CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidated Financial Statements and Supplemental Schedules

June 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

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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, 2011 and 2010, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the 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, 2011 and 2010, 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.

As indicated in note 14, the System adopted Accounting Standards Codification Topic 958, *Not-for-Profit Entitles: Mergers and Acquisition.*

KPMG LLP

October 26, 2011

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidated Balance Sheets

June 30, 2011 and 2010

(In thousands)

Assets		**2011**	**2010**
Current assets:			
Cash and cash equivalents	$	32,245	47,646
Short-term investments		14,323	13,145
Current portion of assets limited as to use		12,350	9,485
Patient receivables, net of allowance for uncollectible of $6,629 in 2011 and $6,537 in 2010		23,017	23,705
Other receivables		1,556	1,542
Inventory		3,410	3,838
Prepaid expenses		2,747	3,111
Total current assets		89,648	102,472
Property and equipment, net		152,510	153,890
Long-term investments		53,788	30,869
Long-term investments – other		18,684	17,693
Investments in joint ventures		4,696	4,831
Assets limited as to use, less current portion		12,579	10,832
Other assets		14,118	8,294
Total assets	$	346,023	328,881
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	1,921	1,870
Current obligation under capital lease		1,066	1,647
Accounts payable and accrued expenses		23,019	23,368
Accrued payroll and related taxes		9,287	10,352
Deferred revenue		214	196
Advances from third-party payors		6,724	4,454
Total current liabilities		42,231	41,887
Long-term debt, less current portion		132,954	132,845
Long-term obligation under capital lease, less current portion		696	1,271
Other liabilities		25,835	29,597
Accrued pension and postretirement benefits		6,874	16,056
Total liabilities		208,590	221,656
Net assets:			
Unrestricted:			
Unrestricted net assets		127,772	101,489
Noncontrolling interest in consolidated subsidiaries		4,316	3,465
Total unrestricted net assets		132,088	104,954
Restricted:			
Temporarily restricted		4,232	1,158
Permanently restricted		1,113	1,113
Total restricted net assets		5,345	2,271
Total net assets		137,433	107,225
Total liabilities and net assets	$	346,023	328,881

See accompanying notes to consolidated financial statements.

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended June 30, 2011 and 2010

(In thousands)

		2011	2010
Unrestricted revenues, gains, and other support:			
Net patient service revenue	$	234,960	224,406
Other operating revenues		19,814	17,757
Net assets released from restrictions used for operations		20	11
Total unrestricted revenues, gains, and other support		254,794	242,174
Expenses:			
Salaries and wages		103,349	98,948
Employee benefits		19,581	21,646
Departmental supplies and expenses		38,206	39,165
Professional fees		18,324	20,903
Purchased services		31,405	33,930
Depreciation and amortization		15,993	15,990
Interest		8,525	7,700
Provision for bad debts		9,980	5,189
Total expenses		245,363	243,471
Operating income (loss)		9,431	(1,297)
Other income (expense):			
Investment income		7,949	5,327
Unrestricted gifts		2,039	2,006
Other, net		705	(8,212)
Excess (deficit) of revenues over (under) expenses	$	20,124	(2,176)

See accompanying notes to consolidated financial statements.

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2011 and 2010

(In thousands)

		Unrestricted net assets	Temporarily restricted net assets	Permanently restricted net assets	Total net assets
Balance at June 30, 2009	$	109,958	855	1,113	111,926
Deficit of revenues over expenses		(2,176)	—	—	(2,176)
Restricted gifts, bequests, and contributions		—	790	—	790
Change in unrealized gains/losses other than trading securities		(18)	101	—	83
Net assets released from restrictions used for capital expenditures		577	(577)	—	—
Net assets released from restrictions used for operations		—	(11)	—	(11)
Distributions to noncontrolling owners		(1,996)	—	—	(1,996)
Change in funded status of pension plan and postretirement		(1,391)	—	—	(1,391)
Changes in net assets		(5,004)	303	—	(4,701)
Balance at June 30, 2010		104,954	1,158	1,113	107,225
Deficit of revenues over expenses		20,124	—	—	20,124
Restricted gifts, bequests, and contributions		—	3,306	—	3,306
Change in unrealized gains/losses other than trading securities		—	240	—	240
Net assets released from restrictions used for capital expenditures		452	(452)	—	—
Net assets released from restrictions used for operations		—	(20)	—	(20)
Distributions to noncontrolling owners		(924)	—	—	(924)
Change in funded status of pension plan and postretirement		7,482	—	—	7,482
Changes in net assets		27,134	3,074	—	30,208
Balance at June 30, 2011	$	132,088	4,232	1,113	137,433

See accompanying notes to consolidated financial statements.

CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended June 30, 2011 and 2010

(In thousands)

		2011	2010
Cash flows from operating activities:			
Change in net assets	$	30,208	(4,701)
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		15,993	15,990
Provision for bad debts		9,980	5,189
Change in funded status of pension plan and postretirement		(7,482)	1,391
Equity in losses (earnings) of joint ventures		22	(46)
Loss on disposition of property and equipment		129	1,659
Distributions to noncontrolling interest holder		924	1,996
Restricted gifts, bequests, and contributions		(3,306)	(790)
Change in net unrealized gains on investments		(4,826)	(3,253)
Realized gains on sales of investments		(683)	(428)
Change in unrealized losses (gains) on derivative instruments		(1,559)	5,375
Changes in assets and liabilities:			
Patient and other receivables		(9,306)	(3,286)
Inventory		428	52
Prepaid expenses		364	336
Other assets		(1,424)	(1,996)
Accounts payable, accrued expenses, accrued payroll and related taxes, and other liabilities		(2,556)	3,220
Deferred revenue		18	(25)
Advances from third-party payors		2,270	(551)
Net cash provided by operating activities		29,194	20,132
Cash flows from investing activities:			
Purchases of property and equipment, net		(13,209)	(15,895)
Proceeds from sale of property and equipment		—	72
Investment in joint ventures		(546)	(553)
Net purchases of investments		(21,045)	(20,605)
Sales of long-term investments, other		1,465	1,603
Purchases of assets limited as to use, net		(4,612)	(847)
Distributions from joint ventures		659	1,161
Payment on derivative instrument		(2,760)	—
Cash paid for acquisitions		(5,933)	—
Net cash used in investing activities		(45,981)	(35,064)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt		1,684	12,404
Payments on long-term debt		(1,524)	(1,767)
Payments on capital lease obligation		(1,156)	(949)
Distributions to noncontrolling interest holder		(924)	(1,996)
Proceeds from restricted gifts, bequests, and contributions		3,306	790
Net cash provided by financing activities		1,386	8,482
Net decrease in cash and cash equivalents		(15,401)	(6,450)
Cash and cash equivalents, beginning of year		47,646	54,096
Cash and cash equivalents, end of year	$	32,245	47,646
Supplemental cash flow information:			
Interest paid	$	8,525	7,700
Medical Office Building		391	15,833
Additions to property and equipment for capital leases		678	1,223
Note payable for interest in joint venture		—	—

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 Associates LLC, Carroll Orthopaedic Specialists LLC, Carroll Vascular Center LLC, Carroll Surgical Specialists LLC and Carroll Neurology 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 Marsh Management Services (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 GAAP 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) Excess (Deficit) of Revenues over (under) Expenses

The consolidated statements of operations and changes in net assets include a performance indicator, excess (deficit) of revenues over expenses. Changes in unrestricted net assets that are excluded from excess (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, distributions to noncontrolling owners 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 3 to 50 years. Amortization of assets held under capital leases are 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.

(Continued)

(In thousands)

The System periodically evaluates the realizability of property and equipment based upon projected undiscounted cash flows and operating income for each business. There were no impairments of long lived assets during the years ended June 30, 2011 and 2010.

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	3 – 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 $18,684 and $17,693 at June 30, 2011 and 2010, 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 excess (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 and recorded in nonoperating gains (losses). Unrealized gains and losses are included in nonoperating gains (losses) within the excess (deficit) of revenue over (under) expenses.

(j) Investments in Joint Ventures and Partnerships

In addition to investments in CCR, Carroll Care Pharmacies, 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).These investments are accounted for under the cost or equity method of accounting, as appropriate and are included in Investments in joint ventures in the consolidated balance sheet. The Corporation utilizes the equity method of accounting for its investments in entities over which it exercises significant influence. The Hospital's equity income or loss is recognized in investment income.

(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 including the credit valuation adjustment.

(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 $726 and $630 as of June 30, 2011 and 2010, respectively.

(m) Net Patient Service Revenue

Patient service revenue of the Hospital is recorded at rates established by the State of Maryland Health Services Cost Review Commission (HSCRC) and, accordingly, reflects actual charges to patients based on rates in effect during the period in which the services are rendered. Prior to fiscal year 2011, the Hospital had a charge per case (CPC) agreement with the HSCRC, which were renewed annually. These CPC agreements established a prospectively approved average charge per inpatient case (defined as hospital admissions plus births) and an estimated case mix index. These approved CPC targets were adjusted during the rate year for actual changes in case mix. The CPC agreements allowed hospitals to adjust approved unit rates, within certain limits, to achieve the average charge per case target for each rate year ending June 30.

On March 31, 2011, The Hospital and the HSCRC agreed to a three year contract for the System to implement the Total Patient Revenue (TPR) methodology, effective July 1, 2010. The TPR agreement establishes a prospective, fixed revenue base, the "TPR cap", for the upcoming year. This includes both inpatient and outpatient regulated services. Under TPR, the System's revenue for all HSCRC regulated services is predetermined for the upcoming year, regardless of changes in volume, service mix intensity, or mix of inpatient or outpatient services that occurred during the year. The

TPR agreement allows the System to adjust unit rates, within certain limits, to achieve the overall revenue base for the System at year end. Any overcharge or undercharge versus the TPR cap is prospectively added to the subsequent year's TPR cap. Although the TPR cap does not adjust for changes in volume or service mix, the TPR cap is adjusted annually for inflation, and for changes in payor mix and uncompensated care. Beginning in year three of the three year contract, the Hospital will receive an annual adjustment to its cap for the change in population in the System's service area. TPR is designed to encourage hospitals to operate efficiently by reducing utilization and managing patients in the appropriate care delivery setting.

