KPMG

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidated Financial Statements and Supplemental Schedules

June 30, 2010 and 2009

(With Independent Auditors' Report Thereon)

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Table of Contents

KPMG LLP
1 East Pratt Street
Baltimore, MD 21202-1128

Independent Auditors' Report

The Board of Directors
Carroll Hospital Center, Inc.:

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Carroll Hospital Center, Inc. and Subsidiaries as of June 30, 2010 and 2009, and the consolidated results of their operations, changes in their net assets, and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information included in schedules 1 and 2 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and the results of operations of the individual corporations. The consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as whole.

KPMG LLP

October 22, 2010

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2010 and 2009

(In thousands)

Assets		2010	2009
Current assets:			
Cash and cash equivalents	$	47,646	54,096
Short-term investments (notes 4 and 5)		13,145	6,000
Current portion of assets limited as to use (notes 2 and 5)		9,485	7,842
Patient receivables, net of allowance for uncollectibles of $6,537 in 2010 and $5,800 in 2009 (note 15)		23,705	24,820
Other receivables		1,542	2,312
Inventory		3,838	3,890
Prepaid expenses		3,111	3,447
Total current assets		102,472	102,407
Property and equipment, net (note 3)		153,890	145,615
Long-term investments (notes 4 and 5)		30,869	15,389
Long-term investments – other (note 6)		17,693	17,631
Investments in joint ventures (note 7)		4,831	3,027
Assets limited as to use, less current portion (notes 2 and 5)		10,832	11,628
Other assets (note 8)		8,294	6,371
Total assets	$	328,881	302,068
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt (note 9)	$	1,870	1,406
Current obligation under capital lease (note 17)		1,647	834
Accounts payable and accrued expenses		23,368	21,085
Accrued payroll and related taxes		10,352	9,489
Deferred revenue		196	221
Advances from third-party payors		4,454	5,005
Total current liabilities		41,887	38,040
Long-term debt, less current portion (note 9)		132,845	122,251
Long-term obligation under capital lease, less current portion (note 17)		1,271	1,839
Other liabilities (note 3)		29,597	12,309
Accrued pension and postretirement benefits (notes 11 and 12)		16,056	15,703
Total liabilities		221,656	190,142
Minority interest		3,465	3,896
Net assets:			
Unrestricted		101,489	106,062
Temporarily restricted (note 13)		1,133	855
Permanently restricted (note 13)		1,138	1,113
Total net assets		103,760	108,030
Total liabilities and net assets	$	328,881	302,068

See accompanying notes to consolidated financial statements.

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended June 30, 2010 and 2009

(In thousands)

		2010	2009
Unrestricted revenues, gains, and other support:			
Net patient service revenue (notes 15, 16, 17, and 18)	$	224,406	222,700
Other operating revenues		17,757	17,405
Net assets released from restrictions used for operations		11	14
Total unrestricted revenues, gains, and other support		242,174	240,119
Expenses (note 14):			
Salaries and wages		98,948	94,858
Employee benefits		21,646	20,081
Departmental supplies and expenses		39,165	39,463
Professional fees		20,903	21,334
Purchased services		33,930	34,582
Depreciation and amortization		15,990	13,537
Interest		7,700	7,060
Provision for bad debts		5,189	5,074
Total expenses		243,471	235,989
Operating (loss) income		(1,297)	4,130
Other income (expense):			
Investment income (loss) (note 4)		5,327	(3,025)
Unrestricted gifts		2,006	2,060
Other, net (note 9)		(8,212)	(3,424)
Deficit of revenues over expenses before minority interest		(2,176)	(259)
Minority interest		(1,565)	(2,302)
Deficit of revenues over expenses		(3,741)	(2,561)
Other changes in net assets:			
Net change in unrealized (loss) gain on investments		(18)	18
Net assets released from restrictions used for capital expenditures		577	1,362
Change in funded status of pension plan and postretirement		(1,391)	(10,890)
Decrease in unrestricted net assets	$	(4,573)	(12,071)

See accompanying notes to consolidated financial statements.

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2010 and 2009

(In thousands)

		Unrestricted net assets	Temporarily restricted net assets	Permanently restricted net assets	Total net assets
Balance at June 30, 2008	$	118,133	1,343	1,079	120,555
Deficit of revenues over expenses		(2,561)	—	—	(2,561)
Restricted gifts, bequests, and contributions		—	1,134	—	1,134
Change in unrealized gains/losses other than trading securities		18	(189)	(23)	(194)
Net assets released from restrictions used for capital expenditures		1,362	(1,362)	—	—
Net assets released from restrictions used for operations		—	(14)	—	(14)
Transfer from temporarily restricted to permanently restricted		—	(57)	57	—
Change in funded status of pension plan and postretirement		(10,890)	—	—	(10,890)
Changes in net assets		(12,071)	(488)	34	(12,525)
Balance at June 30, 2009		106,062	855	1,113	108,030
Deficit of revenues over expenses		(3,741)	—	—	(3,741)
Restricted gifts, bequests, and contributions		—	790	—	790
Change in unrealized gains/losses other than trading securities		(18)	84	17	83
Net assets released from restrictions used for capital expenditures		577	(577)	—	—
Net assets released from restrictions used for operations		—	(11)	—	(11)
Transfer from temporarily restricted to permanently restricted		—	(8)	8	—
Change in funded status of pension plan and postretirement		(1,391)	—	—	(1,391)
Changes in net assets		(4,573)	278	25	(4,270)
Balance at June 30, 2010	$	101,489	1,133	1,138	103,760

See accompanying notes to consolidated financial statements.

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended June 30, 2010 and 2009

(In thousands)

		2010	2009
Cash flows from operating activities:			
Change in net assets	$	(4,270)	(12,525)
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		15,990	13,537
Provision for bad debts		5,189	5,074
Change in funded status of pension plan and postretirement		1,391	10,890
Equity in earnings of joint ventures		(46)	(57)
Loss on disposition of property and equipment		1,659	56
Minority interest		1,565	2,302
Restricted gifts, bequests, and contributions		(790)	(1,134)
Change in net unrealized gains on securities		(1,722)	1,754
Realized (gains) losses on sales of securities		(428)	588
Equity in earnings of long-term investments – other		(1,531)	3,556
Change in unrealized losses on derivative instruments		5,375	2,232
Changes in assets and liabilities:			
Patient and other receivables		(3,286)	(6,588)
Inventory		52	(343)
Prepaid expenses		336	(888)
Other assets		(1,996)	(531)
Accounts payable, accrued expenses, accrued payroll and related taxes, and other liabilities		3,220	(1,456)
Deferred revenue		(25)	(10)
Advances from third-party payors		(551)	823
Net cash provided by operating activities		20,132	17,280
Cash flows from investing activities:			
Purchases of property and equipment		(15,895)	(28,651)
Proceeds from sale of property and equipment		72	13
Investment in joint ventures		(553)	(494)
Net (purchases) sales of investments		(20,605)	10,172
Sales of long-term investments, other		1,603	329
Use of assets limited as to use, net		(847)	9,351
Distributions from joint ventures		1,161	677
Distributions to minority interest shareholders		(1,996)	(1,740)
Net cash used in investing activities		(37,060)	(10,343)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt		12,404	52
Payments on long-term debt		(1,767)	(1,374)
Payments on capital lease obligation		(949)	(711)
Proceeds from restricted gifts, bequests, and contributions		790	1,134
Net cash provided by (used in) financing activities		10,478	(899)
Net change in cash and cash equivalents		(6,450)	6,038
Cash and cash equivalents, beginning of year		54,096	48,058
Cash and cash equivalents, end of year	$	47,646	54,096
Supplemental cash flow information:			
Interest paid	$	7,700	7,060
Medical Office Building (note 3)		15,833	6,407
Additions to property and equipment in exchange for capital lease obligations		1,223	468
Note payable for interest in joint venture		—	989

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies

(a) Organization

Carroll Hospital Center, Inc. (the Hospital) is a not-for-profit entity engaged in providing comprehensive healthcare services through an integrated network in Carroll County, Maryland. The Hospital is a wholly owned subsidiary of Carroll County Health Services Corporation (the Corporation). The accompanying consolidated financial statements include the accounts of the Hospital and its wholly or partially owned subsidiaries, as described below (collectively referred to as the System).

