interest and taxes	(1,169)	42,976	-	41,807	3,018	1,112	(34)	45,903
TOTAL EXPENSES	88,173	716,389	(31,760)	772,802	262,501	9,504	(61,592)	983,215
OPERATING INCOME (LOSS)	426	10,385	(1,488)	9,323	(15,930)	(1,106)	16,038	8,325
Nonoperating gains (losses):								
Interest and dividend income	673	10,841	-	11,514	2,401	1,332	(34)	15,213
Net realized gains (losses) on the sale of securities	21	611	-	632	(3,227)	-	-	(2,595)
Change in net unrealized gains on securities	(455)	(3,758)	-	(4,213)	133	1,196	-	(2,884)
Derivative related income	-	6,051	-	6,051	-	1,464	-	7,515
Loss on early extinguishment of debt	-	(2,553)	-	(2,553)	(83)	-	-	(2,636)
Change in estimated fair value of derivatives	-	(6,086)	-	(6,086)	(133)	21	-	(6,198)
Other nonoperating gains (losses)	823	12,485	-	13,308	(1,977)	(95)	-	11,236
NET NONOPERATING GAINS	1,062	17,591	-	18,653	(2,886)	3,918	(34)	19,651
EXCESS (DEFICIT) OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	$ 1,488	$ 27,976	$ (1,488)	$ 27,976	$ (18,816)	$ 2,812	$ 16,004	$ 27,976

*Management Services Organization only.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Statement of Changes in Net Assets (Dollars in Thousands)

Year Ended June 30, 2012

	Blue Ridge Medical Management *	*Other Obligated Group Members*			*Total*	*Other Entities*		*Total*			
		Mountain States Health Alliance	*Noncontrolling Interests*	*Eliminations*	*Obligated Group*	*Mountain States Health Alliance*	*Noncontrolling Interests*	*Other Entities*	*Mountain States Properties*	*Eliminations*	*Total*
UNRESTRICTED NET ASSETS:											
Excess (deficit) of revenue, gains and support over expenses and losses	$ 1,488	$ 31,702	$ (3,726)	$ (1,488)	$ 27,976	$ (12,729)	$ (6,087)	$ (18,816)	$ 2,812	$ 16,004	$ 27,976
Pension and other defined benefit plan adjustments	-	(1,119)	(1,115)	-	(2,234)	(9)	(9)	(18)	-	18	(2,234)
Net assets released from restrictions used for the purchase of property, plant and equipment	-	1,550	-	-	1,550	1,550	-	1,550	-	(1,550)	1,550
Distributions to noncontrolling interests	-	-	(324)	-	(324)	-	(324)	(324)	-	324	(324)
Repurchases of noncontrolling interests	-	3,860	(3,860)	-	-	-	-	-	-	-	-
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	1,488	35,993	(9,025)	(1,488)	26,968	(11,188)	(6,420)	(17,608)	2,812	14,796	26,968
TEMPORARILY RESTRICTED NET ASSETS:											
Restricted grants and contributions	-	3,860	39	-	3,899	3,036	12	3,048	-	(3,048)	3,899
Net assets released from restrictions	-	(3,352)	(46)	-	(3,398)	(3,255)	(22)	(3,277)	-	3,277	(3,398)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	-	508	(7)	-	501	(219)	(10)	(229)	-	229	501
INCREASE (DECREASE) IN TOTAL NET ASSETS	1,488	36,501	(9,032)	(1,488)	27,469	(11,407)	(6,430)	(17,837)	2,812	15,025	27,469
NET ASSETS, BEGINNING OF YEAR	155,611	411,237	-	(155,611)	411,237	239,164	172,041	411,205	132,631	(371,795)	583,278
ADDITION OF OBLIGATED MEMBERS	-	-	54,025	-	54,025	(52,559)	(54,054)	(106,613)	-	52,588	-
NET ASSET TRANSFER	-	-	(5,820)	-	(5,820)	-	5,820	5,820	-	-	-
NET ASSETS, END OF YEAR	$ 157,099	$ 447,738	$ 39,173	$ (157,099)	$ 486,911	$ 175,198	$ 117,377	$ 292,575	$ 135,443	$ (304,182)	$ 610,747

*Management Services Organization only.

NOTE A--OBLIGATED GROUP MEMBERS

As described in Note F to the consolidated financial statements, the Alliance has granted a deed of trust on JCMC and SSH to secure the payment of the outstanding bonds. The bonds are also secured by the Alliance's receivables, inventories and other assets as well as certain funds held under the documents pursuant to which the bonds were issued. In accordance with Article Six, Section 6.6 of the Amended and Restated Master Trust Indenture between Mountain States Health Alliance and the Bank of New York Mellon Trust Company, NA as Master Trustee, those members pledged in 2011 include Johnson City Medical Center Hospital, Indian Path Medical Center, Franklin Woods Community Hospital, Sycamore Shoals Hospital, Johnson County Community Hospital, Russell County Medical Center and Blue Ridge Medical Management Corporation (parent company only), collectively defined as the Obligated Group (Obligated Group). In 2012, NCH and SCCH (hospitals only) were admitted into the Obligated Group. These entities' operations since admission (including noncontrolling interests) are included as part of the Obligated Group results for 2012 in the accompanying consolidated statements of operations and changes in net assets.

The supplemental consolidating schedules include the accounts of the members of the Obligated Group after elimination of all significant intergroup accounts and transactions. Certain other subsidiaries of the Alliance, Mountain States Properties, Inc. (MSP) and all other affiliates (Other Entities), are not pledged to secure the payment of the outstanding bonds as they are not part of the Obligated Group. These affiliates have been accounted for within the Obligated Group based upon the Alliance's original and subsequent investments, as adjusted for the Alliance's pro rata share of income or losses and any distributions, and are included as a part of equity in affiliates in the supplemental consolidating balance sheet.

MOUNTAIN STATES HEALTH ALLIANCE

Audited Consolidated Financial Statements
(and Supplemental Schedules)

Years Ended June 30, 2013 and 2012

PYA
Certified Public Accountants

MOUNTAIN STATES HEALTH ALLIANCE

Audited Consolidated Financial Statements (and Supplemental Schedules)

Years Ended June 30, 2013 and 2012

PYA
Certified Public Accountants

PERSHING YOAKLEY & ASSOCIATES, P.C.
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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Mountain States Health Alliance:

We have audited the accompanying consolidated financial statements of Mountain States Health Alliance and its subsidiaries (the Alliance), which comprise the consolidated balance sheets as of June 30, 2013 and 2012, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Alliance's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Alliance's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mountain States Health Alliance and its subsidiaries as of June 30, 2013 and 2012, and the results of their operations, changes in net assets, and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

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

Pershing Yoakley & Associates, PC

Knoxville, Tennessee
October 24, 2013

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Balance Sheets
(Dollars in Thousands)

	June 30, 2013	June 30, 2012
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	**$ 74,902**	$ 65,107
Current portion of investments - Note C	**20,386**	36,557
Patient accounts receivable, less estimated allowances for uncollectible accounts of $49,449 in 2013 and $52,696 in 2012	**164,187**	147,466
Other receivables, net	**33,468**	30,190
Inventories and prepaid expenses	**31,073**	28,810
TOTAL CURRENT ASSETS	**324,016**	308,130
INVESTMENTS, less amounts required to meet current obligations	**601,352**	560,697
PROPERTY, PLANT AND EQUIPMENT, net	**884,293**	853,625
OTHER ASSETS		
Goodwill	**154,391**	154,391
Net deferred financing, acquisition costs and other charges	**28,480**	28,187
Other assets	**46,544**	39,975
TOTAL OTHER ASSETS	**229,415**	222,553
	$ 2,039,076	$ 1,945,005

	June 30,	
	2013	2012
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accrued interest payable	$ 19,706	$ 18,525
Current portion of long-term debt and capital lease obligations	34,417	32,477
Current portion of estimated fair value of derivatives - Note D	-	10,395
Accounts payable and accrued expenses	94,302	108,870
Accrued salaries, compensated absences and amounts withheld	63,665	55,589
Estimated amounts due to third-party payors, net	26,775	22,018
TOTAL CURRENT LIABILITIES	238,865	247,874
OTHER LIABILITIES		
Long-term debt and capital lease obligations, less current portion	1,090,348	1,048,098
Estimated fair value of derivatives, less current portion	8,185	8,986
Deferred revenue	2,216	3,134
Estimated professional liability self-insurance	8,758	9,344
Other long-term liabilities	17,721	16,822
TOTAL LIABILITIES	1,366,093	1,334,258
COMMITMENTS AND CONTINGENCIES - Notes D, F, G, and N		
NET ASSETS		
Unrestricted net assets		
Mountain States Health Alliance	490,414	436,388
Noncontrolling interests in subsidiaries	169,614	162,959
TOTAL UNRESTRICTED NET ASSETS	660,028	599,347
Temporarily restricted net assets		
Mountain States Health Alliance	12,776	11,223
Noncontrolling interests in subsidiaries	52	50
TOTAL TEMPORARILY RESTRICTED NET ASSETS	12,828	11,273
Permanently restricted net assets	127	127
TOTAL NET ASSETS	672,983	610,747
	$ 2,039,076	$ 1,945,005

See notes to consolidated financial statements.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Operations
(Dollars in Thousands)

	Year Ended June 30, 2013	2012
Revenue, gains and support:		
Patient service revenue, net of contractual allowances and discounts	$ 1,045,245	$ 1,075,050
Provision for bad debts	(112,497)	(122,917)
Net patient service revenue	932,748	952,133
Premium revenue	1,003	-
Net investment gain	40,980	9,734
Net derivative gain	7,118	1,317
Other revenue, gains and support	77,455	50,643
TOTAL REVENUE, GAINS AND SUPPORT	1,059,304	1,013,827
Expenses:		
Salaries and wages	355,590	358,607
Physician salaries and wages	74,258	65,706
Contract labor	3,942	6,375
Employee benefits	74,590	69,600
Fees	105,891	97,959
Supplies	162,955	170,186
Utilities	16,857	17,289
Medical costs	1,039	-
Other	80,211	76,285
Loss on early extinguishment of debt - Note F	-	2,636
Depreciation	78,941	73,060
Amortization	2,260	2,245
Interest and taxes	43,203	45,903
TOTAL EXPENSES	999,737	985,851
EXCESS OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	$ 59,567	$ 27,976

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Changes in Net Assets
(Dollars in Thousands)

Year Ended June 30, 2013

	Mountain States Health Alliance	Noncontrolling Interests	Total
UNRESTRICTED NET ASSETS:			
Excess of Revenue, Gains and Support over Expenses and Losses	$ 52,692	$ 6,875	$ 59,567
Pension and other defined benefit plan adjustments	(172)	(171)	(343)
Net assets released from restrictions used for the purchase of property, plant and equipment	1,506	-	1,506
Distributions to noncontrolling interests	-	(49)	(49)
INCREASE IN UNRESTRICTED NET ASSETS	54,026	6,655	60,681
TEMPORARILY RESTRICTED NET ASSETS:			
Restricted grants and contributions	4,969	21	4,990
Net assets released from restrictions	(3,416)	(19)	(3,435)
INCREASE IN TEMPORARILY RESTRICTED NET ASSETS	1,553	2	1,555
INCREASE IN TOTAL NET ASSETS	55,579	6,657	62,236
NET ASSETS, BEGINNING OF YEAR	447,738	163,009	610,747
NET ASSETS, END OF YEAR	$ 503,317	$ 169,666	$ 672,983

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Changes in Net Assets - Continued
(Dollars in Thousands)

Year Ended June 30, 2012

	Mountain States Health Alliance	*Noncontrolling Interests*	*Total*
UNRESTRICTED NET ASSETS:			
Excess (Deficit) of Revenue, Gains and Support over Expenses and Losses	$ 31,702	$ (3,726)	$ 27,976
Pension and other defined benefit plan adjustments	(1,119)	(1,115)	(2,234)
Net assets released from restrictions used for the purchase of property, plant and equipment	1,550	-	1,550
Distributions to noncontrolling interests	-	(324)	(324)
Repurchases of noncontrolling interests	3,860	(3,860)	-
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	35,993	(9,025)	26,968
TEMPORARILY RESTRICTED NET ASSETS:			
Restricted grants and contributions	3,860	39	3,899
Net assets released from restrictions	(3,352)	(46)	(3,398)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	508	(7)	501
INCREASE (DECREASE) IN TOTAL NET ASSETS	36,501	(9,032)	27,469
NET ASSETS, BEGINNING OF YEAR	411,237	172,041	583,278
NET ASSETS, END OF YEAR	$ 447,738	$ 163,009	$ 610,747

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Cash Flows
(Dollars in Thousands)

	Year Ended June 30, 2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	$ 62,236	$ 27,469
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Provision for depreciation and amortization	81,786	75,777
Provision for bad debts	112,497	122,917
Loss on early extinguishment of debt	-	2,636
Change in estimated fair value of derivatives	(457)	6,198
Equity in net income of joint ventures, net	(636)	(979)
Loss (gain) on disposal of assets	(1)	446
Amounts received on interest rate swap settlements	(6,661)	(7,515)
Gain on escrow restructuring - Note F	(13,847)	(5,337)
Gain on swap settlement - Note D	(3,020)	-
Income recognized through forward sale agreements	-	(864)
Gain on termination of swaption and forward sale agreements - Note D	-	(7,766)
Capital Appreciation Bond accretion and other	3,910	3,159
Restricted contributions	(4,990)	(3,899)
Pension and other defined benefit plan adjustments	343	2,234
Increase (decrease) in cash due to change in:		
Patient accounts receivable	(129,218)	(138,996)
Other receivables, net	(3,192)	(3,501)
Inventories and prepaid expenses	(2,263)	155
Trading securities	(17,845)	107,593
Other assets	(1,073)	(2,733)
Accrued interest payable	1,181	(1,522)
Accounts payable and accrued expenses	(20,263)	4,131
Accrued salaries, compensated absences and amounts withheld	8,076	(2,211)
Estimated amounts due to third-party payers, net	4,757	3,247
Other long-term liabilities	556	236
Estimated professional liability self-insurance	(586)	(348)
Total adjustments	9,054	153,058
NET CASH PROVIDED BY OPERATING ACTIVITIES	71,290	180,527
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(105,751)	(132,890)
Purchases of land held for expansion	(5,769)	-
Additions to goodwill	-	(5,725)
Purchases of held-to-maturity securities	(8,722)	(9,516)
Net distribution from joint ventures and unconsolidated affiliates	732	882
Proceeds from sale of property, plant and equipment	335	1,881
NET CASH USED IN INVESTING ACTIVITIES	(119,175)	(145,368)

	Year Ended June 30, 2013	2012
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments on long-term debt and capital lease obligations, including deposits to escrow	(75,066)	(71,997)
Payment of acquisition and financing costs	(2,314)	(2,742)
Proceeds from issuance of long-term debt and other financing arrangements	117,085	67,451
Payment on termination of derivative agreements - Note D	(7,375)	(93,353)
Gain on escrow restructuring - Note F	13,847	5,337
Net amounts received on interest rate swap settlements	6,661	7,515
Restricted contributions received	4,842	4,969
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	57,680	(82,820)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9,795	(47,661)
CASH AND CASH EQUIVALENTS, beginning of year	65,107	112,768
CASH AND CASH EQUIVALENTS, end of year	$ 74,902	$ 65,107

SUPPLEMENTAL INFORMATION AND NON-CASH TRANSACTIONS:		
Cash paid for interest	$ 37,023	$ 41,168
Cash paid for federal and state income taxes	$ 616	$ 336
Construction related payables in accounts payable and accrued expenses	$ 11,598	$ 6,821
Property acquired through capital lease arrangement	$ -	$ 13,959
Payable on termination of forward sale agreements in accounts payable and accrued expenses	$ -	$ 13,429
Land held for expansion placed in use	$ -	$ 1,610

During the year ended June 30, 2012, the Alliance refinanced previously issued debt of $174,547.

NOTE A--ORGANIZATION AND OPERATIONS

Mountain States Health Alliance (the Alliance) is a tax-exempt entity with operations primarily located in Washington, Sullivan, and Carter counties of Tennessee and Smyth, Wise, Dickenson, Russell and Washington counties of Virginia. The initial funds for the establishment of the Alliance in 1945 were provided by individuals and various institutions.

The primary operations of the Alliance consist of ten acute and specialty care hospitals, as follows:

- Johnson City Medical Center (JCMC) - licensed for 658 beds
- Indian Path Medical Center (IPMC) - licensed for 261 beds
- Smyth County Community Hospital (SCCH) - licensed for 153 beds
- Norton Community Hospital (NCH) - licensed for 129 beds
- Sycamore Shoals Hospital (SSH) - licensed for 121 beds
- Johnston Memorial Hospital (JMH) - licensed for 116 beds
- Franklin Woods Community Hospital (FWCH) - licensed for 80 beds
- Russell County Medical Center (RCMC) - licensed for 78 beds
- Dickenson Community Hospital (DCH) - licensed for 25 beds
- Johnson County Community Hospital (JCCH) - licensed for 2 beds

The Alliance has a 50.1% interest in JMH. JMH is also the sole member of Abingdon Physician Partners (APP), a non-taxable corporation that owns and manages physician practices.

The Alliance has a 50.1% interest in NCH. NCH is also the sole member or shareholder of DCH and Norton Community Physician Services, LLC (NCPS), a taxable corporation that consists of physician practices and a pharmacy and Community Home Care (CHC), a taxable corporation that provides home medical equipment.

The Alliance has an 80% interest in SCCH. SCCH is the sole shareholder of Southwest Community Health Services, Inc. (SWCH), a taxable entity that operates a pharmacy and provides other health services.

The activities and accounts of JMH, NCH and SCCH are included in the accompanying consolidated financial statements.

The Alliance is the sole shareholder of Blue Ridge Medical Management Corporation (BRMM), a for-profit entity that owns and manages physician practices and provides other healthcare services to patients in Tennessee and Virginia. BRMM also operates as a medical office real estate developer by owning, selling and leasing real estate to physician practices and other entities. BRMM is either the sole shareholder, a significant shareholder, or member of the following consolidated organizations:

NOTE A--ORGANIZATION AND OPERATIONS - Continued

Mountain States Physician Group, Inc. (MSPG): A company that contracts with physicians to provide services to BRMM physician practices.

Mountain States Properties, Inc. (MSPI): An entity that owns and manages certain real estate (primarily medical office buildings) and provides rehabilitation and fitness services.

Mediserve Medical Equipment of Kingsport, Inc. (Mediserve): A company that provides durable medical equipment services.

Kingsport Ambulatory Surgery Center (KASC) (d.b.a. Kingsport Day Surgery): A joint venture operating as an outpatient surgery center which performs procedures primarily in otolaryngology, orthopedics, ophthalmology, and general surgery. BRMM has a 43% ownership of KASC and maintains control over KASC through a management agreement. The accounts and activities of KASC are included in the accompanying consolidated financial statements.

Piney Flats Urgent Care (PFUC): A for-profit entity that provides urgent care patient services. BRMM has a 75% ownership of PFUC. The accounts and activities of PFUC are included in the accompanying consolidated financial statements.

Wilson Pharmacy, Inc. (Wilson): In August 2012, BRMM acquired Wilson, a company that owns and operates retail pharmacies. BRMM purchased 100% of the total issued and outstanding capital stock of Wilson for $8,114 and recognized goodwill of $5,725.

The Alliance is the primary beneficiary of the activities of Mountain States Foundation, Inc. (MSF), a not-for-profit foundation formed to coordinate fundraising and development activities of the Alliance. The Alliance is also the beneficiary of the Mountain States Health Alliance Auxiliary (Auxiliary), a not-for-profit organization formed to coordinate volunteer activities of the Alliance. The activities and accounts of MSF and the Auxiliary are included in the accompanying consolidated financial statements.

The Alliance is a 99.6% shareholder of Integrated Solutions Health Network, LLC (ISHN). The primary function of ISHN is to establish, operate and administer a provider-sponsored health care delivery network. ISHN is the sole shareholder of the following subsidiaries:

CrestPoint Health Insurance Company (CHIC): A for-profit insurance company licensed in the State of Tennessee which provides network access and administration and third-party Medicare administrator services. During 2013, CHIC entered into a risk-based contract with the Center for Medicare & Medicaid Services (CMS) to provide or arrange for the provision of healthcare

NOTE A--ORGANIZATION AND OPERATIONS - Continued

services to senior citizens who have Medicare Part A, Medicare Part B and Medicare Part D entitlements.

AnewCare Collaborative (AnewCare): A for-profit accountable care organization which began participating in the CMS's Medicare Shared Savings Program (MSSP) in July 2012.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Alliance and its subsidiaries after elimination of all significant intercompany accounts and transactions.

Noncontrolling Interests in Subsidiaries: The Alliance's accompanying consolidated financial statements include all assets, liabilities, revenues, expenses, and changes in net assets, including amounts attributable to the noncontrolling interests. Noncontrolling interests represent the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to the Alliance. For the years ending June 30, 2013 and 2012, the Alliance attributed an Excess (Deficit) of Revenue, Gains and Support over Expenses and Losses of $6,875 and ($3,726), respectively, to the noncontrolling interests in JMH, NCH, SCCH, KASC, PFUC and ISHN based on the noncontrolling interests' respective ownership percentage.

Use of Estimates: The preparation of the 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 as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents: Cash and cash equivalents include all highly liquid investments with a maturity of three months or less when purchased. Cash and cash equivalents designated as assets limited as to use or uninvested amounts included in investment portfolios are not included as cash and cash equivalents on the Consolidated Balance Sheets.