Net patient service revenue for CH, CCMS 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 $214 and $196 as of June 30, 2011 and 2010, 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. The System is also 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 estimates for incurred but not reported claims as of June 30, 2011 and 2010. The estimates are based on actuarial analysis of historical trends, claims asserted, and reported incidents and are discounted.

(p) 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.

(q) 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 statements 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.

(r) Income Taxes

The Hospital 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.

(s) Reclassifications

Certain prior year amounts have been classified to conform to present period presentation. The effect of which is not material.

(t) New Accounting Pronouncements

In December 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-29, *Business Combinations (Topic 805), Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29), which requires an entity to disclose pro forma information for material business combinations that occurred in the current reporting period. If comparative financial statements are presented, the disclosures should include pro forma revenue and earnings of the combined entity as though the business combinations that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period. The adoption of ASU 2010-29 is effective for business combinations on or after July 1, 2011. The adoption of ASU 2010-29 is not expected to have an impact on the Hospital’s consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-07, *Not-for-Profit Entities (Topic 958), Not-for Profit Entities: Mergers and Acquisition (ASU 2010-07)*, which codified previous guidance on accounting for a combination of not-for-profit entities and applies to a combination that meets the definition of either a merger of not-for-profit entities or an acquisition by a not-for-profit entity. ASU 2010-07 also amends previous guidance for the reporting of goodwill and other intangibles and noncontrolling interests in consolidated financial statements to make their provisions fully applicable to not-for-profit entities. This guidance establishes that goodwill be tested annually for impairment and an impairment loss be recognized if it is determined that the carrying amount of the reporting unit's net assets exceed its fair value. Beginning on July 1, 2010, the Health System applied the transition provisions of the guidance which requires the Health System to cease amortization of previously recognized goodwill and to test goodwill for impairment annually or more frequently if events or circumstances indicate that the carrying value of an asset may not be recoverable. The Health System completed a transitional and annual goodwill impairment test. No adjustments to the carrying value of previously recognized goodwill were recorded during the year ended June 30, 2011. The guidance also requires the presentation of noncontrolling interests in the net assets of consolidated subsidiaries be reported as a separate component of the appropriate class of net assets in the consolidated balance sheets and the amount of consolidated excess of revenues over expenses attributable to the Health System and to the noncontrolling interest be disclosed. The provisions of the standard related to the presentation and disclosure of noncontrolling interests are to be applied retrospectively to all periods presented. The adoption of this standard did not have a material impaction the Health System's consolidated financial statements, other than the following:

a) Noncontrolling interests of $3,896 were reclassified from other long-term liabilities to unrestricted net assets, separate from the Health System's unrestricted net assets.

b) Consolidated excess of revenues over expenses includes excess of revenues over expenses attributable to both the Health System and noncontrolling interests See note 14.

c) The consolidated statements of cash flows now begin with change in net assets (including noncontrolling interests) with excess of revenues over expenses from noncontrolling interests included in changes in assets and liabilities and is no longer a reconciling item in arriving at net cash provided by operating activities. Distributions and contributions to/from noncontrolling owners are reported in cash flows from financing.

In January 2010, the FASB issued 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 fiscal year 2010, ASU 2010-06 required disclosure of the amounts of significant transfers between Level 1 and Level 2 investments and the reasons for such transfers, the reasons for any transfers into or out of Level 3 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 3 measurements. Effective in fiscal year 2011, ASU 2010-06 also requires that information in the reconciliation of recurring Level 3 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 Hospital does not have significant transfers between levels, or any Level 3 measurements, no additional disclosures were necessary.

(Continued)

(In thousands)

(2) Assets Limited as to Use

Assets limited as to use, stated at fair value, as of June 30, 2011 and 2010, include the following:

		2011	2010
Donor-restricted:			
Pledges receivable, less allowance of $429 in 2011 and $44 in 2010	$	3,468	419
Donor-restricted investments:			
Cash and cash equivalents		548	629
Money market funds		—	84
Government and corporate bonds		171	157
Mutual funds invested in equity securities		907	813
Investments in limited partnerships		267	186
		1,893	1,869
Cen-Mar Reserves held:			
Cash and cash equivalents		788	969
Government and corporate bonds		5,272	3,237
		6,060	4,206
Funds held by trustee:			
Cash and cash equivalents		5	—
Money market funds		4,286	6,316
Government and corporate bonds		9,152	7,261
		13,443	13,577
Physician loan program:			
Cash and cash equivalents		65	246
Total assets limited as to use		24,929	20,317
Less current portion		12,350	9,485
Total assets limited as to use, less current portion	$	12,579	10,832