Carroll County Med-Services, Inc. (CCMS) is a wholly owned subsidiary that is involved in real estate holdings, physician recruitment, and support service activities, and maintains ownership interests in various joint ventures as described in note 7. Carroll County CMO, LLC., Carroll OB/GYN Associates, LTD, Family Medical Associates (FMA), LLC, Advanced Urology Associates LLC, Carroll Endocrinology Associates Inc, Om Cardiovascular LLC (Dba Cardiovascular Consultants of Carroll County), Advanced OB GYN Care LLC, Carroll Neurosurgical Associate Inc, Carroll Orthopaedic Specialist LLC, Carroll Vascular Center LLC, and Carroll Neurosurgical Associates LLC are wholly owned subsidiaries of CCMS. Carroll Care Pharmacies, LLC is a 60% owned joint venture that owns and operates retail pharmacies. Carroll Occupational Health, LLC is a 75% owned joint venture that provides occupational health and wellness services. Carroll Ear, Nose and Throat, LLC is a 50% owned joint venture that provides otolaryngology services.

Carroll Hospital Center Foundation, Inc. (the Foundation) is a wholly owned charitable organization formed with the intent of charitable fund-raising for the Hospital and Carroll Hospice, Inc.

Carroll Hospice, Inc. (CH) is a wholly owned subsidiary that provides healthcare services to terminally ill patients.

Carroll County Radiology, LLC (CCR) is a 60% owned joint venture that provides outpatient diagnostic imaging services.

Cen-Mar Assurance Co. (the Captive or Cen-Mar) is a wholly owned subsidiary of the Hospital, managed by USA Risk Group (Cayman) Ltd. The Captive is an offshore, medical malpractice insurance company domiciled in the Cayman Islands. Malpractice insurance coverage through the Captive is effective July 1, 2007.

(b) Basis of Presentation

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (GAAP). All majority-owned and direct member entities are consolidated. All entities where the System exercises significant influence but for which it does not have control are accounted for under the equity method. All other entities are accounted for under the cost method. All significant intercompany accounts and transactions have been eliminated.

(c) Use of Estimates

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

(d) Deficit of Revenues over Expenses

The consolidated statements of operations and changes in net assets include deficit of revenues over expenses. Changes in unrestricted net assets that are excluded from deficit of revenue over expenses, include contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purpose of acquiring such assets), certain changes in accounting principle, and defined benefit obligations in excess of recognized pension cost, among others.

(e) Cash and Cash Equivalents

All highly liquid investments with a maturity date of three months or less when purchased are considered to be cash equivalents.

(f) Inventory

Inventory, which primarily consists of medical supplies and pharmaceuticals, is stated at the lower of cost or market, with cost being determined primarily under the average cost or first-in, first-out methods.

(g) Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under bond indenture agreements, self-insurance trust arrangements, physician loan program, pledges receivable, assets restricted by donor, and assets designated by the board of directors for future capital improvements and other purposes over which it retains control and may, at its discretion, use for other purposes.

(h) Property and Equipment

Property and equipment acquisitions are recorded at cost and are depreciated over the estimated useful lives of the assets. Estimated useful lives range from 2 to 50 years. Amortization of assets held under capital leases is computed using the shorter of the lease term or the estimated useful life of the leased asset and is included in depreciation and amortization expense.

The System periodically evaluates the realizability of property and equipment based upon projected undiscounted cash flows and operating income for each business.

(Continued)

Depreciation is computed on a straight-line basis. Major classes and estimated useful lives of property and equipment are as follows:

Leasehold improvements	Lease term
Building and improvements	5 – 50 years
Equipment	2 – 10 years

Gifts of long-lived assets, such as land, building, or equipment, are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are reported are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as temporarily restricted net assets. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported as released from restrictions when the donated or acquired long-lived assets are placed in service.

(i) Long-Term Investments and Long-Term Investment – Other

The System's investment portfolio is considered trading and is classified as current or noncurrent assets based on management's intention as to use. All equity securities are reported at fair value principally based on quoted market prices on the consolidated balance sheets.

The System has investments in alternative investments, primarily hedge funds of funds totaling $17,693 and $17,631 at June 30, 2010 and 2009, respectively. These funds utilize various types of debt and equity securities and derivative instruments in their investment strategies. Alternative investments are recorded under the equity method.

Investment income (interest and dividends) including realized gains and losses on investment sales are reported as nonoperating gains or losses in the deficit of revenues over expenses in the accompanying consolidated statements of operations and changes in net assets unless the income or loss is restricted by the donor or law. Realized gains and losses are determined based on the specific security's original purchase price or adjusted cost if the investment was previously determined to be other-than-temporarily impaired. Unrealized gains and losses are included in nonoperating gains (losses) within the deficit of revenue over expenses.

(j) Investments in Joint Ventures and Partnerships

In addition to investments in CCR, Carroll Care Pharmacy, LLC, Carroll Occupational Health, LLC and Carroll Ear, Nose and Throat, LLC described in note 1(a), CCMS and the Hospital have investments in unconsolidated affiliates for which their ownership interests range from less than 1% to 50%, as noted in 1(a).

(k) Derivative Instruments

The Hospital accounts for derivatives and hedging activities in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 815, *Derivatives and Hedging*, which requires that all derivative instruments be recorded on the balance sheet at their respective fair values. In addition, for those derivative instruments that meet the criteria of an effective fair value hedge, it requires the hedged item to be recorded at fair value.

The Hospital utilizes derivative financial instruments to manage its interest rate risks associated with tax-exempt debt. The Hospital does not hold or issue derivative financial instruments for trading purposes. The Hospital's current derivative investments do not qualify for hedge accounting; therefore, the changes in fair value have been recognized in the accompanying consolidated statements of operations and changes in net assets as mark-to-market adjustments.

(l) Bond Issuance and Financing Costs

Costs related to issuance of debt instruments are deferred and amortized using the effective-interest method over the life of the instrument. Accumulated amortization was $630 and $541 as of June 30, 2010 and 2009, respectively.

(m) Net Patient Service Revenue

Net patient service revenue for the Hospital reflects actual charges to patients based on rates established by the State of Maryland Health Services Cost Review Commission (HSCRC) in effect during the period in which the services are rendered, net of contractual adjustments. Contractual adjustments represent the difference between amounts billed by the Hospital and amounts paid by third-party payors. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue.

