

**DIGNITY HEALTH
AND SUBORDINATE
CORPORATIONS**

**Consolidated Financial Statements as of
and for the Years Ended June 30, 2012 and 2011
and Independent Auditors' Report**

DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

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INDEPENDENT AUDITORS' REPORT

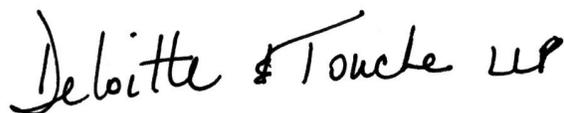
To the Board of Directors of
Dignity Health
San Francisco, California

We have audited the accompanying consolidated balance sheets of Dignity Health and Subordinate Corporations ("Dignity Health") as of June 30, 2012 and 2011, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of Dignity Health's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Dignity Health as of June 30, 2012 and 2011, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The un-sponsored community benefit expense information in Note 4, which is the responsibility of Dignity Health's management, is not a required part of the basic financial statements, and we did not audit or apply limited procedures to such information and we do not express any assurances on such information.



September 25, 2012

DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

CONSOLIDATED BALANCE SHEETS June 30, 2012 and 2011 (in thousands)

Assets	2012	2011
Current assets:		
Cash and cash equivalents	\$ 406,052	\$ 704,044
Short-term investments	932,864	825,849
Collateral held under securities lending program	335,968	290,526
Assets limited as to use	1,242,277	828,632
Patient accounts receivable, net of allowance for doubtful accounts of \$351,387 and \$297,294 in 2012 and 2011, respectively	1,282,895	1,257,296
Broker receivables for unsettled investment trades	20,534	200,150
Other current assets	<u>815,632</u>	<u>542,936</u>
Total current assets	<u>5,036,222</u>	<u>4,649,433</u>
Assets limited as to use:		
Board-designated assets (including \$351,400 and \$308,202 of assets loaned under securities lending program in 2012 and 2011, respectively) for:		
Capital projects	3,211,433	3,139,101
Workers' compensation	448,107	367,554
Hospital professional and general liability	202,316	162,091
Under bond indenture agreements for:		
Capital projects	214,930	51,679
Debt service	140,600	190,975
Bond reserves	20,631	26,387
Donor-restricted	417,061	439,932
Other	68,202	68,213
Less amount required to meet current obligations	<u>(1,242,277)</u>	<u>(828,632)</u>
Net assets limited as to use	<u>3,481,003</u>	<u>3,617,300</u>
Property and equipment, net	4,216,570	4,102,551
Ownership interests in health-related activities	570,873	558,178
Other long-term assets, net	<u>239,327</u>	<u>196,163</u>
Total assets	<u>\$ 13,543,995</u>	<u>\$ 13,123,625</u>

(Continued)

DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

CONSOLIDATED BALANCE SHEETS June 30, 2012 and 2011 (in thousands)

Liabilities and Net Assets	2012	2011
Current liabilities:		
Current portion of long-term debt	\$ 295,920	\$ 107,381
Demand bonds subject to short-term liquidity arrangements, excluding current maturities	785,400	574,000
Accounts payable	531,441	418,155
Payable under securities lending program	336,357	291,148
Accrued salaries and benefits	518,147	507,915
Accrued workers' compensation	46,938	31,647
Accrued hospital professional and general liability	69,885	61,304
Pension and other postretirement liabilities	318,633	278,369
Broker payables for unsettled investment trades	20,644	293,063
Other accrued liabilities	<u>691,965</u>	<u>577,979</u>
Total current liabilities	<u>3,615,330</u>	<u>3,140,961</u>
Other liabilities:		
Workers' compensation	341,200	234,938
Hospital professional and general liability	212,712	228,559
Pension and other postretirement liabilities	1,093,155	598,697
Other	<u>111,966</u>	<u>115,823</u>
Total other liabilities	<u>1,759,033</u>	<u>1,178,017</u>
Long-term debt, net of current portion	<u>3,440,794</u>	<u>3,556,817</u>
Total liabilities	<u>8,815,157</u>	<u>7,875,795</u>
Net assets:		
Unrestricted - attributable to Dignity Health	4,177,650	4,715,076
Unrestricted - noncontrolling interest	137,870	98,304
Temporarily restricted	308,445	326,503
Permanently restricted	<u>104,873</u>	<u>107,947</u>
Total net assets	<u>4,728,838</u>	<u>5,247,830</u>
Total liabilities and net assets	<u>\$ 13,543,995</u>	<u>\$ 13,123,625</u>

(Concluded)

See notes to consolidated financial statements.

DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED June 30, 2012 and 2011 (in thousands)

	2012	2011
Unrestricted revenues and other support:		
Net patient revenue	\$ 9,583,948	\$ 9,332,840
Premium revenue	589,077	558,103
Revenue from health-related activities, net	60,263	134,528
Other operating revenue	272,246	241,865
Contributions	16,734	15,320
Total unrestricted revenues and other support	<u>10,522,268</u>	<u>10,282,656</u>
Expenses:		
Salaries and benefits	5,120,288	4,984,330
Supplies	1,376,472	1,371,824
Provision for bad debts	891,179	811,904
Purchased services and other	2,319,485	2,297,390
Depreciation	425,949	417,984
Interest expense, net	293,910	156,528
Special charges	35,873	-
Total expenses	<u>10,463,156</u>	<u>10,039,960</u>
Operating income	59,112	242,696
Other income:		
Investment income, net	<u>73,437</u>	<u>717,851</u>
Excess of revenues over expenses	<u>\$ 132,549</u>	<u>\$ 960,547</u>

(Continued)

DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED June 30, 2012 and 2011 (in thousands)

	2012	2011
Unrestricted net assets:		
Excess of revenues over expenses	\$ 132,549	\$ 960,547
Change in net unrealized gains (losses) on available-for-sale investments	(2,934)	5,528
Net assets released from restrictions used for purchase of property and equipment	26,247	14,479
Change in funded status of pension and other postretirement benefit plans	(582,711)	324,174
Loss from discontinued operations (including property value loss of \$82.6 million and \$0 in 2012 and 2011, respectively)	(126,727)	(41,779)
Change in noncontrolling interest in health-related activities	39,566	9,099
Change in accumulated unrealized derivative gains, net	2,683	9,055
Funds donated from unconsolidated sources for purchase of property and equipment	15,664	14,207
Other	<u>(2,197)</u>	<u>2,379</u>
Increase (decrease) in unrestricted net assets	<u>(497,860)</u>	<u>1,297,689</u>
Temporarily restricted net assets:		
Contributions	38,231	39,025
Net realized and unrealized gains (losses) on investments	(134)	7,166
Net assets released from restrictions	(50,505)	(37,829)
Change in interest in net assets of unconsolidated foundations	(536)	29,093
Other	<u>(5,114)</u>	<u>(1,993)</u>
Increase (decrease) in temporarily restricted net assets	<u>(18,058)</u>	<u>35,462</u>
Permanently restricted net assets:		
Contributions	25	2,289
Net realized and unrealized gains on investments	77	62
Change in interest in net assets of unconsolidated foundations	51	5,961
Other	<u>(3,227)</u>	<u>560</u>
Increase (decrease) in permanently restricted net assets	<u>(3,074)</u>	<u>8,872</u>
Increase (decrease) in net assets	(518,992)	1,342,023
Net assets, beginning of year	<u>5,247,830</u>	<u>3,905,807</u>
Net assets, end of year	<u>\$ 4,728,838</u>	<u>\$ 5,247,830</u>

(Concluded)

See notes to consolidated financial statements.

DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED June 30, 2012 and 2011 (in thousands)

	2012	2011
Cash flows from operating activities:		
Change in net assets	\$ (518,992)	\$ 1,342,023
Adjustments to reconcile change in net assets to cash provided by operating activities:		
Depreciation, including discontinued operations	431,025	432,438
Amortization	(481)	1,693
Health-related activities:		
Equity in earnings	(39,679)	(118,427)
Change in control of consolidated entities	(40,268)	-
Gain, net, on disposal of assets	(1,030)	(43,082)
Property value adjustments, including discontinued operations	84,097	-
Software development abandonment	22,019	-
Restricted contributions and investment income, net	(38,199)	(44,553)
Change in funded status of pension and other postretirement benefit plans	582,711	(324,174)
Undistributed portion of change in net assets of unconsolidated foundations	485	(35,054)
Change in net realized and unrealized gains on investments	13,022	(632,368)
Change in fair value of swaps	117,358	(50,038)
Changes in certain assets and liabilities:		
Accounts receivable, net	(15,260)	(53,621)
Accounts payable	98,874	23,963
Workers' compensation and hospital professional and general liabilities	12,969	122,359
Accrued salaries and benefits	9,264	22,299
Pension and other postretirement liabilities	(47,988)	15,203
Provider fee assets and liabilities	(192,445)	58,917
Other accrued liabilities	(80,021)	(2,261)
Other, net	(68,338)	(49,740)
Cash provided by operating activities	<u>329,123</u>	<u>665,577</u>

(Continued)

DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED June 30, 2012 and 2011 (in thousands)

	2012	2011
Cash flows from investing activities:		
Purchase of investments	(7,218,347)	(7,016,253)
Proceeds from sale of investments	6,806,363	6,878,766
Cash proceeds on disposal of assets, including discontinued operations	54,424	447
Investments in health-related activities	(15,911)	(8,629)
Cash distributions from health-related activities	19,050	30,000
Additions to operating property and equipment, including discontinued operations	(608,327)	(610,078)
Increase in securities lending collateral	(45,209)	(17,203)
Other, net	26,218	(2,692)
Cash used in investing activities	<u>(981,739)</u>	<u>(745,642)</u>
Cash flows from financing activities:		
Borrowings	1,423,650	133,509
Repayments	(1,144,505)	(204,322)
Increase in payable under securities lending program	45,209	17,203
Restricted contributions and investment income	38,199	44,553
Deferred financing costs	(7,929)	(2,868)
Cash provided by (used in) financing activities	<u>354,624</u>	<u>(11,925)</u>
Net decrease in cash and cash equivalents	(297,992)	(91,990)
Cash and cash equivalents at beginning of year	<u>704,044</u>	<u>796,034</u>
Cash and cash equivalents at end of year	<u>\$ 406,052</u>	<u>\$ 704,044</u>
Components of cash and cash equivalents and investments at end of year:		
Cash and cash equivalents	406,052	704,044
Short-term investments	932,864	825,849
Board-designated assets for capital projects	<u>3,211,433</u>	<u>3,139,101</u>
Total	<u>\$ 4,550,349</u>	<u>\$ 4,668,994</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest, net of capitalized interest	<u>\$ 180,949</u>	<u>\$ 210,555</u>
Supplemental schedule of noncash investing and financing activities:		
Property and equipment acquired through capital lease or note payable	<u>\$ 6,503</u>	<u>\$ 20,284</u>
Accrued purchases of property and equipment	<u>\$ 115,169</u>	<u>\$ 61,107</u>
Broker receivables for unsettled investment trades	<u>\$ 20,534</u>	<u>\$ 200,150</u>
Broker payables for unsettled investment trades	<u>\$ 20,644</u>	<u>\$ 293,063</u>

(Concluded)

See notes to consolidated financial statements.

DIGNITY HEALTH AND SUBORDINATE CORPORATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED June 30, 2012 and 2011

1. ORGANIZATION

Dignity Health (“the Corporation”), formerly Catholic Healthcare West, is a California nonprofit public benefit corporation exempt from federal and state income taxes. In January 2012, the Corporation implemented a governance restructuring and announced its name change. The governance restructuring was implemented through revisions to Catholic Healthcare West’s corporate documents, including Restated Articles of Incorporation and Restated Bylaws. Dignity Health has transitioned to a self-perpetuating Board of Directors structure from the prior structure where the Board of Directors was appointed by Corporate Members, which had been comprised of women religious appointed by the religious orders that sponsored the organization. There was no change to the ownership, use of the corporation’s assets or federal tax identification number, nor did the governance restructuring impact the corporation’s management structure or nonprofit status. Dignity Health has received an IRS determination letter to maintain its 501(c)(3) tax-exempt status, retroactive to the application date in December 2011.

Dignity Health owns and operates healthcare facilities in California, Arizona and Nevada, and is the sole corporate member (parent corporation) of other primarily nonprofit corporations in California, Arizona and Nevada, which are exempt from federal and state income taxes. These organizations provide a variety of healthcare-related activities, education and other benefits to the communities in which they operate. Healthcare services include inpatient, outpatient, subacute and home healthcare services, as well as physician services through Dignity Health Medical Foundation and other affiliated medical groups. As further discussed in Note 3, in August 2012, Dignity Health acquired a for-profit company that provides occupational health and urgent care services in 15 states.

The accompanying consolidated financial statements include Dignity Health and its subordinate corporations and subsidiaries (together “Dignity Health”), as disclosed in Note 18.

As part of a system-wide corporate financing plan, Dignity Health established an Obligated Group to access the capital markets and make loans to its members. Obligated Group members are jointly and severally liable for the long-term debt outstanding under the Master Trust Indenture. None of the other Dignity Health subordinate corporations have assumed any financial obligation related to payment of debt service on obligations issued under the Master Trust Indenture. A list of Obligated Group members and other subordinate corporations and subsidiaries is included in Note 18. The Obligated Group’s unrestricted net assets represent approximately 96% and 97% of the consolidated unrestricted net assets of Dignity Health at June 30, 2012 and 2011, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis for Presentation – The accompanying consolidated financial statements include the accounts of Dignity Health after elimination of intercompany transactions and balances. Certain reclassifications and changes in presentation were made in the 2011 consolidated financial statements to conform to the 2012 presentation.

Statement of Cash Flow Presentation – Subsequent to the issuance of the consolidated financial statements as of and for the year ended June 30, 2011, Dignity Health management determined that the consolidated statement of cash flows should have been adjusted for the impact of the amounts due to/from brokers for unsettled trades on investments, and the impact of funds donated from unconsolidated sources for the purchase of property and equipment. As a result, amounts in the consolidated statement of cash flows for the year ended June 30, 2011, have been restated as follows; purchases of investments increased by \$47,116, proceeds from sales of investments decreased by \$43,906, additions to operating property and equipment

increased by \$14,207, and other changes in cash flows from operating activities increased by \$105,229. Total cash provided by operating activities increased by \$105,229 and the total cash used in investing activities increased by \$105,229 for the year ended June 30, 2011. There were no changes to the net decrease in cash and cash equivalents or the total cash and cash equivalents within the consolidated statement of cash flows.