Investments: Investments as reported in the Consolidated Balance Sheets include trading securities and held-to-maturity securities (Note C). The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 958-320, *Investments – Debt and Equity Securities*, allows not-for-profit organizations to report in a manner similar to business entities by identifying securities as available-for-sale or held-to-maturity and to exclude the unrealized gains and losses on

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

those securities from the Performance Indicator (as defined below). Investments which the Alliance has the positive intent and ability to hold to maturity are considered as held-to-maturity. Substantially all other investments are considered as trading securities.

On June 30, 2013, the Alliance determined that it no longer intended to hold certain of its held-to-maturity investment portfolios to maturity and reclassified investments with an amortized cost of $161,929 into the trading designation. As a result, the Alliance recognized net unrealized gains of approximately $8,255 in the accompanying 2013 Consolidated Statement of Operations. The investments that remain designated as held-to-maturity are limited as to use under a safekeeping agreement or are otherwise unavailable for disposition.

Management annually evaluates investments designated as held-to-maturity and recognizes any "other-than-temporary" losses as deductions from the Performance Indicator (as defined below). Management's evaluation considers the amount of decline in fair value, as well as the time period of any such decline. Management does not believe any investment classified as held-to-maturity is other-than-temporarily impaired at June 30, 2013.

Within the trading securities portfolio, all debt securities and marketable equity securities with readily determinable fair values are reported at fair value based on quoted market prices. Investments without readily determinable fair values are reported at estimated fair market value pursuant to FASB ASC 825, *Financial Instruments*.

Realized gains and losses are computed using the specific identification method for cost determination. Interest and dividend income is reported net of related investment fees.

Investments in joint ventures are generally reported under the equity method of accounting, which approximates the Alliance's equity in the underlying net book value, unless the ownership structure requires consolidation. Other assets include investments in joint ventures of $2,057 and $2,153 at June 30, 2013 and 2012, respectively. Subsequent to June 30, 2013, the Alliance liquidated a portion of its investment in one joint venture (Note S).

Inventories: Inventories, consisting primarily of medical supplies, are stated at the lower of cost or market.

Property, Plant and Equipment: Property, plant and equipment is stated on the basis of cost, or if donated, at the fair value at the date of gift. Generally, depreciation is computed by the straight-line method over the estimated useful life of the asset. Equipment held under capital lease obligations is

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

amortized under the straight-line method over the shorter of the lease term or estimated useful life. Amortization of buildings and equipment held under capital leases is shown as a part of depreciation expense and accumulated depreciation in the accompanying consolidated financial statements. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets.

The Alliance reviews capital assets for indications of potential impairment when there are changes in circumstances related to a specific asset. If this review indicates that the carrying value of these assets may not be recoverable, the Alliance estimates future cash flows from operations and the eventual disposition of such assets. If the sum of these undiscounted future cash flows is less than the carrying amount of the asset, a write-down to estimated fair value is recorded. The Alliance did not recognize any impairment losses during 2013 and 2012.

Other assets include property held for resale and property held for expansion of $20,220 and $14,451, respectively, at June 30, 2013 and 2012. Property held for resale and property held for expansion primarily represent land contributed to, or purchased by, the Alliance plus costs incurred to develop the infrastructure of such land. Management annually evaluates its investment and records non-temporary declines in value when it is determined the ultimate net realizable value is less than the recorded amount. No such declines were identified in 2013 and 2012.

Goodwill: Goodwill represents the difference between the acquisition cost of assets and the estimated fair value of net tangible and any separately identified intangible assets. In accordance with ASC 350, *Intangibles – Goodwill and Other,* goodwill is evaluated for impairment at least annually. The reporting unit for evaluation of the majority of the Alliance's goodwill is the aggregate acute-care operations. Management performed an evaluation of goodwill for impairment considering qualitative and quantitative factors and does not believe it is more likely than not that goodwill associated with any of its reporting units is impaired as of June 30, 2013.

Deferred Financing, Acquisition Costs and Other Charges: Other assets, including deferred financing, acquisition costs and other charges, total $28,480 and $28,187 at June 30, 2013 and 2012, respectively. Deferred financing costs are amortized over the life of the respective bond issue principally using the average bonds outstanding method. Other intangible assets include licenses and similar assets and are being amortized over the intangible's estimated useful life under the straight-line method.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Prior to 2009, the Alliance routinely financed interest rate swap and other derivative transaction issuance costs through modification of future settlement terms. As such, the unamortized issuance costs of these derivatives are included as deferred financing costs in the accompanying Consolidated Balance Sheets and are being amortized over the term of the respective derivative instrument. The unpaid issuance costs are included as a part of the estimated fair value of derivatives in the accompanying Consolidated Balance Sheets. Subsequent to 2009, interest rate swap and derivative transaction issuance costs were expensed as incurred.

Derivative Financial Instruments: As further described in Note D, the Alliance is a party to various interest rate swaps. These financial instruments are not designated as hedges and have been presented at estimated fair market value in the accompanying Consolidated Balance Sheets as either current or long-term liabilities, based upon the remaining term of the instrument. Changes in the estimated fair value of these derivatives are included in the Consolidated Statements of Operations as part of net derivative gain.

Estimated Professional Liability Self-Insurance and Other Long-Term Liabilities: Self-insurance liabilities include estimated reserves for reported and unreported professional liability claims (Note G) and are recorded at the estimated net present value of such claims. Other long-term liabilities include contributions payable and obligations under deferred compensation arrangements, a defined benefit pension plan, a post-retirement employee benefit plan as well as other liabilities which management estimates are not payable within one year.

Net Patient Service Revenue/Receivables: Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Alliance's revenue recognition policies related to self-pay and other types of payers emphasize revenue recognition only when collections are reasonably assured.

Patient accounts receivable are reported net of both an estimated allowance for uncollectible accounts and an estimated allowance for contractual adjustments. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, Medicaid, TennCare and other third-party payment programs. Current operations include a provision for bad debts in the Consolidated Statements of Operations estimated based upon the age of the patient accounts receivable, historical writeoffs and recoveries and any unusual circumstances (such as local, regional or national economic conditions) which affect the collectibility of receivables, including management's assumptions about conditions it expects to exist and courses of action it expects to take. Additions to the allowance for uncollectible accounts result from the

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

provision for bad debts. Patient accounts written off as uncollectible are deducted from the allowance for uncollectible accounts.

For uninsured patients that do not qualify for charity care, the Alliance recognizes revenue on the basis of discounted rates under the Alliance's self-pay patient policy. Under the policy, a patient who has no insurance and is ineligible for any government assistance program has his or her bill reduced to the amount which generally would be billed to a commercially insured patient.

The Alliance's policy does not require collateral or other security for patient accounts receivable. The Alliance routinely accepts assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans or policies.

Charity Care: The Alliance accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the Alliance and various guidelines outlined by the Federal Government. These policies define charity as those services for which no payment is anticipated and, as such, charges at established rates are not included in net patient service revenue. The estimated direct and indirect cost of providing these services totaled approximately \$24,354 and \$24,709 in 2013 and 2012, respectively. Such costs are determined using a ratio of cost to charges analysis with indirect cost allocated.

In addition to the charity care services described above, the Alliance provides a number of other services to benefit the poor for which little or no payment is received. Medicare, Medicaid, TennCare and State indigent programs do not cover the full cost of providing care to beneficiaries of those programs. The Alliance also provides services to the community at large for which it receives little or no payment.

Excess (Deficit) of Revenue, Gains and Support Over Expenses and Losses: The Consolidated Statements of Operations and the Consolidated Statements of Changes in Net Assets includes the caption Excess (Deficit) of Revenue, Gains and Support Over Expenses and Losses (the Performance Indicator). Changes in unrestricted net assets which are excluded from the Performance Indicator, consistent with industry practice, include contributions of long-lived assets or amounts restricted to the purchase of long-lived assets, certain pension and related adjustments, and transactions with noncontrolling interests.

Income Taxes: The Alliance is classified as an organization exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. As such, no provision for income taxes has been made in the accompanying consolidated financial statements for the Alliance and its tax-exempt subsidiaries. Taxable entities account for income taxes in accordance with FASB ASC 740, *Income*

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

Taxes (Note L). The Alliance has no significant uncertain tax positions at June 30, 2013 and 2012. At June 30, 2013, tax returns for 2009 through 2013 are subject to examination by the Internal Revenue Service.

Temporarily and Permanently Restricted Net Assets: Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. When a donor or time restriction expires; that is, when a stipulated time restriction ends or purpose restriction is fulfilled, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the Consolidated Statements of Operations and Changes in Net Assets as net assets released from restrictions. The Alliance's policy is to net contribution and grant revenues against related expenses and present such amounts as a part of other revenue, gains and support in the Consolidated Statements of Operations. Permanently restricted net assets have been restricted by donors to be maintained by the Alliance in perpetuity.

Premium Revenue: Premiums earned include premiums from individuals and Medicare. Medicare revenue includes premiums based on predetermined prepaid rates under Medicare risk contracts. Premiums are recognized in the month in which the members are entitled to health care services. Premiums collected in advance are deferred and recorded as unearned premium revenue. Premium deficiency losses are recognized when it is probable that expected future claim expenses will exceed future premiums on existing contracts. CHIC evaluated the need for a premium deficiency reserve and recorded an estimated reserve of $1,500 at June 30, 2013.

Medicare Shared Savings Program (MSSP): AnewCare, an Accountable Care Organization (ACO), participates in CMS's Medicare Shared Savings Program which is designed to facilitate coordination and cooperation among providers to improve the quality of care for Medicare beneficiaries and reduce unnecessary costs. ACOs participating in the program are assigned beneficiaries by CMS and are entitled to share in the savings if they are able to lower growth in Medicare Parts A and B fee-for-service costs while meeting performance standards on quality of care. The program is based on performance periods, the first of which specific to AnewCare is the period of July 2012 to December 2013. Utilizing statistical data and the methodology employed by CMS, AnewCare has estimated and recognized $2,644 of net shared savings through June 30, 2013. Variability is inherent in the estimation methodology and due to uncertainties in the estimation; it is probable that management's estimates of shared savings, if any, will change by the end of the performance period, and such change could be significant.

Electronic Health Record Incentives: The American Recovery and Reinvestment Act of 2009 (ARRA) provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified electronic health

NOTE B--SIGNIFICANT ACCOUNTING POLICIES - Continued

record (EHR) technology. The incentive payments are calculated based upon estimated discharges, charity care and other input data and are predicated upon the Alliance's attainment of program and attestation criteria and are subject to regulatory audit. During the years ending June 30, 2013 and 2012, the Alliance recognized EHR incentive revenues of $22,474 and $4,894, respectively, comprised of $17,340 of Medicare revenues in 2013 and $5,134 and $4,894 of Medicaid revenues in 2013 and 2012, respectively. EHR incentive revenues are included in other revenue, gains and support in the accompanying Consolidated Statements of Operations.

The Alliance incurs both capital expenditures and operating expenses in connection with the implementation of its various EHR initiatives. The amount and timing of these expenditures does not directly correlate with the timing of the Alliance's receipt or recognition of the EHR incentive payments.

Medical Costs: The cost of health care services is recognized in the period in which services are provided. Medical costs include an estimate of the cost of services provided to CHIC members by third-party providers, which have been incurred but not provided to CHIC. The estimate for incurred but not reported claims is based on actuarial projections of costs using historical paid claims and industry data. Due to uncertainties in the estimation, it is at least reasonably possible that management's estimates of incurred but not reported claims will change in 2014, although the amount of the change cannot be estimated.

Fair Value Measurement: The Alliance had previously adopted FASB ASC 820, *Fair Value Measurements and Disclosures,* which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements.

Subsequent Events: The Alliance evaluated all events or transactions that occurred after June 30, 2013, through October 24, 2013, the date the consolidated financial statements were available to be issued. During this period management did not note any material recognizable subsequent events that required recognition or disclosure in the June 30, 2013 consolidated financial statements, other than as discussed in Note S.

Reclassifications: Certain 2012 amounts have been reclassified to conform with the 2013 presentation in the accompanying consolidated financial statements. Prior to 2013, the Alliance classified only those activities directly associated with its mission of providing healthcare services, as well as other activities deemed significant to its operations, as operating activities. In 2013, the Alliance no longer presents an intermediate measure of operating income (loss) and the 2012 Consolidated Statement of Operations has been reformatted to be consistent with this presentation.

(Dollars in Thousands)

NOTE C--INVESTMENTS

Assets limited as to use are summarized by designation or restriction as follows at June 30:

	2013	*2012*
Designated or restricted:		
Under safekeeping agreements and other	$ 10,350	$ 24,026
By Board for capital improvements	-	4
Under bond indenture agreements:		
For debt service and interest payments	60,823	77,602
For capital acquisitions	36,989	29,578
	108,162	131,210
Less: amount required to meet current obligations	(20,386)	(36,557)
	$ 87,776	$ 94,653

Assets limited as to use consist of the following at June 30:

	2013	*2012*
Cash, cash equivalents and money market funds	$ 57,190	$ 80,304
U.S. Government securities	11,164	8,582
U.S. Agency securities	30,407	40,398
Corporate and foreign bonds	7,530	-
Municipal obligations	1,871	1,926
	$ 108,162	$ 131,210

Trading securities consist of the following at June 30:

	2013	*2012*
Cash, cash equivalents and money market funds	$ 9,488	$ 5,186
U.S. Government securities	18,481	10,697
U.S. Agency securities	19,620	26,165
Corporate and foreign bonds	172,350	52,581
Municipal obligations	17,749	961
Preferred and asset backed securities	3,491	11,183
U.S. equity securities	10,944	28,344
Mutual funds	186,028	141,968
Other	37,353	34,880
	$ 475,504	$ 311,965

(Dollars in Thousands)

NOTE C--INVESTMENTS - Continued

Held-to-maturity securities (other than assets limited as to use) are carried at amortized cost and consist of the following at June 30:

	2013	2012
Cash, cash equivalents and money market funds	$ 75	$ 298
Corporate and foreign bonds	33,060	138,232
Municipal obligations	4,937	15,549
	$ 38,072	$ 154,079

Held-to-maturity securities had gross unrealized gains and losses of $15 and $1,421, respectively, at June 30, 2013 and $11,432 and $33, respectively at June 30, 2012. At June 30, 2013 and 2012, the Alliance held no securities within the held-to-maturity portfolio which had been at an unrealized loss position for over one year. At June 30, 2013, the contractual maturities of held-to-maturity securities were $2,702 due in one year or less, $17,923 due from one to five years and $17,447 due after five years. At June 30, 2012, the contractual maturities of held-to-maturity securities were $11,225 due in one year or less, $67,532 due from one to five years and $75,322 due after five years.

The net investment gain is comprised of the following for the years ending June 30:

	2013	2012
Interest and dividend income, net of fees	$ 13,881	$ 15,213
Net realized (losses) gains on the sale of securities	3,074	(2,595)
Change in net unrealized gains on securities	24,025	(2,884)
	$ 40,980	$ 9,734

At June 30, 2013 and 2012, the Alliance held investments in certain limited partnerships and hedge funds with a recorded value of $37,353 and $34,880, respectively, that have a wide range of investment strategies with various levels of risk. These funds are included within trading securities and do not have readily determinable fair values. The funds are reported at estimated fair market value pursuant to FASB ASC 825, *Financial Instruments*.

NOTE D--DERIVATIVE TRANSACTIONS

The Alliance is a party to a number of derivative transactions. These derivatives have not been designated as hedges and are valued at estimated fair value in the accompanying Consolidated Balance Sheets. Management's primary objective in holding such derivatives is to introduce a

(Dollars in Thousands)

NOTE D--DERIVATIVE TRANSACTIONS - Continued

variable rate component into its fixed rate debt structure. Under the terms of these agreements, changes in the interest rate environment could have a significant effect on the Alliance. Deferred financing and acquisition costs, net of amortization, include $5,791 and $6,135 at June 30, 2013 and 2012, respectively, related to these swaps.

These derivative agreements require that the Alliance post additional collateral for the derivatives' fair market value deficits above specified levels. As of June 30, 2013, the Alliance was not required to post additional collateral. Such investments totaling $13,809 are included as assets limited as to use in the accompanying 2012 Consolidated Balance Sheet.

The following is a summary of the interest rate swap agreements at June 30, 2013 and 2012:

Notional Amount	*Term*	*Counterparty*	*Payments by:* *Receive*	*Pay*	*Estimated Fair Value* *2013*	*2012*
$ 170,000	4/2008-4/2026	Bank of America, Merrill Lynch	1.27% 7/2012-4/2013 1.07% 5/2013-6/2013	0.00%	$ 3,895	$ 3,500
95,000	4/2008-4/2026	Bank of America, Merrill Lynch	1.27% 7/2012-4/2013 1.08% 5/2013-6/2013	0.00%	2,205	1,983
173,030	4/2008-4/2034	Bank of America, Merrill Lynch	1.32% 7/2012-4/2013 1.12% 5/2013-6/2013	0.00%	(710)	(513)
82,055	12/2007-7/2033	Bank of America, Merrill Lynch	67% USD-LIBOR-BBA	0.312% + USD-SIFMA	(9,322)	(9,520)
50,000	2/2008-7/2038	Bank of America, Merrill Lynch	67% (USD-LIBOR-BBA + 0.15%)	USD-SIFMA	(4,218)	(3,895)
21,400	7/2007-7/2015	Bank of America, Merrill Lynch	1.05% + USD-SIFMA	4.50%	35	(320)
5,524	Various	Various	Various	Various	(70)	(221)
					$ (8,185)	$ (8,986)

(Dollars in Thousands)

NOTE D--DERIVATIVE TRANSACTIONS - Continued

The terms of five of these agreements were modified without settlement during 2013. No gain or loss was realized as a result of the modifications although such modifications did impact the estimated fair value of the interest rate swaps as of June 30, 2013.

The net investment derivative gain is comprised of the following for the years ending June 30:

	2013	*2012*
Settlement income and other	$ 6,661	$ 7,515
Change in estimated fair value	457	(6,198)
	$ 7,118	$ 1,317

These fair values are based on the estimated amount the Alliance would receive, or be required to pay, to enter into equivalent agreements at the valuation date and include an estimated credit value adjustment. The fair value of various derivatives are netted on the Consolidated Balance Sheets based on management's evaluation of the settlement provisions in the master contract. Gross positions of these derivatives are indicated in the table above. Due to the nature of these financial instruments, such estimates of fair value are subject to significant change in the near term.

The Alliance was previously a party to a total return swap with Lehman Brothers as the counterparty. Lehman Brothers filed for bankruptcy in September 2008. The Alliance subsequently received notification from Lehman Brothers Special Financing, Inc. indicating the intent of the counterparty to terminate this agreement effective January 1, 2009. The Alliance and Lehman Brothers Special Financing, Inc. were unable to reach a settlement agreement at the time the swap was terminated. An estimated liability related to the agreement of $10,395 was recognized by the Alliance at June 30, 2012. In addition, a third party held investments with a fair market value of approximately $13,809, at June 30, 2012, as collateral. In 2013, the parties reached a settlement agreement and in full settlement of the liability, the Alliance paid the counterparty $7,375 from the funds held as collateral and the remaining collateral was returned to the Alliance. A gain of approximately $3,020 was recognized on the settlement, which is included within other revenue, gains and support in the accompanying 2013 Consolidated Statement of Operations.

In June 2004, the Alliance entered into an agreement with Bear Stearns (acquired by JP Morgan) whereby Bear Stearns purchased from the Alliance an option to enter into an interest rate swap agreement (swaption) with the Alliance beginning July 1, 2011. During 2012, the counterparty expressed their intent to exercise the swaption on January 1, 2012 and the Alliance exercised its right to terminate the swaption at its fair market value. To effectuate the termination, the Alliance transferred $93,353 of a Guaranteed Investment Contract (GIC), to the third party as a termination payment. A gain of $3,058 was recognized on the termination, which is included within other

(Dollars in Thousands)

NOTE D--DERIVATIVE TRANSACTIONS - Continued

revenue, gains and support in the accompanying 2012 Consolidated Statement of Operations. Net derivative gain in the accompanying 2012 Consolidated Statement of Operations includes an unrealized loss of $4,676 related to this derivative, prior to termination.

Also in June 2004, the Alliance entered into two related forward sale agreements with the counterparty to the swaption agreements and the Master Trustee of the Series 2000 Bonds. In June 2012, the Alliance and the counterparty terminated the agreements. To effectuate the termination, the Alliance agreed to pay $13,429 to the counterparty. The termination payable is included in accounts payable and accrued expenses in the accompanying 2012 Consolidated Balance Sheet. The Alliance recognized a gain of $4,708 on the termination of these agreements, which is included within other revenue, gains and support in the accompanying 2012 Consolidated Statement of Operations.

NOTE E--PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following at June 30:

	2013	*2012*
Land	$ 60,180	$ 57,525
Buildings and leasehold improvements	718,489	661,146
Property and improvements held for leasing	77,767	74,914
Equipment	664,469	571,774
Buildings and equipment held under capital lease	671	20,540
	1,521,576	1,385,899
Less: Allowances for depreciation and amortization	(704,002)	(626,552)
	817,574	759,347
Construction in progress (Note N)	66,719	94,278
	$ 884,293	$ 853,625

Accumulated depreciation and amortization on property and improvements held for leasing purposes is $25,146 and $22,951 at June 30, 2013 and 2012, respectively. Net interest capitalized was $4,163 and $3,110 for the years ended June 30, 2013 and 2012, respectively.