Net patient service revenue for CH and CCR is recorded at established rates net of contractual adjustments. Contractual adjustments result from the terms of certain reimbursement contracts.

The Medicare program reimburses the Hospital for home health services pursuant to the Prospective Payment System (PPS). Rates under PPS are prospectively determined rates per 60-day episode, based on the patients' acuity level. Unearned PPS revenue was $196 and $221 as of June 30, 2010 and 2009, respectively. This unearned revenue is included in deferred revenue in the consolidated balance sheets.

(n) Other Operating Revenue

Other operating revenue mostly comprises pharmaceutical sales from Carroll Care Pharmacies, LLC. Other operating revenue activities also include various community education and outreach programs, rental income, professional fee revenue, and cafeteria and vending sales. Other operating revenue is recognized in the period in which the sales are realized or the services are provided.

(o) Self-Insurance

The System maintains self-insurance programs for workers' compensation and employee health benefits. Expenses related to these programs include estimates for incurred but not reported claims as of June 30, 2010 and 2009. The estimates are based on actuarial analysis of historical trends, claims asserted, and reported incidents and are discounted.

(p) Malpractice Insurance

The System is self-insured for general and professional liability under a claims-made policy through its wholly owned subsidiary, Cen-Mar Assurance Company. Expenses related to these programs include an estimate for incurred but not reported claims as of June 30, 2010 and 2009.

(q) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the System or individual operating units has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the System or individual operating units in perpetuity.

(r) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

(s) Income Taxes

Carroll Hospital Center, Inc. and its subsidiaries, except for CCMS, CCR, and Cen-Mar, have been recognized by the Internal Revenue Service (IRS) as tax-exempt under Section 501(c)(3) of the Internal Revenue Code and are exempt from income taxes on related income. CCMS is organized as a for-profit entity and, therefore, is subject to federal and state income taxes, which are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

(t) New Accounting Pronouncements

In June 2009, the FASB issued guidance that eliminates the hierarchy of authoritative accounting and reporting guidance on nongovernmental GAAP and replaces it with a single authoritative source, the FASB ASC. The ASC affects the way in which users refer to GAAP and perform accounting research, but does not change GAAP. This guidance is effective for reporting periods ending after September 15, 2009. The System adopted the provisions of this guidance as of September 30, 2009. The adoption did not have an impact on the System's consolidated financial position or results of operations.

In January 2010, the FASB issued Accounting Standards Update No. 2010-06 (ASU 2010-06), *Improving Disclosures about Fair Value Measurements*. ASU 2010-06 amends ASC Topic 820, *Fair Value Measurements and Disclosures*, to require a number of additional disclosures regarding fair value measurements. Effective in fiscal year 2011, ASU 2010-06 requires disclosure of the amounts of significant transfers between Level I and Level II investments and the reasons for such transfers, the reasons for any transfers in or out of Level III investments, and disclosure of the policy for determining when transfers among levels are recognized. ASU 2010-06 also clarified that disclosures should be provided for each class of assets and liabilities and clarified the requirement to disclose information about the valuation techniques and inputs used in estimating Level II and Level III measurements. Effective in fiscal year 2011, ASU 2010-06 also requires that information in the reconciliation of recurring Level III measurements about purchases, sales, issuances, and settlements be provided on a gross basis. The adoption of ASU 2010-06 only required additional disclosures and did not have an impact on the consolidated financial statements. As the System does not have significant transfers between Levels, or any Level III measurements, no additional disclosures were necessary.

In December 2008, the FASB issued guidance related to *Employers' Disclosures about Postretirement Benefit Plan Assets*, which amended previously issued guidance. The purpose of the guidance is to enhance disclosures and provide users' with information regarding the types of assets and associated risks in an employer's defined benefit pension or other postretirement plan and events in the economy and markets that could have a significant effect on the value of plan assets. The disclosures about plan assets required shall be provided for fiscal years ending after December 15, 2009. The System adopted this disclosure requirement for the year ended June 30, 2010.

In April 2009, the FASB issued guidance related to *Not-for-Profit Entities: Mergers and Acquisitions Including an Amendment of FASB Statement No. 142*. This guidance establishes principles and requirements for how a not-for-profit entity determines whether a combination is a merger or an acquisition and amends previously issued guidance related to *Intangibles – Goodwill and Other*, to make it fully applicable to not-for-profit entities. The guidance is effective for acquisitions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2009; therefore, effective for the System on July 1, 2010. It may not be applied to mergers or acquisitions before those dates.

(Continued)

In July 2010, the FASB issued guidance related to *Health Care Entities: Presentation of Insurance Claims and Related Insurance Recoveries*. The purpose of this guidance is to distinguish between common healthcare industry practice and proper financial presentation standards. This guidance clarifies that netting receivables for expected insurance recoveries with liabilities accrued for medical malpractice and other similar claims on the balance sheet is inconsistent with other industries and current accounting guidance, namely ASC Subtopic 720-20, *Insurance Costs*. The guidance also explains that offsetting receivables for expected insurance recoveries against a recognized liability would not be appropriate unless certain criteria of ASC Topic 210-20, *Offsetting*, are met. The System will adopt this guidance on July 1, 2011.

In July 2010, the FASB issued guidance related to *Health Care Entities: Measuring Charity Care for Disclosure*. This guidance serves to further standardize the required charity care disclosures. Effective in fiscal year 2012, the System will be required to disclose charity care provided the during year measured using cost instead of its current (and most prevalent) measurement of the total charges forgone. Any related reimbursements recorded should be separately disclosed. Retrospective application is required with this guidance and early adoption is permitted.

(In thousands)

(2) Assets Limited as to Use

Assets limited as to use, stated at fair value, as of June 30, 2010 and 2009, include the following:

		2010	2009
Donor-restricted:			
Pledges receivable, less allowance of $44 in 2010 and $84 in 2009	$	419	674
Donor-restricted investments:			
Cash and cash equivalents		629	163
Money market funds		84	171
Government and corporate bonds		157	229
Mutual funds invested in equity securities		813	596
Investments in limited partnerships		186	136
		1,869	1,295
Cen-Mar Reserves held:			
Cash and cash equivalents		969	456
Government and corporate bonds		3,237	2,508
		4,206	2,964
Funds held by trustee:			
Money market funds		6,316	2,671
Government and corporate bonds		7,261	11,220
		13,577	13,891
Physician loan program:			
Cash and cash equivalents		246	646
Total assets limited as to use		20,317	19,470
Less current portion		9,485	7,842
Total assets limited as to use, less current portion	$	10,832	11,628

(Continued)

(In thousands)

The net present value of donor-restricted pledges receivable at June 30, 2010 totaled $419, discounted at 6%, and net of an allowance for uncollectible pledges of $44. The payment terms of the net present value of the pledges receivable at June 30, 2010 are as follows for the years ending June 30:

2011	$	442
2012		9
2013		7
2014		2
2015 and thereafter		3
		463
Less allowance for uncollectible pledges		(44)
	$	419

Funds held by the trustee as of June 30, 2010 and 2009 are as follows:

		2010	2009
Debt service reserve fund	$	8,609	8,735
Principal and interest fund		4,968	4,500
Capitalized interest fund		—	656
	$	13,577	13,891

The debt service reserve fund has been established to provide for future deficiencies, if any, in various bond repayment terms established by the 2006 and the 2002 Maryland Health and Higher Educational Facilities Authority Loan Agreements. The principal and interest fund comprises monthly installment payments paid by the Hospital to the trustee in accordance with the loan agreement. The trustee releases these funds to respective bondholders January 1 and July 1 of each year. The capitalized interest fund was established with Series 2006 Bond proceeds in order to pay the interest on the Series 2006 Bonds during the construction period.