Additionally, within cash flows from operating activities for the year ended June 30, 2011, Dignity Health reclassified provider fee assets and liabilities of \$58,917 to a separate line item from its previous presentation within other changes to conform to the current year presentation.

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management bases its estimates on historical experience and various other assumptions that it believes are reasonable under the particular facts and circumstances. Actual results could differ from those estimates.

Cash and Cash Equivalents – Cash and cash equivalents consist primarily of cash and highly liquid marketable securities with an original maturity of three months or less.

Securities Lending Program – Dignity Health participates in securities lending transactions with its custodian whereby Dignity Health lends a portion of its investments to various brokers in exchange for collateral for the securities loaned, usually on a short-term basis. Dignity Health maintains effective control of the loaned securities through its custodian during the term of the arrangement in that they may be recalled at any time. Collateral is provided by brokers at an amount equal to at least 100% of the original value of the securities on loan, and is subsequently adjusted for market fluctuations. Dignity Health must return to the borrower the original value of collateral received regardless of the impact of market fluctuations. Under the terms of the agreement, the borrower must return the same, or substantially the same, investments that were borrowed.

The securities on loan under this program are recorded in Board-designated assets in the accompanying consolidated balance sheets. Dignity Health receives both cash and non-cash collateral. Cash collateral is recorded as an asset of the organization. The market value of collateral held for loaned securities is reported as collateral held under securities lending program, and an obligation is reported for repayment of collateral upon settlement of the lending transaction as payable under securities lending program.

Inventory – Inventories are stated at the lower of cost or market value, determined using the first-in, first-out method.

Broker Receivables and Payables for Unsettled Investment Trades – Dignity Health accounts for its investments on a trade date basis. Amounts due to/from brokers for investment activity for transactions that have been initiated prior to the consolidated balance sheet date that are formally settled subsequent to the consolidated balance sheet date are recorded in broker receivables for unsettled investment trades for sales of investments and in broker payables for unsettled investment trades for purchases of investments.

Investments and Investment Income – The Dignity Health Board of Directors Investment Committee establishes guidelines for investment decisions. Within those guidelines, Dignity Health invests in equity and debt securities which are measured at fair value and are classified as trading securities.

Dignity Health also invests in alternative investments through limited partnerships. Alternative investments are comprised of private equity, real estate, hedge fund and other investment vehicles. Dignity Health receives a proportionate share of the investment gains and losses of the partnerships. The limited partnerships generally contract with managers who have full discretionary authority over the investment decisions, within Dignity Health's guidelines. These alternative investment vehicles invest in equity securities, fixed income securities, currencies, real estate, commodities, and derivatives.

Dignity Health accounts for its ownership interests in these alternative investments under the equity method, whose value is based on the net asset value (“NAV”), which approximates fair value, and is determined using investment valuations provided by the external investment managers and fund managers or the general partners.

Alternative investments generally are not marketable and many alternative investments have underlying investments which may not have quoted market values. The estimated value of such investments is subject to uncertainty and could differ had a ready market existed. Such differences could be material. Dignity Health’s risk is limited to its capital investment in each investment and capital call commitments as discussed in Note 7.

Investment income or loss is included in excess of revenues over expenses unless the income or loss is restricted by donor or law. Income earned on tax-exempt borrowings for specific construction projects is offset against interest expense capitalized for such projects.

Board-Designated Assets for Capital Projects – The Board of Directors has a policy of funding depreciation, to the extent that funds are available, to be used for replacement, expansion and improvement of operating property and equipment.

Deferred Financing Costs and Original Issue Discounts/Premiums on Bond Indebtedness – Dignity Health amortizes deferred financing costs and original issue discounts/premiums on bond indebtedness over the estimated average period the related bonds will be outstanding. Deferred financing costs are included in other long-term assets. Original issue discounts/premiums are recorded with the related debt.

Property and Equipment – Property and equipment are stated at cost, if purchased, and at fair market value, if donated. Depreciation of property and equipment is recorded using the straight-line method for financial statement purposes. Amortization of capital leases is included in depreciation expense. Estimated useful lives by major classification are as follows:

Land improvements	2 to 40 years
Buildings	3 to 65 years
Equipment	2 to 40 years
Software development	5 to 10 years

Asset Retirement Obligations – Dignity Health recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the consolidated statements of operations and changes in net assets.

Asset Impairment – Dignity Health routinely evaluates the carrying value of its long-lived assets and goodwill for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset, or related group of assets, may not be recoverable from estimated future undiscounted cash flows generated by the underlying tangible assets. When the carrying value of an asset exceeds the estimated recoverability, an asset impairment charge is recognized. The impairment tests are based on financial projections prepared by management that incorporate anticipated results from programs and initiatives being implemented. If these projections are not met, or if negative trends occur that impact the future outlook, the value of long-lived assets may be impaired, which could be material. Other than the asset impairment charges recognized with respect to Saint Mary’s Regional Medical Center discussed in Note 3, no other significant asset impairment charges were recorded in 2012 or 2011.

Fair Value of Financial Instruments – The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate fair value due to their short maturities. The fair value of investments is disclosed in Note 7 and the fair value of debt is disclosed in Note 13.

Derivative Instruments – Dignity Health utilizes derivative arrangements to manage interest costs and the risk associated with changing interest rates. Dignity Health records derivative instruments on the consolidated balance sheet as either an asset or liability measured at its fair value. See Notes 7 and 14.

Dignity Health does not currently have derivative instruments that are designated as hedges. For derivative instruments that have discontinued hedge accounting treatment, the cumulative amount that has been charged or credited to net assets is reclassified to interest expense, net, in the consolidated statements of operations and changes in net assets in the same period or periods during which the previously hedged transaction affects excess of revenues over expenses.

For derivative instruments that have not been designated as hedges, changes in fair value are included in interest expense, net, in the consolidated statements of operations and changes in net assets.

Ownership Interests in Health-Related Activities – Generally, when the ownership interest in health-related activities is more than 50% and Dignity Health has a controlling interest, the ownership interests are consolidated and a noncontrolling interest is recorded in unrestricted net assets. Changes in noncontrolling interests related to revenues, expenses, gains and losses of consolidated investments in health-related activities are recorded in purchased services and other expense. When the ownership interest is at least 20%, but not more than 50%, or Dignity Health has the ability to exercise significant influence over operating and financial policies of the investee, it is accounted for under the equity method and the income or loss is reflected in revenue from health-related activities, net. Ownership interests for which Dignity Health's ownership is less than 20% or for which Dignity Health does not have the ability to exercise significant influence are carried at the lower of cost or estimated net realizable value. Other than the investments in Scripps Health, Mercy Care Plan and Phoenix Children's Hospital, Inc. (Note 10), these ownership interests are not material to the consolidated financial statements.

Self-Insurance Plans – Dignity Health has established self-insurance programs for workers' compensation benefits for employees and for hospital professional and general liability risks. Annual self-insurance expense under these programs is based on past claims experience and projected losses. Actuarial estimates of uninsured losses for each program at June 30, 2012 and 2011, have been accrued as liabilities and include an actuarial estimate for claims incurred but not reported. Liabilities as of June 30, 2011, were determined using a 70% confidence level and discounted at 4.25%. In July 2011, Dignity Health discontinued the application of a discount factor and confidence level in determining its actuarially estimated liabilities and changed to present the liabilities on an expected, undiscounted basis, which resulted in a \$3.5 million increase in self-insurance expense during the year ended June 30, 2012.

Dignity Health has insurance coverage in place for amounts in excess of the self-insured retention for workers' compensation and professional and general liabilities. Dignity Health adopted the provisions of ASU 2010-24, *Health Care Entities (Topic 954), Presentation of Insurance Claims and Related Insurance Recoveries*, prospectively beginning July 2011. This resulted in the reclassification of \$101.3 million in anticipated insurance recoveries from excess workers' compensation insurers, which were previously netted against liabilities for self-insurance programs, to a receivable within board-designated assets limited as to use for workers' compensation. All subsequent changes to such anticipated insurance recoveries are recorded to the receivable in the same manner. This change had no effect on expenses or net assets.

Dignity Health maintains separate trusts for these programs from which claims and related expenses and costs of administering the plans are paid. Dignity Health's policy is to fund the trusts such that over time, assets held equal liabilities for claims incurred for workers' compensation and claims made for professional liability risks.

Self-insurance expense decreased by \$16.2 million in 2012 and increased by \$63.5 million in 2011, related to revisions to prior years' actuarially estimated liabilities, including the effect of the change in discount factor and confidence level discussed above. The expenses and related adjustments are recorded in salaries and benefits for workers' compensation benefits and in purchased services and other for hospital

professional and general liability risks in the accompanying consolidated statements of operations and changes in net assets.

Patient Accounts Receivable, Allowance for Doubtful Accounts and Net Patient Revenue – Dignity Health has agreements with third-party payors that provide for payments at amounts different from each hospital’s established rates. Patient accounts receivable and net patient revenue are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered.

Dignity Health regularly reviews accounts and contracts and provides appropriate contractual allowances, reserves for charity and uncollectible amounts that are netted against patient accounts receivable in the consolidated balance sheet. Management periodically reviews the adequacy of the allowance for uncollectible accounts based on historical experience, trends in health care coverage, and other collection indicators.

As part of Dignity Health’s mission to serve the community, Dignity Health provides care to patients even though they may lack adequate insurance or may participate in programs with negotiated or regulated amounts. Dignity Health makes every effort to determine if a patient qualifies for charity care upon admission, though determination may also be made at a later time. After satisfaction of amounts due from insurance, the application of any financial, uninsured or other discounts or payments received on the account, and reasonable efforts to collect from the patient have been exhausted, Dignity Health follows established guidelines for placing certain past-due patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by Dignity Health.

Payment arrangements with third-party payors include prospectively determined rates per discharge, per diem payments, discounted charges and reimbursed costs. Net patient revenue includes estimated settlements under negotiated payment agreements with third-party payors. Settlements with third-party payors are accrued on an estimated basis in the period in which the related services are rendered and adjusted in future periods as final settlements are determined.

Inpatient acute care services, outpatient services and skilled nursing services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Certain inpatient nonacute services and medical education costs related to Medicare beneficiaries are paid based on a cost settlement methodology.

Medicaid and contracted-rate payors are paid on a per diem, per discharge, modified cost or capitated basis, or a combination of these.

Gross patient revenue is recorded on the basis of usual and customary charges. Gross patient revenue was \$37.8 billion and \$36.7 billion in 2012 and 2011, respectively. The percentage of inpatient and outpatient services is as follows:

	2012	2011
Inpatient services	64%	66%
Outpatient services	36%	34%

The following table reflects the estimated percentage of gross patient revenues by major payor groups:

	2012	2011
Medicare fee for service	32%	31%
Medicare capitated	1%	1%
Medicare managed care fee for service	9%	9%
Medicaid fee for service	13%	16%
Medicaid capitated	0%	0%
Medicaid managed care fee for service	8%	6%
Contracted rate payors	26%	27%
Commercial capitated	2%	2%
Self pay	5%	4%
Other	4%	4%
Total	<u>100%</u>	<u>100%</u>

Beginning in 2009, the State of California established provider fee programs. Net patient revenue includes \$575.3 million and \$583.7 million related to supplemental Medi-Cal payments provided under the California provider fee programs in 2012 and 2011, respectively. These programs are funded by quality assurance fees paid by participating hospitals and matching federal funds. Dignity Health recorded \$320.7 million and \$359.1 million in such fees in purchased services and other expense in 2012 and 2011, respectively. Grant payments to the California Health Foundation and Trust (“CHFT”) were recognized in connection with the provider fee programs resulting in \$20.9 million and \$25.8 million recorded in purchased services and other expense in 2012 and 2011, respectively. Total net income recognized in 2012 and 2011 related to the provider fee programs was \$233.7 million and \$198.8 million, respectively.

The most recent provider fee legislation was enacted in September 2011, covering the 30-month period from July 1, 2011 through December 31, 2013. The legislation is subject to CMS review and approval. To date, CMS has approved a major portion of the legislation, and as such, amounts reported above include \$132.2 million related to this program. Advocacy efforts are currently underway to promote the enactment of provider fee arrangements to cover periods beyond December 2013. There is no certainty that such efforts will be successful and that these payments will continue.

In 2012 and 2011, net patient revenue included \$53.9 million and \$39.3 million, respectively, relating to net prior years’ settlements from Medicare, Medicaid and other programs, including \$69.3 million in 2012 for settlement of an appeal with CMS related to underpayments that occurred between 1998 and 2011 as a result of errors in the Medicare inpatient wage index calculation.

Certain hospitals qualified for and received Medi-Cal funding as disproportionate-share hospitals from the State of California in 2012 and 2011. The amounts received were \$82.0 million (of which \$23.8 million related to prior years) and \$74.1 million, respectively, and are included in net patient revenue.

Premium Revenue – Dignity Health has at-risk agreements with various payors to provide medical services to enrollees. Under these agreements, Dignity Health receives monthly payments based on the number of enrollees, regardless of services actually performed by Dignity Health. Dignity Health accrues costs when services are rendered under these contracts, including estimates of incurred but not reported (“IBNR”) claims and amounts receivable/payable under risk-sharing arrangements. The IBNR accrual includes an estimate of the costs of services for which Dignity Health is responsible, including out-of-network services.

Traditional Charity Care – Charity care is free or discounted health services provided to persons who cannot afford to pay and who meet Dignity Health’s criteria for financial assistance. The amount of services quantified as customary charges was \$883.7 million and \$713.8 million for 2012 and 2011, respectively, including such charges from discontinued operations. Dignity Health estimates the cost of charity care by calculating a ratio of cost to gross charges and applying that ratio to the gross uncompensated charges.

associated with providing care to patients that qualify for charity care. The estimated cost of charity care provided in 2012 and 2011 was \$188.4 million and \$152.6 million, respectively. See Note 4.

Other Operating Revenue – Other operating revenue includes meaningful use incentives, net gains and losses on the sale of assets, cafeteria revenues, rental revenues, contributions released from restrictions and other nonpatient-care revenues.

The American Recovery and Reinvestment Act of 2009 (“ARRA”) established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record (“EHR”) technology. The Medicare incentive payments are paid out to qualifying hospitals over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals and physicians must meet EHR “meaningful use” criteria that become more stringent over three stages as determined by CMS.