During 2012, the Alliance executed an Amendment and Mutual Release Agreement with a vendor whereby the Alliance waived its right to take any action with respect to prior contracts in exchange for professional services in future periods, primarily related to accelerated deployment of information

(Dollars in Thousands)

NOTE E--PROPERTY, PLANT AND EQUIPMENT - Continued

systems. The Alliance recognized approximately $3,386 and $3,799 in 2013 and 2012 as additions to property, plant and equipment with an offsetting gain related to the agreed-upon value of such professional services. The Alliance anticipates recognition of additional amounts in future periods as such services are provided.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS

Long-term debt and capital lease obligations consist of the following at June 30:

			Outstanding Balance	
Description	*Maturities*	*Rates*	*2013*	*2012*
2012A Hospital Revenue Bonds, net of unamortized premium of $1,817 at June 30, 2013	$55,000 uninsured term bonds, due August 15, 2042, subject to early redemption	5.00%	$ 56,817	$ -
2012B Hospital Revenue Bonds	$28,095 uninsured term bonds, due August 15, 2042, subject to early redemption or tender	Variable, 0.06% at June 30, 2013	28,095	-
2012C Hospital Revenue Bonds	$9,785 uninsured term bonds, due August 15, 2042, subject to early redemption or tender	Variable, 0.06% at June 30, 2013	9,785	-
2011A Hospital Revenue Bonds	$61,185 uninsured term bonds, due July 1, 2033, subject to early redemption or tender	Variable, 0.06% at June 30, 2013	61,185	65,260
2011B Hospital Revenue Bonds	$20,000 uninsured term bonds, due July 1, 2033, subject to early redemption or tender	Variable, 0.06% at June 30, 2013	20,000	20,000
2011C Hospital Revenue Bonds	$48,974 uninsured term bonds, due July 1, 2031, subject to early redemption or tender	Variable, 0.06% at June 30, 2013	48,974	49,875
2011D Hospital Revenue Bonds	$60,705 uninsured term bonds, due July 1, 2031, subject to early redemption or tender	Variable, 0.06% at June 30, 2013	60,705	60,705
2011E Taxable Bonds	$15,960 uninsured term bonds, due July 1, 2026, subject to early redemption or tender	Variable, 0.17% at June 30, 2013	15,960	15,960
2011 Hospital Facility Revenue Refunding and Improvement Bonds (JMH)	$23,095 uninsured term bonds, due July 1, 2033, subject to early redemption or tender	Variable, 1.14% at June 30, 2013	23,095	24,870
2010A Hospital Revenue Bonds, net of unamortized premium of $978 and $1,017 at June 30, 2013 and 2012, respectively	$28,780 uninsured serially, through 2020 $14,985 uninsured term bonds, due July 1, 2025 $19,230 uninsured term bonds, due July 1, 2030 $39,570 uninsured term bonds, due July 1, 2038 $55,480 uninsured term bonds, due July 1, 2038	3.00% to 5.00% 5.38% 5.63% 6.50% 6.00%	159,023	162,952
2010B Hospital Revenue Bonds, net of unamortized premium of $626 and $669 at June 30, 2013 and 2012, respectively	$20,295 uninsured serially, through 2020 $4,355 uninsured term bonds, due July 1, 2023 $4,250 uninsured term bonds, due July 1, 2028	2.50% to 5.00% 5.00% 5.50%	29,526	33,129
2009A Hospital Revenue Bonds, net of unamortized discount of $113 and $117 at June 30, 2013 and 2012, respectively	$655 uninsured term bonds, due July 1, 2019 $1,730 uninsured term bonds, due July 1, 2029 $3,105 uninsured term bonds, due July 1, 2038	7.25% 7.50% 7.75%	5,377	5,443
2009B Hospital Revenue Bonds	$5,470 uninsured term bonds, due July 1, 2038	8.00%	5,470	5,535
2009C Hospital Revenue Bonds, net of unamortized discount of $2,246 and $2,334 at June 30, 2013 and 2012, respectively	$18,800 uninsured term bonds, due July 1, 2019 $20,000 uninsured term bonds, due July 1, 2029 $74,855 uninsured term bonds, due July 1, 2038	7.25% 7.50% 7.75%	111,409	113,621
2008A Hospital Revenue Bonds	$13,245 uninsured term bonds, due July 1, 2038, subject to early redemption or tender	Variable, 0.06% at June 30, 2013	13,245	13,245
2008B Hospital Revenue Bonds	$51,965 uninsured term bonds, due July 1, 2038, subject to early redemption or tender	Variable, 0.06% at June 30, 2013	51,965	52,930
2007B Taxable Hospital Revenue Bonds, sub-series B-1 and B-2	$123,335 uninsured term bonds, due July 1, 2033, subject to early redemption or tender, sub-series B-3 redeemed in 2013	Variable, 0.17% to 0.18% at June 30, 2013	123,335	156,760

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Description	*Maturities*	*Rates*	*Outstanding Balance* 2013	2012
2006A Hospital First Mortgage Revenue Bonds, net of unamortized premium of $135 and $141 at June 30, 2013 and 2012, respectively	$5,295 uninsured serially, through 2019 $7,375 uninsured term bonds, due July 1, 2026 $20,505 uninsured term bonds, due July 1, 2031 $135,175 uninsured term bonds, due July 1, 2036	5.00% 5.25% 5.50% 5.50%	168,485	169,136
2001A Hospital First Mortgage Revenue Bonds	$21,400 term bonds, due July 1, 2026, subject to early redemption or tender	4.50%	21,400	22,300
2000A Hospital First Mortgage Revenue Refunding Bonds	$34,645 insured Capital Appreciation Bonds, interest and principal due July 1, 2026 through 2030	6.63%	34,645	32,431
2000C Hospital First Mortgage Revenue Bonds	$32,040 insured term bonds, due July 1, 2026	8.50%	32,040	33,230
2000D First Mortgage Taxable Bonds	$13,800 insured term bonds, due July 1, 2026	8.50%	13,800	14,315
Capitalized lease obligations secured by equipment	Various monthly payments of principal and interest	Various	1,240	1,645
$1,593 note payable, secured by equipment	Various annual principal payments through July 2014	Unspecified	896	1,343
Capitalized lease obligation secured by medical office building (JMH)	Lease was paid-off in 2013	N/A	-	15,498
Master installment payment agreement	Various quarterly payments through May 2014	Unspecified	2,320	4,438
Master installment payment agreement, secured by equipment	Various quarterly payments through May 2014	Unspecified	1,503	3,032
$1,640 note payable, secured by land	Monthly principal payments of $10 through maturity in July 2015	Unspecified	1,640	1,870
$985 in promissory notes secured by assets of Emmaus Community Healthcare, LLC	Various monthly principal and interest payments through 2019	3.00% - 3.75%	985	1,052
$17,607 term note	Monthly principal and interest payments of $60 beginning November 2012 maturing September 2015; remaining principal due October 2015	Variable, 1.14% at June 30, 2013	17,607	-
$4,238 in notes payable, secured by land	Annual principal payments of $215 beginning October 2013 maturing October 2015; remaining principal due October 2016. Interest is payable monthly.	Variable, 0.19% at June 30, 2013	4,238	-
			1,124,765	1,080,575
	Less current portion		(34,417)	(32,477)
			$ 1,090,348	$ 1,048,098

Series 2012 Bonds: In September 2012, the Alliance issued $55,000 (Series 2012A) fixed rate and $28,095 (Series 2012B) variable rate tax-exempt Hospital Revenue Bonds through The Health and Educational Facilities Board of the City of Johnson City, Tennessee, and $9,785 (Series 2012C) variable rate tax-exempt Hospital Revenue Bonds through the Industrial Development Authority of Wise, Virginia (collectively, the Series 2012 Bonds). The proceeds from the Series 2012A Bonds will be used to finance a surgery center project at JCMC and pay issuance costs related to these Bonds. The proceeds from the Series 2012B and 2012C Bonds will be used to finance or refinance capital improvements and equipment acquisitions and to pay issuance costs associated with these Bonds. The timely payment of the Series 2012B and Series 2012C Bonds is secured by irrevocable transferable direct-pay letters of credit which expire September 17, 2015.

Series 2011 Bonds: In October 2011, the Alliance issued $65,260 (Series 2011A) and $20,000 (Series 2011B) variable rate tax-exempt Hospital Revenue Bonds through The Health and

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

Educational Facilities Board of the City of Johnson City, Tennessee, $49,875 (Series 2011C) and $60,705 (Series 2011D) variable rate tax-exempt Hospital Revenue Bonds through the Industrial Development Authority of Smyth, Virginia and $15,960 (Series 2011E) variable rate Taxable Bonds (collectively, the Series 2011 Bonds). The proceeds from the Series 2011A and Series 2011B Bonds were used to finance certain capital acquisitions in the State of Tennessee and pay issuance costs related to these Bonds. The proceeds from the Series 2011C and 2011D Bonds were used to refinance the 2001 NCH Hospital Refunding and Improvement Revenue Bonds, finance capital acquisitions for NCH, JMH and SCCH and to pay issuance costs associated with these Bonds. The Series 2011E Bond proceeds were used to refinance certain capital acquisitions of SCCH and BRMM and pay issuance costs. The timely payment of the Series 2011 Bonds is secured by a letter of credit which expires October 19, 2014.

In November 2011, JMH issued $24,870 (JMH Series 2011) variable rate tax-exempt Hospital Facility Revenue Refunding and Improvement Bonds through the Industrial Development Authority of Smyth County. The proceeds from the JMH Series 2011 Bonds were used to refinance the 1998 Hospital Refunding and Improvement Revenue Bonds, refinance existing indebtedness incurred to finance capital acquisitions and to pay issuance costs associated with the Bonds.

Series 2010 Bonds: In April 2010, the Alliance issued $168,080 (Series 2010A) and $35,935 (Series 2010B) fixed rate Hospital Refunding Revenue Bonds (collectively, the Series 2010 Bonds). Proceeds of the Series 2010A and the Series 2010B Bonds were used to refinance outstanding indebtedness, specifically related to the Alliance's facilities in Tennessee and in Virginia, respectively, fund debt service reserve funds and pay costs of issuance.

Series 2009 Bonds: In March 2009, the Alliance issued $5,560 (Series 2009A), $5,535 (Series 2009B) and $115,955 (Series 2009C) fixed rate Hospital Revenue Bonds (collectively, the Series 2009 Bonds). The proceeds of Series 2009 Bonds were used to refinance a portion of the outstanding Series 2006C Taxable Notes, which were originally issued to finance a capital commitment to SCCH and purchase certain leased assets, finance the acquisition of a majority ownership in JMH, fund a debt service reserve fund and pay costs of issuance. The portion of the 2006C taxable notes which were not refinanced with the Series 2009 Bonds were repaid with cash on hand.

Series 2008 Bonds: In February 2008, the Alliance issued $72,770 (Series 2008A) and $54,230 (Series 2008B) variable rate Hospital Revenue Bonds (collectively, the Series 2008 Bonds). The proceeds of Series 2008 Bonds were primarily used to finance certain future capital projects for the Alliance's hospital facilities and for the repayment of previously issued 2008 Taxable Notes used for the acquisition of RCMC. The payment of principal and interest on the Series 2008 Bonds and the purchase price of any tendered bonds on each series are secured by a separate, irrevocable,

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

transferable, direct-pay letter of credit. A portion ($59,525) of the Series 2008A Bonds were repaid from proceeds of the Series 2010 Bonds.

Series 2007 Bonds: In December 2007, the Alliance issued $104,355 (Series 2007A), $327,170 (Series 2007B taxable) and $36,575 (Series 2007C) variable rate Hospital Revenue Bonds (collectively, the Series 2007 Bonds). The proceeds of Series 2007 Bonds were primarily used to early extinguish a portion of the outstanding Series 2000A Bonds, all of the outstanding 2000B Bonds, all of the outstanding Series 1994 Bonds, and all of the outstanding Series 2006B Bonds; to finance the acquisition of a majority ownership in NCH, and to finance certain capital improvements and equipment acquisitions for the Alliance's hospital facilities. A portion of the outstanding Series 2007A ($91,685) and Series 2007C ($32,840) Bonds were repaid from proceeds of the Series 2010 Bonds.

During 2012, the Alliance redeemed $115,135 of the Series 2007B-1 Bonds and $29,405 of the Series 2007B-3 Bonds. The Alliance redeemed $26,530 of the Series 2007B-3 Bonds during 2013. The payment of principal and interest on the outstanding Sub-Series 2007B Bonds and the purchase price of any tendered bonds on each series are secured by a separate, irrevocable, transferable, direct-pay letter of credit.

Series 2006 Bonds: During 2006, the Alliance issued $173,030 Hospital First Mortgage Revenue Bonds (Series 2006A) and $66,500 Hospital First Mortgage Variable Rate Revenue Bonds (Series 2006B). The proceeds from the sale of the Series 2006A Bonds were used to finance certain future and prior capital projects for the Alliance's hospital facilities and to refund certain existing indebtedness, specifically the Series 2001B Bonds (discussed below) and certain existing short and intermediate term loans and leases, as well as fund a debt service reserve fund. The Series 2006B Bond proceeds were substantially used to refund the remaining outstanding principal of the Series 2001B Bonds and establish a debt service reserve fund.

Series 2001 Bonds: During 2001, the Alliance issued $26,000 Hospital First Mortgage Revenue Bonds (Series 2001A). The Alliance redeemed the 2001A Bonds and released a new Series 2001A to Bank of America Merrill Lynch during 2012.

Series 2000 Bonds: The Hospital First Mortgage Revenue Refunding (Series 2000A Bonds) and First Mortgage Revenue Refunding Bonds (Series 2000B Bonds), were used to advance refund previously existing indebtedness as well as fund a required debt service reserve fund. The Hospital First Mortgage Revenue Bonds (Series 2000C Taxable Bonds) were used to refinance certain mortgage indebtedness of BRMM, and to refund other previously existing indebtedness. The

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

proceeds from the sale of the First Mortgage Bonds (Series 2000D Taxable Bonds) were used primarily to fund working capital for the Alliance.

The Series 2000A Bonds included at issue date $14,680 of insured Capital Appreciation Bonds. Such bonds bear a 0% coupon rate and have a yield of 6.625% annually. The Alliance recognizes interest expense and increases the amount of outstanding debt each year based upon this yield. Total principal and interest due at maturity (2026 through 2030) is $93,675.

Derecognized Bonds: The advance refunding of previously issued debt requires funds to be placed in irrevocable trusts in order to satisfy remaining scheduled principal and interest payments. Management, upon advice of legal counsel, believes the amounts deposited in such irrevocable trust accounts have contractually relieved the Alliance of any future obligations with respect to this debt, and the debt and escrowed securities are not considered liabilities or assets of the Alliance. Therefore, such debt has been derecognized. Debt outstanding and not recognized in the Consolidated Balance Sheet at June 30, 2013 due to previous advance refundings of the Series 2000A Bonds, Series 2000B Bonds, Series 1998C Bonds, and Series 1991 Bonds, totaled approximately $213,060.

The assets placed in the irrevocable trust accounts are also not recognized as assets of the Alliance. These assets consist primarily of various investments, as permitted by bond indentures and other documents, including United States Treasury obligations, an investment contract with MBIA Insurance Corporation (MBIA) in the original amount of $54,300, as well as the Series 2000C and 2000D Bonds which were purchased with the proceeds of the 2000A and 2000B Bonds specifically for the purpose of utilizing the Series 2000C and 2000D Bonds in the irrevocable trust. Therefore, certain of the assets held in the irrevocable trust accounts have future income streams contingent upon payments by the Alliance.

The Alliance instructed the trustee of the 1998C Bonds to liquidate certain investments held in the related irrevocable trust account and to redeem a portion of the 1998C Bonds with the proceeds from the liquidation. The fair value of the liquidated assets exceeded the payment necessary to redeem the 1998C Bonds and the excess was paid to the Alliance. As a result of this transaction, the Alliance recognized a net gain in 2013 and 2012 of $13,847 and $5,337, respectively, which is included in other revenue, gains and support in the accompanying Consolidated Statements of Operations.

Variable Rate Issuances: The variable rate of interest on the Series 2012, Series 2011, Series 2008 and Series 2007 Bonds is determined weekly by the Remarketing Agent, as the rate equal to the lowest rate which, in regard to general financial conditions and other special conditions bearing on the rate, would produce as nearly as possible a par bid for the Bonds in the secondary market. In no

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

event shall the variable rate on the Bonds during any period where interest is calculated weekly exceed the lesser of 12% annually or the maximum contract rate of interest permitted by the applicable State of issue. The Alliance has the option, upon written approval of the holder of the letters of credit, the Remarketing Agent and others, to convert to a medium-term rate period or to a fixed rate.

Early Redemption: Essentially all of the Alliance's bonds are subject to redemption prior to maturity, including optional, mandatory sinking fund and extraordinary redemption, at various dates and prices as described in the respective Bond indentures and other documents.

Other Bonds, Notes Payable and Financing Arrangements: The Alliance has granted a deed of trust on JCMC and SSH to secure the payment of the outstanding Bonds. The Bonds are also secured by the Alliance's receivables, inventories and other assets as well as certain funds held under the documents pursuant to which the bonds were issued. The JMH Series 2011 Hospital Refunding and Improvement Revenue Bonds are secured by pledged revenues of JMH, as defined in the Credit Agreement.

The scheduled maturities and mandatory sinking fund payments of the long-term debt and capital lease obligations (excluding interest), exclusive of net unamortized original issue discount and premium, at June 30, 2013 are as follows:

Year Ending June 30,		
2014		$ 34,417
2015		28,191
2016		45,427
2017		32,290
2018		29,253
Thereafter		953,990
		1,123,568
	Net premium	1,197
		$ 1,124,765

Certain members of the Alliance and JMH are each members of separate Obligated Groups. The bond indentures, master trust indentures, letter of credit agreements and loan agreements related to the various bond issues and notes payable contain covenants with which the respective Obligated Groups must comply. These requirements include maintenance of certain financial and liquidity ratios, deposits to trustee funds, permitted indebtedness, use of facilities and disposals of property.

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS - Continued

These covenants also require that failure to meet certain debt service coverage tests will require the deposit of all daily cash receipts of the Alliance into a trust fund. Management has represented the Alliance and JMH are in compliance with all such covenants at June 30, 2013.

In connection with the tax-exempt bonds, the Alliance is required every five years, and at maturity, to remit to the Internal Revenue Service amounts which are due related to positive arbitrage on the borrowed funds. The Alliance performs such computations when required and recognizes any liability at that time. Management does not believe there are any significant arbitrage liabilities at June 30, 2013 or 2012.

During 2012, the Alliance recognized a $2,636 loss on early extinguishment of debt representing the write off of previously deferred and unamortized financing costs generally related to the refinanced or otherwise redeemed portion of the Series 2007B Bonds, Series 1998 JMH Bonds and the Series 2001 NCH Bonds.

NOTE G--SELF-INSURANCE PROGRAMS

The Alliance is substantially self-insured for professional and general liability claims and related expenses. The Alliance maintains a $25,000 umbrella liability policy that attaches over the self-insurance limits of $10,000 per claim and a $15,000 annual aggregate retention. The Alliance's insurance program also provides professional liability coverage for certain affiliates and joint ventures.

The Alliance is also substantially self-insured for workers' compensation claims in the State of Tennessee and has established estimated liabilities for both reported and unreported claims. The Alliance maintains a stop-loss policy that attaches over the self-insurance limits of $1,000 per occurrence and $1,000 annual aggregate retention. In the State of Virginia, the Alliance is not self-insured and maintains workers' compensation insurance through commercial carriers.

At June 30, 2013, the Alliance is involved in litigation relating to medical malpractice and workers' compensation and other claims arising in the ordinary course of business. There are also known incidents occurring through June 30, 2013 that may result in the assertion of additional claims, and other unreported claims may be asserted arising from services provided in the past. Alliance management has estimated and accrued for the cost of these unreported claims based on historical data and actuarial projections. The estimated net present value of malpractice and workers' compensation claims, both reported and unreported, as of June 30, 2013 and 2012 was $12,348 and $12,896, respectively. The discount rate utilized was 5% at June 30, 2013 and 2012.

(Dollars in Thousands)

NOTE G--SELF-INSURANCE PROGRAMS - Continued

Additionally, the Alliance is self-insured for employee health claims and recognizes expense each year based upon actual claims paid and an estimate of claims incurred but not yet paid, including a catastrophic claims reserve based on historical claims in excess of $75. Such amount is included in accounts payable and accrued expenses in the Consolidated Balance Sheets.

NOTE H--NET PATIENT SERVICE REVENUE

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the accompanying Consolidated Statements of Operations is as follows for the years ended June 30:

	2013	2012
Inpatient service charges	$ 2,086,519	$ 2,095,036
Outpatient service charges	2,120,400	1,982,154
Gross patient service charges	4,206,919	4,077,190
Less:		
Estimated contractual adjustments and other discounts	3,058,580	2,899,678
Charity care	103,094	102,462
Provision for bad debts	112,497	122,917
	3,274,171	3,125,057
Net patient service revenue	$ 932,748	$ 952,133

Patient service revenue, net of contractual allowances and discounts is composed of the following for the years ended June 30:

	2013	2012
Third-party payers	946,979	$ 968,101
Patients	98,266	106,949
Patient service revenue	$ 1,045,245	$ 1,075,050

Patient deductibles and copayments under third-party payment programs are included within the patient amounts above.

NOTE H--NET PATIENT SERVICE REVENUE - Continued

Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts. For receivables associated with services provided to patients who have third-party coverage, the Alliance analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for bad debts, if necessary, for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not paid or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely. For receivables associated with patients, which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill, the Alliance records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between rates and the amounts actually collected after all reasonable collections efforts have been exhausted is charged against the allowance for uncollectible accounts.

The Alliance's allowance for doubtful accounts totaled $49,449 and $52,696 at June 30, 2013 and 2012, respectively. The allowance for doubtful accounts decreased from 26% of patient accounts receivable, net of contractual allowances, at June 30, 2012 to 23% of patient accounts receivable, net of contractual allowances, as of June 30, 2013. During 2013, MSHA began recording contractual allowances at time-of-billing for three additional payers, two of whom are MSHA's largest commercial payers. Previously, MSHA had recorded an allowance for bad debt for those three payers in addition to an estimated allowance for contractual adjustments. As a result of a more accurate methodology for recording contractual allowances for those three payers, MSHA was able to decrease its allowance for bad debts by a minimal amount. The provision for bad debts associated with the Alliance's ancillary service lines are not significant.