(Continued)

(In thousands)

(3) Property and Equipment, Net

Property and equipment, net as of June 30, 2010 and 2009 are as follows:

		2010	2009
Land	$	1,787	1,787
Land improvements		22,846	22,267
Building and building improvements		125,512	105,742
Computer software and hardware		30,394	24,229
Equipment		85,726	84,152
Leasehold improvements		7,140	4,157
		273,405	242,334
Less accumulated depreciation and amortization		(123,344)	(108,577)
		150,061	133,757
Construction in progress		3,829	11,858
	$	153,890	145,615

Depreciation expense for the years ended June 30, 2010 and 2009 was $15,880 and $13,426, respectively. Construction in progress represents costs incurred on the Hospital's expansion projects and other facility renovations not completed as of June 30, 2010.

During September 2008, the Hospital entered into a 50-year ground lease on the campus of the Hospital to a nonaffiliated developer. Under the terms of the ground lease, the developer will construct a Medical Office Building (MOB), which the developer will own and operate during the construction period. Construction was completed in December 2009 and ownership of the MOB was transferred to Carroll MOB Associates, LLC. The Hospital determined that due to certain structural elements installed by the Hospital during construction, the Hospital is required to be treated, for accounting purposes, as the "owner" of the MOB, in accordance with FASB ASC Subtopic 840-40, *Leases-Sale-Leaseback Transactions* (Emerging Issues Task Force (EITF) Issue No. 97-10, *The Effect of Lessee Involvement in Asset construction)*. The MOB has a total of 77,000 sq. ft., of which the Health System leases 70,800 sq ft., broken down as follows: Hospital (37,000 sq ft), Carroll County Radiology (18,400 sq ft), and CCMS (15,400 sq ft)

(In thousands)

The following table shows the future minimum lease payments for the Health System related to the MOB:

		Future minimum lease payments
Year ending June 30:		
2011	$	1,988
2012		2,022
2013		2,058
2014		2,094
2015		1,928
Thereafter		8,204
Total minimum lease payments	$	18,294

At June 30, 2010, the cost of the asset is $15,833 and is included in building and building improvements with the offsetting obligation in other long-term liabilities. Total accumulated depreciation on the MOB is $422 as of June 30, 2010.

(4) Short-Term and Long-Term Investments

Investments, at fair value, as of June 30, 2010 and 2009 are as follows:

		2010	2009
Money market account and certificate of deposits	$	3,800	6,908
Government and corporate bonds		21,287	1,210
Mutual funds invested in equity securities		18,927	13,271
	$	44,014	21,389

Investments are classified as of June 30, 2010 and 2009 as follows:

		2010	2009
Short-term investments	$	13,145	6,000
Long-term investments		30,869	15,389
	$	44,014	21,389

(Continued)

(In thousands)

The System's consolidated total return on short-term and long-term investments, cash and cash equivalents, assets limited to use, long-term investments – other, and investments in joint ventures and partnerships was as follows for the years ended June 30, 2010 and 2009:

		2010	2009
Investment income (loss):			
Interest and dividend income	$	1,146	2,128
Realized gains (losses) on securities		428	(588)
Unrealized gains (losses) on securities		1,639	(1,560)
Investments in joint ventures and partnerships:			
Equity method earning		46	57
Cost method dividend income		553	494
Equity in gains (losses) on long-term investments – other		1,515	(3,556)
Total investment income (loss)		5,327	(3,025)
Other changes in net assets:			
Net changes in unrealized (losses) gains on other-than-trading securities classified as unrestricted		(18)	18
Net change in unrealized gains (losses) on other-than-trading securities in restricted net assets		101	(212)
Total other changes in net assets		83	(194)
Total investment return	$	5,410	(3,219)

(5) Fair Value of Financial Instruments

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the System's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the System based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, accounts receivable, due from affiliates, other assets, line of credit, accounts payable, advances from third-party payors, due to affiliates, accrued expenses, and other long-term liabilities: The carrying amounts, at face value or cost plus accrued interest, approximate fair value.

Board-designated and other investments: Equity and debt securities classified as trading are measured using quoted market prices at the reporting date multiplied by the quantity held.

(In thousands)

The System adopted ASC Topic 820, *Fair Value Measurements and Disclosure*, for fair value measurements of financial assets and financial liabilities and for the fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. ASC Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the System has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability, including nonexchange-traded funds, which are typically valued utilizing the net asset valuations provided by the underlying private investment companies.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The following table presents assets that are measured at fair value on a recurring basis as of June 30, 2010:

		Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3	Total
Assets:					
Money market funds	$	10,200	—	—	10,200
Mutual funds and equity securities		19,740	—	—	19,740
Government and corporate bonds		28,737	3,205	—	31,942
Total assets	$	58,677	3,205	—	61,882
Liabilities:					
Derivative instrument	$	—	7,905	—	7,905

(Continued)

(In thousands)

The following table presents assets that are measured at fair value on a recurring basis as of June 30, 2009:

		Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3	Total
Assets:					
Money market funds	$	9,750	—	—	9,750
Mutual funds and equity securities		13,867	—	—	13,867
Government and corporate bonds		12,659	2,508	—	15,167
Total assets	$	36,276	2,508	—	38,784
Liabilities:					
Derivative instrument	$	—	2,530	—	2,530

(In thousands)

(6) Long-Term Investments – Other

Total long-term investments – other consists of counts to 15 limited partnership investments, which amount to $17,693 and $17,631 as of June 30, 2010 and 2009, respectively, as follows:

	2010	2009	Percentage ownership
Pine Grove	$ 3,306	2,958	1.08%
Friess	1,094	698	0.34
Silver Creek Low Vol.	1,649	1,657	0.21
Oaktree Cap Management	142	155	0.40
WMS Income Opportunity Fund	726	990	4.95
Touchstone Opportunity Fund	826	849	3.47
Mariner Access Fund	507	402	3.40
Endowment Fund	508	320	0.03
Chesapeake Investments	882	879	1.12
Greenspring Fund	650	517	1.16
Lanx Offshore Partners	1,079	991	2.55
Silver Creek Early Advantage	1,510	2,027	2.08
Seamark Fund	1,555	897	4.42
Archstone Offshore Fund	2,497	2,271	0.13
Collins Capital	762	2,020	0.88
Total	$ 17,693	17,631	

The System's limited partnership investments are reported on the equity method, based on the fair value of the underlying investments of the partnership. In the case of certain less marketable underlying investments, principally real estate, natural resources, and private equity investments, value is established based on either external events, which substantiate a change in fair value, or a reasonable methodology that exists to capture and quantify changes in value. In some instances, those changes in value may require the use of significant estimates. Accordingly, such values may differ materially from the values that would have been used had an active market for the investments existed. The Silver Creek Low Vol. and Silver Creek Early Advantage funds are being liquidated. Management anticipates the liquidation process to be complete within the next 3-5 years.