Medicaid programs and payment schedules vary by state. The Medicaid programs in California and Arizona require hospitals to register for the program prior to 2016, to engage in efforts to adopt, implement or upgrade certified EHR technology in order to qualify for the initial year of participation, and to demonstrate meaningful use of certified EHR technology in order to qualify for payment for up to three additional years through 2019 for Arizona and 2021 for California. Nevada implemented a similar program in August 2012 requiring hospitals to demonstrate meaningful use of EHR technology by 2016 to qualify for payment for up to two additional years through 2018.

In 2012, Dignity Health recorded incentive payments of \$21.7 million related to the Medicare program and \$38.7 million related to Medicaid programs. These incentives have been recognized following the grant accounting model, recognizing income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria.

Amounts recognized represent management’s best estimates for payments ultimately expected to be received based on estimated discharges, charity care, and other input data. Subsequent changes to these estimates will be recognized in other operating revenue in the period in which additional information is available.

Contributions and Restricted Net Assets – Gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is met, temporarily restricted net assets related to capital purchases are reclassified as unrestricted and reflected as net assets released from restrictions used for the purchase of property and equipment on the statements of changes in net assets, whereas temporarily restricted net assets related to other gifts are reclassified as unrestricted and recorded as other operating revenue in unrestricted revenues and other support. Gifts received with no restrictions are recorded as contributions in unrestricted revenues and other support. Gifts of long-lived operating assets, such as property and equipment, are reported as unrestricted net assets unless specified by the donor.

Unconditional promises to give cash and other assets to Dignity Health are recorded at fair value at the date the promise is received. Conditional promises to give are recorded when the conditions have been substantially met. Indications of intentions to give are not recorded; such gifts are recorded at fair value only upon actual receipt of the gift. Investment income on temporarily or permanently restricted net assets is classified pursuant to the intent or requirement of the donor.

Endowment assets include donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period. Dignity Health preserves the fair value of these gifts as of the date of donation unless otherwise stipulated by the donor. The portion of donor-restricted endowment funds that are not classified in permanently restricted net assets are classified as temporarily restricted net assets until those amounts are appropriated for expenditure. Dignity Health considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund, (2) the purposes of the organization and the donor-restricted endowment fund, (3) general economic conditions, (4) the possible effect of inflation and deflation, (5) the expected total return

from income and the appreciation of investments, (6) other resources of the organization, and (7) the investment policies of Dignity Health.

Dignity Health has investment and spending policies for endowment assets designed to provide a predictable stream of funding to programs supported by its endowments while seeking to maintain the purchasing power of the endowment assets.

Endowment assets are invested in a manner that is intended to produce results that achieve the respective benchmark while assuming a moderate level of investment risk. Actual returns in any given year may vary from this amount. To satisfy its long-term rate-of-return objectives, Dignity Health relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). Dignity Health targets a diversified asset allocation to achieve its long-term return objectives within prudent risk constraints.

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that Dignity Health is required to retain as a fund of perpetual duration. Deficits of this nature are reported in unrestricted net assets, unless otherwise specified by the donor.

Community Benefits – As part of its mission, Dignity Health provides services to the poor and benefits for the broader community. The costs incurred to provide such services are included in excess of revenues over expenses in the consolidated statements of operations and changes in net assets. Dignity Health prepares a summary of unsponsored community benefit expense in accordance with Internal Revenue Service Form 990, Schedule H, and the Catholic Health Association of the United States (“CHA”) publication, *A Guide for Planning and Reporting Community Benefit*. See Note 4.

Interest Expense – Interest expense on debt issued for construction projects is capitalized until the projects are placed in service. The components of interest expense, net, include the following (in thousands):

	2012	2011
Interest and fees on debt and swap cash settlements	\$ 204,027	\$ 217,720
Market adjustment on swaps and amortization of amounts in unrestricted net assets	<u>120,041</u>	<u>(40,983)</u>
Total interest expense	324,068	176,737
Capitalized interest expense	<u>(30,158)</u>	<u>(20,209)</u>
Interest expense, net	<u>\$ 293,910</u>	<u>\$ 156,528</u>

Income Taxes – Dignity Health has established its status as an organization exempt from income taxes under the Internal Revenue Code Section 501(c)(3) and the laws of the states in which it operates. Certain subsidiaries are subject to income taxes; such amounts are not significant to the consolidated financial statements.

Performance Indicator – Management considers excess of revenues over expenses to be Dignity Health’s performance indicator. Excess of revenues over expenses includes all changes in unrestricted net assets except for the effect of changes in accounting principles, losses from discontinued operations, changes in net unrealized gains and losses on available-for-sale investments, net assets released from restrictions used for purchase of property and equipment, change in funded status of pension and other postretirement benefit plans, change in noncontrolling interest in health-related activities, change in accumulated unrealized derivative gains and losses, and funds donated from unconsolidated sources for purchase of property and equipment.

Transactions between Related Organizations – Certain Obligated Group members have a policy whereby assets are periodically transferred as charitable distributions to nonprofit corporations that are subordinate corporations of Dignity Health but are not members of the Obligated Group. The subordinate corporations

conduct charitable healthcare, educational and religious activities and support subordinate nonprofit healthcare organizations. These transfers are accounted for as direct charges to the Obligated Group members' unrestricted net assets and direct credits to the subordinate corporations' unrestricted net assets. It is anticipated that Obligated Group members will continue to make asset transfers to the subordinate corporations.

Recent Accounting Pronouncements – In December 2011, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2011-11, *Balance Sheet (Topic 210), Disclosures about Offsetting Assets and Liabilities* (“ASU 2011-11”). The amendments in ASU 2011-11 require entities to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The disclosure requirements of ASU 2011-11, which are to be applied retrospectively, are effective for Dignity Health as of July 1, 2013. The adoption of ASU 2011-11 is not expected to have a material impact on the consolidated financial statements of Dignity Health.

In September 2011, the FASB issued Accounting Standards Update (“ASU”) No. 2011-08, *Testing Goodwill for Impairment* (“ASU 2011-08”). The objective of ASU 2011-08 is to simplify how entities test goodwill for impairment. The update permits entities to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The provisions of ASU 2011-08, which are to be applied prospectively, are effective for Dignity Health as of July 1, 2012. The adoption of ASU 2011-08 is not expected to have a material impact on the consolidated financial statements of Dignity Health.

In July 2011, the FASB issued ASU No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* (“ASU 2011-07”) which amended Accounting Standards Codification (“ASC”) No. 954, *Health Care Entities* (“ASC 954”) to provide greater transparency regarding a health care entity’s net patient revenue and the related allowance for doubtful accounts. ASU 2011-07 requires certain health care entities to change the presentation of the provision for bad debts associated with patient service revenue by reclassifying the provision from operating expenses to a deduction from net patient revenue and requires enhanced disclosures about net patient revenue and the policies for recognizing revenue and assessing bad debts. The adoption of ASU 2011-07 is effective for Dignity Health beginning July 1, 2012. The adoption of ASU 2011-07 is not expected to have a material impact on Dignity Health’s consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (“ASU 2011-04”), which amended ASC No. 820, *Fair Value Measurement* (“ASC 820”) to change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. Dignity Health adopted the provisions of ASU 2011-04 beginning January 1, 2012. The adoption of ASU 2011-04 did not have a material impact on Dignity Health’s consolidated financial statements.

In August 2010, the FASB issued ASU No. 2010-23, *Health Care Entities (Topic 954), Measuring Charity Care for Disclosure* (“ASU 2010-23”), which requires that cost be used as a measurement for charity care disclosure purposes and that cost be identified as the direct and indirect costs of providing the charity care. It also requires disclosure of the method used to identify or determine such costs. Dignity Health adopted the provisions of ASU 2010-23 beginning July 1, 2011. The adoption of ASU 2010-23 did not have a material impact on Dignity Health’s consolidated financial statements.

Subsequent Events –Dignity Health has evaluated subsequent events occurring between the end of the most recent fiscal year and September 25, 2012, the date the financial statements were available to be issued. See Note 3.

3. MERGERS, ACQUISITIONS AND DIVESTITURES

In June 2012, Dignity Health and its wholly-owned subsidiary Saint Mary's Multi-Specialty Clinic, Inc. (dba, Saint Mary's Medical Group) sold substantially all of the land, buildings, equipment, inventory and certain other property of Saint Mary's Regional Medical Center, a 380-bed hospital, and the operations of Saint Mary's Medical Group, both in Reno, Nevada, to an unrelated party for \$50.0 million and the assumption of certain lease obligations pursuant to an asset purchase agreement. Property value adjustments were recorded in loss from discontinued operations in the statements of operations and changes in net assets when the assets were recorded as held for sale and a loss of approximately \$1.0 million was recorded upon closure of the sale. As a result of the sale, approximately \$94.0 million in outstanding tax-exempt debt will require remediation within 90 days of the closure of the sale. Proceeds from the sale will be used to legally defease \$42.1 million of outstanding bond obligations to the first call date. This satisfies the remediation requirement. The remaining bonds will remain subject to their original maturity date.

The accompanying consolidated statements of operations and changes in net assets reflect the results of the operations of facilities sold, closed or held for sale as discontinued operations for all periods presented, including revenues of \$301.5 million and \$288.1 million for 2012 and 2011, respectively.

In August 2012, Dignity Health acquired all of the common stock of USHW Holdings Corporation (dba U.S. HealthWorks), a multi-state for-profit operator of occupational health and urgent care centers, for \$455.0 million in cash and additional contingent consideration. Dignity Health will account for the transaction using the acquisition method with the fair value of all assets and liabilities of U.S. HealthWorks as of the transaction date being recorded. The results of operations of U.S. HealthWorks will be included in Dignity Health's consolidated financial statements from the date of the acquisition. Dignity Health is still assessing the initial accounting of certain assets acquired and liabilities assumed and expects to complete this assessment during the first quarter of fiscal 2013. In connection with the acquisition, U.S. HealthWorks' subsidiaries became indirect subsidiaries of Dignity Health. These subsidiaries operate approximately 174 occupational health and urgent care centers in 15 states. Dignity Health management anticipates that earnings from U.S. HealthWorks will be accretive to Dignity Health.

4. UNSPONSORED COMMUNITY BENEFIT EXPENSE (UNAUDITED)

Un-sponsored community benefits are programs or activities that provide treatment and/or promote health and healing as a response to identified community needs. These benefits (a) generate a low or negative margin, (b) respond to the needs of special populations, such as persons living in poverty and other disenfranchised persons, (c) supply services or programs that would likely be discontinued, or would need to be provided by another nonprofit or government provider, if the decision was made on a purely financial basis, (d) respond to public health needs, and/or (e) involve education or research that improves overall community health.

Benefits for the Poor include services provided to persons who are economically poor or are medically indigent and cannot afford to pay for healthcare services because they have inadequate resources and/or are uninsured or underinsured.

Benefits for the Broader Community refer to persons in the general communities that Dignity Health serves, beyond and including those in a target population. Most services for the broader community are aimed at improving the health and welfare of the overall community. Such services include the interest rate differential on below market rate loans that Dignity Health makes to nonprofit community-based organizations that promote the total health of their communities, including the development of affordable housing for low-income persons and families, increasing opportunities for jobs and job training, and expanding access to healthcare for uninsured and underinsured persons. As of June 30, 2012 and 2011, Dignity Health's community investment loan portfolio totaled \$39.6 million and \$38.7 million, respectively, which is included in other assets limited as to use.

Traditional Charity Care is free or discounted health services provided to persons who cannot afford to pay and who meet Dignity Health's criteria for financial assistance. The comparable cost of traditional charity care was \$152.6 million for 2011, which includes discontinued operations.

Net Community Benefit, excluding the unpaid cost of Medicare, is the total cost incurred after deducting direct offsetting revenue from government programs, patients, and other sources of payment or reimbursement for services provided to program patients. Including discontinued operations, the comparable amount of net community benefit was \$947.1 million for 2011, and Net Community Benefit including the unpaid cost of Medicare was \$1.4 billion for 2011.

The following is a summary of Dignity Health's community benefits for 2012, in terms of services to the poor and benefits for the broader community, which has been prepared in accordance with Internal Revenue Service Form 990, Schedule H and the CHA publication, *A Guide for Planning and Reporting Community Benefit* (dollars in thousands):

	Unaudited				% of Total Expenses Excluding Bad Debt Expense
	Persons Served	Total Benefit Expense	Direct Offsetting Revenue	Net Community Benefit	
Benefits for the poor:					
Traditional charity care	108,530	\$ 189,101	\$ (721)	\$ 188,380	2.0%
Unpaid costs of Medicaid / Medi-Cal	1,060,508	2,260,680	(1,689,189)	571,491	6.0%
Other means-tested programs	280,517	103,364	(37,297)	66,067	0.7%
Community services:					
Community health services	525,831	55,530	(2,063)	53,467	0.6%
Health professions education	86	27	-	27	0.0%
Subsidized health services	193,751	32,386	(4,089)	28,297	0.3%
Donations	155,219	33,376	(236)	33,140	0.3%
Community building activities	12,811	2,961	(1,338)	1,623	0.0%
Community benefit operations	3,884	8,911	-	8,911	0.1%
Total community services for the poor	<u>891,582</u>	<u>133,191</u>	<u>(7,726)</u>	<u>125,465</u>	<u>1.3%</u>
Total benefits for the poor	<u>2,341,137</u>	<u>2,686,336</u>	<u>(1,734,933)</u>	<u>951,403</u>	<u>10.0%</u>
Benefits for the broader community:					
Community services:					
Community health services	585,949	22,546	(5,512)	17,034	0.2%
Health professions education	68,974	78,752	(9,620)	69,132	0.7%
Subsidized health services	9,430	3,182	(972)	2,210	0.0%
Research	26,281	30,097	(48)	30,049	0.3%
Donations	165,149	7,611	(27)	7,584	0.1%
Community building activities	38,641	3,146	(8)	3,138	0.0%
Community benefit operations	87	1,469	(23)	1,446	0.0%
Total benefits for the broader community	<u>894,511</u>	<u>146,803</u>	<u>(16,210)</u>	<u>130,593</u>	<u>1.3%</u>
Total Community Benefits	<u>3,235,648</u>	<u>\$ 2,833,139</u>	<u>\$ (1,751,143)</u>	<u>\$ 1,081,996</u>	<u>11.3%</u>
Unpaid costs of Medicare	<u>1,116,214</u>	<u>2,604,316</u>	<u>(2,084,335)</u>	<u>519,981</u>	<u>5.4%</u>
Total Community Benefits including unpaid costs of Medicare	<u>4,351,862</u>	<u>\$ 5,437,455</u>	<u>\$ (3,835,478)</u>	<u>\$ 1,601,977</u>	<u>16.7%</u>

5. OTHER CURRENT ASSETS

Other current assets consist of the following at June 30, 2012 and 2011 (in thousands):

	2012	2011
Inventories	\$ 158,711	\$ 159,362
Receivables, other than patient accounts receivable	217,310	168,713
Provider fee receivables	345,018	-
Prepaid expenses	62,544	60,552
Deferred provider fee expense	-	126,363
Deposits	2,592	2,789
Other	29,457	25,157
Total other current assets	<u>\$ 815,632</u>	<u>\$ 542,936</u>

6. INVESTMENTS AND ASSETS LIMITED AS TO USE

Investments and assets limited as to use, including assets loaned under securities lending program, consist of the following at June 30, 2012 and 2011 (in thousands):

	2012	2011
Cash and cash equivalents	\$ 769,674	\$ 579,206
U.S. government securities	553,912	903,488
U.S. corporate bonds	758,443	636,035
U.S. equity securities	1,480,663	1,666,690
Foreign government securities	169,541	243,329
Foreign corporate bonds	39,430	7,369
Foreign equity securities	459,875	400,339
Asset-backed securities	16,656	36,938
Structured debt	187,779	105,106
Private equity investments	128,358	102,944
Multi-strategy hedge fund investments	485,498	107,889
Real estate	181,395	162,624
Other	202,462	96,881
Interest in net assets of unconsolidated foundations	222,458	222,943
Total	<u>\$ 5,656,144</u>	<u>\$ 5,271,781</u>
Assets limited as to use:		
Current	\$ 1,242,277	\$ 828,632
Long-term	3,481,003	3,617,300
Short-term investments	932,864	825,849
Total	<u>\$ 5,656,144</u>	<u>\$ 5,271,781</u>

The current portion of assets limited as to use includes the amount of assets available to meet current obligations for debt service and claims payments under the self-insured programs for workers' compensation for employees and hospital professional and general liability.

