Grant Thornton

Consolidated Financial Statements and Report of Independent Certified Public Accountants

Meritus Health, Inc.

(Formerly The Washington County Health System, Inc. and Subsidiaries)

June 30, 2011 and 2010

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Audit – Tax – Advisory

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Report of Independent Certified Public Accountants

To the Board of Directors
Meritus Health, Inc.

We have audited the accompanying consolidated balance sheets of Meritus Health, Inc. (formerly The Washington County Health System, Inc. and Subsidiaries) ("Meritus") at June 30, 2011 and 2010, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of Meritus' management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of Meritus Healthcare Foundation (formerly Antietam Healthcare Foundation) (the "Foundation"), which statements reflect total assets of approximately three and two percent of total consolidated assets at June 30, 2011 and 2010, respectively, and total revenues of approximately one percent of the related consolidated total revenues for the years then ended of Meritus. Those statements were audited by other auditors, whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Foundation, is based on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants. 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 Meritus' 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 and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Meritus Health, Inc. (formerly The Washington County Health System, Inc. and Subsidiaries) as of June 30, 2011 and 2010, and the results of its operations and changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Baltimore, Maryland
September 26, 2011

CONSOLIDATED FINANCIAL STATEMENTS

Meritus Health, Inc.

(Formerly The Washington County Health System, Inc. and Subsidiaries)

CONSOLIDATED BALANCE SHEETS

June 30,

ASSETS	2011	2010
CURRENT ASSETS		
Cash and cash equivalents	$ 18,380,698	$ 23,025,683
Restricted cash	2,614,437	2,601,651
Short-term investments	4,399,794	4,731,657
Current portion of assets whose use is limited	10,232,054	23,081,967
Accounts receivable, net	45,878,319	41,385,245
Supplies	10,252,192	9,640,469
Prepaid and other current assets	5,914,333	5,749,191
Total current assets	97,671,827	110,215,863
EQUITY INVESTMENTS IN AFFILIATES	22,752,291	19,432,755
ASSETS WHOSE USE IS LIMITED		
Board designated funds	75,555,190	60,171,745
Supplemental retirement benefit investments	3,539,997	2,969,470
Temporarily and permanently restricted donor funds	1,165,136	924,031
	80,260,323	64,065,246
Assets held by trustee for debt service and construction	18,465,329	59,402,684
Funds designated for insurance purposes	7,647,952	7,154,386
	106,373,604	130,622,316
PROPERTY, PLANT AND EQUIPMENT, net	303,540,192	272,716,066
PLEDGES RECEIVABLE, net	3,893,162	3,484,189
DEFERRED FINANCING COSTS, net	2,805,574	2,937,209
OTHER ASSETS	1,292,149	759,506
Total assets	$538,328,799	$540,167,904

The accompanying notes are an integral part of these financial statements.

LIABILITIES AND NET ASSETS	2011	2010
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 15,151,202	$ 12,761,464
Construction and retainage payable	1,153,823	14,166,331
Accrued salaries, wages and withholdings	4,151,982	8,920,979
Accrued compensation benefit	16,210,039	15,014,599
Advances from third-party payors	6,684,832	6,663,875
Accrued interest payable	7,795,244	7,504,756
Current portion of long-term debt	9,140,210	6,067,114
Total current liabilities	60,287,332	71,099,118
LONG-TERM DEBT, net of current portion	266,146,562	273,591,018
ACCRUED RETIREMENT BENEFITS	3,900,084	8,312,366
ASSET RETIREMENT OBLIGATION	-	1,993,500
OTHER LONG-TERM LIABILITIES	4,555,379	3,500,265
Total liabilities	334,889,357	358,496,267
NET ASSETS		
Unrestricted		
Meritus	190,332,321	170,208,396
Non-controlling interest	1,440,713	1,664,348
Total unrestricted net assets	191,773,034	171,872,744
Temporarily restricted	10,637,790	8,770,275
Permanently restricted	1,028,618	1,028,618
Total net assets	203,439,442	181,671,637
Total liabilities and net assets	$538,328,799	$540,167,904

Meritus Health, Inc.