(In thousands)

(7) Investments in Joint Ventures

Investments in joint ventures and partnerships, accounted for under the equity or cost method, consist of the following at June 30, 2010 and 2009:

		2010		2009	
Joint venture	Business purpose	Percentage ownership	Balance	Percentage ownership	Balance
Carroll County Dialysis Facilities, LP	Dialysis services	33%	$ 506	33%	$ 391
Carroll County Sleep Disorder Services. LLC	Sleep disorder services	33	37	33	7
Carroll Digestive Disease Center, LLC	Diagnostic services	10	18	10	18
Advanced PET Imaging of Maryland, LP	Diagnostic services	5	8	5	8
New Maryland Kidney Stone Management, LLC	Lithotripsy services	1	4	1	7
Carroll County Cancer Center, LLC	Oncology treatment center	1.4	100	1.4	100
Mt. Airy Surgery Center	Diagnostic services	50	65	50	(80)
Mt. Airy Plaza, LLC	Real estate activities	50	1,278	50	1,290
Carroll MOB Associates, LLC	Medical Office Building	36	2,067	—	—
Premier Purchasing Partners, LP	Purchasing partnership	0.12	231	0.12	227
Mt. Airy Health Services, LLC	Diagnostic services	50	517	50	1,059
Total			$ 4,831		$ 3,027

For those joint ventures and partnerships accounted for using the equity method, CCMS and the Hospital recorded equity in earnings of joint ventures and partnerships. For those joint ventures and partnerships accounted for using the cost method, CCMS and the Hospital recorded dividend income. Such amounts are included in investment income in the consolidated statements of operations (note 4).

(In thousands)

(8) Other Assets

Other assets as of June 30, 2010 and 2009 are as follows:

		2010	2009
Notes receivable, net	$	295	279
Financing costs, net		1,922	1,755
Goodwill		84	84
Other intangible assets, net		84	105
Deferred compensation assets		2,672	2,034
Reinsurance recoverable		2,463	1,555
Other		774	559
	$	8,294	6,371

(In thousands)

(9) Long-Term Debt

Long-term debt as of June 30, 2010 and 2009 is as follows (the indebted entity is noted parenthetically):

		2010	2009
Bond payable:			
Maryland Health and Higher Educational Facilities Authority:			
Revenue Bonds, Carroll County General Hospital Issue, Series 2002; collateralized by a Deed of Trust on certain facilities and property and a pledge of certain receipts; interest rates ranging from 3.5% to 6.0%; due in July 2037	$	86,630	87,890
Maryland Health and Higher Educational Facilities Authority:			
Revenue Bonds, Carroll Hospital Center Issue, Series 2006; collateralized by a Deed of Trust on certain facilities and property and a pledge of certain receipts; interest rates ranging from 4.5% to 5.0%; due in July 2041		35,000	35,000
Maryland Health and Higher Educational Facilities Authority:			
Revenue Bonds, Carroll Hospital Center Issue, Series 2010; collateralized by a Deed of Trust on certain facilities and property and a pledge of certain receipts; interest rates based on 68% of the 30-day LIBOR plus 1.1%; due in July 2020		12,405	—
Bank loan payable; interest at 5.125%; due in June 2014 (CCMS); secured by Carroll Care Pharmacies, LLC pharmacy inventory and equipment		615	636
Other		65	131
		134,715	123,657
Less current maturities		1,870	1,406
	$	132,845	122,251

(In thousands)

Aggregate maturities of long-term debt as of June 30, 2010 are as follows during the years ending June 30:

2011	$	1,870
2012		1,866
2013		1,946
2014		2,024
2015		2,011
Thereafter		124,998
	$	134,715

In June 2002, the Maryland Health and Higher Education Facilities Authority (MHHEFA) issued Carroll County General Hospital Issue Series 2002 Bonds on behalf of the Hospital, resulting in proceeds of $91,760. In November 2006, MHHEFA issued Carroll Hospital Center Issue Series 2006 Bonds on behalf of the Hospital, resulting in proceeds of $35,000. In June 2010, MHHEFA issued Carroll Hospital Center Issue Series 2010 Bonds on behalf of the Hospital, resulting in proceeds of $12,404. The fair value of outstanding tax-exempt bonds is estimated to be $124,769 and $117,223 as of June 30, 2010 and 2009, respectively. The fair value of other long-term debt and bank loans payable approximates its carrying value.

Under the Series 2002, 2006, and 2010 Bonds, the Hospital is required to comply with certain financial and nonfinancial covenants such as a coverage ratio, days cash on hand, debt to capitalization ratio, payments of interest and principal on specified due dates, limitations on merger, consolidation, transfer, or acquisition of assets, and limitations on the disposition of assets.

On February 23, 2007, the Hospital entered into a floating-to-fixed interest rate swap agreement (Swap) with Merrill Lynch Capital Services, Inc. to hedge a future debt issuance. The Swap has a notional amount of $50,000 with an effective date of December 15, 2009 and a termination date of December 15, 2039. During fiscal year 2010, the effective date was extended to December 15, 2011. The Hospital has recorded the change in fair value from the swap agreement in the amount of $(5,375) and $(2,232) as other, net (a component of other income/expense) in the consolidated statements of operations for the years ended June 30, 2010 and 2009, respectively.

(10) Income Tax

At June 30, 2010, the System has approximately $14,276 of net operating loss carryforwards, primarily at CCMS, that will expire through 2030. The net operating loss carryforwards created a net deferred tax asset of approximately $6,869 and $5,086 as of June 30, 2010 and 2009, respectively. Management has determined that it is more likely than not that the System will not be able to utilize the deferred tax asset; therefore, a full valuation allowance has been recorded against the deferred tax asset as of June 30, 2010 and 2009.

(In thousands)

(11) Retirement Plans

The Hospital sponsors a Defined Benefit Cash Balance Plan (the Plan) covering substantially all of the employees of the Hospital, CCMS, and the Foundation. The Hospital's funding policy is to make contributions to the Plan based on actuarially determined amounts necessary to provide assets sufficient to meet benefits to be paid to plan participants and to meet the minimum funding requirements of the Employee Retirement Income Security Act of 1974 and IRS regulations, plus such amounts as the Hospital may determine to be appropriate from time to time. Under the cash balance plan structure, the benefits under the Plan are determined based on employee tenure rather than age. The Hospital elected to freeze benefit accruals and participation in its defined benefit pension plan on December 31, 2006.