Investment income and losses on assets limited as to use, cash equivalents, collateral held under securities lending program, notes receivable, and investments are comprised of the following for 2012 and 2011 (in thousands):

	2012	2011
Interest and dividend income	\$ 115,143	\$ 116,115
Net realized gains on sales of securities	226,157	180,735
Net unrealized gains (losses) on securities	(239,124)	442,609
Investment related fees and other, net of capitalized investment income	<u>(28,739)</u>	<u>(21,608)</u>
Total investment income, net	<u><u>\$ 73,437</u></u>	<u><u>\$ 717,851</u></u>

7. FAIR VALUE MEASUREMENTS

Dignity Health accounts for certain assets and liabilities at fair value or on a basis that approximates fair value. A fair value hierarchy for valuation inputs prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels and is determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1: Quoted prices are available in active markets for identical assets or liabilities as of the measurement date. Financial assets and liabilities in Level 1 include U.S. Treasury securities and listed equities.

Level 2: Pricing inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in this category generally include asset-backed securities, corporate bonds and loans, municipal bonds, and interest rate swaps.

Level 3: Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of fair value require management's judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques. Financial assets in this category include alternative investments.

The following represents assets and liabilities measured at fair value on a recurring basis and certain assets accounted for under the equity method as of June 30, 2012 and 2011 (in thousands):

	Fair Value Measurements at June 30, 2012 Using			
	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance at June 30, 2012
Assets				
Cash and cash equivalents	\$ 769,674	\$ -	\$ -	\$ 769,674
U.S. government securities	477,067	76,845	-	553,912
U.S. corporate bonds	61,861	546,359	150,223	758,443
U.S. equity securities	1,143,398	337,265	-	1,480,663
Foreign government securities	19	169,522	-	169,541
Foreign corporate bonds	5,129	34,301	-	39,430
Foreign equity securities	459,778	97	-	459,875
Asset-backed securities	-	16,656	-	16,656
Structured debt	-	187,779	-	187,779
Private equity investments	-	-	128,358	128,358
Multi-strategy hedge fund investments	-	-	485,498	485,498
Real estate	7,637	-	173,758	181,395
Collateral held under securities lending program	-	335,968	-	335,968
Other fund investments	7,851	-	-	7,851
Total assets	<u>\$ 2,932,414</u>	<u>\$ 1,704,792</u>	<u>\$ 937,837</u>	<u>\$ 5,575,043</u>
Liabilities				
Derivative instruments	<u>\$ -</u>	<u>\$ 228,052</u>	<u>\$ -</u>	<u>\$ 228,052</u>

**Fair Value Measurements at June 30, 2011 Using
Quoted Prices**

	in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Balance at June 30, 2011
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Assets				
Cash and cash equivalents	\$ 579,206	\$ -	\$ -	\$ 579,206
U.S. government securities	392,981	510,507	-	903,488
U.S. corporate bonds	62,061	573,974	-	636,035
U.S. equity securities	1,461,940	204,750	-	1,666,690
Foreign government securities	5,896	237,433	-	243,329
Foreign corporate bonds	-	7,369	-	7,369
Foreign equity securities	400,339	-	-	400,339
Asset-backed securities	-	36,938	-	36,938
Structured debt	-	105,106	-	105,106
Private equity investments	-	-	102,944	102,944
Multi-strategy hedge fund investments	-	-	107,889	107,889
Real estate	6,805	-	155,819	162,624
Collateral held under securities lending program	-	290,526	-	290,526
Other fund investments	8,724	-	-	8,724
Total assets	<u><u>\$ 2,917,952</u></u>	<u><u>\$ 1,966,603</u></u>	<u><u>\$ 366,652</u></u>	<u><u>\$ 5,251,207</u></u>
Liabilities				
Derivative instruments	<u><u>\$ -</u></u>	<u><u>\$ 110,694</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 110,694</u></u>

Assets and liabilities measured at fair value on a recurring basis and certain assets accounted for under the equity method are reported in short-term investments, assets limited as to use, and other accrued liabilities in the consolidated balance sheet. Such amounts do not include certain restricted receivables and interests in unconsolidated foundations recorded in assets limited as to use.

Dignity Health's policy is to recognize transfers to or from Levels 1, 2 or 3 within the fair value hierarchy as of the beginning of the period. There were no significant transfers to or from Levels 1 or 2 during the periods presented.

The Level 2 and 3 instruments listed in the fair value hierarchy tables above use the following valuation techniques and inputs:

For marketable securities such as U.S. and foreign government securities, U.S. and foreign corporate bonds, U.S. and foreign equity securities, asset-backed securities, and structured debt, in the instances where identical quoted market prices are not readily available, fair value is determined using quoted market prices and/or other market data for comparable instruments and transactions in establishing prices, discounted cash flow models and other pricing models. These inputs to fair value are included in industry-standard valuation techniques such as the income or market approach. Dignity Health classifies all such investments as Level 2.

For investments such as private equity funds, multi-strategy hedge funds, real estate funds, and other limited partnership investments, fair value is determined using the calculated net asset value ("NAV") provided by the fund. The value of underlying investments of private equity funds are estimated based on recent filings, operating results, balance sheet stability, growth, and other business and market sector fundamentals. Real estate investments are priced using valuation techniques that include income,

market, and cost approaches. Significant inputs include contract and market rents, operating expenses, capitalization rates, discount rates, sales of comparable properties, and market rent growth trends, as well as the use of the value of property plus the cost of building a similar structure of equal utility. Hedge funds and other limited partnership investments typically value underlying securities traded on a national securities exchange or reported on a national market at the last reported sales price on the day of the valuation. Underlying securities traded in the over-the-counter market and listed securities for which no sale was reported on the valuation date are typically valued at the mean between representative bid and ask quotes obtained. Where no fair value is readily available, the fund or investment manager may determine, in good faith, the fair value using models that take into account relevant information considered material. Due to the significant unobservable inputs present in these valuations, Dignity Health classifies all such investments as Level 3. Dignity Health's management regularly monitors and evaluates the accounting and valuation methodologies of the investment managers. Management also performs, on a regular basis when information is made available, various validations and testing of the NAV provided and determines that the investment managers' valuation techniques are compliant with fair value measurement accounting standards. Significant increases (decreases) in any unobservable inputs used for Level 3 holdings, in isolation, would result in significantly lower (higher) fair value measurement.

The fair value of collateral held under securities lending program classified as Level 2 is determined using the calculated NAV. The collateral held under this program is placed in commingled funds whose underlying investments are valued using techniques similar to those used for the marketable securities noted above. Amounts reported do not include non-cash collateral of \$17.3 million and \$23.7 million as of June 30, 2012 and 2011, respectively.

The fair value of liabilities for derivative instruments such as interest rate swap instruments classified as Level 2 is determined using an industry standard valuation model, which is based on a market approach. A credit risk spread (in basis points) is added as a flat spread to the discount curve used in the valuation model. Each leg is discounted and the difference between the present value of each leg's cash flows equals the market value of the swap.

The fair value of liabilities for derivative instruments such as risk participation agreements classified as Level 3 is determined using the market value of the referenced securities in the agreements, which factors in the credit risk of the issuer.

The following table presents the change in the balance of financial assets and liabilities using significant unobservable inputs (Level 3) measured on a recurring basis and certain assets accounted for under the equity method in 2012 and 2011 (in thousands):

	2012				
	Private Equity Investments	Multi-Strategy Hedge Fund Investments	Real Estate	Debt Securities	Total
Balance at beginning of period	\$ 102,944	\$ 107,889	\$ 155,819	\$ -	\$ 366,652
Total realized gains, net, included in excess of revenues over expenses	1,207	2,316	-	-	3,523
Total unrealized gains, net, included in excess of revenues over expenses	4,016	14,026	10,993	7,610	36,645
Purchases, issuances, sales and settlements					
Purchases	32,606	474,808	6,946	143,280	657,640
Sales	(12,415)	(113,541)	-	(667)	(126,623)
Balance at June 30	<u>\$ 128,358</u>	<u>\$ 485,498</u>	<u>\$ 173,758</u>	<u>\$ 150,223</u>	<u>\$ 937,837</u>

	2011				
	Multi-Strategy				Total
	Private Equity Investments	Hedge Fund Investments	Real Estate	Debt Securities	
Balance at beginning of period	\$ 83,344	\$ 152,272	\$ 128,509	\$ -	\$ 364,125
Total realized gains, net, included in excess of revenues over expenses	976	10,870	-	-	11,846
Total unrealized gains, net, included in excess of revenues over expenses	10,702	1,881	27,310	-	39,893
Purchases, issuances, sales and settlements					
Purchases	18,068	89,563	-	-	107,631
Sales	(10,146)	(146,697)	-	-	(156,843)
Balance at June 30	<u>\$ 102,944</u>	<u>\$ 107,889</u>	<u>\$ 155,819</u>	<u>\$ -</u>	<u>\$ 366,652</u>

Included within the assets above are investments in certain entities that report fair value using a calculated NAV or its equivalent. The following table and explanations identify attributes relating to the nature and risk of such investments as of June 30, 2012 and 2011 (in thousands):

		As of June 30, 2012			
		Fair Value	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period
<u>Level 2</u>					
Debt securities	(1)	\$ 171,717	\$ -	Daily, Quarterly	1 - 90 days
Equity securities	(2)	335,879	-	Daily, Monthly	1 - 30 days
Collateral held under securities lending	(3)	<u>335,968</u>	-	Daily	10 days
Total Level 2		<u>\$ 843,564</u>	<u>\$ -</u>		
<u>Level 3</u>					
Multi-strategy hedge funds	(4)	\$ 485,498	\$ -	Monthly, Quarterly, Semi-Annually, Annually	5 - 370 days
Private equity	(5)	128,358	136,005	-	-
Real estate	(6)	173,758	-	Quarterly	90 days
Debt securities	(7)	<u>150,223</u>	<u>16,145</u>	Quarterly	90 days
Total Level 3		<u>937,837</u>	<u>152,150</u>		
Total Level 2 and Level 3		<u>\$ 1,781,401</u>	<u>\$ 152,150</u>		

As of June 30, 2011					
	Fair Value	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Period	
<u>Level 2</u>					
Debt securities	(1) \$ 202,794	\$ -	Daily, Semi-Monthly	1 - 5 days	
Equity securities	(2) 203,352	-	Daily, Semi-Monthly, Monthly	1 - 30 days	
Collateral held under securities lending	(3) <u>290,526</u>	<u>-</u>	Daily	10 days	
Total Level 2	<u>\$ 696,672</u>	<u>\$ -</u>			
<u>Level 3</u>					
Multi-strategy hedge funds	(4) \$ 107,889	\$ -	Quarterly, Semi-Annually, Annually	65 - 370 days	
Private equity	(5) 102,944	116,595	-	-	
Real estate	(6) <u>155,819</u>	<u>-</u>	Quarterly	90 days	
Total Level 3	<u>366,652</u>	<u>116,595</u>			
Total Level 2 and Level 3	<u>\$ 1,063,324</u>	<u>\$ 116,595</u>			

- (1) This category includes investments in commingled funds that invest primarily in domestic and foreign debt and fixed income securities, the majority of which are traded in over-the-counter markets.
- (2) This category includes investments in commingled funds that invest primarily in domestic or foreign equity securities with multiple investment strategies. A majority of the funds attempt to match the returns of specific equity indices.
- (3) This category includes investments of collateral held under securities lending program. Dignity Health participates in a securities lending program administered by its custodian as a means to augment income from its portfolio. Securities are loaned to select brokerage firms who in turn post collateral. The collateral is placed in commingled funds that invest primarily in cash and cash equivalents, and domestic and foreign debt securities. The collateral pool is allocated between two separate pools. While Dignity Health can fully withdraw from the program at any time, the redemption conditions differ. For the "duration pool", which represents approximately 3.7% of the value of this category at June 30, 2012, Dignity Health can fully withdraw from the program, but in return can only receive a proportional distribution of the investments held by the collateral lending fund. For the "liquidity pool", which represents approximately 96.3% of the value of this category at June 30, 2012, no such redemption restrictions are applicable. The cash flow maturity schedule provided by the custodian anticipates that the cash collateral in the duration pool will fully mature and become available through December 2012, with a de minimis amount remaining in the duration pool thereafter.