NOTE I--THIRD-PARTY REIMBURSEMENT

The Alliance renders services to patients under contractual arrangements with Medicare, Medicaid, TennCare, Blue Cross and various other commercial payers. The Medicare program pays for inpatient services on a prospective basis. Payments are based upon diagnosis related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. The Alliance also receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid and other low income patients. Most Medicare outpatient services are reimbursed on a prospectively determined payment methodology. The Medicare program also reimburses certain other services on the basis of reasonable cost, subject to various prescribed limitations and reductions.

NOTE I--THIRD-PARTY REIMBURSEMENT - Continued

Reimbursement under the State of Tennessee's Medicaid waiver program (TennCare) for inpatient and outpatient services is administered by various managed care organizations (MCOs) and is based on diagnosis related group assignments, a negotiated per diem or fee schedule basis. The Alliance also receives additional supplemental payments from the State of Tennessee. These supplemental payments recognized totaled \$8,455 and \$11,300 for the years ended June 30, 2013 and 2012, respectively. Such payments are not guaranteed in future periods.

The Virginia Medicaid program reimbursement for inpatient hospital services is based on a prospective payment system using both a per case and per diem methodology. Additional payments are made for the allowable costs of capital. Payments for outpatient services are based on Medicare cost reimbursement principles and settled through the filing of an annual Medicaid cost report.

Amounts earned under the contractual agreements with the Medicare and Medicaid programs are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. During 2013, the State of Virginia outsourced its Medicaid program to six managed care organizations. ISHN provides the provider network for Southwest Virginia to five Virginia Medicaid managed care organizations; two of which are on an exclusive basis. ISHN is not at-risk under these contracts.

Activity with respect to audits and reviews of the governmental programs in the healthcare industry has increased and is expected to increase in the future. No additional specific reserves or allowances have been established with regard to these increased audits and reviews as management is not able to estimate such amounts, if any. Management believes that any adjustments from these increased audits and reviews will not have a material adverse impact on the consolidated financial statements. However, due to uncertainties in the estimation, it is at least reasonably possible that management's estimate will change in 2014, although the amount of any change cannot be estimated. The impact of final settlements of cost reports or changes in estimates increased net patient service revenue by \$1,328 in 2013 and decreased net patient service revenue by \$1,556 in 2012.

Participation in the Medicare program subjects the Alliance to significant rules and regulations; failure to adhere to such could result in fines, penalties or expulsion from the program. Management believes that adequate provision has been made for any adjustments, fines or penalties which may result from final settlements or violations of other rules or regulations. Management has represented that the Alliance is in substantial compliance with these rules and regulations as of June 30, 2013.

The Alliance has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations and employer groups. The basis

NOTE I--THIRD-PARTY REIMBURSEMENT - Continued

for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

NOTE J--EMPLOYEE BENEFIT PLANS

The Alliance sponsors a retirement plan (the Plan) which covers substantially all employees. The Plan is a defined contribution plan which consists principally of employer-funded contributions. During 2013 and 2012, the Alliance made contributions to the Plan under a stratified system, whereby the Alliance's contribution percentage is based on each employee's years of service. Employees of certain other subsidiaries are covered by other plans, although such plans are not significant. The total expense related to defined contribution plans for the years ended June 30, 2013 and 2012 was $16,121 and $15,072, respectively.

NCH maintains a defined benefit pension plan and a post-retirement employee benefit plan. The accrued unfunded pension liability was $3,028 and $2,560, and the accrued unfunded post-retirement liability was $4,943 and $4,554 at June 30, 2013 and 2012, respectively.

The Alliance sponsors a secured executive benefit program (SEBP) for certain key executives. Contributions to the plan by the Alliance are based on an annual amount of funding necessary to produce a target benefit for the participants at their retirement date, although the Alliance does not guarantee any level of benefit will be achieved. The Alliance contributed $1,020 and $1,734 to the plan during 2013 and 2012, respectively. Other assets at June 30, 2013 and 2012 include $10,721 and $9,675, respectively, related to the Alliance's portion of the benefits which are recoverable upon the death of the participant. In addition, the Alliance sponsors a Section 457(f) plan for certain key executives. The Alliance contributed $294 and $452 to the Section 457(f) plan during 2013 and 2012, respectively.

NOTE K--CONCENTRATION OF RISK

The Alliance has locations primarily in upper East Tennessee and Southwest Virginia which is considered a geographic concentration. The Alliance grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. Net patient service revenue from Washington County, Tennessee operations were approximately 51% and 51% of total net patient service revenue for 2013 and 2012, respectively.

The mix of receivables from patients and third-party payers based on charges at established rates is as follows as of June 30:

(Dollars in Thousands)

NOTE K--CONCENTRATION OF RISK - Continued

	2013	*2012*
Medicare	38%	36%
Tenncare/Medicaid	16%	14%
Commercial	28%	26%
Other third-party payers	9%	13%
Patients	9%	11%
	100%	100%

Approximately 88% and 94% of the consolidated total revenue, gains and support were related to the provision of healthcare services during 2013 and 2012, respectively. Admitting physicians are primarily practitioners in the regional area.

Two of the Alliance's Virginia hospitals' employees are covered under collective bargaining agreements which extend through February 2014 and January 2015, respectively.

The Hospital maintains bank accounts at various financial institutions covered by the Federal Deposit Insurance Corporation (FDIC). At times throughout the year, the Alliance may maintain bank account balances in excess of the FDIC insured limit. Management believes the credit risk associated with these deposits is not significant.

The Alliance routinely invests in investment vehicles as listed in Note C. The Alliance's investment portfolio is managed by outside investment management companies. Investments in corporate and foreign bonds, municipal obligations, money market funds, equities and other vehicles that are held by safekeeping agents are not insured or guaranteed by the U.S. government.

NOTE L--INCOME TAXES

BRMM and its subsidiaries file a consolidated federal tax return and separate state tax returns. As of June 30, 2013 and 2012, BRMM and its subsidiaries had net operating loss carryforwards for consolidated federal purposes of $33,620 and $35,968, respectively, related to operating loss carryforwards which expire through 2031. At June 30, 2013 and 2012, BRMM had state net operating loss carryforwards of $70,347 and $69,403, respectively, which expire through 2027. The net operating loss carryforwards may be offset against future taxable income to the extent permitted by the Internal Revenue Code and Tennessee Code Annotated.

NOTE L--INCOME TAXES - Continued

At June 30, 2013 and 2012, SWCH had federal and state net operating loss carryforwards of $5,906 and $5,614, respectively, which expire through 2032. The net operating loss carryforwards may be off-set against future taxable income to the extent permitted by the Internal Revenue Code and tax codes of the Commonwealth of Virginia.

Net deferred tax assets related to these carryforwards and other deferred tax assets have been substantially offset through valuation allowances equal to these amounts. Income taxes paid relate primarily to state taxes for certain subsidiaries and federal alternative minimum tax.

NOTE M--RELATED PARTY TRANSACTIONS

The Alliance enters into transactions with entities affiliated with certain members of the Board of Directors including transactions to construct Alliance facilities and provide professional services to the Alliance. Board members refrain from discussion and abstain from voting on transactions with entities with which they are related.

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES

Construction in Progress: Construction in progress at June 30, 2013 represents costs incurred related to various hospital and medical office building facility renovations and additions and information technology infrastructure. The Alliance has outstanding contracts and other commitments related to the completion of these projects, and the cost to complete these projects is estimated to be approximately $39,110 at June 30, 2013. The Alliance does not expect any significant costs to be incurred for infrastructure improvements to assets held for resale.

Physician Contracts: BRMM employs physicians to provide services to BRMM's physician practices through employment agreements which provide annual compensation, plus incentives based upon specified productivity levels. These contracts have various terms.

In addition, the Alliance has entered into contractual relationships with non-employed physicians to provide services in Upper East Tennessee and Southwest Virginia. These contracts guarantee certain base payments and allowable expenses and have terms of varying lengths. Amounts drawn and outstanding under each agreement are treated as a loan bearing interest at various rates and are subject to repayment over a specified period. The physician notes may also be amortized by virtue of the physician's continued practice in the specified community during the repayment period. A net receivable of $884 and $1,436 related to these agreements is included in the accompanying Consolidated Balance Sheets at June 30, 2013 and 2012, respectively.

(Dollars in Thousands)

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES - Continued

Employee Scholarships: The Alliance offers scholarships to certain individuals which require that the recipients return to the Alliance to work for a specified period of time after they complete their degree. Amounts due are then forgiven over a specific period of time as provided in the individual contracts. If the recipient does not return and work the required period of time, the funds disbursed on their behalf become due immediately and interest is charged until the funds are repaid. Other receivables at June 30, 2013 and 2012 include $9,021 and $8,005, respectively, related to students in school, graduates working at the Alliance and amounts due from others who are no longer in the scholarship program, net of an estimated allowance.

Operating Leases and Maintenance Contracts: Total lease expense for the years ended June 30, 2013 and 2012 was $8,739 and $8,823, respectively. Future minimum lease payments for each of the next five years and in the aggregate for the Alliance's noncancellable operating leases with remaining lease terms in excess of one year are as follows:

Year Ending June 30,		
2014	$	5,165
2015		6,044
2016		4,491
2017		2,459
2018		1,848
Thereafter		6,297
	$	26,304

Asset Retirement Obligation: The Alliance has identified asbestos in certain facilities and is required by law to dispose of it in a special manner if the facility undergoes major renovations or is demolished; otherwise, the Alliance is not required to remove the asbestos from the facility. The Alliance has complied with regulations by treating the asbestos so that it presents no known immediate or future safety concerns. An asset retirement obligation has been established to the extent that sufficient information exists upon which to estimate the liability.

Other: The Alliance is a party to various transactions and agreements in the normal course of business, which include purchase and re-purchase agreements, put arrangements and other commitments, which may bind the Alliance to undertake additional transactions or activities in the future. In addition, the Alliance has agreed to guarantee a portion of the outstanding indebtedness of a joint venture. Management estimates that the fair value of the guarantee of this debt is immaterial as of June 30, 2013.

(Dollars in Thousands)

NOTE N--OTHER COMMITMENTS AND CONTINGENCIES - Continued

Healthcare Industry: Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

In March 2010, Congress adopted comprehensive health care insurance legislation, *Patient Care Protection and Affordable Care Act* and *Health Care and Education Reconciliation Act*. The legislation, among other matters, is designated to expand access to coverage to substantively all citizens by 2019 through a combination of public program expansion and private industry health insurance. Changes to existing TennCare and Medicaid coverage and payments are also expected to occur as a result of this legislation. Implementing regulations are generally required for these legislative acts, which are to be adopted over a period of years and, accordingly, the specific impact of any future regulations is not determinable.

NOTE O--RENTAL INCOME UNDER OPERATING LEASES

The Alliance leases rental properties to third parties, most of whom are physician practices, for various terms, generally five years. The following is a schedule by year and in the aggregate of minimum future rental income due under noncancellable operating leases at June 30, 2013:

Year Ending June 30,		
2014	$	1,779
2015		1,487
2016		727
2017		379
2018		248
Thereafter		225
Total minimum future rentals	$	4,845

NOTE P--FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments has been estimated by the Alliance using available market information as of June 30, 2013 and 2012, and valuation methodologies considered appropriate. The estimates presented are not necessarily indicative of amounts the Alliance could realize in a current market exchange. The carrying value of substantially all financial instruments approximates fair value due to the nature or term of the instruments, except as described below.

NOTE P--FAIR VALUE OF FINANCIAL INSTRUMENTS - Continued

Investment in Joint Ventures: It is not practical to estimate the fair market value of the investments in joint ventures.

Other Long-Term Liabilities: Estimates of reported and unreported professional liability claims, pension and post-retirement liabilities are discounted to approximate their estimated fair value. It is not practical to estimate the fair market value of other long-term liabilities due to uncertainty of when these amounts may be paid. Other long-term liabilities are not discounted.

Long-Term Debt: The fair value of long-term debt is estimated based upon quotes obtained from brokers for bonds and discounted future cash flows using current market rates for other debt. For long-term debt with variable interest rates, the carrying value approximates fair value.

The estimated fair value of the Alliance's financial instruments that have carrying values different from fair value is as follows at June 30:

	2013		*2012*	
	Carrying Value	*Estimated Fair Value*	*Carrying Value*	*Estimated Fair Value*
FINANCIAL LIABILITIES:				
Long-term debt	$ 1,124,765	$ 1,167,846	$ 1,080,575	$ 1,150,201

NOTE Q--FAIR VALUE MEASUREMENT

FASB ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 - Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.

- Level 2 - Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. The Alliance's Level 2 investments are valued primarily using the market valuation approach.

(Dollars in Thousands)

NOTE Q–FAIR VALUE MEASUREMENT - Continued

- Level 3 - Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes values determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Alliance's own assumptions.

In instances where the determination of the fair value hierarchy measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Alliance's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following table sets forth, by level within the fair value hierarchy, the financial assets and liabilities recorded at fair value on a recurring basis and long-term debt as disclosed at fair value as of June 30, 2013 and 2012:

	Total	*Level 1*	*Level 2*	*Level 3*
June 30, 2013				
Cash, cash equivalents and money market funds	$ 66,075	$ 66,075	$ -	$ -
U.S. Government securities	25,905	25,905	-	-
U.S. Agency securities	45,997	45,997	-	-
Corporate and foreign bonds	179,880	-	179,880	-
Municipal obligations	17,749	-	17,749	-
Preferred and asset backed securities	3,491	-	3,491	-
U.S. equity securities	10,944	10,944	-	-
Mutual funds	186,028	125,479	60,548	
Other	37,353	-	-	37,353
Total assets	$ 573,422	$ 274,400	$ 261,668	$ 37,353
Fair value of derivative agreements - Note D	$ (8,185)	$ -	$ -	$ (8,185)
Fair value of long-term debt	$ (1,167,846)	$ -	$ -	$ (1,167,846)

(Dollars in Thousands)

NOTE Q--FAIR VALUE MEASUREMENT - Continued

	Total	Level 1	Level 2	Level 3
June 30, 2012				
Cash, cash equivalents and money market funds	$ 85,017	$ 85,017	$ -	$ -
U.S. Government securities	15,693	15,693	-	-
U.S. Agency securities	62,437	62,437	-	-
Corporate and foreign bonds	52,581	-	52,581	-
Municipal obligations	961	-	961	-
Preferred and asset backed securities	11,183	-	11,183	-
U.S. equity securities	28,344	28,344	-	-
Mutual funds	141,968	97,600	44,368	-
Other	34,880	-	-	34,880
Total assets	$ 433,064	$ 289,091	$ 109,093	$ 34,880
Fair value of derivative agreements - Note D	$ (19,381)	$ -	$ -	$ (19,381)
Fair value of long-term debt	$ (1,150,201)	$ -	$ -	$ (1,150,201)

The valuation of the Alliance's derivative agreements is determined using market valuation techniques, including discounted cash flow analysis on the expected cash flows of each agreement. This analysis reflects the contractual terms of the agreement, including the period to maturity, and uses certain observable market-based inputs. The fair values of interest rate agreements are determined by netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The variable cash receipts (or payments) are based on the expectation of future interest rates and the underlying notional amount. The Alliance also incorporates credit valuation adjustments (CVAs) to appropriately reflect both its own nonperformance or credit risk and the respective counterparty's nonperformance or credit risk in the fair value measurements. The CVA on the Alliance's interest rate swap agreements at June 30, 2013 and 2012 resulted in a decrease in the fair value of the related liability of $3,080 and $5,726, respectively.

A certain portion of the inputs used to value its interest rate swap agreements, including the forward interest rate curves and market perceptions of the Alliance's credit risk used in the CVAs, are unobservable inputs available to a market participant. As a result, the Alliance has determined that the interest rate swap valuations are classified in Level 3 of the fair value hierarchy.

The following tables provide a summary of changes in the fair value of the Alliance's Level 3 financial assets and liabilities during the fiscal years ended June 30, 2013 and 2012:

(Dollars in Thousands)

NOTE Q--FAIR VALUE MEASUREMENT - Continued

	Trading Securities	Derivatives, Net
July 1, 2011	$ 32,718	$ (110,732)
Total unrealized/realized gains in the Performance Indicator, net	1,466	(6,198)
Net investment income	1,221	515
Purchases	5,107	-
Settlements	-	97,034
Distributions	(5,632)	-
June 30, 2012	34,880	(19,381)
Total unrealized/realized gains in the Performance Indicator, net	1,614	457
Net investment income	1,360	399
Purchases	807	-
Settlements	-	10,340
Distributions	(1,308)	-
June 30, 2013	$ 37,353	$ (8,185)

There were no changes in valuation techniques in 2013 or 2012.

NOTE R--OPERATING EXPENSES BY FUNCTIONAL CLASSIFICATION

The Alliance does not present expense information by functional classification because its resources and activities are primarily related to providing healthcare services. Further, since the Alliance receives substantially all of its resources from providing healthcare services in a manner similar to business enterprises, other indicators contained in these consolidated financial statements are considered important in evaluating how well management has discharged their stewardship responsibilities.

NOTE S--SUBSEQUENT EVENTS

On March 28, 2013, the Alliance executed an agreement to acquire Unicoi County Memorial Hospital (UCMH), a 48-bed acute care hospital located in Erwin, Tennessee. UCMH has approximately 250 employees and offers emergency, surgical, and home health services. Nursing home services are provided in a 46 licensed bed long term care facility. The Alliance will fund the acquisition from cash flow and intends to construct a new acute care hospital in Erwin, Tennessee. After consideration of the revenues and expenses expected from operation of the facility, management of the Alliance does not expect this acquisition to have a material effect on the Alliance. The Tennessee attorney general's office is expected to approve the transaction and the Alliance anticipates that Unicoi County Memorial Hospital will become a member of Mountain States Health Alliance on or around November 1, 2013.

NOTE S--SUBSEQUENT EVENTS - Continued

In July 2013, the Alliance issued $16,235 (Series 2013A) tax-exempt variable rate Hospital Revenue Bonds and $99,680 (Series 2013B) variable rate Taxable Hospital Refunding Revenue Bonds through The Health and Educational Facilities Board of the City of Johnson City, Tennessee. The proceeds from the Series 2013A Bonds will be used to finance or refinance capital improvements and equipment acquisitions and pay issuance costs related to these Bonds. The proceeds from the Series 2013B Bonds will be used to refund $97,915 of the Series 2007B-2 Bonds and to pay issuance costs associated with these Bonds. Contemporaneously with the issuance of the Series 2013A and Series 2013B Bonds, the Alliance refunded the Series 2008A, Series 2008B, Series 2011C, Series 2011D, Series 2012B and Series 2012C through private placements with financial institutions.

At June 30, 2013 and 2012, the Alliance owned membership units in Premier, Inc. Subsequent to yearend Premier, as part of a reorganization, converted to a publically traded entity. As part of its reorganization, certain of the Alliance's membership units were redeemed for approximately $3,000 and a gain was recognized on the sale of these units. Unredeemed units continue to be held by the Alliance and may be effectively exchanged for Class A common stock of Premier ratably over a seven year period. The unredeemed membership units may be exchanged for up to 723 thousand Class A shares.