(Formerly The Washington County Health System, Inc. and Subsidiaries)

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

Years ended June 30,

	2011	2010
Unrestricted revenue, gains and other support		
Net patient service revenue	$327,046,507	$301,173,125
Sales	27,809,493	28,884,376
Rental income, net of expense	1,932,293	2,056,141
Loss on disposal of assets	(197,187)	(384,413)
Other revenue	9,765,511	4,795,330
Equity earnings in affiliates	7,094,777	7,231,427
Net assets released from restriction used for operations	847,815	1,236,272
	374,299,209	344,992,258
Expenses		
Salaries and wages	141,555,417	138,625,975
Professional fees	9,620,750	9,781,100
Cost of goods sold	19,070,547	19,558,504
Supplies and other	147,655,304	141,454,848
Interest	9,212,306	621,399
Depreciation and amortization	22,153,445	16,366,229
Provision for bad debts	14,550,932	13,722,835
	363,818,701	340,130,890
Operating income before other items	10,480,508	4,861,368
Other items		
Demolition costs	(954,579)	-
Early retirement costs	(569,942)	(1,451,379)
Transition costs	(2,797,289)	(706,986)
	(4,321,810)	(2,158,365)
Operating income	6,158,698	2,703,003
Non-operating gains (losses), net		
Investment returns, net	12,762,559	10,240,301
Other, net	874,080	(1,545,929)
Income tax expense	(174,635)	(1,194,992)
Excess of revenue over expenses	19,620,702	10,202,383
Excess of revenue over expenses attributable to non-controlling interest	(296,365)	(300,815)
Excess of revenue over expenses attributable to Meritus	19,324,337	9,901,568

The accompanying notes are an integral part of these financial statements.

	2011	2010
Other changes in unrestricted net assets		
Net assets released from restrictions for property, plant and equipment	-	2,946,776
Change in retirement benefit obligation	714,279	2,445,987
Change in non-controlling interests	(223,635)	(159,184)
Other	85,309	1,375,715
Increase in unrestricted net assets	19,900,290	16,510,862
Temporarily restricted net assets		
Contributions	2,667,532	3,142,588
Net realized and unrealized gains and losses on investments	47,798	19,836
Net assets released from restrictions for property, plant and equipment	-	(2,946,776)
Net assets released from restrictions for operations	(847,815)	(1,236,272)
Increase (decrease) in temporarily restricted net assets	1,867,515	(1,020,624)
INCREASE IN NET ASSETS	21,767,805	15,490,238
Net assets		
Beginning of year	181,671,637	166,181,399
End of year	$203,439,442	$181,671,637

Meritus Health, Inc.

(Formerly The Washington County Health System, Inc. and Subsidiaries)

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended June 30,

	2011	2010
Cash flows from operating activities		
Increase in net assets	$ 21,767,805	$ 15,490,238
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	22,153,445	16,366,229
Provision for bad debts	14,550,932	13,722,835
Change in retirement benefit obligation	(714,279)	(2,445,987)
Change in non-controlling interest	223,635	159,184
Net realized and unrealized gains on investments	(10,583,839)	(7,839,926)
Loss on disposal of assets	197,187	384,413
Equity earnings in affiliates	(7,094,777)	(7,231,427)
Accretion of asset retirement obligation	165,960	99,675
Changes in assets and liabilities		
Accounts receivable	(19,044,006)	(9,460,460)
Supplies, prepaid, and other current assets	(776,865)	(1,024,791)
Other assets	(941,616)	794,890
Accounts payable, accrued expenses and long-term liabilities	513,054	1,768,037
Accrued salaries, wages and withholdings	(4,768,997)	1,080,963
Accrued compensation benefit	(752,427)	700,699
Advances from third-party payors	20,957	590,196
Interest payable	290,488	-
Retirement benefits	(1,069,798)	(1,255,883)
Net cash provided by operating activities	14,136,859	21,898,885
Cash flows from investing activities		
Purchase of property, plant and equipment	(66,021,503)	(112,494,039)
Proceeds from the disposal of assets	5	217,886
Purchase of restricted cash, short-term investments, and assets whose use is limited	(314,611,853)	(529,195,760)
Sale of restricted cash, short-term investments, and assets whose use is limited	362,613,394	625,800,326
Equity investments in affiliates	3,775,241	3,248,304
Net cash used in investing activities	(14,244,716)	(12,423,283)

The accompanying notes are an integral part of these financial statements.