- (4) This category includes investments in hedge funds that pursue diversification of both domestic and foreign fixed income and equity securities through multiple investment strategies. The primary objective for these funds is to seek attractive long-term risk-adjusted absolute returns. Under certain circumstances, an otherwise redeemable investment or portion thereof could become restricted. Such restrictions were not applicable at June 30, 2012. The following table reflects the various redemption frequencies, notice periods required, and any applicable lock-up periods or gates to redemption as of June 30, 2012:

Percentage of the Value of Category (4)		Redemption Frequency	Redemption Notice Period	Redemption Locked Up Until (if applicable)	Redemption Gate % of Account (if applicable)
Total	Subtotal				
27.7%	9.5%	Annually	45 - 90 days	-	-
	9.1%	Annually	45 - 75 days	3/31/2013 to 12/31/2014	-
	9.1%	Annually	60 - 65 days		up to 33.3% - 50.0%
5.3%	5.3%	Semi-Annually	75 - 90 days	-	-
43.4%	19.9%	Quarterly	30 - 370 days	-	-
	8.8%	Quarterly	90 days	7/1/2012 to 7/1/2013	-
	14.7%	Quarterly	45 - 90 days	-	up to 25.0% - 33.3%
23.6%	13.6%	Monthly	5 - 60 days	-	-
	5.0%	Monthly	120 days	until 8/31/2012	-
	5.0%	Monthly	45 days	-	up to 16.7%

- (5) This category includes several private equity funds that specialize in providing capital to a variety of investment groups, including but not limited to venture capital, leveraged buyout, mezzanine debt, distressed debt, and other situations. There are no provisions for redemptions during the life of these funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated, estimated at June 30, 2012, to be over the next 2-12 years.
- (6) This category includes an open-ended real estate fund that invests primarily in institutional quality commercial and residential real estate assets within the United States.
- (7) This category includes a commingled fund that invests primarily in a fixed income fund that provides capital in a variety of mezzanine debt, distressed debt, and other special debt securities situations.

The investments included above are not expected to be sold at amounts that are different from NAV.

8. PROPERTY AND EQUIPMENT, NET

Property and equipment, net, consist of the following at June 30, 2012 and 2011 (in thousands):

	2012	2011
Land	\$ 220,006	\$ 223,873
Land improvements	110,274	114,379
Buildings	4,474,792	4,371,353
Equipment	3,394,346	3,265,014
Construction in progress	711,418	619,223
Total	8,910,836	8,593,842
Less: Accumulated depreciation	(4,694,266)	(4,491,291)
Property and equipment, net	<u>\$ 4,216,570</u>	<u>\$ 4,102,551</u>

9. OTHER LONG-TERM ASSETS, NET

Other long-term assets, net, consist of the following at June 30, 2012 and 2011 (in thousands):

	2012	2011
Notes receivable, primarily secured	\$ 35,353	\$ 42,371
Deferred financing costs, net	28,804	27,924
Goodwill	123,013	95,549
Other	52,157	30,319
Total other long-term assets, net	<u>\$ 239,327</u>	<u>\$ 196,163</u>

10. OWNERSHIP INTERESTS IN HEALTH-RELATED ACTIVITIES

Dignity Health's consolidated investments in health-related activities recorded net changes in noncontrolling interests related to revenues, expenses, gains, and losses of \$21.2 million and \$24.1 million in purchased services and other in the consolidated statements of operations and changes in net assets for 2012 and 2011, respectively.

Additional goodwill of \$27.5 million and \$13.3 million was recorded in 2012 and 2011, respectively, related to the acquisition of interests in health-related organizations. No goodwill impairment was recorded during 2012 and 2011.

Dignity Health has significant ownership interests in three health-related activities, as further described below, that are accounted for under the equity method and reflected in the accompanying balance sheet in ownership interests in health-related activities:

- Dignity Health and Scripps Health ("Scripps") entered into an affiliation agreement in August 1995 to enhance their mutual ability to serve the San Diego community. Through the affiliation, Dignity Health transferred the sole voting membership of one of its subordinate corporations, Mercy Healthcare San Diego ("MHSD") to Scripps, along with the responsibility for its operation and governance. MHSD's principal activity is the operation of a hospital and a network of clinics.

Pursuant to the affiliation agreement, among other things, Dignity Health obtained the right to receive a 20% interest in the annual change in unrestricted net assets of Scripps and the right to 20% of the net proceeds, with certain restrictions, upon the liquidation of Scripps. Twenty percent of the members of the Scripps Board of Directors are elected from nominees proposed by Dignity Health.

- Dignity Health and Carondelet Health Network (now a member of Ascension Health) entered into an affiliation agreement in June 1985 by which each affiliate made a 50% investment in Southwest Catholic Healthcare Network, dba Mercy Care Plan. Mercy Care Plan operates a health plan for Arizona's Medicaid program, Arizona Health Care Cost Containment System, with approximately 342,100 enrollees. Mercy Care Plan classifies its investment portfolio as available-for-sale.
- Dignity Health transferred and contributed to Phoenix Children's Hospital, Inc., ("PCH"), an Arizona nonprofit corporation, substantially all of the pediatric program services and related assets of its facility in Phoenix, Arizona in June 2011. Pursuant to the transaction, Dignity Health obtained 20% of the outstanding membership interests of PCH. Dignity Health recorded a gain on the transaction of \$47.3 million in 2011, which is recorded in other operating revenue in the accompanying consolidated statements of operations and changes in net assets.

The following table summarizes the financial position and results of operations for the health-related organizations discussed above which are accounted for under the equity method, as of and for the 12 months ended June 30, 2012 and 2011 (in thousands):

	2012			2011		
	Phoenix			Phoenix		
	Scripps Health	Children's Hospital	Mercy Care Plan	Scripps Health	Children's Hospital	Mercy Care Plan
Total assets	\$ 3,399,377	\$ 973,856	\$ 387,135	\$ 2,914,536	\$ 946,694	\$ 434,750
Total liabilities	1,324,728	746,736	206,551	1,035,234	641,960	246,637
Total net assets	2,074,649	227,120	180,584	1,879,302	304,734	188,113
Total revenues, net	2,445,881	580,083	1,741,353	2,596,459	434,472	1,930,479
Excess of revenues over expenses	184,025	(81,770)	28,339	377,266	21,685	57,688
Investment at June 30 recorded in ownership interests in health- related activities	375,253	31,960	92,292	334,244	48,180	94,057
Income recorded in revenue from health-related activities, net	\$ 41,009	\$ (16,220)	\$ 14,169	\$ 79,739	\$ -	\$ 29,134

11. OTHER ACCRUED LIABILITIES

Other accrued liabilities, net, consist of the following at June 30, 2012 and 2011 (in thousands):

	2012	2011
Accrued interest expense	\$ 75,610	\$ 82,690
Deferred provider fee revenue	-	185,280
Provider fee and CHFT grant payables	211,489	-
Derivative liabilities	228,052	110,694
Other	176,814	199,315
Total other accrued liabilities	<u>\$ 691,965</u>	<u>\$ 577,979</u>

12. RETIREMENT AND POSTRETIREMENT BENEFIT PLANS

Dignity Health maintains defined benefit pension plans that cover substantially all eligible employees. Benefits are generally based on age, years of service and employee compensation. Dignity Health also offers postretirement healthcare benefits to most of its employees. For the majority of covered employees, the benefits are determined based on age, years of service and compensation up to specified amounts.

The plans are actuarially evaluated and involve various assumptions. These assumptions include the discount rate and the expected rate of return on plan assets (for pension), which are important elements of expense and liability measurement. Other assumptions involve demographic factors such as retirement age, mortality, turnover and the rate of compensation increases. Dignity Health evaluates assumptions annually and modifies them as appropriate. Pension costs and postretirement costs are allocated over the service period of the employees in the plans. The principle underlying this accounting is that employees render service ratably over the period and, therefore, the effects in the consolidated statements of operations and changes in net assets follow the same pattern.

Contributions to the defined benefit pension plans are based on actuarially determined amounts sufficient to meet the benefits to be paid to plan participants. Management believes these plans qualify under a Church Plan Exemption, and as such are not subject to Employee Retirement Income Security Act (“ERISA”) funding requirements. Dignity Health’s funding policy requires that, at a minimum, contributions equal the unfunded normal cost plus amortization of any unfunded actuarial accrued liability. Contributions to these plans are anticipated at \$305.5 million in 2013.

During 2011, Dignity Health amended the pension plans resulting in a lower benefit obligation as of June 30, 2011 and 2012, and also lower expense in future years. The most significant provisions include freezing certain ongoing final average pay formulas and replacing them with cash balance formulas, freezing certain past service benefits for employees already in cash balance formulas, modifying the cash balance interest crediting rate, and updating the actuarial equivalence definitions and methodology.

The accumulated benefit obligation exceeds plan assets for each of the defined benefit plans and postretirement benefit plans for the years ended June 30, 2012 and 2011. The following summarizes the benefit obligations and funded status for the defined benefit pension and postretirement benefit plans for 2012 and 2011 (in thousands):

	2012		2011	
	Retirement Plans	Other Benefit Plans	Retirement Plans	Other Benefit Plans
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 3,034,443	\$ 115,694	\$ 2,757,644	\$ 102,270
Service cost	198,135	6,287	183,712	6,031
Interest cost	176,514	6,412	163,438	5,497
Plan changes/amendments	2,366	-	(169,648)	1,190
Actuarial loss	415,947	-	191,822	5,870
Acquisitions and other	-	-	(5,856)	-
Administrative expenses	(20,284)	-	(14,930)	-
Benefits paid	(83,170)	(5,842)	(71,739)	(5,164)
Benefit obligation at end of year	<u>\$ 3,723,951</u>	<u>\$ 122,551</u>	<u>\$ 3,034,443</u>	<u>\$ 115,694</u>
Accumulated benefit obligation	<u>\$ 3,354,957</u>	<u>\$ 122,551</u>	<u>\$ 2,644,136</u>	<u>\$ 115,694</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ 2,276,324	\$ -	\$ 1,677,799	\$ -
Actual return on plan assets	(10,887)	-	419,022	-
Employer contributions	278,153	5,842	270,228	5,164
Benefits paid	(83,170)	(5,842)	(71,739)	(5,164)
Acquisitions and other	-	-	(4,056)	-
Administrative expenses	(20,284)	-	(14,930)	-
Fair value of plan assets at end of year, net	<u>\$ 2,440,136</u>	<u>\$ -</u>	<u>\$ 2,276,324</u>	<u>\$ -</u>
Funded status	<u>\$ (1,283,815)</u>	<u>\$ (122,551)</u>	<u>\$ (758,119)</u>	<u>\$ (115,694)</u>

The following table summarizes the amounts recognized in unrestricted net assets as of June 30, 2012 and 2011 (in thousands):

	2012		2011	
	Retirement Plans	Other Benefit Plans	Retirement Plans	Other Benefit Plans
Net actuarial loss	\$ 1,423,761	\$ 6,329	\$ 853,992	\$ 6,456
Prior service cost (credit)	(159,126)	39,239	(178,228)	45,272
Amounts in unrestricted net assets	<u>\$ 1,264,635</u>	<u>\$ 45,568</u>	<u>\$ 675,764</u>	<u>\$ 51,728</u>

The estimated net loss and prior service credit for the pension plans and postretirement plans that will be amortized from unrestricted net assets into net periodic benefit cost in 2013 are \$92.2 million and \$10.5 million, respectively.

Current pension and other postretirement liabilities reflect amounts expected to be funded in the following year. The following table summarizes the amounts recognized in the consolidated balance sheets as of June 30, 2012 and 2011 (in thousands):

	2012		2011	
	Retirement Plans	Other Benefit Plans	Retirement Plans	Other Benefit Plans
Current liabilities	\$ (306,330)	\$ (8,563)	\$ (267,374)	\$ (7,718)
Long-term liabilities	(977,485)	(113,988)	(490,745)	(107,976)
Accrued benefit cost	<u>\$ (1,283,815)</u>	<u>\$ (122,551)</u>	<u>\$ (758,119)</u>	<u>\$ (115,694)</u>

The following table summarizes the weighted-average assumptions used to determine benefit obligations as of June 30, 2012 and 2011 (dollars in thousands):

	2012		2011	
	Retirement Plans	Other Benefit Plans	Retirement Plans	Other Benefit Plans
To determine benefit obligations:				
Discount rate	5.00%	5.70%	5.90%	5.70%
Rate of compensation increase	4.13%	5.25%	5.25%	5.25%
To determine net periodic benefit cost:				
Discount rate	5.90%	5.70%	6.00%	5.50%
Expected return on plan assets	8.00%	N/A	7.50%	N/A
Rate of compensation increase	5.25%	5.25%	5.25%	5.25%

The following table summarizes the components of net periodic cost recognized in the consolidated statements of operations and changes in net assets for 2012 and 2011 (in thousands):

	2012		2011	
	Retirement Plans	Other Benefit Plans	Retirement Plans	Other Benefit Plans
Service cost	\$ 198,135	\$ 6,287	\$ 183,712	\$ 6,031
Interest cost	176,514	6,412	163,438	5,497
Expected return on plan assets	(188,823)	-	(133,205)	-
Net prior service cost (credit) amortization	(16,736)	6,033	(2,319)	5,935
Net loss (gain) amortization	47,688	127	61,965	210
Net periodic benefit cost	\$ 216,778	\$ 18,859	\$ 273,591	\$ 17,673
Net periodic benefit cost, excluding discontinued operations	\$ 208,091	\$ 18,239	\$ 262,549	\$ 17,051

The following represents the fair value of plan assets, net, measured on a recurring basis as of June 30, 2012 and 2011 (in thousands). See Note 7 for the definition of Levels 1, 2 and 3 in the fair value hierarchy.