Supplemental Schedules

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Balance Sheet
(Dollars in Thousands)

June 30, 2013

	Blue Ridge Medical Management *	Other Obligated Group Members	Eliminations	Total Obligated Group	Other Entities	Mountain States Properties	Eliminations	Total
ASSETS								
CURRENT ASSETS								
Cash and cash equivalents	$ 659	$ 48,607	$ -	$ 49,266	$ 25,137	$ 499	$ -	$ 74,902
Current portion of investments	-	20,387	-	20,387	(1)	-	-	20,386
Patient accounts receivable, less estimated allowance for uncollectible accounts	6,928	128,708	-	135,636	28,551	-	-	164,187
Other receivables, net	649	20,580	-	21,229	12,862	377	(1,000)	33,468
Inventories and prepaid expenses	605	23,068	-	23,673	7,333	67	-	31,073
TOTAL CURRENT ASSETS	8,841	241,350	-	250,191	73,882	943	(1,000)	324,016
INVESTMENTS, less amounts required to meet current obligations	19,735	416,147	-	435,882	110,109	55,361	-	601,352
EQUITY IN AFFILIATES	146,284	333,086	(161,250)	318,120	-	-	(318,120)	-
PROPERTY, PLANT AND EQUIPMENT, net	18,743	614,210	-	632,953	197,192	54,148	-	884,293
OTHER ASSETS								
Goodwill	7,575	144,708	-	152,283	2,108	-	-	154,391
Net deferred financing, acquisition costs and other charges	270	26,800	-	27,070	860	550	-	28,480
Other assets	9,663	28,193	-	37,856	6,126	2,562	-	46,544
TOTAL OTHER ASSETS	17,508	199,701	-	217,209	9,094	3,112	-	229,415
	$ 211,111	$ 1,804,494	$ (161,250)	$ 1,854,355	$ 390,277	$ 113,564	$ (319,120)	$ 2,039,076

* Management Services Organization only

Consolidating Balance Sheet - Continued (Dollars in Thousands)

June 30, 2013

	*Blue Ridge Medical Management **	*Other Obligated Group Members*	*Eliminations*	*Total Obligated Group*	*Other Entities*	*Mountain States Properties*	*Eliminations*	*Total*
LIABILITIES AND NET ASSETS								
CURRENT LIABILITIES								
Accrued interest payable	$ 46	$ 19,622	$ -	$ 19,668	$ 38	$ -	$ -	$ 19,706
Current portion of long-term debt and capital lease obligations	13	31,422	-	31,435	2,982	-	-	34,417
Accounts payable and accrued expenses	5,543	74,934	-	80,477	12,902	923	-	94,302
Accrued salaries, compensated absences and amounts withheld	3,836	44,713	-	48,549	15,116	-	-	63,665
Payables to (receivables from) affiliates, net	16,697	2,194	-	18,891	7,738	(26,629)	-	-
Estimated amounts due to third-party payers, net	-	25,970	-	25,970	805	-	-	26,775
TOTAL CURRENT LIABILITIES	26,135	198,855	-	224,990	39,581	(25,706)	-	238,865
OTHER LIABILITIES								
Long-term debt and capital lease obligations, less current portion	13,663	1,036,740	-	1,050,403	40,945	-	(1,000)	1,090,348
Estimated fair value of derivatives	-	8,220	-	8,220	-	(35)	-	8,185
Deferred revenue	-	2,130	-	2,130	86	-	-	2,216
Estimated professional liability self-insurance	2,576	5,198	-	7,774	984	-	-	8,758
Other long-term liabilities	7,487	10,058	-	17,545	176	-	-	17,721
TOTAL LIABILITIES	49,861	1,261,201	-	1,311,062	81,772	(25,741)	(1,000)	1,366,093
NET ASSETS								
Unrestricted net assets								
Mountain States Health Alliance	161,250	490,414	(161,250)	490,414	171,901	139,305	(311,206)	490,414
Noncontrolling interests in subsidiaries	-	39,923	-	39,923	123,945	-	5,746	169,614
TOTAL UNRESTRICTED NET ASSETS	161,250	530,337	(161,250)	530,337	295,846	139,305	(305,460)	660,028
Temporarily restricted net assets								
Mountain States Health Alliance	-	12,776	-	12,776	12,531	-	(12,531)	12,776
Noncontrolling interests in subsidiaries	-	53	-	53	1	-	(2)	52
TOTAL TEMPORARILY RESTRICTED NET ASSETS	-	12,829	-	12,829	12,532	-	(12,533)	12,828
Permanently restricted net assets	-	127	-	127	127		(127)	127
TOTAL NET ASSETS	161,250	543,293	(161,250)	543,293	308,505	139,305	(318,120)	672,983
	$ 211,111	$ 1,804,494	$ (161,250)	$ 1,854,355	$ 390,277	$ 113,564	$ (319,120)	$ 2,039,076

*Management Services Organization only.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Statement of Operations
(Dollars in Thousands)

Year Ended June 30, 2013

	*Blue Ridge Medical Management **	*Other Obligated Group Members*	*Eliminations*	*Total Obligated Group*	*Other Entities*	*Mountain States Properties*	*Eliminations*	*Total*
Revenue, gains and support:								
Patient service revenue, net of contractual allowances and discounts	$ 60,981	$ 800,370	$ (2,002)	$ 859,349	$ 185,896	$ -	$ -	$ 1,045,245
Provision for bad debts	(5,851)	(84,508)	-	(90,359)	(22,138)	-	-	(112,497)
Net patient service revenue	55,130	715,862	(2,002)	768,990	163,758	-	-	932,748
Premium revenue	-	-	-	-	1,003	-	-	1,003
Net investment gain	2,029	27,241	-	29,270	7,543	4,230	(63)	40,980
Net derivative gain	-	5,803	-	5,803	133	1,182	-	7,118
Other revenue, gains and support	47,477	46,942	(36,666)	57,753	86,929	8,384	(75,611)	77,455
Equity in net gain (loss) of affiliates	3,380	731	(4,151)	(40)	-	-	40	-
TOTAL REVENUE, GAINS AND SUPPORT	108,016	796,579	(42,819)	861,776	259,366	13,796	(75,634)	1,059,304
Expenses:								
Salaries and wages	23,274	271,876	-	295,150	65,919	430	(5,909)	355,590
Physician salaries and wages	52,482	1,354	-	53,836	70,450	-	(50,028)	74,258
Contract labor	1,169	1,505	-	2,674	1,545	-	(277)	3,942
Employee benefits	8,493	56,307	(2,067)	62,733	17,033	57	(5,233)	74,590
Fees	4,997	114,967	(36,005)	83,959	28,619	692	(7,379)	105,891
Supplies	2,989	133,185	-	136,174	26,976	13	(208)	162,955
Utilities	604	12,172	-	12,776	3,065	1,019	(3)	16,857
Medical Costs	-	-	-	-	1,039	-	-	1,039
Other	8,981	48,958	(596)	57,343	25,324	4,118	(6,574)	80,211
Depreciation	1,828	58,199	-	60,027	16,664	2,250	-	78,941
Amortization	34	2,179	-	2,213	47	-	-	2,260
Interest and taxes	(986)	42,213	-	41,227	684	1,355	(63)	43,203
TOTAL EXPENSES	103,865	742,915	(38,668)	808,112	257,365	9,934	(75,674)	999,737
EXCESS OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	$ 4,151	$ 53,664	$ (4,151)	$ 53,664	$ 2,001	$ 3,862	$ 40	$ 59,567

*Management Services Organization only.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Statement of Changes in Net Assets (Dollars in Thousands)

Year Ended June 30, 2013

	Blue Ridge Medical Management *	Other Obligated Group Members: Mountain States Health Alliance	Other Obligated Group Members: Noncontrolling Interests	Eliminations	Total Obligated Group	Other Entities: Mountain States Health Alliance	Other Entities: Noncontrolling Interests	Total Other Entities	Mountain States Properties	Eliminations	Total
UNRESTRICTED NET ASSETS:											
Excess of Revenue, Gains and Support over Expenses and Losses	$ 4,151	$ 52,692	$ 972	$ (4,151)	$ 53,664	$ (2,539)	$ 4,540	$ 2,001	$ 3,862	$ 40	$ 59,567
Pension and other defined benefit plan adjustments	-	(172)	(171)	-	(343)	(2)	(2)	(4)	-	4	(343)
Net assets released from restrictions used for the purchase of property, plant and equipment	-	1,506	-	-	1,506	1,506	-	1,506	-	(1,506)	1,506
Distributions to noncontrolling interests	-	-	-	-	-	-	(49)	(49)	-	-	(49)
Net asset transfers	-	-	-	-	-	8,820	2,080	10,900	-	(10,900)	-
INCREASE IN UNRESTRICTED NET ASSETS	4,151	54,026	801	(4,151)	54,827	7,785	6,569	14,354	3,862	(12,362)	60,681
TEMPORARILY RESTRICTED NET ASSETS:											
Restricted grants and contributions	-	4,969	18	-	4,987	4,556	8	4,564	-	(4,561)	4,990
Net assets released from restrictions	-	(3,416)	(16)	-	(3,432)	(2,980)	(8)	(2,988)	-	2,985	(3,435)
INCREASE IN TEMPORARILY RESTRICTED NET ASSETS	-	1,553	2	-	1,555	1,576	-	1,576	-	(1,576)	1,555
INCREASE IN TOTAL NET ASSETS	4,151	55,579	803	(4,151)	56,382	9,361	6,569	15,930	3,862	(13,938)	62,236
NET ASSETS, BEGINNING OF YEAR	157,099	447,738	39,173	(157,099)	486,911	175,198	117,377	292,575	135,443	(304,182)	610,747
NET ASSETS, END OF YEAR	$ 161,250	$ 503,317	$ 39,976	$ (161,250)	$ 543,293	$ 184,559	$ 123,946	$ 308,505	$ 139,305	$ (318,120)	$ 672,983

*Management Services Organization only.

NOTE A--OBLIGATED GROUP MEMBERS

As described in Note F to the consolidated financial statements, the Alliance has granted a deed of trust on JCMC and SSH to secure the payment of the outstanding bonds. The bonds are also secured by the Alliance's receivables, inventories and other assets as well as certain funds held under the documents pursuant to which the bonds were issued. In accordance with Article Six, Section 6.6 of the Amended and Restated Master Trust Indenture between Mountain States Health Alliance and the Bank of New York Mellon Trust Company, NA as Master Trustee, those members pledged include Johnson City Medical Center Hospital, Indian Path Medical Center, Franklin Woods Community Hospital, Sycamore Shoals Hospital, Johnson County Community Hospital, Russell County Medical Center and Blue Ridge Medical Management Corporation (parent company only), collectively defined as the Obligated Group (Obligated Group). In 2012, NCH and SCCH (hospitals only) were admitted into the Obligated Group.

The supplemental consolidating schedules include the accounts of the members of the Obligated Group after elimination of all significant intergroup accounts and transactions. Certain other subsidiaries of the Alliance, Mountain States Properties, Inc. (MSP) and all other affiliates (Other Entities), are not pledged to secure the payment of the outstanding bonds as they are not part of the Obligated Group. These affiliates have been accounted for within the Obligated Group based upon the Alliance's original and subsequent investments, as adjusted for the Alliance's pro rata share of income or losses and any distributions, and are included as a part of equity in affiliates in the supplemental consolidating balance sheet.

MOUNTAIN STATES HEALTH ALLIANCE

Audited Consolidated Financial Statements (and Supplemental Schedules)

Years Ended June 30, 2014 and 2013

PYA

Certified Public Accountants

MOUNTAIN STATES HEALTH ALLIANCE

Audited Consolidated Financial Statements (and Supplemental Schedules)
(Dollars in Thousands)

Years Ended June 30, 2014 and 2013

PERSHING YOAKLEY & ASSOCIATES, P.C.
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PYA
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Mountain States Health Alliance:

We have audited the accompanying consolidated financial statements of Mountain States Health Alliance and its subsidiaries (the Alliance), which comprise the consolidated balance sheets as of June 30, 2014 and 2013, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Alliance's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Alliance's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mountain States Health Alliance and its subsidiaries as of June 30, 2014 and 2013, and the results of their operations, changes in net assets, and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

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

Pershing Yoakley & Associates PC

Knoxville, Tennessee
October 29, 2014

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Balance Sheets
(Dollars in Thousands)

		June 30,		
		2014		2013
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	$	59,185	$	74,902
Current portion of investments		25,029		20,386
Patient accounts receivable, less estimated allowances for uncollectible accounts of $47,853 in 2014 and $49,449 in 2013		161,318		164,187
Other receivables, net		45,502		33,468
Inventories and prepaid expenses		30,838		31,073
TOTAL CURRENT ASSETS		321,872		324,016
INVESTMENTS, less amounts required to meet current obligations		648,475		601,352
PROPERTY, PLANT AND EQUIPMENT, net		881,429		884,293
OTHER ASSETS				
Goodwill		156,613		154,391
Net deferred financing, acquisition costs and other charges		25,841		28,480
Other assets		48,350		46,544
TOTAL OTHER ASSETS		230,804		229,415
	$	2,082,580	$	2,039,076

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Balance Sheets - Continued
(Dollars in Thousands)

	June 30, 2014	June 30, 2013
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accrued interest payable	$ 18,648	$ 19,706
Current portion of long-term debt and capital lease obligations	30,618	34,417
Accounts payable and accrued expenses	87,126	94,302
Accrued salaries, compensated absences and amounts withheld	72,181	63,665
Estimated amounts due to third-party payers, net	10,463	26,775
TOTAL CURRENT LIABILITIES	219,036	238,865
OTHER LIABILITIES		
Long-term debt and capital lease obligations, less current portion	1,075,069	1,090,348
Estimated fair value of derivatives	10,603	8,185
Estimated professional liability self-insurance	8,957	8,758
Other long-term liabilities	35,974	19,937
TOTAL LIABILITIES	1,349,639	1,366,093
COMMITMENTS AND CONTINGENCIES - Notes D, F, G, and N		
NET ASSETS		
Unrestricted net assets		
Mountain States Health Alliance	541,979	490,414
Noncontrolling interests in subsidiaries	178,547	169,614
TOTAL UNRESTRICTED NET ASSETS	720,526	660,028
Temporarily restricted net assets		
Mountain States Health Alliance	12,204	12,776
Noncontrolling interests in subsidiaries	84	52
TOTAL TEMPORARILY RESTRICTED NET ASSETS	12,288	12,828
Permanently restricted net assets	127	127
TOTAL NET ASSETS	732,941	672,983
	$ 2,082,580	$ 2,039,076

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Operations
(Dollars in Thousands)

	Year Ended June 30, 2014	2013
Revenue, gains and support:		
Patient service revenue, net of contractual allowances and discounts	$ **1,050,426**	$ 1,045,245
Provision for bad debts	**(122,642)**	(112,497)
Net patient service revenue	**927,784**	932,748
Premium revenue	**10,683**	1,003
Net investment gain	**50,703**	40,980
Net derivative gain	**3,219**	7,118
Other revenue, gains and support	**62,457**	77,455
TOTAL REVENUE, GAINS AND SUPPORT	**1,054,846**	1,059,304
Expenses and losses:		
Salaries and wages	**340,589**	355,590
Physician salaries and wages	**77,636**	74,258
Contract labor	**4,282**	3,942
Employee benefits	**69,173**	74,590
Fees	**115,606**	105,891
Supplies	**163,699**	162,955
Utilities	**17,052**	16,857
Medical costs	**10,292**	1,039
Other	**79,980**	80,211
Loss on early extinguishment of debt - Note F	**4,622**	-
Depreciation	**69,437**	78,941
Amortization	**1,742**	2,260
Interest and taxes	**44,392**	43,203
TOTAL EXPENSES AND LOSSES	**998,502**	999,737
EXCESS OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	$ **56,344**	$ 59,567

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Changes in Net Assets
(Dollars in Thousands)

Year Ended June 30, 2014

	Mountain States Health Alliance	Noncontrolling Interests	Total
UNRESTRICTED NET ASSETS:			
Excess of Revenue, Gains and Support over Expenses and Losses	$ 48,058	$ 8,286	$ 56,344
Pension and other defined benefit plan adjustments	194	194	388
Net assets released from restrictions used for the purchase of property, plant and equipment	3,313	-	3,313
Noncontrolling interest in acquired subsidiary	-	914	914
Distributions to noncontrolling interests	-	(461)	(461)
INCREASE IN UNRESTRICTED NET ASSETS	51,565	8,933	60,498
TEMPORARILY RESTRICTED NET ASSETS:			
Restricted grants and contributions	4,693	88	4,781
Net assets released from restrictions	(5,265)	(56)	(5,321)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	(572)	32	(540)
INCREASE IN TOTAL NET ASSETS	50,993	8,965	59,958
NET ASSETS, BEGINNING OF YEAR	503,317	169,666	672,983
NET ASSETS, END OF YEAR	$ 554,310	$ 178,631	$ 732,941

See notes to consolidated financial statements.

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Changes in Net Assets - Continued
(Dollars in Thousands)

Year Ended June 30, 2013

	Mountain States Health Alliance	*Noncontrolling Interests*	*Total*
UNRESTRICTED NET ASSETS:			
Excess of Revenue, Gains and Support over Expenses and Losses	$ 52,692	$ 6,875	$ 59,567
Pension and other defined benefit plan adjustments	(172)	(171)	(343)
Net assets released from restrictions used for the purchase of property, plant and equipment	1,506	-	1,506
Distributions to noncontrolling interests	-	(49)	(49)
INCREASE IN UNRESTRICTED NET ASSETS	54,026	6,655	60,681
TEMPORARILY RESTRICTED NET ASSETS:			
Restricted grants and contributions	4,969	21	4,990
Net assets released from restrictions	(3,416)	(19)	(3,435)
INCREASE IN TEMPORARILY RESTRICTED NET ASSETS	1,553	2	1,555
INCREASE IN TOTAL NET ASSETS	55,579	6,657	62,236
NET ASSETS, BEGINNING OF YEAR	447,738	163,009	610,747
NET ASSETS, END OF YEAR	$ 503,317	$ 169,666	$ 672,983

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Cash Flows
(Dollars in Thousands)

	Year Ended June 30, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	$ **59,958**	$ 62,236
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Provision for depreciation and amortization	**71,789**	81,786
Provision for bad debts	**122,642**	112,497
Loss on early extinguishment of debt	**4,622**	-
Change in estimated fair value of derivatives	**2,761**	(457)
Equity in net income of joint ventures, net	**(369)**	(636)
Loss (gain) on disposal of assets	**(3,489)**	(1)
Amounts received on interest rate swap settlements	**(5,980)**	(6,661)
Gain on escrow restructuring	**-**	(13,847)
Gain on swap settlement	**-**	(3,020)
Capital Appreciation Bond accretion and other	**2,629**	3,910
Restricted contributions	**(4,781)**	(4,990)
Pension and other defined benefit plan adjustments	**(388)**	343
Increase (decrease) in cash due to change in:		
Patient accounts receivable	**(115,380)**	(129,218)
Other receivables, net	**(11,880)**	(3,192)
Inventories and prepaid expenses	**959**	(2,263)
Trading securities	**(46,451)**	(17,845)
Other assets	**(2,492)**	(1,073)
Accrued interest payable	**(1,058)**	1,181
Accounts payable and accrued expenses	**(6,666)**	(20,263)
Accrued salaries, compensated absences and amounts withheld	**8,006**	8,076
Estimated amounts due to third-party payers, net	**(16,312)**	4,757
Estimated professional liability self-insurance	**199**	(586)
Other long-term liabilities	**16,425**	556
Total adjustments	**14,786**	9,054
NET CASH PROVIDED BY OPERATING ACTIVITIES	**74,744**	71,290
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	**(63,851)**	(105,751)
Purchases of land held for expansion	**(573)**	(5,769)
Acquisitions, net of cash acquired	**(4,256)**	-
Purchases of held-to-maturity securities	**(5,978)**	(8,722)
Net distribution from joint ventures and unconsolidated affiliates	**661**	732
Proceeds from sale of property, plant and equipment	**2,858**	335
NET CASH USED IN INVESTING ACTIVITIES	**(71,139)**	(119,175)

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Cash Flows - Continued
(Dollars in Thousands)

		Year Ended June 30, 2014		2013
CASH FLOWS FROM FINANCING ACTIVITIES:				
Payments on long-term debt and capital lease obligations, including deposits to escrow		**(38,768)**		(75,066)
Payment of acquisition and financing costs		**(3,826)**		(2,314)
Proceeds from issuance of long-term debt and other financing arrangements		**11,916**		117,085
Payment on termination of derivative agreements		-		(7,375)
Gain on escrow restructuring		-		13,847
Net amounts received on interest rate swap settlements		**5,980**		6,661
Restricted contributions received		**5,376**		4,842
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		**(19,322)**		57,680
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		**(15,717)**		9,795
CASH AND CASH EQUIVALENTS, beginning of year		**74,902**		65,107
CASH AND CASH EQUIVALENTS, end of year	**$**	**59,185**	$	74,902
SUPPLEMENTAL INFORMATION AND NON-CASH TRANSACTIONS:				
Cash paid for interest	**$**	**40,546**	$	37,023
Cash paid for federal and state income taxes	**$**	**854**	$	616
Construction related payables in accounts payable and accrued expenses	**$**	**8,604**	$	11,598
Supplemental cash flow information regarding acquisitions - Note A:				
Assets acquired, net of cash	**$**	**12,715**	$	-
Liabilities assumed		**(8,459)**		-
Acquisitions, net of cash acquired	**$**	**4,256**	$	-

During the year ended June 30, 2014, the Alliance refinanced previously issued debt of $318,385.

NOTE A--ORGANIZATION AND OPERATIONS

Mountain States Health Alliance (the Alliance) is a tax-exempt entity with operations primarily located in Washington, Sullivan, Unicoi, and Carter counties of Tennessee and Smyth, Wise, Dickenson, Russell and Washington counties of Virginia. The initial funds for the establishment of the Alliance in 1945 were provided by individuals and various institutions.

The primary operations of the Alliance consist of eleven acute and specialty care hospitals, as follows:

- Johnson City Medical Center (JCMC) - licensed for 658 beds
- Indian Path Medical Center (IPMC) - licensed for 261 beds
- Smyth County Community Hospital (SCCH) - licensed for 153 beds
- Norton Community Hospital (NCH) - licensed for 129 beds
- Sycamore Shoals Hospital (SSH) - licensed for 121 beds
- Johnston Memorial Hospital (JMH) - licensed for 116 beds
- Franklin Woods Community Hospital (FWCH) - licensed for 80 beds
- Russell County Medical Center (RCMC) - licensed for 78 beds
- Unicoi County Memorial Hospital (UCMH) - licensed for 48 beds
- Dickenson Community Hospital (DCH) - licensed for 25 beds
- Johnson County Community Hospital (JCCH) - licensed for 2 beds

The Alliance has a 50.1% interest in JMH. JMH is also the sole member of Abingdon Physician Partners (APP), a non-taxable corporation that owns and manages physician practices.

The Alliance has a 50.1% interest in NCH. NCH is also the sole member or shareholder of DCH and Norton Community Physician Services, LLC (NCPS), a taxable corporation that consists of physician practices and a pharmacy and Community Home Care (CHC), a taxable corporation that provides home medical equipment.

The Alliance has an 80% interest in SCCH. SCCH is the sole shareholder of Southwest Community Health Services, Inc. (SWCH), a taxable entity that operates a pharmacy and provides other health services.

The activities and accounts of JMH, NCH and SCCH are included in the accompanying consolidated financial statements.

Effective November 1, 2013, the Alliance acquired substantially all the assets, and certain liabilities, of Unicoi County Memorial Hospital from Unicoi County, Tennessee. To effectuate the acquisition, the Alliance paid approximately $2,500 and committed to construct a new facility within five years.

The accounts and activities of UCMH since acquisition are included in the accompanying consolidated financial statements.

The Alliance is the sole shareholder of Blue Ridge Medical Management Corporation (BRMM), a for-profit entity that owns and manages physician practices and provides other healthcare services to patients in Tennessee and Virginia. BRMM is either the sole shareholder, a significant shareholder, or member of the following consolidated organizations:

Mountain States Physician Group, Inc. (MSPG): A company that contracts with physicians to provide services to BRMM physician practices.