	2011	2010
Cash flows from financing activities		
Proceeds from long-term debt	1,300,000	700,000
Payments on long-term debt	(5,837,128)	(6,931,468)
Net cash used in financing activities	(4,537,128)	(6,231,468)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(4,644,985)	3,244,134
Cash and cash equivalents		
Beginning of year	23,025,683	19,781,549
End of year	$ 18,380,698	$ 23,025,683
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$ 1,041,108	$ 952,024
Cash paid for interest, net of amounts capitalized	8,631,330	621,399
Supplemental disclosure of non-cash investing and financing activities:		
Assets acquired under capital leases	$ 165,768	$ 4,557,137
Decrease in accrual for the purchase of property, plant and equipment	(13,012,508)	(201,566)

1. DESCRIPTION OF ORGANIZATION

Organization

Meritus Health, Inc. (formerly The Washington County Health System, Inc.) ("Parent"), is the parent corporation of the Meritus Medical Center, Inc. (formerly Washington County Hospital Association) ("Hospital"), Meritus Enterprises (formerly Antietam Health Services, Inc.) ("MEI"), the Meritus Medical Center Endowment Fund, Inc. (formerly Washington County Hospital Endowment Fund, Inc.) ("Fund"), the Meritus Healthcare Foundation, Inc. (formerly Antietam Healthcare Foundation, Inc.) ("Foundation"), and the Meritus Insurance Company, Ltd. (formerly Antietam Insurance Company, Ltd.) ("MIC"). These entities are collectively referred to as "Meritus".

The Hospital is a not-for-profit acute care hospital located in Hagerstown, Maryland and serves the residents of western Maryland, southern Pennsylvania, and the panhandle of West Virginia. The Parent is the sole corporate member of the Hospital. The Hospital currently offers acute general hospital inpatient services including adult medical/surgical care, obstetrics and newborn care, including a family birthing center, cardiac catheterizations, comprehensive inpatient rehabilitation, radiology and diagnostic services, inpatient and outpatient mental health services, a regional Level III Trauma Center, an intensive care unit, a progressive care unit, a coronary care unit, and a pediatric unit. The Hospital completed construction of a replacement hospital, which opened in December 2010.

MEI is a for-profit corporation located in Hagerstown, Maryland and serves the residents of western Maryland, southern Pennsylvania, and the panhandle of West Virginia. MEI is wholly-owned by the Parent. MEI has a 100% interest in entities that provide laboratory, pharmacy, and other health services. In addition, MEI holds a 60% interest in Robinwood Surgery Center which provides ambulatory surgery services and a 50% interest in Diagnostic Imaging Services which provides outpatient imaging services.

The Fund is a not-for-profit corporation which manages gifts, donations or bequests given for the benefit of Meritus. The Parent is the sole corporate member of the Fund. The Fund also acquires real estate properties for rental to medical provider entities and development opportunities. The Fund is the sole member of Meritus Medical Center Endowment Development Company, Inc. (formerly The Washington County Endowment Development Company, Inc.) ("Development Company") a not-for-profit corporation, which was formed to develop and lease real estate properties for rental to medical provider entities.

The Fund's By Laws and Articles of Incorporation provide that the Fund is to be operated exclusively for the support and benefit of the Hospital and the Parent or activities or programs which benefit the Hospital or the Parent. Distributions are made to the Hospital or the Parent in amounts and in periods determined by the Fund's Board of Directors, who may also restrict the use of funds. In the event the Fund is dissolved, all remaining assets would be returned to the Hospital or the Parent.

The Foundation a not-for-profit corporation whose purpose is to raise philanthropic support for the capital and endowment campaigns of the Hospital and the Fund. The Foundation also raises money for the Hospital's medical programs, healthcare objectives, scientific research, educational programs, and related community activities. Resources for the Foundation's activities are primarily provided by donors.