(In thousands)

The net present value of donor-restricted pledges receivable at June 30, 2011 totaled $3,468, discounted at 6%, and net of an allowance for uncollectible pledges of $429. The payment terms of the net present value of the pledges receivable at June 30, 2011 are as follows for the years ending June 30:

2012	$	1,522
2013		603
2014		591
2015		556
2016 and thereafter		625
		3,897
Less allowance for uncollectible pledges		(429)
	$	3,468

Funds held by the trustee as of June 30, 2011 and 2010 are as follows:

		2011	2010
Debt service reserve fund	$	8,612	8,609
Principal and interest fund		4,831	4,968
	$	13,443	13,577

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 on January 1 and July 1 of each year.

(Continued)

(In thousands)

(3) Property and Equipment, Net

Property and equipment, net as of June 30, 2011 and 2010 are as follows:

	2011	2010
Land	$ 1,787	1,787
Land improvements	24,412	22,846
Building and building improvements	128,361	125,512
Computer software and hardware	34,206	30,394
Equipment	87,095	85,726
Leasehold improvements	5,849	7,140
	281,710	273,405
Less accumulated depreciation and amortization	(134,577)	(123,344)
	147,133	150,061
Construction in progress	5,377	3,829
	$ 152,510	153,890

Depreciation expense for the years ended June 30, 2011 and 2010 was $15,894 and $15,880, respectively. Construction in progress represents costs incurred on the Hospital's expansion projects and other facility renovations not completed as of June 30, 2011.

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 constructed a Medical Office Building (MOB), which the developer owned and operated 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), CCR (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:		
2012	$	2,022
2013		2,058
2014		2,094
2015		1,928
2016		1,758
Thereafter		6,446
Total minimum lease payments	$	16,306

At June 30, 2011, the cost of the asset is $16,224 and is included in building and building improvements with the offsetting obligation in other long-term liabilities. Total accumulated depreciation on the MOB is $1,072 and $422 as of June 30, 2011 and 2010 respectively.

(4) Short-Term and Long-Term Investments

Investments, at fair value, as of June 30, 2011 and 2010 are as follows:

		2011	**2010**
Money market account and certificate of deposits	$	1,114	3,800
Government and corporate bonds		34,218	21,287
Mutual funds invested in equity securities		32,779	18,927
	$	68,111	44,014

Investments are classified as of June 30, 2011 and 2010 as follows:

		2011	**2010**
Short-term investments	$	14,323	13,145
Long-term investments		53,788	30,869
	$	68,111	44,014

(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 were as follows for the years ended June 30, 2011 and 2010:

		2011	2010
Investment income (loss):			
Interest and dividend income	$	2,156	1,146
Realized gains on securities		74	428
Unrealized gains on securities		3,298	1,639
Investments in joint ventures and partnerships:			
Equity method earning		(22)	46
Cost method dividend income		546	553
Equity in gains on long-term investments – other:			
Realized gains on long term investments		609	—
Unrealized gains on long term investments		1,288	1,515
Total investment income		7,949	5,327
Other changes in net assets:			
Net changes in unrealized losses on other-than-trading securities classified as unrestricted		—	(18)
Net change in unrealized gains on other-than-trading securities in restricted net assets		240	101
Total other changes in net assets		240	83
Total investment return	$	8,189	5,410

(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.

(In thousands)

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.

The System adopted ASC Topic 820 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, 2011:

		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	$	5,400	—	—	5,400
Mutual funds and equity securities		33,686	—	—	33,686
Government and corporate bonds		43,541	5,272	—	48,813
Total assets	$	82,627	5,272	—	87,899
Liabilities:					
Derivative instrument	$	—	3,586	—	3,586

(In thousands)

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

There were no significant transfers between levels 1, 2 and 3 during the years ended June 30, 2011 and 2010.

(In thousands)

(6) Long-Term Investments – Other

Total long-term investments – other consists of 18 limited partnership investments, which amount to $18,684 and $17,693 as of June 30, 2011 and 2010, respectively, as follows:

		2011	2010
Pine Grove	$	3,537	3,306
Friess		—	1,094
Silver Creek Low Vol.		1,120	1,649
Oaktree Cap Management		135	142
WMS Income Opportunity Fund		651	726
Touchstone Opportunity Fund		795	826
Mariner Access Fund		432	507
OZ OFII Access		366	—
Partners Group Private		214	—
Endowment Fund		562	508
Chesapeake Investments		867	882
Greenspring Fund		969	650
Lanx Offshore Partners		1,202	1,079
Silver Creek Early Advantage		744	1,510
Seamark Fund		2,949	1,555
Archstone Offshore Fund		2,739	2,497
Collins Capital		352	762
Titan Masters International Fund		1,050	—
Total	$	18,684	17,693

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 completed within the next 2 to 4 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, 2011 and 2010:

		2011		2010	
Joint venture	**Business purpose**	**Percentage ownership**	**Balance**	**Percentage ownership**	**Balance**
Carroll County Dialysis Facilities, LP	Dialysis services	33%	$ 519	33%	$ 506
Carroll County Sleep Disorder Services. LLC	Sleep disorder services	33	29	33	37
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	—	1	4
Carroll County Cancer Center, LLC	Oncology treatment center	—	—	1.4	100
Mt. Airy Surgery Center	Diagnostic services	50	117	50	65
Mt. Airy Plaza, LLC	Real estate activities	50	1,278	50	1,278
Carroll MOB Associates, LLC	Medical Office Building	36	2,015	36	2,067
Premier Purchasing Partners, LP	Purchasing partnership	0.12	276	0.12	231
Mt. Airy Health Services, LLC	Diagnostic services	50	436	50	517
Total			$ 4,696		$ 4,831

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).

(Continued)

(In thousands)

(8) Other Assets

Other assets as of June 30, 2011 and 2010 are as follows:

		2011	2010
Notes receivable, net	$	145	295
Financing costs, net		1,868	1,922
Goodwill		2,234	84
Other intangible assets, net		2,313	84
Deferred compensation assets		3,790	2,672
Reinsurance recoverable		3,376	2,463
Other		392	774
	$	14,118	8,294

On June 30th, 2011, the Hospital purchased the assets of Carroll Regional Cancer Center for $5,933. Included above in other assets is $2,250 in Other intangible assets, net and $2,150 in Goodwill. The remaining $1,533 relates to building and equipment costs and is included in note (3) property and equipment, net.

(Continued)

(In thousands)

(9) Long-Term Debt

Long-term debt as of June 30, 2011 and 2010 is as follows (the indebted entity is noted parenthetically):

		2011	2010
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	$	85,315	86,630
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%, (1.24% and 1.34% at June 30, 2011 and 2010, respectively; due in July 2020		14,015	12,405
Bank loan payable; interest at 5.125%; due in June 2014 (CCMS); secured by Carroll Care Pharmacies, LLC pharmacy inventory and equipment		515	615
Other		30	65
		134,875	134,715
Less current maturities		1,921	1,870
	$	132,954	132,845

(Continued)

(In thousands)

Aggregate maturities of long-term debt as of June 30, 2011 are as follows during the years ending June 30:

2012	$	1,921
2013		1,963
2014		2,040
2015		1,976
2016		2,116
Thereafter		124,859
	$	134,875

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, of which annual principal payments are made from July 1, 2005 through July 1, 2037. In November 2006, MHHEFA issued Carroll Hospital Center Issue Series 2006 Bonds on behalf of the Hospital, resulting in proceeds of $35,000. The Hospital will begin making annual principal payments on the series 2006 Bonds beginning on July 1, 2019. In June 2010, MHHEFA issued Carroll Hospital Center Issue Series 2010 Bonds on behalf of the Hospital in the amount of $15,000, of which monthly principal payments are made from July 1, 2010 through July 1, 2020. The fair value of outstanding tax-exempt bonds is estimated to be $121,195 and $124,769 as of June 30, 2011 and 2010, 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 upon acquisition had 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. During fiscal year 2011, The Hospital paid down the swap liability by $2,760, which decreased the notional amount to $30,000. The Hospital has recorded the change in fair value from the swap agreement in the amount of $1,559 and $(5,375) as other, net (a component of other income/expense) in the consolidated statements of operations for the years ended June 30, 2011 and 2010, respectively.

(In thousands)

(10) Other Liabilities

Other liabilities as of June 30, 2011 and 2010 are as follows:

		2011	2010
Medical office building	$	15,152	15,411
Interest rate swap		3,586	7,905
Deferred revenue		1,050	1,500
Deferred compensation liability		3,790	2,672
2006 Bond premium		1,095	1,113
Other		1,162	996
	$	25,835	29,597

(11) Income Tax

At June 30, 2011, the System has approximately $20,332 of net operating loss carryforwards, primarily at CCMS, that will expire through 2031. The net operating loss carryforwards created a net deferred tax asset of approximately $9,664 and $6,869 as of June 30, 2011 and 2010, 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, 2011 and 2010.

(12) 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.

(In thousands)

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, 2011 and 2010:

		2011	2010
Change in projected benefit obligation:			
Projected benefit obligation at beginning of period	$	51,060	46,586
Interest cost		2,765	2,635
Actuarial loss		(2,531)	3,364
Benefits paid		(1,653)	(1,525)
Projected benefit obligation at end of period		49,641	51,060
Change in plan assets:			
Fair value of plan assets at beginning of period		35,855	31,022
Actual return on plan assets		6,161	3,718
Employer contribution		3,240	2,640
Benefits paid		(1,653)	(1,525)
Fair value of plan assets at end of period		43,603	35,855
Funded status	$	(6,038)	(15,205)

The accumulated benefit obligation for the Plan was $49,641 and $51,060 at June 30, 2011 and 2010, respectively.