	Fair Value Measurements at June 30, 2012 Using			
	Quoted Prices			
	in Active	Significant	Significant	Total
	Markets for	Other	Unobservable	Balance at
	Identical	Observable	Inputs	June 30,
	Instruments	Inputs	Inputs	June 30,
	(Level 1)	(Level 2)	(Level 3)	2012
Assets				
Cash and cash equivalents	\$ 203,162	\$ -	\$ -	\$ 203,162
U.S. government securities	60,435	3,862	-	64,297
U.S. corporate bonds	-	136,949	47,605	184,554
U.S. equity securities	772,707	251,842	-	1,024,549
Foreign government securities	-	47,520	-	47,520
Foreign corporate bonds	-	5,248	-	5,248
Foreign equity securities	404,351	98	-	404,449
Asset-backed securities	-	1,942	-	1,942
Structured debt	-	13,322	-	13,322
Private equity investments	-	-	124,015	124,015
Multi-strategy hedge fund investments	-	-	309,961	309,961
Real estate	6,307	-	47,068	53,375
Collateral held under securities lending program	-	161,442	-	161,442
Other, including due from brokers for unsettled investment trades and prepaid fund subscriptions	-	12,279	-	12,279
Total assets	\$ 1,446,962	\$ 634,504	\$ 528,649	\$ 2,610,115
Liabilities				
Payable under securities lending program	\$ -	\$ 161,442	\$ -	\$ 161,442
Other, including due to brokers for unsettled investment trades	-	8,537	-	8,537
Total liabilities	\$ -	\$ 169,979	\$ -	\$ 169,979
Fair value of plan assets, net	\$ 1,446,962	\$ 464,525	\$ 528,649	\$ 2,440,136

	Fair Value Measurements at June 30, 2011 Using			
	Quoted Prices			
	in Active	Significant	Significant	Total
	Markets for	Other	Unobservable	Balance at
	Identical	Observable	Inputs	June 30,
	Instruments	Inputs	Inputs	2011
	(Level 1)	(Level 2)	(Level 3)	
Assets				
Cash and cash equivalents	\$ 249,136	\$ -	\$ -	\$ 249,136
U.S. government securities	40,585	97,683	-	138,268
U.S. corporate bonds	-	94,554	-	94,554
U.S. equity securities	868,368	122,508	-	990,876
Foreign government securities	-	89,000	-	89,000
Foreign corporate bonds	-	3,702	-	3,702
Foreign equity securities	320,516	-	-	320,516
Asset-backed securities	-	5,808	-	5,808
Structured debt	-	18,386	-	18,386
Private equity investments	-	-	96,321	96,321
Multi-strategy hedge fund investments	-	-	84,782	84,782
Real estate	6,919	-	101,539	108,458
Collateral held under securities lending program	-	204,466	-	204,466
Other, including due from brokers for unsettled investment trades and prepaid fund subscriptions	-	151,705	112,000	263,705
Total assets	\$ 1,485,524	\$ 787,812	\$ 394,642	\$ 2,667,978
Liabilities				
Payable under securities lending program	\$ -	\$ 204,466	\$ -	\$ 204,466
Other, including due to brokers for unsettled investment trades	-	187,188	-	187,188
Total liabilities	\$ -	\$ 391,654	\$ -	\$ 391,654
Fair value of plan assets, net	\$ 1,485,524	\$ 396,158	\$ 394,642	\$ 2,276,324

For information about the valuation techniques and inputs used to measure the fair value of plan assets, see discussion regarding fair value measurements in Note 7.

The following table presents the change in the plan assets using significant unobservable inputs (Level 3) measured on a recurring basis in 2012 and 2011 (in thousands):

	2012				
	Private Equity Investments	Multi-Strategy Hedge Fund Investments	Real Estate	Debt Securities	Total
Balance at beginning of period	\$ 96,321	\$ 84,782	\$ 101,539	\$ 112,000	\$ 394,642
Total realized gains, net	349	1,565	29,947	-	31,861
Total unrealized gains (losses), net	9,818	9,432	(22,108)	2,679	(179)
Purchases, issuances, sales and settlements					
Purchases	28,703	300,778	-	45,315	374,796
Sales	(11,176)	(86,596)	(62,310)	(389)	(160,471)
Transfers out of level 3	-	-	-	(112,000)	(112,000)
Balance at June 30	<u>\$ 124,015</u>	<u>\$ 309,961</u>	<u>\$ 47,068</u>	<u>\$ 47,605</u>	<u>\$ 528,649</u>
	2011				
	Private Equity Investments	Multi-Strategy Hedge Fund Investments	Real Estate	Debt Securities	Total
Balance at beginning of period	\$ 69,193	\$ 133,452	\$ 85,992	\$ -	\$ 288,637
Total realized gains (losses), net	221	8,204	(499)	-	7,926
Total unrealized gains, net	13,813	2,677	18,770	-	35,260
Purchases, issuances, sales and settlements					
Purchases	17,175	75,362	-	112,000	204,537
Sales	(4,081)	(134,913)	(2,724)	-	(141,718)
Balance at June 30	<u>\$ 96,321</u>	<u>\$ 84,782</u>	<u>\$ 101,539</u>	<u>\$ 112,000</u>	<u>\$ 394,642</u>

In 2012, transfers out of Level 3 within the fair value of the retirement plan assets represent amounts related to prepaid subscriptions. As part of Dignity Health's on-going assessment of the inputs and valuation techniques for fair value measurement, it was deemed that the inputs and valuation techniques related to these amounts are to be classified as Level 2 as significant inputs to valuation are considered observable inputs.

The following table summarizes the weighted-average asset allocations by asset category for the pension plans for 2012 and 2011:

	Plan Assets at June 30	
	2012	2011
Cash and cash equivalents	8%	11%
U.S. government securities	3%	6%
U.S. corporate bonds	7%	4%
U.S. equity securities	42%	44%
Foreign government securities	2%	4%
Foreign equity securities	17%	14%
Structured debt	1%	1%
Private equity investments	5%	4%
Multi-strategy hedge fund investments	13%	4%
Real estate	2%	5%
Other, net	0%	3%
Total	<u>100%</u>	<u>100%</u>

The asset allocation policy for the pension plans for 2012 and 2011 is as follows: domestic fixed income, 20% (which may include U.S. government securities, U.S. corporate bonds, asset-backed securities and/or structured debt); domestic equity 30% (including U.S. equity securities); international equity, 27% (including foreign equity securities); private equity, 10% (which may include private equity investments and/or structured debt); hedge funds, 11% (which may include hedge fund investments, asset-backed securities and/or structured debt); and real estate, 2%.

Dignity Health's investment strategy for the assets of the pension plans is designed to achieve returns to meet obligations and grow the assets of the portfolio longer term, consistent with a prudent level of risk. The strategy balances the liquidity needs of the retirement plans with the long-term return goals necessary to satisfy future obligations. The target asset allocation is diversified across traditional and non-traditional asset classes. Diversification is also achieved through participation in U.S. and non-U.S. markets, market capitalization, and investment manager style and philosophy. The complimentary investment styles and approaches used by both traditional and alternative investment managers are aimed at reducing volatility while capturing the equity premium from the capital markets over the long term. Risk tolerance is established through consideration of plan liabilities, plan funded status, and corporate financial condition. Consistent with Dignity Health's fiduciary responsibilities, the fixed income allocation generally provides for security of principal to meet near term expenses and obligations. Periodic reviews of the market values and corresponding asset allocation percentages are performed to determine whether a rebalancing of the portfolio is necessary.

Dignity Health's pension plan portfolio return assumptions of 8.0% and 7.5% for 2012 and 2011, respectively, were based on the long-term weighted average return of comparative market indices for the asset classes represented in the portfolio and discounted for pension plan expenses, and expectations about future returns.

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

	Retirement Benefits	Other Benefits
2013	\$ 99,004	\$ 8,563
2014	114,206	9,057
2015	132,632	9,415
2016	151,753	10,864
2017	173,280	11,639
2018 - 2022	<u>1,224,007</u>	<u>63,446</u>
Total	<u>\$ 1,894,882</u>	<u>\$ 112,984</u>

Dignity Health maintains defined contribution retirement plans for most employees. Employer contributions to those plans of \$45.1 million and \$41.0 million for 2012 and 2011, respectively, are primarily based on a percentage of a participant's contribution. Total retirement and postretirement expenses under all plans, including the defined contribution plans, was \$282.2 million and \$328.5 million for 2012 and 2011, respectively, and are included in salaries and benefits in the consolidated statements of operations and changes in net assets.

13. DEBT

Debt consists of the following at June 30, 2012 and 2011 (in thousands):

	2012	2011
Under Master Trust Indenture:		
Fixed rate debt:		
Fixed rate revenue bonds payable in installments through 2042; interest at 3.0% to 6.25%	\$ 2,526,364	\$ 2,176,089
Put bonds payable in installments through 2039; interest at 5.0%	196,738	456,996
Senior secured notes payable from 2013 through 2018; interest at 5.7% to 6.5%	<u>374,309</u>	<u>374,192</u>
Total fixed rate debt	<u>3,097,411</u>	<u>3,007,277</u>
Variable rate debt:		
Variable rate demand bonds payable in installments through 2047; interest set at prevailing market rates (0.1% to 0.3% at June 30, 2012)	789,500	640,700
Auction rate certificates payable in installments through 2042; interest set at prevailing market rates (0.3% to 0.4% at June 30, 2012)	323,900	324,400
Notes payable to banks under credit agreement payable in 2014; interest set at prevailing market rates (1.3% at June 30, 2012)	<u>164,034</u>	<u>133,509</u>
Total variable rate debt	<u>1,277,434</u>	<u>1,098,609</u>
Total debt under Master Trust Indenture	<u>4,374,845</u>	<u>4,105,886</u>
Other		
Various notes payable and other debt payable in installments through 2042; interest ranging up to 8.0%	74,386	37,526
Capitalized lease obligations	<u>72,883</u>	<u>94,786</u>
Total debt	<u>4,522,114</u>	<u>4,238,198</u>
Less current portion of long-term debt	(295,920)	(107,381)
Less demand bonds subject to short-term liquidity arrangements, excluding current maturities	<u>(785,400)</u>	<u>(574,000)</u>
Total long-term debt	<u>\$ 3,440,794</u>	<u>\$ 3,556,817</u>

Scheduled principal debt payments, net of discounts and considering obligations subject to short-term liquidity arrangements as due according to their long-term amortization schedule, for the next five years and thereafter are as follows (in thousands):

	Long-Term Debt Other Than Demand Bonds	Demand Bonds Subject to Short-Term Liquidity Arrangements	Total Long-Term Debt
2013	\$ 291,820	\$ 4,100	\$ 295,920
2014	283,328	2,600	285,928
2015	340,902	6,400	347,302
2016	97,378	7,000	104,378
2017	98,700	7,600	106,300
Thereafter	<u>2,620,486</u>	<u>761,800</u>	<u>3,382,286</u>
Total	<u>\$ 3,732,614</u>	<u>\$ 789,500</u>	<u>\$ 4,522,114</u>

Master Trust Indenture – Dignity Health issues debt under a Master Trust Indenture of the Obligated Group which requires, among other things, gross revenue pledged as collateral, certain limitations on additional indebtedness, liens on property, and disposition or transfers of assets, and the maintenance of certain cash balances and other financial ratios. Dignity Health is in compliance with these requirements at June 30, 2012.

Debt Arrangements - Fixed Rate Revenue Bonds – Dignity Health has fixed rate revenue bonds outstanding that may be redeemed, in whole or in part, prior to the stated maturities without a premium.

Put Bonds - Dignity Health has put bonds outstanding with interest rates that were fixed at issuance for 5 and 10-year periods, with bond maturities that extend over longer terms. The bonds are not subject to optional redemption during the fixed rate period but are subject to a mandatory purchase on the respective put redemption date. Prior to a put redemption date, Dignity Health will appoint a remarketing agent to convert the bonds to another fixed rate put period or to a short-term interest rate mode, or Dignity Health will repay the par amount of the mandatory purchase. Put bonds maturing in July 2012 were legally defeased in June 2012 from the proceeds of the June 2012 debt issuance. The remaining put bonds have a mandatory purchase date of July 2014 in the amount of \$195.0 million.

Senior Secured Notes Payable – Dignity Health has taxable, senior secured notes outstanding at a fixed interest rate that are due at their stated maturity from 2013 to 2018. Early redemption of the debt, in whole or in part, may require a premium depending on market rates.

Variable Rate Demand Bonds –Variable rate demand bonds (“VRDBs”) are remarketed weekly and the VRDBs may be put at the option of the holders. Dignity Health maintains bank letters of credit to support \$789.5 million of VRDBs. The letters of credit serve as credit enhancement to ensure the availability of funds to purchase any bonds tendered that the remarketing agent is unable to remarket.

The bank letters of credit supporting \$317.0 million of VRDBs were renewed in August 2010. The renewed letters of credit are set to expire in August 2013. The bank letter of credit supporting \$65.5 million was renewed in July 2010 and is set to expire in July 2013. In January 2010, Dignity Health negotiated new bank letters of credit, supporting \$91.0 million of VRDBs, which expire in June 2014. Dignity Health also has bank letters of credit supporting \$166.0 million of VRDBs that mature in November 2012 and \$150.0 million that mature in November 2016. In the event that the remarketing agent is unable to remarket the VRDBs, the bond trustee will make a draw on the bank letters of credit and the tendered VRDBs will become bank bonds.

Certain bank bonds are subject to various repayment provisions ranging from one to four years with further accelerations upon successful bond remarketing, early redemptions, bond cancellations, conversion to a different interest rate mode, defaults, substitution of letter of credit providers or under certain other conditions.

VRDBs that are not remarketed and are subsequently funded by amounts drawn under the bank letters of credit and held as bank bonds are reported as extinguishments of debt and new borrowings, respectively, in the consolidated statements of cash flows. Repayments of these draws from proceeds of remarketed VRDBs are reported as extinguishments of debt and new borrowings, respectively, in the consolidated statements of cash flows.

Auction Rate Certificates – Dignity Health has \$240.0 million of auction rate certificates (“ARCs”) that are remarketed weekly and \$83.9 million of ARCs that are remarketed every 35 days. The certificates are insured by various bond insurers. Holders of ARCs are required to hold the certificates until the remarketing agent can find a new buyer for any tendered certificates.

Notes Payable to Bank Under Credit Agreement – Dignity Health maintained a \$350.0 million syndicated line of credit facility during 2010 for working capital, letters of credit, capital expenditures and other general corporate purposes. In August 2010, the facility was renegotiated at an increased amount of \$480.0 million.

During 2012 and 2011, the maximum amount outstanding under the syndicated credit facility was \$459.9 million and \$133.5 million, respectively. There were no letters of credit issued under this facility as of June 30, 2012 and 2011.

Dignity Health has a \$20.0 million single-bank line of credit facility for letters of credit. Letters of credit issued under this facility were \$17.0 million and \$12.9 million as of June 30, 2012 and 2011, respectively, but no amounts have been drawn. This facility was similarly renewed in August 2010.

Both credit facilities expire in August 2013.

2012 Financing Activity – In July 2011, Dignity Health issued \$106.5 million of tax-exempt fixed rate bonds with a premium of \$8.5 million to repay \$115.0 million of previously outstanding bonds. Dignity Health also repaid \$30.5 million of outstanding bonds and the \$45.9 million put bond with a draw on its syndicated line of credit.