Mountain States Properties, Inc. (MSPI): A company that owns and manages real estate (primarily medical office buildings) and provides rehabilitation and fitness services.

Mediserve Medical Equipment of Kingsport, Inc. (Mediserve): A company that provides durable medical equipment services.

Kingsport Ambulatory Surgery Center (KASC) (d.b.a. Kingsport Day Surgery): A joint venture operating as an outpatient surgery center which performs procedures primarily in otolaryngology, orthopedics, ophthalmology, and general surgery. BRMM has a 43% ownership of KASC and maintains control over KASC through a management agreement. The accounts and activities of KASC are included in the accompanying consolidated financial statements.

Emmaus Community Healthcare LLC (d.b.a. Piney Flats Urgent Care (PFUC)): A for-profit entity that provides urgent care patient services. BRMM has a 75% ownership of PFUC. The accounts and activities of PFUC are included in the accompanying consolidated financial statements.

Mountain States Pharmacy (MSP): A for-profit company that owns and operates retail pharmacies.

East Tennessee Ambulatory Surgery Center (ETASC): Effective January 1, 2014, BRMM acquired a controlling 66.1% ownership in ETASC and recognized approximately $2,244 of goodwill as a result of the transaction. The accounts and activities of ETASC since acquisition are included in the accompanying consolidated financial statements.

The Alliance is the primary beneficiary of the activities of Mountain States Foundation, Inc. (MSF), a not-for-profit foundation formed to coordinate fundraising and development activities of the Alliance. The Alliance is also the beneficiary of the Mountain States Health Alliance Auxiliary (Auxiliary), a not-for-profit organization formed to coordinate volunteer activities of the Alliance.

The activities and accounts of MSF and the Auxiliary are included in the accompanying consolidated financial statements.

The Alliance is a 99.8% shareholder of Integrated Solutions Health Network, LLC (ISHN). The primary function of ISHN is to establish, operate and administer a provider-sponsored health care delivery network. ISHN is the sole shareholder of the following subsidiaries:

CrestPoint Health Insurance Company (CHIC): A for-profit insurance company licensed in the State of Tennessee which provides network access and administration and third-party administrator services. CHIC has a risk-based contract with the Center for Medicare & Medicaid Services (CMS) to provide or arrange for the provision of healthcare services to senior citizens who have Medicare Part A, Medicare Part B and Medicare Part D entitlements.

AnewCare Collaborative (AnewCare): A for-profit accountable care organization which participates in CMS's Medicare Shared Savings Program.

NOTE B--SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of the Alliance and its consolidated subsidiaries after elimination of all significant intercompany accounts and transactions.

Noncontrolling Interests in Subsidiaries: The Alliance's accompanying consolidated financial statements include all assets, liabilities, revenues, expenses, and changes in net assets, including amounts attributable to the noncontrolling interests. Noncontrolling interests represent the portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to the Alliance. For the years ending June 30, 2014 and 2013, the Alliance attributed an Excess of Revenue, Gains and Support over Expenses and Losses of $8,286 and $6,875, respectively, to the noncontrolling interests in JMH, NCH, SCCH, KASC, PFUC, ETASC and ISHN based on the noncontrolling interests' respective ownership percentage.

Use of Estimates: The preparation of the 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 as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents: Cash and cash equivalents include all highly liquid investments with a maturity of three months or less when purchased. Cash and cash equivalents designated as assets limited as to use or uninvested amounts included in investment portfolios are not included as cash and cash equivalents.

Investments: Investments include trading securities and held-to-maturity securities. Within the trading securities portfolio, all debt securities and marketable equity securities with readily determinable fair values are reported at fair value based on quoted market prices. Investments without readily determinable fair values are reported at estimated fair market value pursuant to The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 825, *Financial Instruments.* Realized gains and losses are computed using the specific identification method for cost determination. Interest and dividend income is reported net of related investment fees.

Investments which the Alliance has the positive intent and ability to hold to maturity are classified as held-to-maturity and are stated at amortized cost. On June 30, 2013, the Alliance determined that it no longer intended to hold certain of its held-to-maturity investment portfolios to maturity and reclassified investments with an amortized cost of $161,929 into the trading designation. As a result, the Alliance recognized net unrealized gains of approximately $8,255 in the accompanying 2013 Consolidated Statement of Operations. The investments that remain designated as held-to-maturity are limited as to use under a safekeeping agreement or are otherwise unavailable for disposition.

Management annually evaluates investments designated as held-to-maturity and recognizes any "other-than-temporary" losses as deductions from the Performance Indicator (as defined below). Management's evaluation considers the amount of decline in fair value, as well as the time period of any such decline. Management does not believe any investment classified as held-to-maturity is other-than-temporarily impaired at June 30, 2014.

Investments in joint ventures are generally reported under the equity method of accounting, which approximates the Alliance's equity in the underlying net book value, unless the ownership structure requires consolidation. Other assets include investments in joint ventures of $1,364 and $2,057 at June 30, 2014 and 2013, respectively.

Inventories: Inventories, consisting primarily of medical supplies, are stated at the lower of cost or market with cost determined by first-in, first-out method.

Property, Plant and Equipment: Property, plant and equipment is stated on the basis of cost, or if donated, at the fair value at the date of gift. Generally, depreciation is computed by the straight-line method over the estimated useful life of the asset. During 2014, the Alliance changed its estimates of depreciable lives for certain classes of property and equipment. Management evaluated the useful lives of certain classes of equipment and determined that, based on information available to them, the previously assigned lives were not consistent with actual usage of such assets. As a result, management extended the depreciable lives of certain classes of property and equipment to better reflect the actual usage pattern. The impact of this change in estimated useful lives was to decrease depreciation expense in the Consolidated Statement of Operations for the year ended June 30, 2014 by approximately $7,500.

Equipment held under capital lease obligations is amortized under the straight-line method over the shorter of the lease term or estimated useful life. Amortization of buildings and equipment held under capital leases is shown as a part of depreciation expense and accumulated depreciation in the accompanying consolidated financial statements. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets.

The Alliance reviews capital assets for indications of potential impairment when there are changes in circumstances related to a specific asset. If this review indicates that the carrying value of these assets may not be recoverable, the Alliance estimates future cash flows from operations and the eventual disposition of such assets. If the sum of these undiscounted future cash flows is less than the carrying amount of the asset, a write-down to estimated fair value is recorded. The Alliance did not recognize any impairment losses during 2014 and 2013.

Other assets include property held for resale and property held for expansion of $20,793 and $20,220, respectively, at June 30, 2014 and 2013. Property held for resale and property held for expansion primarily represent land contributed to, or purchased by, the Alliance plus costs incurred to develop the infrastructure of such land. Management annually evaluates its investment and records non-temporary declines in value when it is determined the ultimate net realizable value is less than the recorded amount. No such declines were identified in 2014 and 2013.

Goodwill: Goodwill represents the difference between the acquisition cost of assets and the estimated fair value of net tangible and any separately identified intangible assets. Goodwill is evaluated for impairment at least annually. The reporting unit for evaluation of the majority of the Alliance's goodwill is the aggregate acute-care operations. Management performed an evaluation of goodwill for impairment considering qualitative and quantitative factors and does not believe the goodwill associated with any of its reporting units is impaired as of June 30, 2014. Management's estimates utilized in the evaluation contain significant estimates and it is reasonably possible that such estimates could change in the near term.

Deferred Financing, Acquisition Costs and Other Charges: Other assets include deferred financing, acquisition costs and other charges of $25,841 and $28,480 at June 30, 2014 and 2013, respectively.

Deferred financing costs are amortized over the life of the respective bond issue principally using the average bonds outstanding method.

Prior to 2009, the Alliance routinely financed interest rate swap and other derivative transaction issuance costs through modification of future settlement terms. As such, the unamortized issuance costs of these derivatives are included as deferred financing costs in the accompanying Consolidated Balance Sheets and are being amortized over the term of the respective derivative instrument. The unpaid issuance costs are included as a part of the estimated fair value of derivatives in the accompanying Consolidated Balance Sheets. Beginning in 2009, interest rate swap and derivative transaction issuance costs were expensed as incurred.

Derivative Financial Instruments: The Alliance is a party to various interest rate swaps. These financial instruments are not designated as hedges and have been presented at estimated fair market value in the accompanying Consolidated Balance Sheets as either current or long-term liabilities, based upon the remaining term of the instrument. Changes in the estimated fair value of these derivatives are included in the Consolidated Statements of Operations as part of net derivative gain.

Estimated Professional Liability Self-Insurance and Other Long-Term Liabilities: Self-insurance liabilities include estimated reserves for reported and unreported professional liability claims and are recorded at the estimated net present value of such claims. Other long-term liabilities include contributions payable and obligations under deferred compensation arrangements, a defined benefit pension plan, a post-retirement employee benefit plan as well as other liabilities which management estimates are not payable within one year.

Net Patient Service Revenue/Receivables: Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Alliance's revenue recognition policies related to self-pay and other types of payers emphasize revenue recognition only when collections are reasonably assured.

Patient accounts receivable are reported net of both an estimated allowance for uncollectible accounts and an estimated allowance for contractual adjustments. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, Medicaid, TennCare and other third-party payment programs. Current operations include a provision for bad debts in the Consolidated Statements of Operations estimated based upon the age of the patient accounts receivable, historical writeoffs and recoveries and any unusual circumstances (such as local, regional or national economic conditions) which affect the collectibility of receivables, including management's assumptions about conditions it expects to exist and courses of action it expects to take. The primary uncertainty lies with uninsured patient receivables and deductibles, co-payments or other amounts due from individual patients. Additions to the allowance for uncollectible accounts result from the provision for bad debts. Patient accounts written off as uncollectible are deducted from the allowance for uncollectible accounts.

For uninsured patients that do not qualify for charity care, the Alliance recognizes revenue on the basis of discounted rates under the Alliance's self-pay patient policy. Under the policy, a patient who has no insurance and is ineligible for any government assistance program has his or her bill reduced to the amount which generally would be billed to a commercially insured patient. The Alliance's policy does not require collateral or other security for patient accounts receivable. The Alliance routinely accepts assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans or policies.

Charity Care: The Alliance accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the Alliance and various guidelines outlined by the Federal Government. These policies define charity as those services for which no payment is anticipated and, as such, charges at established rates are not included in net patient service revenue. Charges forgone, based on established rates, totaled approximately \$109,550 and \$103,084 during 2014 and 2013, respectively. The estimated direct and indirect cost of providing these services totaled approximately \$23,733 and \$24,709 in 2014 and 2013, respectively. Such costs are determined using a ratio of cost to charges analysis with indirect cost allocated.

In addition to the charity care services, the Alliance provides a number of other services to benefit the poor for which little or no payment is received. Medicare, Medicaid, TennCare and State indigent programs do not cover the full cost of providing care to beneficiaries of those programs. The Alliance also provides services to the community at large for which it receives little or no payment.

Excess of Revenue, Gains and Support Over Expenses and Losses: The Consolidated Statements of Operations and the Consolidated Statements of Changes in Net Assets includes the caption Excess of Revenue, Gains and Support Over Expenses and Losses (the Performance Indicator). Changes in unrestricted net assets which are excluded from the Performance Indicator, consistent with industry practice, include contributions of long-lived assets or amounts restricted to the purchase of long-lived assets, certain pension and related adjustments, and transactions with noncontrolling interests.

Income Taxes: The Alliance is classified as an organization exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. As such, no provision for income taxes has been made in the accompanying consolidated financial statements for the Alliance and its tax-exempt subsidiaries. The Alliance's taxable subsidiaries are discussed in Note L. The Alliance has no significant uncertain tax positions at June 30, 2014 and 2013. At June 30, 2014, tax returns for 2010 through 2013 are subject to examination by the Internal Revenue Service.

Temporarily and Permanently Restricted Net Assets: Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. When a donor or time restriction expires; that is, when a stipulated time restriction ends or purpose restriction is fulfilled, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the Consolidated Statements of Operations and Changes in Net Assets as net assets released from restrictions. The Alliance's policy is to net contribution and grant revenues against related expenses and present such amounts as a part of other revenue, gains and support in the Consolidated Statements of Operations. Permanently restricted net assets have been restricted by donors to be maintained by the Alliance in perpetuity.

Premium Revenue: Premiums earned include premiums from individuals and Medicare. Medicare revenue includes premiums based on predetermined prepaid rates under Medicare risk contracts. Premiums are recognized in the month in which the members are entitled to health care services. Premiums collected in advance are deferred and recorded as unearned premium revenue. Premium deficiency losses are recognized when it is probable that expected future claim expenses will exceed future premiums on existing contracts. CHIC evaluated the need for a premium deficiency reserve and recorded an estimated reserve of $2,000 at June 30, 2014.

Medicare Shared Savings Program (MSSP): AnewCare, an Accountable Care Organization (ACO), participates in CMS's Medicare Shared Savings Program which is designed to facilitate coordination and cooperation among providers to improve the quality of care for Medicare beneficiaries and reduce unnecessary costs. ACOs participating in the program are assigned beneficiaries by CMS and are entitled to share in the savings if they are able to lower growth in Medicare Parts A and B fee-for-service costs while meeting performance standards on quality of care. The program is based on performance periods, the first of which specific to AnewCare was the period of July 2012 to December 2013. Utilizing statistical data and the methodology employed by CMS, AnewCare estimated and recognized $2,644 of net shared savings through June 30, 2013. Upon completion of the initial performance period, total net shared savings of $4,745 were recognized. For the second performance period, AnewCare has estimated $1,625 of net shared savings as of June 30, 2014. Variability is inherent in the estimation methodology and due to uncertainties in the estimation; it is probable that management's estimates of shared savings, if any, will change by the end of the second performance period, and such change could be significant.

Electronic Health Record (EHR) Incentives: The American Recovery and Reinvestment Act of 2009 (ARRA) provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified EHR technology. The incentive payments are calculated based upon estimated discharges, charity care and other input data and are recorded upon the Alliance's attainment of program and attestation criteria. The incentive payments are subject to regulatory audit. During the years ending June 30, 2014 and 2013, the Alliance recognized EHR incentive revenues of $18,269 and $22,474, respectively. EHR incentive revenues are included in other revenue, gains and support in the accompanying Consolidated Statements of Operations. The Alliance incurs both capital expenditures and operating expenses in connection with the implementation of its various EHR initiatives. The amount and timing of these expenditures does not directly correlate with the timing of the Alliance's receipt or recognition of the EHR incentive payments.

(Dollars in Thousands)

Medical Costs: The cost of health care services is recognized in the period in which services are provided. Medical costs include an estimate of the cost of services provided to CHIC members by third-party providers, which have been incurred but not reported to CHIC. The estimate for incurred but not reported claims is based on actuarial projections of costs using historical paid claims and industry data. Due to uncertainties in the estimation, it is at least reasonably possible that management's estimates of incurred but not reported claims will change in 2015, although the amount of the change cannot be estimated.

Subsequent Events: The Alliance evaluated all events or transactions that occurred after June 30, 2014, through October 29, 2014, the date the consolidated financial statements were available to be issued. During this period management did not note any material recognizable subsequent events that required recognition or disclosure in the June 30, 2014 consolidated financial statements, other than as discussed in Note Q.

Reclassifications: Certain 2013 amounts have been reclassified to conform with the 2014 presentation in the accompanying consolidated financial statements.

NOTE C--INVESTMENTS

Assets limited as to use are summarized by designation or restriction as follows at June 30:

	2014	*2013*
Designated or restricted:		
Under safekeeping agreements	$ 8,220	$ 8,254
By Board to satisfy regulatory requirements	6,759	2,096
Under bond indenture agreements:		
For debt service and interest payments	55,123	60,823
For capital acquisitions	16,127	36,989
	86,229	108,162
Less: amount required to meet current obligations	(25,029)	(20,386)
	$ 61,200	$ 87,776

(Dollars in Thousands)

Assets limited as to use consist of the following at June 30:

	2014	2013
Cash, cash equivalents and money market funds	$ 54,437	$ 57,190
U.S. Government securities	8,683	11,164
U.S. Agency securities	19,835	30,407
Corporate and foreign bonds	2,354	7,530
Municipal obligations	920	1,871
	$ 86,229	$ 108,162

Trading securities consist of the following at June 30:

	2014	2013
Cash, cash equivalents and money market funds	$ 47,126	$ 9,488
U.S. Government securities	30,721	18,481
U.S. Agency securities	39,084	19,620
Corporate and foreign bonds	96,749	172,350
Municipal obligations	21,409	17,749
Preferred and asset backed securities	3,497	3,491
U.S. equity securities	1,868	10,944
Mutual funds	253,301	186,028
Alternative investments	54,761	37,353
	$ 548,516	$ 475,504

Held-to-maturity securities (other than assets limited as to use) are carried at amortized cost and consist of the following at June 30:

	2014	2013
Cash, cash equivalents and money market funds	$ 220	$ 75
Corporate and foreign bonds	35,131	33,060
Municipal obligations	3,408	4,937
	$ 38,759	$ 38,072

Held-to-maturity securities had gross unrealized gains and losses of $206 and $456, respectively, at June 30, 2014 and $15 and $1,421, respectively, at June 30, 2013. At June 30, 2014, the Alliance held securities within the held-to-maturity portfolio with a fair value and unrealized loss of $13,513 and $456, respectively, which had been at an unrealized loss position for over one year. At June 30, 2013, the Alliance held no securities within the held-to-maturity portfolio which had been in an unrealized loss position for over one year. At June 30, 2014, the contractual maturities of held-to-maturity securities were $17,625 due in one year or less, $5,411 due from one to five years and $15,723 due after five years.

(Dollars in Thousands)

The net investment gain is comprised of the following for the years ending June 30:

	2014	2013
Interest and dividend income, net of fees	$ 12,074	$ 13,881
Net realized gains on the sale of securities	15,311	3,074
Change in net unrealized gains on securities	23,318	24,025
	$ 50,703	$ 40,980

The Alliance is a member of Premier Inc.'s (Premier) group purchasing organization and in connection with this membership, the Alliance held a non-controlling interest in Premier that was accounted for using the cost method of accounting. In October 2013, Premier completed an initial public offering (IPO) and a restructuring of the company. In connection with the restructuring, the Alliance received 860,499 Class B Units and concurrently sold approximately 16% of the units back to Premier. The Alliance recognized a gain of approximately $3,500 on the sale, which is included within other revenue, gains and support in the 2014 Consolidated Statement of Operations.

The Alliance has the ability to convert its remaining Class B units into cash or Premier's Class A common stock over a seven year vesting period. The Alliance recorded an investment in Premier relative to the estimated fair value of the remaining Class B units of approximately $14,713. In addition, as the vesting period is tangential to the Alliance's continued participation in the group purchasing contract, the Alliance recorded a liability equivalent to the estimated fair value of the Class B units, which is included within other long-term liabilities in the 2014 Consolidated Balance Sheet. The liability is being amortized as a vendor incentive over the seven year vesting period. During 2014, the Alliance recognized approximately $2,995 related to the first vesting period (Tranche 1), which is included within other revenue, gains and support in the 2014 Consolidated Statement of Operations.

NOTE D--DERIVATIVE TRANSACTIONS

The Alliance is a party to a number of derivative transactions. These derivatives have not been designated as hedges and are valued at estimated fair value in the accompanying Consolidated Balance Sheets. Management's primary objective in holding such derivatives is to introduce a variable rate component into its fixed rate debt structure. Under the terms of these agreements, changes in the interest rate environment could have a significant effect on the Alliance. Net deferred financing, acquisition costs and other charges include $5,447 and $5,791 at June 30, 2014 and 2013, respectively, related to these swaps.

(Dollars in Thousands)

The Alliance is subject to an enforceable master netting arrangement in the form of an ISDA agreement with Bank of America, Merrill Lynch. Under the terms of this agreement, offsetting of derivative contracts is permitted in the event of default of either party to the agreement. The ISDA agreement requires that the Alliance post additional collateral for the derivatives' fair market value deficits above specified levels. As of June 30, 2014 and 2013, the Alliance was not required to post additional collateral.

The following is a summary of the interest rate swap agreements at June 30, 2014 and 2013:

Notional Amount	*Term*	*Counterparty*	*Payments: Receive*	*Payments: Pay*	*Estimated Fair Value 2014*	*Estimated Fair Value 2013*
$170,000	4/2006-4/2026	Bank of America, Merrill Lynch	1.07% 4/2013-4/2014 1.14% 5/2014-4/2016	0.00%	$ 3,089	$ 3,895
$95,000	4/2006-4/2026	Bank of America, Merrill Lynch	1.08% 4/2013-4/2014 1.14% 5/2014-4/2016	0.00%	1,748	2,205
$173,030	4/2006-4/2034	Bank of America, Merrill Lynch	1.12% 4/2013-4/2014 1.16% 5/2014-4/2016	0.00%	(1,884)	(710)
$82,055	12/2007-7/2033	Bank of America, Merrill Lynch	67% USD-LIBOR-BBA	0.312% + USD-SIFMA	(9,365)	(9,322)
$50,000	2/2008-7/2038	Bank of America, Merrill Lynch	67% (USD-LIBOR-BBA + 0.15%)	USD-SIFMA	(4,210)	(4,218)
$20,400	7/2007-7/2015	Bank of America, Merrill Lynch	1.05% + USD-SIFMA	4.50%	63	35
					(10,559)	(8,115)
$4,680	7/2010-7/2015	First Tennessee Bank	0.00%	USD-LIBOR-BBA	(44)	(70)
					$ (10,603)	$ (8,185)

The net investment derivative gain is comprised of the following for the years ending June 30:

	2014	*2013*
Settlement income and other	$ 5,980	$ 6,661
Change in estimated fair value	(2,761)	457
	$ 3,219	$ 7,118

These fair values are based on the estimated amount the Alliance would receive, or be required to pay, to enter into equivalent agreements at the valuation date and include an estimated credit value adjustment. Due to the nature of these financial instruments, such estimates of fair value are subject to significant change in the near term.