The following tables set forth the changes in the projected benefit obligation, the changes in the Plan's assets, the Plan's funded status, the amounts recognized in the System's consolidated financial statements, and the Plan's net periodic pension cost as of June 30, 2010 and 2009:

		2010	2009
Change in projected benefit obligation:			
Projected benefit obligation at beginning of period	$	46,586	44,722
Interest cost		2,635	2,641
Actuarial loss		3,364	655
Benefits paid		(1,525)	(1,432)
Projected benefit obligation at end of period		51,060	46,586
Change in plan assets:			
Fair value of plan assets at beginning of period		31,022	37,742
Actual return on plan assets		3,718	(8,068)
Employer contribution		2,640	2,780
Benefits paid		(1,525)	(1,432)
Fair value of plan assets at end of period		35,855	31,022
Funded status	$	(15,205)	(15,564)

Net periodic pension expense for the years ended June 30, 2010 and 2009 was as follows:

		2010	2009
Components of net periodic pension expense:			
Interest cost	$	2,635	2,641
Expected return on plan assets		(2,527)	(3,050)
Amortization of actuarial loss		1,196	278
Net periodic pension expense	$	1,304	(131)

(Continued)

(In thousands)

Assumptions used by the Hospital to determine the benefit obligation as of June 30, 2010 and 2009 (the measurement date) are as follows:

	2010	**2009**
Discount rate	5.50%	5.75%
Rate of increase in compensation	N/A	N/A

Assumptions used by the Hospital in the determination of net periodic pension expense for the years ended June 30, 2010 and 2009 are as follows:

	2010	**2009**
Discount rate	5.75%	6.00%
Expected long-term rate of return on plan assets	8.00	8.00

The Hospital's weighted average asset allocations for the plan assets as of June 30, 2010 and 2009 are as follows:

	2010	**2009**
Mutual funds and equity securities	37.1%	49.2%
Government and corporate bonds	21.9	22.4
Alternative investments	31.2	24.6
Cash and cash equivalents	9.8	3.8
	100.0%	100.0%

Pension plan assets are invested in accordance with the Hospital's investment policy statement objectives in an attempt to maximize return with reasonable and prudent levels of risk. This structure includes various assets classes, investment management styles, asset allocation, and acceptable ranges that, in total, are expected to produce a sufficient level of overall diversification and total investment return over the long term. The Hospital periodically reviews performance to test progress toward attainment of longer term targets, to compare results with appropriate indices and peer groups, and to assess overall investment risk levels.

(In thousands)

The following table presents the Plan's assets measured at fair value at June 30, 2010:

	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3	Total
Assets:				
Cash and cash equivalents	$ 3,514	—	—	3,514
Mutual funds and equity securities	15,455	—	—	15,455
Government and corporate bonds	5,689	—	—	5,689
Alternative investments	—	4,483	6,714	11,197
Total assets	$ 24,658	4,483	6,714	35,855

The System's pension plan invests in alternative investments which are primarily hedge fund of funds and private equity funds. Such investments are typically carried at estimated fair value. The System uses the practical expedient to report the net asset values of these funds as an estimate of fair value. Because of the inherent uncertainty of valuation, the determined values may differ significantly from the values that would have been used had a ready market for these investments existed.

The Hospital expects to contribute $2,640 to the Plan in 2011.

The following benefit payments, which reflect future services, as appropriate, are expected to be paid from the Plan's assets during the years ending June 30:

2011	$ 1,691
2012	1,823
2013	2,026
2014	2,160
2015	2,274
Years 2016 – 2019	13,616
	$ 23,590

The current defined contribution (403b) program was redesigned and will serve as the primary retirement program as of January 1, 2007. The Hospital has accrued a liability of $625 as of June 30, 2010 and a liability of $566 as of June 30, 2009 for benefits earned under this plan. The Hospital expensed total employee contributions of $2,116 and $2,716 as of June 30, 2010 and 2009, respectively.

(In thousands)

The Hospital has a supplemental retirement plan (Retirement Plan) for certain key employees. Employees become fully vested based on the vesting schedule pursuant to the Retirement Plan documents. The assets of the Retirement Plan remain as the property of the Hospital until distributed to participants. The Hospital can make discretionary contributions to the Retirement Plan. The Hospital made contributions of $229 and $226 for the years ended June 30, 2010 and 2009, respectively, which are included in employee benefits expense in the accompanying consolidated statements of operations. The Hospital has recorded a liability and deferred compensation asset related to the Retirement Plan of $2,672 and $2,034 as of June 30, 2010 and 2009, respectively.

(12) Postretirement Plan Other than Pension

The Hospital sponsors a postretirement plan other than pension for employees. Hospital employees retired from active employment at 65 years of age or older or at 55 years of age after earning at least 10 years of vesting service are eligible for health and prescription drug benefits under the Hospital's self-insured health plan. Effective January 1, 2009, individuals are no longer permitted to participate in this Plan once they are Medicare eligible. Plan participants contribute premiums to the Plan in amounts determined by the Hospital for Pre-Medicare and post-Medicare age retirees.

The following tables set forth the changes in the projected benefit obligation, the changes in the Plan's assets, the Plan's funded status, the amounts recognized in the System's consolidated financial statements, and the Plan's postretirement benefit expense at June 30, 2010 and 2009:

		2010	2009
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	$	138	689
Service cost		50	26
Interest cost		33	25
Plan amendment		—	(569)
Actuarial gain		449	13
Employer contribution		—	(46)
Projected benefit obligation at end of year	$	670	138
Change in plan assets:			
Employer contribution	$	—	46
Plan participant contribution, net		31	78
Benefits paid, net		(31)	(124)
Fair value of plan assets at end of year	$	—	—

		2010	2009
Reconciliation of funded status to net amounts recognized in the consolidated financial statements:			
Funded status	$	(670)	(138)
Accrued benefit cost	$	(670)	(138)
Components of postretirement benefit expense:			
Service cost	$	50	26
Interest cost		33	25
Amortization of prior service cost		68	118
Recognized actuarial gain		(33)	(69)
Postretirement benefit expense	$	118	100

Assumptions used by the Hospital in the determination of the postretirement benefit obligation and benefit expense for the years ended June 30, 2010 and 2009 (the measurement date) are as follows:

	2010	2009
Weighted average rate used to determine benefit expense for the years ended June 30	5.75%	6.00%
Weighted average rate used to determine benefit obligations at June 30	5.50	5.75
Initial healthcare cost trend rate	10.50	10.50
Next year trend rate	6.54	6.50
Ultimate trend rate	4.20	5.50
Ultimate trend rate year	2080	2011

The Hospital expects to contribute $21 to the postretirement benefit plan in 2010 – 2011.

The following are the projected benefit payments, which reflect expected future service as appropriate, used in determining the benefit obligation:

2011	$	21
2012		25
2013		32
2014		33
2015		29
Years 2016 – 2019		283
	$	423

(In thousands)

(13) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are restricted as of June 30, 2010 and 2009 for the following:

		2010	2009
Hospice program	$	199	140
Cardiac services		187	530
Cancer programs		438	50
Other		309	135
	$	1,133	855

Permanently restricted net assets are to be held in perpetuity, the income from which is expendable for the treatment of heart disease, oncology, cardiology, support of emergency room services, scholarships, and general building maintenance. Permanently restricted net assets, stated at fair value, totaled $1,138 and $1,113 at June 30, 2010 and 2009, respectively.

(14) Functional Expenses

The System provides general healthcare services to residents within its geographic location. Expenses related to providing these services, based on management estimates of expense allocations as of June 30, 2010 and 2009, are as follows:

		2010	2009
Healthcare services	$	210,215	205,149
General and administrative		33,256	30,840
	$	243,471	235,989

(15) Concentrations of Credit Risk

The System provides healthcare services through its inpatient and outpatient care facilities located primarily in Carroll County. The System generally does not require collateral or other security in extending credit; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits receivable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, Workers' Compensation, health maintenance organizations (HMOs), and commercial insurance policies).