Net periodic pension expense for the years ended June 30, 2011 and 2010 was as follows:

		2011	2010
Components of net periodic pension expense:			
Interest cost	$	2,762	2,635
Expected return on plan assets		(2,543)	(2,527)
Amortization of actuarial loss		1,384	1,196
Net periodic pension expense	$	1,603	1,304

Assumptions used by the Hospital to determine the benefit obligation as of June 30, 2011 and 2010 (the measurement date) are as follows:

	2011	2010
Discount rate	5.75%	5.50%

(Continued)

(In thousands)

Assumptions used by the Hospital in the determination of net periodic pension expense for the years ended June 30, 2011 and 2010 are as follows:

	2011	**2010**
Discount rate	5.50%	5.75%
Expected long-term rate of return on plan assets	7.00	8.00

Deferred pension costs, which have not yet been recognized in periodic pension expense but are accrued in unrestricted net assets are $12,911 and $20,444 at June 30, 2001 and 2010 respectfully. Deferred pension costs represents unrecognized actuarial losses or unexpected changes in the projected benefit obligation and plan assets over time primarily due to changes in assumed discount rates and investment experience. The amount of deferred pension costs expected to be recognized as a components of net periodic pension costs during the year ending June 30, 2012 is $869.

The Hospital's weighted average asset allocations for the plan assets as of June 30, 2011 and 2010 are as follows:

	2011	**2010**
Mutual funds and equity securities	46.3%	37.1%
Government and corporate bonds	24.6	21.9
Alternative investments	19.5	31.2
Cash and cash equivalents	9.6	9.8
	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, 2011:

		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	$	4,425	—	—	4,425
Mutual funds and equity securities		19,750	—	—	19,750
Government and corporate bonds		6,645	—	—	6,645
Alternative investments		—	4,297	8,486	12,783
Total assets	$	30,820	4,297	8,486	43,603

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

During fiscal year 2011, Level 3 investments within the pension plan assets increased by $1,772. This increase was the result of purchases of $2,600, sales of $1,421 and earnings on investments of $593. There were no significant transfers between levels 1, 2 and 3 during the years ended June 30, 2011 and 2010.

For the alternative investments, the frequency which redemption requests can be made are either quarterly or annually. The notice required by the Hospital in order to make a redemption is within a range of 65 to 100 days. The audit reserve requirements are 10 percent for each fund. There are generally no gate provisions with the exception of one fund which has a gate of 25% of net asset value (NAV).

(Continued)

(In thousands)

Effective September 1, 2009 the System adopted ASU No. 2009-12, and applied its provisions to its pension plan asset portfolio. The guidance amends ASC Topic 820 and permits, as a practical expedient, fair value of investments within its scope to be estimated using NAV or its equivalent. The alternative investments classified within Level 3 of the fair value hierarchy have been recorded using NAV.

The System's pension plan invests in alternative investments which are primarily hedge fund of funds and real estate funds.

The Hospital expects to contribute $2,640 to the Plan in 2012.

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:

2012	$	1,855
2013		2,040
2014		2,165
2015		2,274
2016		2,393
Years 2017 – 2021		14,347
	$	25,074

The current defined contribution (403(b)) program was redesigned and serves as the primary retirement program beginning as of January 1, 2007. The Hospital has accrued a liability of $625 as of June 30, 2011 and 2010 for benefits earned under this plan. The Hospital expensed total employee contributions of $1,842 and $2,116 for the years ended June 30, 2011 and 2010, respectively.

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 $242 and $229 for the years ended June 30, 2011 and 2010, 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 $3,790 and $2,672 as of June 30, 2011 and 2010, respectively.

(13) 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.

(In thousands)

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, 2011 and 2010:

		2011	2010
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	$	670	138
Service cost		68	50
Interest cost		42	33
Plan amendment		—	—
Actuarial gain		92	449
Employer contribution		(36)	—
Projected benefit obligation at end of year	$	836	670
Change in plan assets:			
Employer contribution	$	(36)	—
Plan participant contribution, net		(16)	31
Benefits paid, net		52	(31)
Fair value of plan assets at end of year	$	—	—

		2011	2010
Reconciliation of funded status to net amounts recognized in the consolidated financial statements:			
Funded status	$	(836)	(670)
Accrued benefit cost	$	(836)	(670)
Components of postretirement benefit expense:			
Service cost	$	68	50
Interest cost		42	33
Amortization of prior service cost		68	68
Recognized actuarial gain		(26)	(33)
Postretirement benefit expense	$	152	118

The accumulated benefit obligation for the Plan was $836 and $670 at June 30, 2011 and 2010, respectively.

(In thousands)

Assumptions used by the Hospital in the determination of the postretirement benefit obligation and benefit expense for the years ended June 30, 2011 and 2010 (the measurement date) are as follows:

	2011	**2010**
Weighted average rate used to determine benefit expense for the years ended June 30	5.50%	5.75%
Weighted average rate used to determine benefit obligations at June 30	5.75	5.50
Initial healthcare cost trend rate	10.50	10.50
Next year trend rate	5.80	6.54
Ultimate trend rate	4.20	4.20
Ultimate trend rate year	2,080	2,080

The Hospital expects to contribute $13 to the postretirement benefit plan in 2011 – 2012.