(Dollars in Thousands)

The Alliance was a party to a total return swap which terminated in 2009. In 2013, the Alliance and counterparty reached a settlement agreement. A gain of approximately $3,020 was recognized on the settlement, which is included within other revenue, gains and support in the accompanying 2013 Consolidated Statement of Operations.

NOTE E--PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following at June 30:

	2014	*2013*
Land	$ 60,722	$ 60,180
Buildings and leasehold improvements	760,853	718,489
Property and improvements held for leasing	80,824	77,767
Equipment and information technology infrastructure	700,748	664,469
Buildings and equipment held under capital lease	340	671
	1,603,487	1,521,576
Less: Allowances for depreciation and amortization	(757,641)	(704,002)
	845,846	817,574
Construction in progress (Note N)	35,583	66,719
	$ 881,429	$ 884,293

Accumulated depreciation and amortization on property and improvements held for leasing purposes is $27,500 and $25,146 at June 30, 2014 and 2013, respectively. Net interest capitalized was $1,533 and $4,419 for the years ended June 30, 2014 and 2013, respectively.

The Alliance entered into an Amendment and Mutual Release Agreement with a vendor whereby the Alliance waived its right to take any action with respect to prior contracts in exchange for professional services, primarily related to accelerated deployment of information systems. The Alliance recognized approximately $282 and $3,386 in 2014 and 2013, respectively, as additions to property, plant and equipment with an offsetting gain related to the agreed-upon value of such professional services. The Alliance anticipates recognition of additional amounts in future periods.

(Dollars in Thousands)

NOTE F--LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS

Long-term debt and capital lease obligations consist of the following at June 30:

Description	Rate as of June 30, 2014	Outstanding Balance 2014	2013
2013 Hospital Revenue and Refunding Revenue Bonds:			
$61,180 variable rate tax-exempt term bond, due August 2031	1.13%	$ 328,665	$ -
$48,600 variable rate tax-exempt term bond, due August 2032	0.91%		
$13,350 variable rate tax-exempt term bond, due August 2038	1.13%		
$89,620, variable rate tax-exempt term bonds, due August 2042	1.10% - 1.21%		
$16,235, variable rate tax-exempt term bond, due August 2043	0.05%		
$99,680 variable rate taxable term bond due August 2043	0.12%		
2012 Hospital Revenue Bonds:			
(net of unamortized premium of $1,756 and $1,817 at June 30, 2014 and 2013, respectively)			
$55,000 fixed rate tax-exempt term bond, due August 2042	5.00%	56,756	94,697
2011 Hospital Revenue and Refunding and Improvement Bonds:			
$6,445 variable rate taxable term bond, due July 2026	0.12%	104,710	229,919
$76,930 variable rate tax-exempt term bonds, due July 2033	0.07%		
$21,335 variable rate tax-exempt term bond, due July 2033 (JMH)	1.10%		
2010 Hospital Revenue Refunding Bonds:			
(net of unamortized premium of $1,523 and $1,604 at June 30, 2014 and 2013, respectively)			
$41,600 fixed rate tax-exempt serial bonds, through 2020	4.00% to 5.00%	180,993	188,549
$4,355 fixed rate tax-exempt term bond, due July 2023	5.00%		
$14,985 fixed rate tax-exempt term bond, due July 2025	5.38%		
$4,250 fixed rate tax-exempt term bond, due July 2028	5.50%		
$19,230 fixed rate tax-exempt term bond, due July 2030	5.63%		
$95,050 fixed rate tax-exempt term bonds, due July 2038	6.00% - 6.50%		
2009 Hospital Revenue Bonds:			
(net of unamortized discount of $2,267 and $2,359 at June 30, 2014 and 2013, respectively)			
$16,990 fixed rate tax-exempt term bonds, due July 2019	7.25%	119,813	122,256
$21,730 fixed rate tax-exempt term bonds, due July 2029	7.50%		
$83,360 fixed rate tax-exempt term bonds, due July 2038	7.75% - 8.00%		
2008 Hospital Revenue Bond:			
Refunded in 2014		-	65,210
2007B Taxable Hospital Revenue Bonds:			
$19,515 variable rate taxable term bond due July 2019	0.13%	19,515	123,335
2006 Hospital First Mortgage Revenue Bonds:			
(net of unamortized premium of $129 and $135 at June 30, 2014 and 2013, respectively)			
$4,680 fixed rate tax-exempt serial bonds, through 2019	5.00%	167,864	168,485
$7,375 fixed rate tax-exempt term bond, due July 2026	5.25%		
$20,505 fixed rate tax-exempt term bond, due July 2031	5.50%		
$135,175 fixed rate tax-exempt term bond, due July 2036	5.50%		
2001 Hospital First Mortgage Revenue Bond:			
$20,400 fixed rate tax-exempt term bond, due July 2026	4.50%	20,400	21,400

(Dollars in Thousands)

Description	*Rate as of June 30, 2014*	*Outstanding Balance 2014*	*2013*
2000 Hospital First Mortgage Revenue and Refunding Bonds:			
$43,995 fixed rate tax-exempt term bonds, due July 2026	8.50%	81,006	80,485
$37,011 fixed rate tax-exempt Capital Appreciation Bonds, interest and principal due July 2026 through 2030	6.63%		
Capitalized lease obligations secured by equipment			
Various monthly principal and interest payments through December 2016	Various	806	1,240
Master installment payment agreements			
Various payments through May 2014	Unspecified	-	3,823
Notes payable secured by real estate			
Various principal and interest payments through 2017	Various	5,542	5,878
Promissory notes secured by assets of PFUC			
Various monthly principal and interest payments through 2019	3.00% - 3.75%	918	985
Term note			
Monthly principal payments of $60 plus variable rate interest beginning November 2012 through September 2015; remaining principal due October 2015	1.14%	16,883	17,607
Notes payable secured by equipment			
Various monthly principal and interest payments through 2016	Various	790	896
Promissory note secured by assets of KASC			
Monthly principal payments of $7 beginning April 2014 through February 2019; remaining principal due March 2019	3.25%	431	-
Promissory note secured by assets of ETASC			
Monthly principal payments of $8 plus variable rate interest beginning January 2011 through August 2015; remaining principal due September 2015	3.25%	595	-
		1,105,687	1,124,765
Less current portion		(30,618)	(34,417)
		$ 1,075,069	$ 1,090,348

Series 2013 Bonds: In July 2013, the Alliance issued $16,235 (Series 2013A) Hospital Revenue Bonds, $99,680 (Series 2013B) Hospital Refunding Revenue Bonds, $13,350 (Series 2013C) Hospital Refunding Revenue Bonds and $28,310 (Series 2013G) Hospital Revenue Bonds through The Health and Educational Facilities Board of the City of Johnson City, Tennessee and $61,180 (Series 2013D) Hospital Refunding Revenue Bonds, $9,880 (Series 2013E) Hospital Refunding Revenue Bonds, $51,430 (Series 2013F) Hospital Refunding Revenue Bonds and $48,600 (Series 2013H) Hospital Refunding Revenue Bonds through the Industrial Development Authority of Smyth County, Virginia (collectively, the Series 2013 Bonds).

The proceeds from the Series 2013A Bonds were used to finance or refinance capital improvements and equipment acquisitions and to pay issuance costs associated with these Bonds. The proceeds from the remaining Series 2013 Bonds were used to refinance outstanding indebtedness, specifically related to the Series 2007B-2, 2008A, 2008B, 2011C, 2011D, 2012B and 2012C Bonds, and to pay issuance costs associated with these Bonds.

Capital Appreciation Bonds: The Series 2000 Bonds include $14,680 of insured Capital Appreciation Bonds. Such bonds bear a 0% coupon rate and have a yield of 6.625% annually. The Alliance recognizes interest expense and increases the amount of outstanding debt each year based upon this yield. Total principal and interest due at maturity (2026 through 2030) is $93,675.

Other: Outstanding tax-exempt bond obligations that were insured under municipal bond insurance policies were $81,006 and $80,485 at June 30, 2014 and 2013, respectively. Under terms of these policies, the insurer guarantees the Alliance's payment of principal and interest. At June 30, 2014 and 2013, the Alliance held $212,360 and $417,290, respectively, in variable rate demand bonds with letter of credit support and $240,530 and $39,055, respectively, in variable rate bonds held under direct purchase agreements.

Early Redemption: Essentially all of the Alliance's bonds are subject to redemption prior to maturity, including optional, mandatory sinking fund and extraordinary redemption, at various dates and prices as described in the respective Bond indentures and other documents.

Derecognized Bonds: In previous years, the advance refunded previously issued debt by placing required funds in irrevocable trusts in order to satisfy remaining scheduled principal and interest payments of the outstanding debt. Management, upon advice of legal counsel, believes the amounts deposited in such irrevocable trust accounts have contractually relieved the Alliance of any future obligations with respect to this debt, and the debt is not a considered liability of the Alliance. Therefore, such debt has been derecognized. Debt outstanding and not recognized in the Consolidated Balance Sheet at June 30, 2014 due to previous advance refundings totaled approximately $196,290.

The assets placed in the irrevocable trust accounts are also not recognized as assets of the Alliance. These assets consist primarily of various investments, as permitted by bond indentures and other documents, including United States Treasury obligations, an investment contract with MBIA Insurance Corporation (MBIA) in the original amount of $54,300, as well as the Series 2000C and 2000D Bonds which were purchased with the proceeds of the 2000A and 2000B Bonds specifically for the purpose of utilizing the Series 2000C and 2000D Bonds in the irrevocable trust. Therefore, certain of the assets held in the irrevocable trust accounts have future income streams contingent upon payments by the Alliance.

The Alliance instructed the trustee of the advance refunded 1998C Bonds to liquidate certain investments held in the related irrevocable trust account and to redeem a portion of the 1998C Bonds with the proceeds from the liquidation. The fair value of the liquidated assets exceeded the payment necessary to redeem the 1998C Bonds and the excess was paid to the Alliance. As a result of this transaction, the Alliance recognized a net gain of $13,847 which is included in other revenue, gains and support in the accompanying 2013 Consolidated Statements of Operations.

(Dollars in Thousands)

Financing Arrangements: The Alliance has granted a deed of trust on JCMC and SSH to secure the payment of the outstanding bonds indebtedness. The bonds are also secured by the Alliance's receivables, inventories and other assets as well as certain funds held under the documents pursuant to which the bonds were issued. The JMH Series 2011 Hospital Refunding and Improvement Revenue Bonds are secured by pledged revenues of JMH, as defined in the Credit Agreement.

Certain members of the Alliance and JMH are each members of separate Obligated Groups. The bond indentures, master trust indentures, letter of credit agreements and loan agreements related to the various bond issues and notes payable contain covenants with which the respective Obligated Groups must comply. These requirements include maintenance of certain financial and liquidity ratios, deposits to trustee funds, permitted indebtedness, use of facilities and disposals of property. These covenants also require that failure to meet certain debt service coverage tests will require the deposit of all daily cash receipts of the Alliance into a trust fund. Management has represented the Alliance and JMH are in compliance with all such covenants at June 30, 2014.

During 2014, the Alliance recognized a $4,622 loss on early extinguishment of debt representing the write off of previously deferred and unamortized financing costs generally related to the refunded portion of the Series 2012 Bonds, Series 2008 Bonds, Series 2011 Bonds and Series 2007B Bonds.

The scheduled maturities and mandatory sinking fund payments of the long-term debt and capital lease obligations (excluding interest), exclusive of net unamortized original issue discount and premium, at June 30, 2014 are as follows:

Year Ending June 30,			
2015		$	30,618
2016			42,329
2017			27,647
2018			24,793
2019			25,924
Thereafter			953,235
			1,104,546
	Net premium		1,141
		$	1,105,687

NOTE G–SELF-INSURANCE PROGRAMS

The Alliance is substantially self-insured for professional and general liability claims and related expenses. The Alliance maintains a $25,000 umbrella liability policy that attaches over the self-insurance limits of $10,000 per claim and a $15,000 annual aggregate retention. The Alliance's insurance program also provides professional liability coverage for certain affiliates and joint ventures.

(Dollars in Thousands)

The Alliance is also substantially self-insured for workers' compensation claims in the State of Tennessee and has established estimated liabilities for both reported and unreported claims. The Alliance maintains a stop-loss policy that attaches over the self-insurance limits of $1,000 per occurrence and $1,000 annual aggregate retention. In the State of Virginia, the Alliance is not self-insured and maintains workers' compensation insurance through commercial carriers.

At June 30, 2014, the Alliance is involved in litigation relating to medical malpractice and workers' compensation and other claims arising in the ordinary course of business. There are also known incidents occurring through June 30, 2014 that may result in the assertion of additional claims, and other unreported claims may be asserted arising from services provided in the past. Alliance management has estimated and accrued for the cost of these unreported claims based on historical data and actuarial projections. The estimated net present value of malpractice and workers' compensation claims, both reported and unreported, as of June 30, 2014 and 2013 was $13,220 and $12,348, respectively. The discount rate utilized was 5% at June 30, 2014 and 2013.

Additionally, the Alliance is self-insured for employee health claims and recognizes expense each year based upon actual claims paid and an estimate of claims incurred but not yet paid, including a catastrophic claims reserve based on historical claims in excess of $75. Such amount is included in accounts payable and accrued expenses in the Consolidated Balance Sheets.

NOTE H--NET PATIENT SERVICE REVENUE

Patient service revenue, net of contractual allowances and discounts is composed of the following for the years ended June 30:

	2014	*2013*
Third-party payers	$ 937,150	$ 946,979
Patients	113,276	98,266
Patient service revenue	$ 1,050,426	$ 1,045,245

Patient deductibles and copayments under third-party payment programs are included within the patient amounts above.

The Alliance also provides services to uninsured and underinsured patients that do not qualify for financial assistance. Based on historical experience, a significant portion of uninsured and underinsured patients are unable or unwilling to pay the portion of their bill for which they are financially responsible and a significant provision for bad debts is recorded in the period the services are provided.

The Alliance's allowance for doubtful accounts totaled $47,853 and $49,449 at June 30, 2014 and 2013, respectively. The allowance for doubtful accounts remained consistent at 23% of patient accounts receivable, net of contractual allowances, at June 30, 2014 and 2013. Management's estimate of the allowance for doubtful accounts is a significant estimate subject to change in the near term. The provision for bad debts associated with the Alliance's ancillary service lines are not significant.

NOTE I--THIRD-PARTY REIMBURSEMENT

The Alliance renders services to patients under contractual arrangements with Medicare, Medicaid, TennCare and various other commercial payers. The Medicare program pays for inpatient services on a prospective basis. Payments are based upon diagnosis related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. The Alliance also receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid and other low income patients. Most Medicare outpatient services are reimbursed on a prospectively determined payment methodology. The Medicare program also reimburses certain other services on the basis of reasonable cost, subject to various prescribed limitations and reductions.

Reimbursement under the State of Tennessee's Medicaid waiver program (TennCare) for inpatient and outpatient services is administered by various managed care organizations (MCOs) and is based on diagnosis related group assignments, a negotiated per diem or fee schedule basis. The Alliance also receives additional supplemental payments from the State of Tennessee through the essential access program. These payments recognized totaled $6,225 and $8,455 for the years ended June 30, 2014 and 2013, respectively. Additionally, during the year ending June 30, 2014, the Alliance recorded approximately $4,097 related to additional supplemental funding through the State of Tennessee as management believes such funding is applicable to 2014. Such payments are not guaranteed in future periods.

The Virginia Medicaid program reimbursement for inpatient hospital services is based on a prospective payment system using both a per case and per diem methodology. Additional payments are made for the allowable costs of capital. Payments for outpatient services were based on Medicare cost reimbursement principles and settled through the filing of an annual Medicaid cost report through December 31, 2013. Beginning January 1, 2014, payments for outpatient services are transitioning from cost-based reimbursement principles to a prospective payment system. Full implementation of this transition is expected to take place over multiple years.

Amounts earned under the contractual agreements with the Medicare and Medicaid programs are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The impact of final settlements of cost reports or changes in estimates increased net patient service revenue by $6,201 and $1,328 in 2014 and 2013, respectively.

Activity with respect to audits and reviews of the governmental programs in the healthcare industry has increased and is expected to increase in the future. No additional specific reserves or allowances have been established with regard to these increased audits and reviews as management is not able to estimate such amounts, if any. Management believes that any adjustments from these increased audits and reviews will not have a material adverse impact on the consolidated financial statements. However, due to uncertainties in the estimation, it is at least reasonably possible that management's estimate will change in 2015, although the amount of any change cannot be estimated.

During 2014, the Alliance recognized $5,600 of estimated receivables from amounts previously recouped as a result of audits and reviews of governmental programs. Such amounts are based on the Alliance's historical experience with appeals of such recoupments. However, such amounts are subject to significant changes in the near term.

Participation in the Medicare program subjects the Alliance to significant rules and regulations; failure to adhere to such could result in fines, penalties or expulsion from the program. Management believes that adequate provision has been made for any adjustments, fines or penalties which may result from final settlements or violations of other rules or regulations. Management has represented that the Alliance is in substantial compliance with these rules and regulations as of June 30, 2014.

The Alliance has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations and employer groups. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

NOTE J--EMPLOYEE BENEFIT PLANS

The Alliance sponsors a retirement plan (the Plan) which covers substantially all employees. The Plan is a defined contribution plan which consists principally of employer-funded contributions. During 2014 and 2013, the Alliance made contributions to the Plan under a stratified system, whereby the Alliance's contribution percentage is based on each employee's years of service. Employees of certain other subsidiaries are covered by other plans, although such plans are not significant. The total expense related to defined contribution plans for the years ended June 30, 2014 and 2013 was $13,850 and $16,121, respectively.

(Dollars in Thousands)

NCH maintains a defined benefit pension plan and a post-retirement employee benefit plan. The accrued unfunded pension liability was $2,086 and $3,028, and the accrued unfunded post-retirement liability was $5,857 and $4,943 at June 30, 2014 and 2013, respectively.

The Alliance sponsors a secured executive benefit program (SEBP) for certain key executives. Contributions to the plan by the Alliance are based on an annual amount of funding necessary to produce a target benefit for the participants at their retirement date, although the Alliance does not guarantee any level of benefit will be achieved. The Alliance contributed $511 and $1,020 to the plan during 2014 and 2013, respectively. Other assets at June 30, 2014 and 2013 include $11,302 and $10,721, respectively, related to the Alliance's portion of the benefits which are recoverable upon the death of the participant. In addition, the Alliance sponsors a Section 457(f) plan for certain key executives. The Alliance contributed $231 and $294 to the Section 457(f) plan during 2014 and 2013, respectively.

NOTE K--CONCENTRATION OF RISK

The Alliance has locations primarily in upper East Tennessee and Southwest Virginia which is considered a geographic concentration. The Alliance grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. Net patient service revenue from Washington County, Tennessee operations were approximately 52% and 51% of total net patient service revenue in 2014 and 2013, respectively.

The mix of receivables from patients and third-party payers based on charges at established rates is as follows as of June 30. The patient responsibility related to charges for which the third-party has not yet paid is included within the third-party payer categories.

	2014	*2013*
Medicare	39%	38%
Tenncare/Medicaid	18%	16%
Commercial	28%	28%
Other third-party payers	8%	9%
Patients	7%	9%
	100%	100%

Approximately 88% of the consolidated total revenue, gains and support were related to the provision of healthcare services during 2014 and 2013. Admitting physicians are primarily practitioners in the regional area.

Employees at two of the Alliance's Virginia hospitals are covered under a collective bargaining agreement which extends through February 2017.

The Hospital maintains bank accounts at various financial institutions covered by the Federal Deposit Insurance Corporation (FDIC). At times throughout the year, the Alliance may maintain bank account balances in excess of the FDIC insured limit. Management believes the credit risk associated with these deposits is not significant.

The Alliance routinely invests in investment vehicles as listed in Note C. The Alliance's investment portfolio is managed by outside investment management companies. Investments in corporate and foreign bonds, municipal obligations, money market funds, equities and other vehicles that are held by safekeeping agents are not insured or guaranteed by the U.S. government.

NOTE L--INCOME TAXES

BRMM and its subsidiaries file a consolidated federal tax return and separate state tax returns. As of June 30, 2014 and 2013, BRMM and its subsidiaries had net operating loss carryforwards for consolidated federal purposes of $27,085 and $33,620, respectively, related to operating loss carryforwards, which expire through 2031. At June 30, 2014 and 2013, BRMM had state net operating loss carryforwards of $74,191 and $71,637, respectively, which expire through 2028. The net operating loss carryforwards may be offset against future taxable income to the extent permitted by the Internal Revenue Code and Tennessee Code Annotated.

At June 30, 2014 and 2013, SWCH had federal and state net operating loss carryforwards of $5,884 and $5,906, respectively, which expire through 2033. The net operating loss carryforwards may be off-set against future taxable income to the extent permitted by the Internal Revenue Code and tax codes of the Commonwealth of Virginia.

Net deferred tax assets related to these carryforwards and other deferred tax assets have been substantially offset through valuation allowances equal to these amounts. Income taxes paid relate primarily to state taxes for certain subsidiaries and federal alternative minimum tax.

NOTE M--RELATED PARTY TRANSACTIONS

The Alliance enters into transactions with entities affiliated with certain members of the Board of Directors including transactions to construct Alliance facilities and provide professional services to the Alliance. Board members refrain from discussion and abstain from voting on transactions with entities with which they are related.