(In thousands)

The mix of receivables for the System at June 30, 2010 and 2009 is as follows:

	2010	**2009**
Medicare	28%	29%
Medicaid	13	10
Blue Cross	13	17
Commercial, HMOs, and other	32	33
Self-pay	14	11
	100%	100%

The mix of net patient service revenue for the System for the years ended June 30, 2010 and 2009 is as follows:

	2010	**2009**
Medicare	39%	42%
Medicaid	10	7
Blue Cross	15	17
Commercial, HMOs, and other	34	31
Self-pay	2	3
	100%	100%

(16) Health Services Cost Review Commission

The Hospital charges are subject to review and approval by the HSCRC. Management has made the required filings with the HSCRC and believes the Hospital is in compliance with HSCRC requirements.

The Hospital has a charge per case (CPC) agreement with the HSCRC. This CPC agreement establishes a prospectively approved average charge per inpatient case (inpatient cases are defined as hospital admissions plus births) and an estimated case mix index. These approved CPC targets are adjusted during the rate year for actual changes in case mix. The CPC agreement allows the Hospital to adjust approved unit rates, within certain limits, to achieve the average charge per case target for each rate year ending June 30.

Hospital-based outpatient revenues continue to be a function of HSCRC established unit rates charged to patients for services rendered.

During 1997, the HSCRC established an uncompensated care fund whereby the majority of hospitals are required to contribute a portion of revenues to this fund to help provide for the cost associated with charity care for all Maryland hospitals. The Hospital contributed $3,514 and $2,220 to this fund for the years ended June 30, 2010 and 2009, respectively. This contribution is recorded within net patient service revenue.

(Continued)

(17) Certain Significant Risks, Uncertainties, and Commitments

(a) Regulation and Reimbursement

The System provides general acute healthcare services in the State of Maryland. The System and other healthcare providers are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the Federal Medicare and state Medicaid programs
- Regulation of hospital rates by the HSCRC
- Government regulation, government budgetary constraints, and proposed legislative and regulatory changes
- Lawsuits alleging malpractice or other claims

Such inherent risks require the use of certain management estimates in the preparation of the System's consolidated financial statements and it is reasonably possible that a change in such estimates may occur.

The Medicare and state Medicaid reimbursement programs represent a substantial portion of the System's revenues and the System's operations are subject to a variety of other federal, state, and local regulatory requirements. Failure to maintain required regulatory approvals and licenses and/or changes in such regulatory requirements could have a significant adverse effect on the System.

Changes in federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on the System.

The healthcare industry is subject to numerous laws and regulations from federal, state, and local governments. The System's compliance with these laws and regulations can be subject to periodic governmental review and interpretation, which can result in regulatory action unknown or unasserted at this time. Management is aware of certain asserted and unasserted legal claims and regulatory matters arising in the ordinary course of business, none of which, in the opinion of management, is expected to result in losses in excess of insurance limits or have a materially adverse effect on the System's consolidated financial position.

The federal government and many states have aggressively increased enforcement under Medicare and Medicaid antifraud and abuse laws and physician self-referral laws (STARK law and regulation). Recent federal initiatives have prompted a national review of federally funded healthcare programs. The System has implemented a compliance program to monitor conformance with applicable laws and regulations, but the possibility of future government review and interpretation exists.

(b) Malpractice Insurance

The Hospital is involved in litigation arising in the normal course of business. Claims alleging malpractice have been asserted and are currently in various states of litigation. Additional claims may be asserted arising from services provided to patients through June 30, 2010. On June 25, 2007, the Hospital established Cen-Mar Assurance Co. (the Captive) – an offshore, medical malpractice insurance company domiciled in the Cayman Islands. The Captive is a wholly owned subsidiary of the Hospital managed by USA Risk Group (Cayman) Ltd. Malpractice insurance coverage through the Captive is effective July 1, 2007.

The Captive was incorporated as an exempted company under the Companies Law of the Cayman Islands on June 20, 2007 and holds an Unrestricted Class ’B’ Insurer’s License under Section 4(2) of the Cayman Islands Insurance Law. The Captive is a wholly owned subsidiary of the Hospital.

The Captive insures the Hospital, its subsidiaries, and employed physicians on a claims-made basis for medical professional liability and general liability. Effective July 1, 2007, the Captive issued a claims-made professional and general liability policy with a retroactive date of July 1, 2007 for general liability and a retroactive date of October 1, 1984 for medical professional liability. The limits of liability provided are $1,000 per incident and a total annual aggregate of $3,000, covering claims to the extent they are reported to the Captive and are within the scope of coverage afforded under the policy terms and conditions. The Captive also issued a claims-made excess policy, which is fully reinsured with unrelated reinsurance parties. The Hospital has accrued a liability within accounts payable and accrued expenses of approximately $3,275 and $2,958 at June 30, 2010 and 2009, respectively, for known claims and incurred but not reported claims.

(c) Health Insurance

The Hospital is self-insured for employee health claims. Under the self-insurance plan, the Hospital has accrued a liability of $976 and $959 at June 30, 2010 and 2009, respectively, for known claims and incurred but not reported claims.

The Hospital maintains a stop-loss policy on health insurance claims. The Hospital is insured for individual claims exceeding $150.

(d) Workers’ Compensation

In 2003, the Hospital became self-insured for workers’ compensation claims. Under the Plan, the Hospital has accrued a liability of $958 for known claims and incurred but not reported claims as of June 30, 2010 and 2009, respectively.

The Hospital maintains a stop-loss policy on workers’ compensation claims. The Hospital is insured for individual claims exceeding $500. The Hospital maintains a letter of credit with a commercial bank in the amount of $1,100 to secure payments on the outstanding workers’ compensation claims as required by the State of Maryland Workers’ Compensation Commission. There were no amounts outstanding on this letter of credit as of June 30, 2010 and 2009.

(In thousands)

(e) Loan Program

In July 1994, the Hospital implemented a loan program for physicians and/or medical practices for the purposes of starting new medical practices, relocating existing practices, or refinancing certain existing loans. The loans will be financed through a bank with an aggregate maximum limit of $2,500. The Hospital is required to maintain a compensating balance with the bank, which can be drawn upon by the bank in the event of default by the physicians and/or medical practices that approximates the outstanding principal balance of all loans. The total amount under the Hospital's compensating balance arrangement was $246 and $646 at June 30, 2010 and 2009, respectively.

(f) Leases

The System leases facilities under several operating leases, the last of which expires in 2019. The Hospital has various options to renew the leases. Rent expense on all operating leases was $2,411 and $2,156 for the years ended June 30, 2010 and 2009, respectively.

Future minimum payments under operating leases and capital leases (with initial or remaining lease terms in excess of one year) as of June 30, 2010 are as follows:

	Operating leases	Capital leases
Year ending June 30:		
2011	$ 1,731	1,823
2012	1,264	926
2013	1,080	416
2014	931	—
2015	906	—
Thereafter	2,290	—
Total minimum lease payments	$ 8,202	3,165
Less amount representing interest		247
Total minimum lease payments		$ 2,918

(In thousands)

As of June 30, 2010, scheduled annual principal portion of obligations under capital leases is as follows:

Year ending June 30:		
2011	$	1,647
2012		865
2013		406
Thereafter		—
	$	2,918

(g) Litigation

The System is subject to numerous laws and regulations from federal, state, and local governments. The System's compliance with these laws and regulations can be subject to periodic governmental review and interpretation, which can result in regulatory action unknown or unasserted at this time. Management is aware of certain asserted and unasserted legal claims and regulatory matters arising in the ordinary course of business. After consultation with legal counsel, it is management's opinion that the ultimate resolution of these claims will not have a material adverse effect on the System's consolidated financial position or changes in net assets.