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

2012	$ 13
2013	22
2014	30
2015	28
2016	44
Years 2017 – 2019	90
	$ 227

(In thousands)

(14) Noncontrolling Interests

Effective June 30, 2011, the Health System adopted new accounting guidance (applied retroactively to June 30, 2009) that requires a not-for-profit reporting entity to account for and present noncontrolling interests in a consolidated subsidiary as separate component of the appropriate class of consolidated net assets (equity). The reconciliation of noncontrolling interest reported in unrestricted net assets is as follows:

	Total	CHC unrestricted net assets	Noncontrolling interest
Unrestricted net assets – June 30, 2009	$ 109,958	106,062	3,896
Excess (deficit) of revenues over expenses	(2,176)	(3,741)	1,565
Change in unrealized losses other than trading securities	(18)	(18)	—
Net assets released from restrictions used for capital expenditures	577	577	—
Change in funded status of pension plan and postretirement	(1,391)	(1,391)	—
Distributions to noncontrolling owners	(1,996)	—	(1,996)
Change in unrestricted net assets	(5,004)	(4,573)	(431)
Unrestricted net assets – June 30, 2010	104,954	101,489	3,465
Excess of revenues over expenses	20,124	18,349	1,775
Net assets released from restrictions used for capital expenditures	452	452	—
Change in funded status of pension plan and postretirement	7,482	7,482	—
Distributions to noncontrolling owners	(924)	—	(924)
Change in unrestricted net assets	27,134	26,283	851
Unrestricted net assets – June 30, 2011	$ 132,088	127,772	4,316

(Continued)

(In thousands)

(15) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are restricted as of June 30, 2011 and 2010 for the following:

		2011	2010
Hospice program	$	274	199
Cardiac services		26	187
Cancer programs		261	438
Capital campaign		3,017	—
Emergency department		250	—
Other		404	334
	$	4,232	1,158

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 $1,113 at June 30, 2011 and 2010, respectively.

(16) 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, 2011 and 2010, are as follows:

		2011	2010
Healthcare services	$	211,025	210,215
General and administrative		34,338	33,256
	$	245,363	243,471

(17) 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).

(Continued)

(In thousands)

The mix of receivables for the System at June 30, 2011 and 2010 is as follows:

	2011	**2010**
Medicare	28%	28%
Medicaid	10	13
Blue Cross	15	13
Commercial, HMOs, and other	33	32
Self-pay	14	14
	100%	100%

The mix of net patient service revenue for the System for the years ended June 30, 2011 and 2010 is as follows:

	2011	**2010**
Medicare	40%	39%
Medicaid	9	10
Blue Cross	15	15
Commercial, HMOs, and other	30	34
Self-pay	6	2
	100%	100%

(18) 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.

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 $4,477 and $3,514 to this fund for the years ended June 30, 2011 and 2010, respectively. This contribution is recorded within net patient service revenue.

(19) 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.

(Continued)

(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, 2011. 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 Marsh Management Services (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 $2,378 and $3,275 at June 30, 2011 and 2010, 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 $767 and $976 at June 30, 2011 and 2010, 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 $200.

(d) Workers' Compensation

In 2003, the Hospital became self-insured for workers' compensation claims. Under the Plan, the Hospital has accrued a liability of $771 and $958 for known claims and incurred but not reported claims as of June 30, 2011 and 2010, 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 $1,500 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, 2011 and 2010.

(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 $65 and $246 at June 30, 2011 and 2010, 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 $2,526 and $2,411 for the years ended June 30, 2011 and 2010, 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, 2011 are as follows:

		Operating leases		Capital leases
Year ending June 30:				
2012	$	1,907		1,147
2013		1,772		638
2014		1,542		79
2015		1,474		—
2016		1,026		—
Thereafter		3,080		—
Total minimum lease payments	$	10,801		1,864
Less amount representing interest				102
Total minimum lease payments			$	1,762

As of June 30, 2011, scheduled annual principal portion of obligations under capital leases is as follows:

Year ending June 30:		
2012	$	1,066
2013		619
2014		77
Thereafter		—
	$	1,762

(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.

(20) 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 $3,012 and $4,992 for the years ended June 30, 2011 and 2010, respectively.