In November 2011, Dignity Health issued \$478.3 million of tax-exempt fixed rate bonds to refund \$249.3 million of previously outstanding bonds and accrued interest and \$40.9 million of draws on the syndicated line of credit, and to provide funds for capital projects. The bonds were sold at a net premium, bear interest at 3.0% to 5.25%, and mature in installments through March 2041. The proceeds used to refund previously outstanding bonds were placed in an irrevocable trust and the bonds were legally defeased.

In November 2011, Dignity Health issued \$150.0 million of variable rate demand bonds supported by new letters of credit from a single bank, which expire in November 2016. The bond proceeds will be used for capital projects.

In June 2012, Dignity Health issued \$215.0 million of tax-exempt fixed rate bonds which were delivered in connection with a tax-exempt private placement negotiated in November 2011 with a forward delivery date of June 2012. The bonds were used to refund \$210.5 million of put bonds and accrued interest due in July 2012. The bonds were sold at par, bear interest at 6.125% to 6.250%, are callable at par after one year, and mature in installments through March 2029. The proceeds used to refund previously outstanding bonds were placed in an irrevocable trust and the bonds were legally defeased.

No material gain or loss on early extinguishment of debt was recorded related to debt transactions in 2012.

In August 2012, Dignity Health drew \$310.0 million on its syndicated line of credit facility to fund a portion of the acquisition of U.S. HealthWorks. See Note 3.

2011 Financing Activity– During 2011, Dignity Health renewed several letters of credit and the lines of credit as described above (see “Variable Rate Demand Bonds” and “Notes Payable to Bank Under Credit Agreement”).

Fair Value of Debt - The fair value of Dignity Health's debt is estimated based on the quoted market prices and/or other market data for the same or similar issues and transactions in active markets or on the current rates offered to Dignity Health for debt of the same remaining maturities, discounted cash flow models and other pricing models. These inputs to fair value are included in industry-standard valuation techniques. Based on the inputs and valuation techniques, the fair value of long-term debt is classified as Level 2 within the fair value hierarchy. The carrying value of Dignity Health's debt is reported within the current portion of long-term debt, demand bonds subject to short-term liquidity arrangements and long-term debt, net of current portion, on the statement of financial position. The estimated fair value of Dignity Health's long-term debt instruments as of June 30, 2012, is as follows (in thousands):

	Carrying Value	Fair Value
Debt issued under Master Trust Indenture:		
Fixed rate revenue bonds	\$ 2,526,364	\$ 2,731,041
Put bonds	196,738	209,092
Senior secured notes payable	374,309	426,608
Variable rate demand bonds	789,500	789,500
Auction rate certificates	323,900	323,900
Notes payable to bank under credit agreement	<u>164,034</u>	<u>164,034</u>
Total debt under Master Trust Indenture	4,374,845	4,644,175
Other	<u>147,269</u>	<u>147,269</u>
Total debt	<u>\$ 4,522,114</u>	<u>\$ 4,791,444</u>

The fair value amounts do not represent the amount Dignity Health would be required to expend to retire the indebtedness.

14. DERIVATIVE INSTRUMENTS

Dignity Health's derivative instruments include 16 floating-to-fixed interest rate swaps as of June 30, 2012 and 2011, respectively. Dignity Health uses floating-to-fixed interest rate swaps to manage interest rate risk associated with outstanding variable rate debt. Under these swaps, Dignity Health receives a percentage of LIBOR ranging from 57.00% to 58.96% plus a spread ranging from 0.13% to 0.32% and pays a fixed rate. Dignity Health's derivative instruments also include four fixed-to-floating risk participation agreements as of June 30, 2012. Dignity Health uses fixed-to-floating risk participation agreements to reduce interest expense associated with fixed rate debt. Under these risk participation agreements, Dignity Health receives a fixed rate and pays a variable rate percentage of SIFMA plus a spread.

In August 2011, Dignity Health novated swaps with a notional amount of \$343.1 million to a new counterparty. One of the swaps with a notional amount of \$80.0 million was insured by Assured Guaranty (formerly FSA); the insurance was removed at the request of Dignity Health and the counterparty upon the novation. Swaps with a notional amount of \$263.1 million were uninsured and the counterparty's right to terminate the swaps at each five-year anniversary was removed on these swaps with the novation. The swaps, as well as the one with the \$80.0 million notional amount, retain certain early termination triggers caused by event of default or termination as described below.

In December 2010, Dignity Health terminated four floating-to-fixed interest rate swaps prior to their scheduled maturities in the aggregate notional amount of \$201.3 million. The termination payment included the market value of the swaps of negative \$12.0 million which was recorded as a swap cash settlement in interest expense, net. Since swaps are recorded at market value, no gain or loss was recognized on this transaction.

The following table shows the outstanding notional amount of derivative instruments measured at fair value as reported in other accrued liabilities in the consolidated balance sheet as of June 30, 2012 and 2011 (in thousands):

	Maturity Date of Derivatives	Interest Rate	Notional Amount Outstanding	Fair Value
June 30, 2012				
Derivatives not designated as hedges				
Interest rate swaps	2026 - 2042	3.2% - 3.4%	<u>\$ 940,600</u>	<u>\$ (228,052)</u>
	2017, with extension options	SIFMA plus spread	<u>\$ 215,000</u>	<u>\$ -</u>
Risk participation agreements				
June 30, 2011				
Derivatives not designated as hedges				
Interest rate swaps	2026 - 2042	3.2% - 3.4%	<u>\$ 944,525</u>	<u>\$ (110,694)</u>

Changes in fair value of derivative instruments have been recorded for 2012 and 2011 as follows (in thousands):

	2012	2011
Loss reclassified from unrestricted net assets into interest expense, net, related to derivatives in cash flow hedging relationships:		
Interest rate swaps - amortization	<u>\$ (2,683)</u>	<u>\$ (9,055)</u>
Gain (loss) recognized in interest expense, net:		
Changes in fair value of non-hedged derivatives - interest rate swaps	(117,358)	50,038
Amortization of amounts in unrestricted net assets - interest rate swaps	<u>(2,683)</u>	<u>(9,055)</u>
Total	<u>\$ (120,041)</u>	<u>\$ 40,983</u>

Of the amounts classified in unrestricted net assets as of June 30, 2012 and 2011, Dignity Health anticipates reclassifying approximately \$2.7 million of additional non-cash losses from unrestricted net assets into interest expense, net, in the next twelve months. Amounts in unrestricted net assets will be amortized into earnings as the interest payments being economically hedged are made.

Of the \$940.6 million and \$944.5 million notional amount of interest rate swaps held by Dignity Health at June 30, 2012 and 2011, respectively, \$160.0 million and \$240.0 million are insured and have a negative fair value of \$47.2 million and \$30.6 million at June 30, 2012 and 2011, respectively. In the event the insurer, Assured Guaranty, is downgraded below A2/A or A3/A- (Moody's/Standard and Poor's), the counterparties have the right to terminate the swaps if Dignity Health does not provide alternative credit support acceptable to them within 30 days of being notified of the downgrade. If the insurer is downgraded below the thresholds noted above and Dignity Health is downgraded below Baa3/BBB- (Moody's/Standard and Poor's), the counterparties have the right to terminate the swaps.

Dignity Health has \$780.6 million and \$704.5 million of interest rate swaps that are not insured at June 30, 2012 and 2011, respectively. While Dignity Health has the right to terminate the swaps prior to maturity for

any reason, certain counterparties have the right to terminate swaps in the outstanding notional amount of \$437.5 million at each five-year anniversary date commencing in May 2013. The termination value would be the fair market value or the replacement cost of the swaps, depending on the circumstances. These interest rate swaps have a negative fair value of \$104.4 million and \$50.1 million at June 30, 2012 and 2011, respectively. The remaining uninsured interest rate swaps in the notional amount of \$343.1 million and \$267.1 million, respectively, have a negative fair value of \$76.5 million and \$30.0 million at June 30, 2012 and 2011, respectively. The fair value of the uninsured risk participation agreements in the notional amount of \$215.0 million have a fair value of zero at June 30, 2012. All of the uninsured swaps and risk participation agreements have certain early termination triggers caused by an event of default or a termination event. The events of default include failure to make payments when due, failure to give notice of a termination event, failure to comply with or perform obligations under the agreements, bankruptcy or insolvency, and defaults under other agreements (cross-default provision). The termination events include credit ratings dropping below Baa1/BBB+ (Moody's/Standard and Poor's) by either party and Dignity Health's cash on hand dropping below 85 days.

Dignity Health, under the terms of its Master Trust Indenture, is prohibited from posting collateral on derivative instruments.

15. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Restricted net assets as of June 30, 2012 and 2011, consist of donor-restricted contributions and grants, which are to be used as follows (in thousands):

	2012	2011
Equipment and expansion	\$ 128,613	\$ 146,704
Research and education	47,408	39,155
Charity and other	<u>132,424</u>	<u>140,644</u>
Total temporarily restricted net assets	<u>\$ 308,445</u>	<u>\$ 326,503</u>
Permanently restricted net assets	<u>104,873</u>	<u>107,947</u>
Total restricted net assets	<u>\$ 413,318</u>	<u>\$ 434,450</u>

The composition of endowment net assets by type of fund as of June 30, 2012 and 2011, is as follows (in thousands):

	June 30, 2012			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor-restricted endowment net assets	\$ -	\$ 26,021	\$ 104,873	\$ 130,894
Board-designated endowment net assets	<u>15,698</u>	<u>-</u>	<u>-</u>	<u>15,698</u>
Total endowment net assets	<u>\$ 15,698</u>	<u>\$ 26,021</u>	<u>\$ 104,873</u>	<u>\$ 146,592</u>

	June 30, 2011			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Donor-restricted endowment net assets	\$ -	\$ 22,235	\$ 107,947	\$ 130,182
Board-designated endowment net assets	<u>17,856</u>	<u>-</u>	<u>-</u>	<u>17,856</u>
Total endowment net assets	<u>\$ 17,856</u>	<u>\$ 22,235</u>	<u>\$ 107,947</u>	<u>\$ 148,038</u>

Changes in endowment net assets during 2012 and 2011 are as follows (in thousands):

	June 30, 2012			Total
	Unrestricted	Temporarily Restricted	Permanently Restricted	
Endowment net assets, beginning of period	\$ 17,856	\$ 22,235	\$ 107,947	\$ 148,038
Investment returns	203	1,549	54	1,806
Unrealized gains	(613)	(2,104)	(15)	(2,732)
Contributions	-	4,975	131	5,106
Change in interest in unconsolidated foundations	-	54	52	106
Appropriation of endowment assets for expenditure	(58)	(918)	-	(976)
Transfers to remove or add to board-designated endowment funds	(1,656)	(248)	(165)	(2,069)
Other	<u>(34)</u>	<u>478</u>	<u>(3,131)</u>	<u>(2,687)</u>
Endowment net assets, end of period	<u>\$ 15,698</u>	<u>\$ 26,021</u>	<u>\$ 104,873</u>	<u>\$ 146,592</u>

	June 30, 2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of period	\$ 11,781	\$ 14,833	\$ 99,073	\$ 125,687
Investment returns	418	2,079	56	2,553
Unrealized gains	3,706	3,444	7	7,157
Contributions	-	2	2,292	2,294
Change in interest in unconsolidated foundations	-	3,596	5,961	9,557
Appropriation of endowment assets for expenditure	(362)	(672)	-	(1,034)
Transfers to remove or add to board-designated endowment funds	1,474	-	672	2,146
Other	839	(1,047)	(114)	(322)
Endowment net assets, end of period	<u>\$ 17,856</u>	<u>\$ 22,235</u>	<u>\$ 107,947</u>	<u>\$ 148,038</u>

Included in donor-restricted assets limited as to use are unconditional promises to give which are recorded using discount rates ranging from 3.0 % to 6.0% and are due as follows as of June 30, 2012 and 2011 (in thousands):

	2012	2011
Less than one year	\$ 6,848	\$ 4,607
One to five years	12,845	14,962
More than five years	403	818
Less: allowance for uncollectible contributions receivable	<u>(1,395)</u>	<u>(1,250)</u>
Total contributions receivable, net	<u>\$ 18,701</u>	<u>\$ 19,137</u>

16. SPECIAL CHARGES

Special charges consist of the following for the year ended June 30, 2012 (in thousands):

Software development costs abandoned	\$ 22,019
Restructuring costs for patient financial services	6,343
Restructuring costs for name and governance changes	<u>7,511</u>
Total special charges	<u>\$ 35,873</u>

Abandoned software development costs relate to the write-off of certain costs in connection with a change in strategic direction and vendor for clinical systems.

Restructuring costs for patient financial services consisting of severance and lease termination costs have been recorded in connection with the announcement in March 2012 that Dignity Health will consolidate four of its patient financial service centers into a single service center.

Expenses related to the name change to Dignity Health and governance restructuring described in Note 1 include legal and implementation costs.

17. COMMITMENTS, CONTINGENT LIABILITIES, GUARANTEES AND OTHER

Litigation, Regulatory and Compliance Matters - General –The healthcare industry is subject to voluminous and complex laws and regulations of federal, state and local governments. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. These laws and regulations include, but are not necessarily limited to, the rules governing licensure, accreditation, government healthcare program participation, government reimbursement, antitrust, anti-kickback and anti-referral by physicians, false claims prohibitions, and in the case of tax-exempt organizations, the requirements of tax exemption. In recent years, government activity has increased with respect to investigations and allegations concerning possible violations by healthcare providers of reimbursement, false claims, anti-kickback and anti-referral statutes and regulations, quality of care provided to patients, and handling of controlled substances. In addition, during the course of business, Dignity Health becomes involved in litigation. Management assesses the probable outcome of unresolved litigation and investigations and records contingent liabilities reflecting estimated liability exposure. Following is a discussion of matters of note.

Department of Justice and OIG Investigations –Dignity Health and/or its facilities periodically receive notices from governmental agencies, such as the Department of Justice or the Office of Inspector General (“OIG”), requesting information regarding billing, payment, or other reimbursement matters, or formally or informally initiating investigations, or indicating the existence of whistleblower litigation. The healthcare industry in general is experiencing an increase in these activities, as the federal government increases enforcement activities and institutes new programs designed to identify areas of potential reimbursement or quality irregularities. Based on the information received to date from the government, Dignity Health does not presently have information indicating that any of these current matters or their resolution will have a material effect on Dignity Health’s financial statements, taken as a whole. Nevertheless, investigations of this type and scope could lead to civil and/or criminal charges and material penalties or settlements. Consequently, there can be no assurance that the resolution of these matters will not affect the financial condition or operations of Dignity Health, taken as a whole.