(18) Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy. The Hospital charges at its established rates but waives all or a portion of reimbursement. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as gross patient service revenue. The Hospital maintains records to identify and monitor the level of charity care it provides. These records reflect the amount of charges forgone under its charity care policy and amounted to $4,992 and $5,211 for the years ended June 30, 2010 and 2009, respectively.

(19) Subsequent Events

The System has evaluated subsequent events from the consolidated balance sheet date through October 22, 2010, the date at which the consolidated financial statements were issued, and determined there were no other items to disclose.

Schedule 1

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidating Balance Sheet Information

June 30, 2010

(In thousands)

Assets	**Carroll Hospital Center Inc.**	**Carroll County MedServices, Inc. and Subsidiaries**	**Carroll Hospice, Inc.**	**Carroll Hospital Center Foundation, Inc.**	**Carroll County Radiology, LLC**	**Cen-Mar**	**Eliminations**	**Consolidated**
Current assets:								
Cash and cash equivalents	$ 44,354	2,221	735	16	320	—	—	47,646
Short-term investments	13,145	—	—	—	—	—	—	13,145
Current portion of assets limited as to use	4,968	—	—	311	—	4,206	—	9,485
Patient receivables, net	18,272	2,633	366	—	2,434	—	—	23,705
Other receivables	557	208	—	—	746	31	—	1,542
Due from affiliates	804	—	—		—	—	(804)	—
Inventory	2,920	912	—	—	6	—	—	3,838
Prepaid expenses	2,590	453	10	4	37	17	—	3,111
Total current assets	87,610	6,427	1,111	331	3,543	4,254	(804)	102,472
Property and equipment, net	133,056	7,737	5,138	—	8,381	—	(422)	153,890
Beneficial interest in net assets of Foundation	9,482	—	—	—	—	—	(9,482)	—
Long-term investments	49,881	—	—	5,758	—	—	(24,770)	30,869
Long-term investments – other	16,678	—	—	1,015	—	—	—	17,693
Investment in joint ventures	2,915	1,916	—	—	—	—	—	4,831
Assets limited as to use, less current portion	8,855	—	123	1,854	—	—	—	10,832
Other assets	4,643	620	17	551	—	2,463	—	8,294
Total assets	$ 313,120	16,700	6,389	9,509	11,924	6,717	(35,478)	328,881
Liabilities and Net Assets								
Current portion of long-term debt	$ 1,656	214	—	—	—	—	—	1,870
Current obligations under capital lease	314	61	—	—	1,272	—	—	1,647
Accounts payable and accrued expenses	16,014	1,230	86	27	472	5,540	(1)	23,368
Accrued payroll and related taxes	9,318	759	—	—	275	—	—	10,352
Deferred revenue	196	—	—	—	—	—	—	196
Advances from third-party payors	4,454	—	—	—	—	—	—	4,454
Due to affiliates	—	789	13	—	—	1	(803)	—
Total current liabilities	31,952	3,053	99	27	2,019	5,541	(804)	41,887
Long-term debt, less current portion	132,379	466	—	—	—	—	—	132,845
Long-term obligations under capital lease, less current portion	240	77	—	—	954	—	—	1,271
Other liabilities	29,036	—	—	—	983	—	(422)	29,597
Accrued pension and postretirement benefits	15,877	179	—	—	—	—	—	16,056
Total liabilities	209,484	3,775	99	27	3,956	5,541	(1,226)	221,656
Minority interest	—	278	—	—	3,187	—	—	3,465
Net assets:								
Unrestricted	94,154	12,647	6,167	7,334	4,781	1,176	(24,770)	101,489
Temporarily restricted	8,344	—	123	1,010	—	—	(8,344)	1,133
Permanently restricted	1,138	—	—	1,138	—	—	(1,138)	1,138
Total net assets	103,636	12,647	6,290	9,482	4,781	1,176	(34,252)	103,760
Total liabilities and net assets	$ 313,120	16,700	6,389	9,509	11,924	6,717	(35,478)	328,881

See accompanying independent auditors' report.

Schedule 2

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidating Statement of Operations Information

Year ended June 30, 2010

(In thousands)

		Carroll Hospital Center Inc.	Carroll County MedServices, Inc. and Subsidiaries	Carroll Hospice, Inc.	Carroll Hospital Center Foundation, Inc.	Carroll County Radiology, LLC	Cen-Mar	Eliminations	Consolidated
Unrestricted revenues, gains, and other support:									
Net patient service revenue	$	188,513	12,435	3,442	—	20,016	—	—	224,406
Other operating revenue		2,790	15,486	—	—	—	2,355	(2,874)	17,757
Net assets released from restrictions used for operations		—	—	11	—	—	—	—	11
Total unrestricted revenues, gains, and other support		191,303	27,921	3,453	—	20,016	2,355	(2,874)	242,174
Expenses:									
Salaries and wages		77,446	14,811	2,780	—	3,911	—	—	98,948
Employee benefits		19,126	1,644	299	—	577	—	—	21,646
Departmental supplies and expenses		27,587	10,344	254	—	980	—	—	39,165
Professional fees		14,738	200	66	—	5,899	—	—	20,903
Purchased services		26,444	5,981	544	—	3,021	1,952	(4,012)	33,930
Depreciation and amortization		13,802	578	203	—	985	—	422	15,990
Interest		6,788	54	—	—	142	—	716	7,700
Provision for bad debts		4,064	161	—	—	964	—	—	5,189
Total expenses		189,995	33,773	4,146	—	16,479	1,952	(2,874)	243,471
Operating income (loss)		1,308	(5,852)	(693)	—	3,537	403	—	(1,297)
Other income (expense):									
Investment income (loss)		4,474	230	(3)	535	—	91	—	5,327
Unrestricted gifts		—	—	860	1,146	—	—	—	2,006
Other		(7,299)	(247)	(232)	(185)	(249)	—	—	(8,212)
(Deficit) excess of revenues over expenses before minority interest		(1,517)	(5,869)	(68)	1,496	3,288	494	—	(2,176)
Minority interest		—	(250)	—	—	(1,315)	—	—	(1,565)
(Deficit) excess of revenues over expenses		(1,517)	(6,119)	(68)	1,496	1,973	494	—	(3,741)
Contributions to (from) foundation		1,166	—	25	(1,191)	—	—	—	—
Net change in unrealized gains on investments		—	—	—	—	—	(18)	—	(18)
Net assets released from restriction for capital expenditures		—	—	—	577	—	—	—	577
Change in funded status of pension plan and postretirement plan		(1,391)	—	—	—	—	—	—	(1,391)
Change in unrestricted net assets	$	(1,742)	(6,119)	(43)	882	1,973	476	—	(4,573)

See accompanying independent auditors' report.