(21) Subsequent Events

The System has evaluated subsequent events from the consolidated balance sheet date through October 26, 2011, 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, 2011

(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 Assurance Co.**	**Eliminations**	**Consolidated**
Current assets:								
Cash and cash equivalents	$ 28,015	2,565	1,151	134	380	—	—	32,245
Short-term investments	14,323	—	—	—	—	—	—	14,323
Current portion of assets limited as to use	4,830	—	—	1,460	—	6,060	—	12,350
Patient receivables, net	16,873	2,767	404	—	2,973	—	—	23,017
Other receivables	645	144	—	—	767	—	—	1,556
Due from affiliates	1,065	3,749	—	17	—	—	(4,831)	—
Inventory	2,637	773	—	—	—	—	—	3,410
Prepaid expenses	2,406	308	11	4	12	6	—	2,747
Total current assets	70,794	10,306	1,566	1,615	4,132	6,066	(4,831)	89,648
Property and equipment, net	132,056	7,623	4,940	—	8,964	—	(1,073)	152,510
Beneficial interest in net assets of Foundation	14,200	—	—	—	—	—	(14,200)	—
Long-term investments	72,509	—	—	7,153	—	—	(25,874)	53,788
Long-term investments – other	17,110	—	—	1,574	—	—	—	18,684
Investment in joint ventures	2,727	1,969	—	—	—	—	—	4,696
Assets limited as to use, less current portion	8,677	—	242	3,660	—	—	—	12,579
Other assets	10,107	398	3	230	4	3,376	—	14,118
Total assets	$ 328,180	20,296	6,751	14,232	13,100	9,442	(45,978)	346,023
Liabilities and Net Assets								
Current portion of long-term debt	$ 1,724	197	—	—	—	—	—	1,921
Current obligations under capital lease	392	73	—	—	601	—	—	1,066
Accounts payable and accrued expenses	12,904	1,496	139	16	967	7,497	—	23,019
Accrued payroll and related taxes	7,840	1,148	—	—	299	—	—	9,287
Deferred revenue	214	—	—	—	—	—	—	214
Advances from third-party payors	6,724	—	—	—	—	—	—	6,724
Due to affiliates	—	4,447	368	17	—	—	(4,832)	—
Total current liabilities	29,798	7,361	507	33	1,867	7,497	(4,832)	42,231
Long-term debt, less current portion	132,605	349	—	—	—	—	—	132,954
Long-term obligations under capital lease, less current portion	307	36	—	—	353	—	—	696
	—	—	—	—	—	—	—	—
Other liabilities	25,721	199	—	—	987	—	(1,072)	25,835
Accrued pension and postretirement benefits	6,874	—	—	—	—	—	—	6,874
Total liabilities	195,305	7,945	507	33	3,207	7,497	(5,904)	208,590
Net assets:								
Unrestricted:								
Unrestricted net assets	118,675	11,992	6,001	9,097	5,936	1,945	(25,874)	127,772
Noncontrolling interest in consolidated subsidiaries	—	359	—	—	3,957	—	—	4,316
Total unrestricted net assets	118,675	12,351	6,001	9,097	9,893	1,945	(25,874)	132,088
Restricted:								
Temporarily restricted	13,087	—	243	3,989	—	—	(13,087)	4,232
Permanently restricted	1,113	—	—	1,113	—	—	(1,113)	1,113
Total restricted net assets	14,200	—	243	5,102	—	—	(14,200)	5,345
Total net assets	132,875	12,351	6,244	14,199	9,893	1,945	(40,074)	137,433
Total liabilities and net assets	$ 328,180	20,296	6,751	14,232	13,100	9,442	(45,978)	346,023

See accompanying independent auditors' report.

Schedule 2

**CARROLL HOSPITAL CENTER, INC.
AND SUBSIDIARIES**

Consolidating Statement of Operations Information

Year ended June 30, 2011

(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 Assurance Co.	Eliminations	Consolidated
Unrestricted revenues, gains, and other support:								
Net patient service revenue	$ 198,341	12,469	3,500	—	20,650	—	—	234,960
Other operating revenue	3,604	16,584	—	—	—	2,609	(2,983)	19,814
Net assets released from restrictions used for operations	—	—	11	9	—	—	—	20
Total unrestricted revenues, gains, and other support	201,945	29,053	3,511	9	20,650	2,609	(2,983)	254,794
Expenses:								
Salaries and wages	80,279	16,071	2,706	—	4,293	—	—	103,349
Employee benefits	16,707	1,925	318	—	631	—	—	19,581
Departmental supplies and expenses	25,463	11,402	313	—	1,028	—	—	38,206
Professional fees	12,259	330	44	—	5,691	—	—	18,324
Purchased services	24,963	6,158	533	—	2,860	1,987	(5,096)	31,405
Depreciation and amortization	13,234	707	200	—	1,202	—	650	15,993
Interest	6,889	46	—	—	127	—	1,463	8,525
Provision for bad debts	8,388	624	—	—	968	—	—	9,980
Total expenses	188,182	37,263	4,114	—	16,800	1,987	(2,983)	245,363
Operating income (loss)	13,763	(8,210)	(603)	9	3,850	622	—	9,431
Other income (expense):								
Investment income (loss)	6,284	258	(2)	1,262	—	147	—	7,949
Unrestricted gifts	—	—	656	1,383	—	—	—	2,039
Other	1,143	32	(272)	(198)	—	—	—	705
Excess (deficit) of revenues over (under) expenses	$ 21,190	(7,920)	(221)	2,456	3,850	769	—	20,124

See accompanying independent auditors' report.