Medicare Certification –From time to time, Dignity Health and/or its facilities receive notices from CMS that steps to terminate provider agreements will be taken unless certain corrective actions related to qualification for Medicare participation are undertaken. The process of responding to these notices involves plan(s) of correction by the facility and resurvey by CMS or its designee. Although termination is rare there is no guarantee that CMS or its designee will be satisfied with a facility’s corrective action. Currently, St. Joseph’s Medical Center of Stockton, Community Hospital of San Bernardino and Mercy Medical Center (Merced) are in the process of addressing such notices.

Wage and Hour Class Actions and Litigation – Federal law and many states, including California, impose standards related to worker classification, eligibility and payment for overtime, liability for providing rest periods and similar requirements. Large employers with complex workforces, such as hospitals, are susceptible to actual and alleged violations of these standards. In recent years, there has been a proliferation of lawsuits over these “wage and hour” issues, often in the form of large, sometimes multi-state, class actions. For large employers such as hospitals and health systems, such class actions can involve multi-million dollar claims, judgments and/or settlements.

In February 2008, a lawsuit was filed against Dignity Health alleging violations of California state wage and hour laws and regulations. The lawsuit was fashioned as a class action on behalf of nurses and medical technicians employed at Dignity Health’s California facilities during the previous four years. In July 2012, the court denied the plaintiffs’ motion to certify the classes of Dignity Health’s employees, leaving the three individual plaintiffs to pursue their individual cases in lieu of a class action. Despite this outcome, lawsuits of this nature have the potential for a material impact on the financial condition or operations of Dignity Health.

Employment Law Litigation – In February 2012, a jury in federal court awarded damages and lost wages to a former employee of Mercy General Hospital (Sacramento) in response to various employment law claims. The aggregate jury award of approximately \$168.0 million appears to include duplication of award

amounts and is subject to elimination of duplication, as well as certain statutory limits on damages. On April 30, 2012, the trial judge entered judgment in the case, reducing the jury verdict to approximately \$82.3 million. Management is of the opinion that the facts do not support the verdict or the damages. The parties are currently involved in post-trial motions in which the Corporation seeks a new trial, or in the alternative, a significantly reduced judgment. If unsuccessful, management plans to appeal the judgment. The Corporation has multiple layers of insurance coverage and the extent to which these layers will be impacted depends in part on the final determination of liability and/or damages. Insurers for a portion of these layers have filed suit in federal court seeking declaratory relief that they have no coverage obligation for the judgment entered against the Corporation. Consequently, there can be no assurance that the resolution of this matter will not have a material effect on the financial condition or results of operations of Dignity Health, taken as a whole.

Property Tax Assessments – Dignity Health received written notification from two county property tax assessors with respect to three of its hospitals asserting that the hospitals failed to satisfy a technical legal requirement to qualify for California property tax exemption. The possible liability exposure with respect to three hospitals could be as high as approximately \$16.8 million. The Corporation disagrees with the assessors' assertions, has made appropriate administrative filings and is considering additional potential responses, including the possibility of court litigation, which would require payment of some portion of the contested amount as a condition to filing a claim in court. Nevertheless, claims of this nature have the potential for a material effect on the financial condition or results of operations of Dignity Health.

Health Care Reform – In March 2010, President Obama signed the Patient Protection and Affordable Care Act ("PPACA") into law. PPACA will result in sweeping changes across the health care industry, including how care is provided and paid for. A primary goal of this comprehensive reform legislation is to extend health coverage to approximately 32 million uninsured legal U.S. residents through a combination of public program expansion and private sector health insurance reforms. To fund the expansion of insurance coverage, the legislation contains measures designed to promote quality and cost efficiency in health care delivery and to generate budgetary savings in the Medicare and Medicaid programs. Given that the final regulations and interpretive guidelines have yet to be published, Dignity Health is unable to fully predict the impact of PPACA on its operations and financial results. There were multiple lawsuits challenging the constitutionality of major portions of PPACA; in June 2012, the U.S. Supreme Court upheld the major portions while limiting the federal government's ability to pressure state Medicaid programs to participate. Even so, Dignity Health's management expects that in the coming years patients who were previously uninsured and unable to pay for care will have basic insurance coverage, and amounts for reimbursement for services from both public and private payers will be reduced and made conditional on various quality measures. Management of Dignity Health is studying and evaluating the anticipated impacts and developing strategies needed to prepare for implementation, and is preparing to work cooperatively with other constituents to optimize available reimbursement.

Operating Leases – Dignity Health leases various equipment and facilities under operating leases. Gross rental expense for 2012 and 2011 was \$108.3 million and \$105.8 million, respectively, which is offset by sublease income of \$1.4 million and \$2.1 million for 2012 and 2011, respectively. These amounts are recorded in purchased services and other on the accompanying statements of operations and changes in net assets.

Net future minimum lease payments under non-cancelable operating leases as of June 30, 2012, are as follows (in thousands):

	Lease Payments	Sublease Income	Net Future Minimum Lease Payments
2013	\$ 64,015	\$ (2,410)	\$ 61,605
2014	49,786	(1,105)	48,681
2015	40,880	(870)	40,010
2016	34,858	(814)	34,044
2017	28,868	(754)	28,114
Thereafter	<u>116,526</u>	<u>(9,766)</u>	<u>106,760</u>
Total	<u>\$ 334,933</u>	<u>\$ (15,719)</u>	<u>\$ 319,214</u>

Long-term Contracts and Agreements – In October 2008, Dignity Health renegotiated a contract for information technology management services which specifies the types and levels of services, which can be modified by mutual agreement, and provides for monthly usage-based adjustments to fees. The agreement contains a mechanism for price adjustments should there be new affiliations or disaffiliations. Based on current modifications to this agreement, the base fee under the contract will be \$35.6 million in 2013 and \$21.9 million per year thereafter, increasing annually by inflation through October 2015, the term of the agreement. Dignity Health may cancel the agreement without cause subject to significant penalties through October 2013, and without penalty during the remaining two years of the contract. Under the terms of this agreement, Dignity Health expensed \$55.2 million and \$52.7 million in 2012 and 2011, respectively, in purchased services and other on the accompanying statements of operations and changes in net assets.

In July 2010, Dignity Health entered into an agreement for the development, implementation and management of certain clinical technology management programs for six Dignity Health hospitals, which has since been modified to include all other Dignity Health hospitals. The agreement is in effect for five years upon each hospital's implementation. Dignity Health may cancel the agreement without cause subject to penalties during the first four years of the contract, based upon the implementation date at the respective hospital, and without penalty during the final year of the contract. As of June 30, 2012, approximately \$200.0 million in commitments remain under this contract through August 2016.

In December 2007, Dignity Health entered into a development agreement with the Sequoia Healthcare District ("District") whereby the District relinquished all control over Sequoia Health Services ("SHS") and agreed to provide funding of \$75.0 million toward the modernization, upgrading and seismic retrofitting of Sequoia Hospital. In return for the funding commitment, the District is entitled to 50% of Sequoia Hospital's annual Operating Earnings Before Interest, Depreciation and Amortization ("EBIDA") exceeding a 9.3% annual Operating EBIDA Margin for 40 years. Operating EBIDA is defined as operating income adjusted for certain excluded items. Dignity Health has committed to funding \$150.0 million toward the construction project and approximately \$15.0 million in additional funding is anticipated from philanthropic gifts. If the construction does not conform to certain agreed-upon specifications or is not completed consistent with the terms of the development agreement related to project timing, the District has the right to require the return of its \$75.0 million contribution. The multi-phased construction project began in September 2007 and is expected to be completed in phases through fiscal 2014. Dignity Health's management expects to meet the required construction specifications and time requirements under the agreement with the District.

Capital and Purchase Commitments – Dignity Health has undertaken various construction and expansion projects that may include certain capital commitment requirements. At June 30, 2012 and 2011, remaining capital commitments related to these projects were approximately \$273.1 million and \$254.6 million, respectively. Dignity Health also enters into various agreements that require certain minimum purchases of goods and services. These commitments are at levels consistent with normal business requirements.

Excluding the capital and long-term contract commitments discussed above, outstanding purchase commitments were approximately \$192.4 million and \$85.5 million at June 30, 2012 and 2011, respectively, excluding the agreements noted above.

Guarantees – Dignity Health has guaranteed the indebtedness of other organizations in the amount of \$12.7 million and \$33.8 million as of June 30, 2012 and 2011, respectively.

Dignity Health enters into physician recruitment agreements with certain physicians who agree to relocate to its communities to fill a need in the hospitals' service areas and commit to remain in practice there. Under these agreements, Dignity Health makes loans available to the physicians that are earned over the period the physicians fulfill their commitment to the community, which is typically three years, or are repayable by the physicians. The maximum potential amount of future undiscounted payments Dignity Health could be required to make under these guarantees is \$18.3 million and \$19.8 million as of June 30, 2012 and 2011, respectively. Dignity Health recorded \$12.1 million and \$13.2 million in other current liabilities as of June 30, 2012 and 2011, respectively, and \$6.2 million and \$6.6 million in other long-term liabilities as of June 30, 2012 and 2011, respectively, related to these guarantees.

Seismic Standards – The State of California issued seismic safety standards in 1994 which have been amended on several occasions since then. The regulations call for more stringent structural building standards to be in place by January 2013 for buildings remaining in acute care service beyond that date, with a two-year extension in most circumstances by meeting certain milestone dates. Recent legislation effective in June 2012 provides for further extension of the deadlines for achieving compliance in certain circumstances. California law currently imposes a separate more rigorous set of seismic standards that become effective in 2030 for acute care facilities.

Each of the acute care service buildings at Dignity Health's California facilities either (1) meets the standards in effect until 2030, (2) is not subject to those standards, (3) will not be used for acute care services beyond 2013 subject to any extension of such deadline, or (4) is scheduled to undergo remediation before applicable deadline dates, as such dates may be extended. Management currently estimates that remaining remediation costs required for meeting the standards for projects specific to structural and non-structural performance in effect until 2030 is approximately \$390.0 million. Management has initiated planning and design efforts at all facilities to meet the extended deadlines. However, with the passage of the recent legislation that provides for longer extensions, Dignity Health has applied for extensions and anticipates that the applications will be approved, which would allow for the deferral of approximately \$225.0 million of capital expenditures from 2013 through 2015 to 2016 through 2019. Dignity Health may choose to withdraw selected buildings from acute care service rather than satisfy the standards.

18. DIGNITY HEALTH, SUBORDINATE CORPORATIONS AND SUBSIDIARIES

Following is a list of corporations and subsidiaries that are included in the accompanying consolidated financial statements for 2012. Unless otherwise indicated, such entities are nonprofit corporations. The Obligated Group Members are denoted by an asterisk (*). Unless otherwise indicated, subsidiaries are not Obligated Group Members.

Dignity Health*	Arroyo Grande Community Hospital Foundation
Operating dba's of Dignity Health	California Hospital Medical Center Foundation
Arroyo Grande Community Hospital	Dignity Health Foundation East Valley
California Hospital Medical Center – Los Angeles	Community Hospital of San Bernardino Foundation
Chandler Regional Medical Center	Dominican Hospital Foundation
Dominican Hospital	French Hospital Medical Center Foundation
French Hospital Medical Center	Glendale Memorial Health Foundation
Glendale Memorial Hospital and Health Center	Marian Medical Center Foundation
Marian Medical Center West	Mercy Foundation, Bakersfield
Marian Regional Medical Center	Mercy Medical Center Merced Foundation
Mercy General Hospital	Northridge Hospital Foundation
Mercy Gilbert Medical Center	Saint Mary's Foundation
Mercy Hospital (Bakersfield)	San Gabriel Valley Medical Center Foundation
Mercy Hospital of Folsom	St. Bernardine Medical Center Foundation
Mercy Medical Center (Merced)	St. Francis Foundation of Santa Barbara
Mercy Medical Center Mt. Shasta	St. John's Healthcare Foundation (Oxnard and Pleasant Valley)
Mercy Medical Center Redding	St. Joseph's Foundation (Phoenix)
Mercy San Juan Medical Center	St. Joseph's Foundation of San Joaquin
Mercy Southwest Hospital	St. Mary Medical Center Foundation
Methodist Hospital of Sacramento	St. Mary's Medical Center Foundation
Northridge Hospital Medical Center	St. Rose Dominican Health Foundation
Saint Mary's Regional Medical Center (See Note 3)	The Congenital Heart Foundation
Sequoia Hospital	CHMC Hope Street Family Center Property Management, LLC
St. Bernardine Medical Center	CDS of Nevada, Inc. (taxable)
St. Elizabeth Community Hospital	Dominican Health Services
St. John's Pleasant Valley Hospital	Dominican Oaks Corporation
St. John's Regional Medical Center	Glendale Memorial Services Corporation (taxable)
St. Joseph's Behavioral Health Center	Golden Umbrella
St. Joseph's Hospital and Medical Center	Inland Health Organization of Southern California (taxable)
St. Joseph's Medical Center of Stockton	Management Services Organization of Santa Maria, Inc. (taxable)
St. Mary Medical Center	Marian Community Clinics, Inc.
St. Mary's Medical Center	Marian Health Services, Inc. (taxable)
St. Rose Dominican Hospital Rose de Lima Campus	Mark Twain St. Joseph's Healthcare Corporation
St. Rose Dominican Hospital Siena Campus	Saint Mary's Healthfirst (taxable)
St. Rose Dominican Hospital San Martin Campus	Saint Mary's Multi-Specialty Clinic, Inc. (taxable) (See Note 3)
Woodland Memorial Hospital	Saint Mary's Preferred Health Insurance Company, Inc. (taxable)
Dignity Health Hospital and Professional Liability Self-Insurance Trust (California trust)	Shasta Senior Nutrition Program
Dignity Health Workers' Compensation Self-Insurance Trust (California trust)	St. Francis Foundation, LLC
Dignity Health Insurance Ltd. (Cayman Island corporation)	St. Mary Catholic Housing Corporation
Bakersfield Memorial Hospital*	St. Mary Health Ventures, Inc. (taxable)
Dignity Health Medical Foundation*	St. Mary Professional Building, Inc.
Community Hospital of San Bernardino*	St. John's Regional Imaging Center, LLC
Mercy Senior Housing, Inc.*	TrinityCare, LLC
Saint Francis Memorial Hospital*	TrinityCare Infusion Services (taxable)
Sierra Nevada Memorial-Miners Hospital*	

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