NOTE N–OTHER COMMITMENTS AND CONTINGENCIES

Construction in Progress: Construction in progress at June 30, 2014 represents costs incurred related to various hospital and medical office building facility renovations and additions and information technology infrastructure. The Alliance has outstanding contracts and other commitments related to the completion of these projects, and the cost to complete these projects is estimated to be approximately $48,844 at June 30, 2014. The Alliance does not expect any significant costs to be incurred for infrastructure improvements to assets held for resale.

Physician Contracts: BRMM employs physicians to provide services to BRMM's physician practices through employment agreements which provide annual compensation, plus incentives based upon specified productivity and performance (quality measures). These contracts have various terms.

In addition, the Alliance has entered into contractual relationships with non-employed physicians to provide services in Upper East Tennessee and Southwest Virginia. These contracts guarantee certain base payments and allowable expenses and have terms of varying lengths. Amounts drawn and outstanding under each agreement are treated as a loan bearing interest at various rates and are subject to repayment over a specified period. The physician notes may also be amortized by virtue of the physician's continued practice in the specified community during the repayment period. A net receivable of $853 and $884 related to these agreements is included in the accompanying Consolidated Balance Sheets at June 30, 2014 and 2013, respectively.

Employee Scholarships: The Alliance offers scholarships to certain individuals which require that the recipients return to the Alliance to work for a specified period of time after they complete their degree. Amounts due are then forgiven over a specific period of time as provided in the individual contracts. If the recipient does not return and work the required period of time, the funds disbursed on their behalf become due immediately and interest is charged until the funds are repaid. Other receivables at June 30, 2014 and 2013 include $8,685 and $9,021, respectively, related to students in school, graduates working at the Alliance and amounts due from others who are no longer in the scholarship program, net of an estimated allowance.

Operating Leases and Maintenance Contracts: Total lease expense for the years ended June 30, 2014 and 2013 was $7,901 and $8,739, respectively. Future minimum lease payments for each of the next five years and in the aggregate for the Alliance's noncancellable operating leases with remaining lease terms in excess of one year are as follows:

(Dollars in Thousands)

Year Ending June 30,		
2015	$	6,996
2016		6,389
2017		4,084
2018		3,292
2019		3,025
Thereafter		12,500
	$	36,286

Other: The Alliance is a party to various transactions and agreements in the normal course of business, which include purchase and re-purchase agreements, put arrangements and other commitments, which may bind the Alliance to undertake additional transactions or activities in the future.

Healthcare Industry: Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

NOTE O--FAIR VALUE MEASUREMENT

The fair value of financial instruments has been estimated by the Alliance using available market information as of June 30, 2014 and 2013, and valuation methodologies considered appropriate. The estimates presented are not necessarily indicative of amounts the Alliance could realize in a current market exchange. The carrying value of substantially all financial instruments approximates fair value due to the nature or term of the instruments, except as described below.

Held-to-Maturity Securities: The estimated fair value of the Alliance's held-to-maturity securities at June 30, 2014 and 2013, is approximately $38,508 and $36,666, respectively, and would be classified in level 2 of the fair value hierarchy (described below). The fair value is based on prices provided by the Alliance's investment managers and its custodian bank, which use a variety of pricing sources to determine market valuations.

Investment in Joint Ventures: It is not practical to estimate the fair market value of the investments in joint ventures.

Estimated Professional Liability Self-Insurance and Other Long-Term Liabilities: Estimates of reported and unreported professional liability claims, pension and post-retirement liabilities are discounted to approximate their estimated fair value. It is not practical to estimate the fair market value of other long-term liabilities.

Long-Term Debt: The estimated fair value of the Alliance's long-term debt at June 30, 2014 and 2013, is approximately $1,172,357 and $1,168,846, respectively, and would be classified in level 2 in the fair value hierarchy. The fair value of long-term debt is estimated based upon quotes obtained from brokers for bonds and discounted future cash flows using current market rates for other debt. For long-term debt with variable interest rates, the carrying value approximates fair value.

FASB ASC 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 - Inputs based on quoted market prices for identical assets or liabilities in active markets at the measurement date.

- Level 2 - Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data. The Alliance's Level 2 investments are valued primarily using the market valuation approach.

- Level 3 - Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes values determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Alliance's own assumptions.

In instances where the determination of the fair value hierarchy measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Alliance's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following table sets forth, by level within the fair value hierarchy, the financial instruments measured at fair value as of June 30, 2014 and 2013:

(Dollars in Thousands)

	Total	Level 1	Level 2	Level 3
June 30, 2014				
Cash, cash equivalents and money market funds	$ 95,459	$ 95,459	$ -	$ -
U.S. Government securities	35,569	35,569	-	-
U.S. Agency securities	54,905	54,905	-	-
Corporate and foreign bonds	99,103	-	99,103	-
Municipal obligations	21,409	-	21,409	-
Preferred and asset backed securities	3,497	-	3,497	-
U.S. equity securities	1,868	1,868	-	-
Mutual funds	253,301	177,067	76,234	-
Alternative investments	69,474	-	54,761	14,713
Total assets	$ 634,585	$ 364,868	$ 255,004	$ 14,713
Derivative agreements	$ (10,603)	$ -	$ -	$ (10,603)
June 30, 2013				
Cash, cash equivalents and money market funds	$ 66,075	$ 66,075	$ -	$ -
U.S. Government securities	25,905	25,905	-	-
U.S. Agency securities	45,997	45,997	-	-
Corporate and foreign bonds	179,880	-	179,880	-
Municipal obligations	17,749	-	17,749	-
Preferred and asset backed securities	3,491	-	3,491	-
U.S. equity securities	10,944	10,944	-	-
Mutual funds	186,028	125,479	60,548	-
Alternative investments	37,353	-	37,353	-
Total assets	$ 573,422	$ 274,400	$ 299,021	$ -
Derivative agreements	$ (8,185)	$ -	$ -	$ (8,185)

Fair values for the Alliance's fixed maturity securities are based on prices provided by the Alliance's investment managers and its custodian bank, which use a variety of pricing sources to determine market valuations. Fair values of equity securities have been determined by the Alliance from market quotations.

Alternative Investments: The Alliance generally uses net asset value per unit as provided by external investment managers without further adjustment as the practical expedient estimate of the fair value of its alternative investment in a real estate fund, consistent with the provisions of FASB ASC 820, *Fair Value Measurement*. Accordingly, such values may differ from values that would have been used had an active market for the investments existed. The real estate fund invests primarily in U.S. commercial real estate. The Alliance may request redemption of all or a portion of its interests as of the end of a calendar quarter by delivering written notice to the fund managers at least 60 days prior to the end of the quarter. Such redemptions are subject to the capital requirements of the fund manager.

(Dollars in Thousands)

The Alliance's investment in Premier's Class B units do not have a readily determinable fair value and have been reported at estimated fair market value. The significant unobservable inputs primarily relate to management's estimate of the discount for lack of marketability of 12%. Accordingly, such value may differ from values that would have been used had an active market for the investment existed and as such it has been classified in Level 3 of the fair value hierarchy.

Derivative Agreements: The valuation of the Alliance's derivative agreements is determined using market valuation techniques, including discounted cash flow analysis on the expected cash flows of each agreement. This analysis reflects the contractual terms of the agreement, including the period to maturity, and uses certain observable market-based inputs. The fair values of interest rate agreements are determined by netting the discounted future fixed cash payments (or receipts) and the discounted expected variable cash receipts (or payments). The variable cash receipts (or payments) are based on the expectation of future interest rates and the underlying notional amount. The Alliance also incorporates credit valuation adjustments (CVAs) to appropriately reflect both its own nonperformance or credit risk and the respective counterparty's nonperformance or credit risk in the fair value measurements. The CVA on the Alliance's interest rate swap agreements at June 30, 2014 and 2013 resulted in a decrease in the fair value of the related liability of $4,584 and $3,080, respectively.

A certain portion of the inputs used to value its interest rate swap agreements, including the forward interest rate curves and market perceptions of the Alliance's credit risk used in the CVAs, are unobservable inputs available to a market participant. As a result, the Alliance has determined that the interest rate swap valuations are classified in Level 3 of the fair value hierarchy.

The following tables provide a summary of changes in the fair value of the Alliance's Level 3 financial assets and liabilities during the fiscal years ended June 30, 2014 and 2013:

	Alternative Investment	*Derivatives, Net*
July 1, 2012	$ -	$ (19,381)
Total unrealized/realized gains in the Performance Indicator, net	-	457
Net investment income	-	399
Settlements	-	10,340
June 30, 2013	-	(8,185)
Total unrealized/realized gains in the Performance Indicator, net	-	(2,761)
Net investment income	-	343
Additions	14,713	-
June 30, 2014	$ 14,713	$ (10,603)

NOTE P--OPERATING EXPENSES BY FUNCTIONAL CLASSIFICATION

The Alliance does not present expense information by functional classification because its resources and activities are primarily related to providing healthcare services. Further, since the Alliance receives substantially all of its resources from providing healthcare services in a manner similar to business enterprises, other indicators contained in these consolidated financial statements are considered important in evaluating how well management has discharged their stewardship responsibilities.

NOTE Q--SUBSEQUENT EVENTS

The Alliance signed an agreement to form a joint venture with HealthSouth Corporation to own and operate James H. & Cecile C. Quillen Rehabilitation Hospital (Quillen). At closing, HealthSouth will obtain a 50.1% ownership of the free-standing 60-bed inpatient rehabilitation hospital. Quillen will be managed by HealthSouth Corporation under a long-term management contract. The formation of the joint venture is subject to customary closing conditions including regulatory approvals. Management anticipates closing the joint venture transaction by the end of the calendar year 2014.

Supplemental Schedules

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Balance Sheets
(Smyth County Community Hospital and Subsidiary and Norton Community Hospital and Subsidiaries)
(Dollars in Thousands)

June 30, 2014

	Smyth County Community Hospital and Subsidiary	*Norton Community Hospital and Subsidiaries*
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 2,465	$ 5,581
Patient accounts receivable, less estimated allowances for uncollectible accounts	7,099	10,583
Other receivables, net	1,235	1,706
Inventories and prepaid expenses	1,035	1,882
Estimated amounts due from third-party payers, net	-	113
Receivables from affiliates, net	560	319
TOTAL CURRENT ASSETS	12,394	20,184
INVESTMENTS, less amounts required to meet current obligations	21,335	30,089
PROPERTY, PLANT AND EQUIPMENT, net	71,083	45,438
OTHER ASSETS		
Net deferred financing, acquisition costs and other charges	148	218
Other assets	741	-
TOTAL OTHER ASSETS	889	218
	$ 105,701	$ 95,929

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Balance Sheets - Continued
(Smyth County Community Hospital and Subsidiary and Norton Community Hospital and Subsidiaries)
(Dollars in Thousands)

June 30, 2014

	Smyth County Community Hospital and Subsidiary	Norton Community Hospital and Subsidiaries
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accrued interest payable	$ 16	$ 15
Current portion of long-term debt and capital lease obligations	1,102	147
Accounts payable and accrued expenses	2,125	4,007
Accrued salaries, compensated absences and amounts withheld	2,171	4,503
Estimated amounts due to third-party payers, net	35	-
TOTAL CURRENT LIABILITIES	5,449	8,672
OTHER LIABILITIES		
Long-term debt and capital lease obligations, less current portion	15,966	21,096
Estimated professional liability self-insurance	395	567
Other long-term liabilities	943	7,646
TOTAL LIABILITIES	22,753	37,981
NET ASSETS		
Unrestricted net assets	82,938	57,786
Temporarily restricted net assets	10	162
TOTAL NET ASSETS	82,948	57,948
	$ 105,701	$ 95,929

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Operations and Changes in Net Assets (Smyth County Community Hospital and Subsidiary and Norton Community Hospital and Subsidiaries) (Dollars in Thousands)

Year Ended June 30, 2014

	Smyth County Community Hospital and Subsidiary	Norton Community Hospital and Subsidiaries
UNRESTRICTED NET ASSETS:		
Revenue, gains and support:		
Patient service revenue, net of contractual allowances and discounts	$ 45,406	$ 77,273
Provision for bad debts	(4,138)	(9,611)
Net patient service revenue	41,268	67,662
Net investment gain	2,148	1,904
Other revenue, gains and support	2,975	5,629
TOTAL REVENUE, GAINS AND SUPPORT	46,391	75,195
Expenses and losses:		
Salaries and wages	17,620	23,622
Physician salaries and wages	261	5,906
Contract labor	112	533
Employee benefits	3,611	8,554
Fees	9,284	9,059
Supplies	5,300	8,319
Utilities	976	1,301
Other	4,740	9,256
Loss on early extinguishment of debt	177	321
Depreciation	4,276	4,420
Amortization	27	8
Interest and taxes	162	349
TOTAL EXPENSES AND LOSSES	46,546	71,648
EXCESS (DEFICIT) OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	(155)	3,547
Pension and postretirement liability adjustments	-	388
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	(155)	3,935

MOUNTAIN STATES HEALTH ALLIANCE

Consolidated Statements of Operations and Changes in Net Assets - Continued
(Smyth County Community Hospital and Subsidiary and Norton Community Hospital and Subsidiaries)
(Dollars in Thousands)

Year Ended June 30, 2014

	Smyth County Community Hospital and Subsidiary	*Norton Community Hospital and Subsidiaries*
TEMPORARILY RESTRICTED NET ASSETS:		
Restricted grants and contributions	17	97
Net assets released from restrictions	(43)	(26)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	(26)	71
INCREASE (DECREASE) IN TOTAL NET ASSETS	(181)	4,006
NET ASSETS, BEGINNING OF YEAR	83,129	53,942
NET ASSETS, END OF YEAR	$ 82,948	$ 57,948

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Balance Sheet
(Obligated Group and Other Entities)
(Dollars in Thousands)

June 30, 2014

	Obligated Group	Other Entities	Eliminations	Total
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	$ 27,419	$ 31,766	$ -	$ 59,185
Current portion of investments	25,029	-	-	25,029
Patient accounts receivable, less estimated allowance for uncollectible accounts	134,586	26,732	-	161,318
Other receivables, net	29,894	15,608	-	45,502
Inventories and prepaid expenses	22,856	7,982	-	30,838
TOTAL CURRENT ASSETS	239,784	82,088	-	321,872
INVESTMENTS, less amounts required to meet current obligations	449,295	199,180	-	648,475
EQUITY IN AFFILIATES	336,532	-	(336,532)	-
PROPERTY, PLANT AND EQUIPMENT, net	639,370	242,059	-	881,429
OTHER ASSETS				
Goodwill	152,283	4,330	-	156,613
Net deferred financing, acquisition costs and other charges	24,506	1,335	-	25,841
Other assets	39,995	8,355	-	48,350
TOTAL OTHER ASSETS	216,784	14,020	-	230,804
	$ 1,881,765	$ 537,347	$ (336,532)	$ 2,082,580

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Balance Sheet – Continued
(Obligated Group and Other Entities)
(Dollars in Thousands)

June 30, 2014

	Obligated Group	Other Entities	Eliminations	Total
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES				
Accrued interest payable	$ 18,613	$ 35	$ -	$ 18,648
Current portion of long-term debt and capital lease obligations	27,311	3,307	-	30,618
Accounts payable and accrued expenses	71,739	15,387	-	87,126
Accrued salaries, compensated absences and amounts withheld	54,710	17,471	-	72,181
Payables to (receivables from) affiliates, net	13,760	(13,760)	-	-
Estimated amounts due to third-party payers, net	10,068	395	-	10,463
TOTAL CURRENT LIABILITIES	196,201	22,835	-	219,036
OTHER LIABILITIES				
Long-term debt and capital lease obligations, less current portion	1,037,407	37,662	-	1,075,069
Estimated fair value of derivatives, net	10,666	(63)	-	10,603
Estimated professional liability self-insurance	7,747	1,210	-	8,957
Other long-term liabilities	33,495	2,479	-	35,974
TOTAL LIABILITIES	1,285,516	64,123	-	1,349,639
NET ASSETS				
Unrestricted net assets				
Mountain States Health Alliance	541,979	329,803	(329,803)	541,979
Noncontrolling interests in subsidiaries	41,855	131,402	5,290	178,547
TOTAL UNRESTRICTED NET ASSETS	583,834	461,205	(324,513)	720,526
Temporarily restricted net assets				
Mountain States Health Alliance	12,204	11,887	(11,887)	12,204
Noncontrolling interests in subsidiaries	84	5	(5)	84
TOTAL TEMPORARILY RESTRICTED NET ASSETS	12,288	11,892	(11,892)	12,288
Permanently restricted net assets	127	127	(127)	127
TOTAL NET ASSETS	596,249	473,224	(336,532)	732,941
	$ 1,881,765	$ 537,347	$ (336,532)	$ 2,082,580

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Statement of Operations
(Obligated Group and Other Entities)
(Dollars in Thousands)

Year Ended June 30, 2014

	Obligated Group	*Other Entities*	*Eliminations*	*Total*
Revenue, gains and support:				
Patient service revenue, net of contractual allowances and discounts	$ 873,422	$ 178,164	$ (1,160)	$ 1,050,426
Provision for bad debts	(103,913)	(18,729)	-	(122,642)
Net patient service revenue	769,509	159,435	(1,160)	927,784
Premium revenue	-	10,683	-	10,683
Net investment gain	34,846	15,889	(32)	50,703
Net derivative gain	2,497	722	-	3,219
Other revenue, gains and support	71,579	98,296	(107,418)	62,457
Equity in net gain of affiliates	1,510	11,182	(12,692)	-
TOTAL REVENUE, GAINS AND SUPPORT	879,941	296,207	(121,302)	1,054,846
Expenses:				
Salaries and wages	283,993	62,198	(5,602)	340,589
Physician salaries and wages	57,829	74,738	(54,931)	77,636
Contract labor	2,833	1,692	(243)	4,282
Employee benefits	59,268	15,483	(5,578)	69,173
Fees	116,527	33,896	(34,817)	115,606
Supplies	138,127	25,731	(159)	163,699
Utilities	13,087	3,969	(4)	17,052
Medical Costs	-	10,292	-	10,292
Other	56,890	29,828	(6,738)	79,980
Loss on early extinguishment of debt	4,622	-	-	4,622
Depreciation	52,544	16,893	-	69,437
Amortization	1,691	51	-	1,742
Interest and taxes	42,734	1,680	(22)	44,392
TOTAL EXPENSES	830,145	276,451	(108,094)	998,502
EXCESS OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	$ 49,796	$ 19,756	$ (13,208)	$ 56,344

MOUNTAIN STATES HEALTH ALLIANCE

Consolidating Statement of Changes in Net Assets (Obligated Group and Other Entities) (Dollars in Thousands)

Year Ended June 30, 2014

	Obligated Group		*Total*	*Other Entities*		*Total*		
	Mountain States Health Alliance	*Noncontrolling Interests*	*Obligated Group*	*Mountain States Health Alliance*	*Noncontrolling Interests*	*Other Entities*	*Eliminations*	*Total*
UNRESTRICTED NET ASSETS:								
Excess of Revenue, Gains and Support over Expenses and Losses	$ 48,057	$ 1,739	$ 49,796	$ 14,412	$ 5,344	$ 19,756	$ (13,208)	$ 56,344
Pension and other defined benefit plan adjustments	194	194	388	(10)	(9)	(19)	19	388
Net assets released from restrictions used for the purchase of property, plant and equipment	3,313	-	3,313	3,313	-	3,313	(3,313)	3,313
Noncontrolling interest in acquired subsidiary	-	-	-	-	914	914	-	914
Distributions to noncontrolling interests	-	-	-	-	(461)	(461)	-	(461)
Net asset transfers	-	-	-	882	1,669	2,551	(2,551)	-
INCREASE IN UNRESTRICTED NET ASSETS	51,564	1,933	53,497	18,597	7,457	26,054	(19,053)	60,498
TEMPORARILY RESTRICTED NET ASSETS:								
Restricted grants and contributions	4,693	52	4,745	4,047	42	4,089	(4,053)	4,781
Net assets released from restrictions	(5,264)	(22)	(5,286)	(4,691)	(38)	(4,729)	4,694	(5,321)
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	(571)	30	(541)	(644)	4	(640)	641	(540)
INCREASE IN TOTAL NET ASSETS	50,993	1,963	52,956	17,953	7,461	25,414	(18,412)	59,958
NET ASSETS, BEGINNING OF YEAR	503,317	39,976	543,293	323,864	123,946	447,810	(318,120)	672,983
NET ASSETS, END OF YEAR	$ 554,310	$ 41,939	$ 596,249	$ 341,817	$ 131,407	$ 473,224	$ (336,532)	$ 732,941

NOTE A--OBLIGATED GROUP MEMBERS

As described in Note F to the consolidated financial statements, the Alliance has granted a deed of trust on JCMC and SSH to secure the payment of the outstanding bonds. The bonds are also secured by the Alliance's receivables, inventories and other assets as well as certain funds held under the documents pursuant to which the bonds were issued. The members pledged pursuant to the Amended and Restated Master Trust Indenture between Mountain States Health Alliance and the Bank of New York Mellon Trust Company, NA as Master Trustee include Johnson City Medical Center Hospital, Indian Path Medical Center, Franklin Woods Community Hospital, Sycamore Shoals Hospital, Johnson County Community Hospital, Russell County Medical Center, Unicoi County Memorial Hospital, Norton Community Hospital (hospital only), Smyth County Community Hospital (hospital only) and Blue Ridge Medical Management Corporation (parent company only), collectively defined as the Obligated Group (Obligated Group).

The supplemental consolidating schedules include the accounts of the members of the Obligated Group after elimination of all significant intergroup accounts and transactions. Certain other subsidiaries of the Alliance are not pledged to secure the payment of the outstanding bonds as they are not part of the Obligated Group. These affiliates have been accounted for within the Obligated Group based upon the Alliance's original and subsequent investments, as adjusted for the Alliance's pro rata share of income or losses and any distributions, and are included as a part of equity in affiliates in the supplemental consolidating balance sheet.