1. DESCRIPTION OF ORGANIZATION - Continued

Organization - continued

MIC is a Cayman Island captive insurance company, wholly-owned by the Parent that provides primary limits of insurance to Meritus for professional liability, employed physicians professional liability, comprehensive general liability, deductible, and stop loss coverage for health insurance.

Effective July 1, 2011, MEI completed a structural realignment to include the formation of a new tax-exempt entity, Meritus Holdings, LLC ("Holdings") which is a Delaware LLC. This realignment included the conversion of taxable subsidiaries of MEI, Hagerstown Medical Lab, Health @ Work, and Meritus Urgent Care to tax-exempt status with a transfer of ownership to Holdings. In addition, Holdings is the only owner of MEI. The Hospital is the sole member of Holdings. Holdings is a disregarded entity for federal income tax purposes.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Parent, the Hospital, MEI, the Fund, the Foundation, and MIC. MEI owns a 60% interest in Robinwood Surgery Center, LLC, at June 30, 2011 and 2010, which is included in the consolidated financial statements with the related non-controlling interest reported as a component of net assets. All material inter-company balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates. The most significant management estimates and assumptions related to the determination of allowance for doubtful accounts and contractual allowances for patient accounts receivable, tax accruals, useful lives of property, plant and equipment, actuarial estimates for the postretirement benefit plan, self-insured reserves, including professional and general liabilities and the reported fair values of certain assets and liabilities.

Fair Value Measurements

Meritus measures fair value as the price that would be received to sell an asset or paid to transfer a liability (the exit price) in an orderly transaction between market participants at the measurement date. The accounting guidance outlines a valuation framework and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and the related disclosures. The fair value hierarchy is broken down into three levels based on the source of inputs as follows:

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Fair Value Measurements - continued

Level I - Quoted prices are available in active markets for identical assets or liabilities as of the report date. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

Level II - Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the report date. The nature of these securities include investments for which quoted prices are available but traded less frequently and investments that are fair valued using other securities, the parameters of which can be directly observed.

Level III - Securities that have little to no pricing observability as of the report date. These securities are measured using management's best estimate of fair value, where the inputs into the determination of fair value are not observable and require significant management judgment or estimation.

Financial instruments consist of cash equivalents, patient accounts receivable, investments, excluding those accounted for by the equity method, accounts payable and accrued expenses and long-term debt. The carrying amounts reported in the consolidated balance sheets for cash equivalents, patient accounts receivable, and accounts payable and accrued expenses approximate fair value. Management's estimates of other financial instruments are described elsewhere in the notes to the consolidated financial statements.

Allowance for Doubtful Accounts

Meritus provides an allowance for doubtful accounts for estimated losses resulting from the unwillingness or inability of patients or third-party payors to make payments for services. The allowance is determined by analyzing specific accounts and historical data and trends. Patient accounts receivable are charged off against the allowance for doubtful accounts when management determines that recovery is unlikely and Meritus ceases collection efforts. Losses have been consistent with management's expectations.

Cash and Cash Equivalents

Cash and cash equivalents consist of short-term, highly liquid investments that are readily convertible to cash and have original maturities of three months or less. Cash and cash equivalents are carried at cost which approximates fair value. Meritus entered into overnight investment repurchase transactions of $13,968,000 and $9,622,806 as of June 30, 2011 and 2010, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Assets Whose Use is Limited

Assets whose use is limited include assets set aside by the Board of Directors for specific purposes, for supplemental retirement benefit investments, to fulfill donor purposes, assets held by trustees under debt indenture agreement (debt and construction), and funds designated for insurance purposes. Amounts required to meet current liabilities are shown as current assets in the consolidated balance sheets.

Investments and Investment Income

Investments in equity securities (i.e., investments that have readily determinable fair values and are not accounted for by the equity method) and all investments in debt securities are reported at fair value on the consolidated balance sheets, under the fair value option.

Investment income, which includes interest and dividends, on proceeds of borrowings that are held by a trustee, to the extent not capitalized, are reported as other revenue. Other investment income, which includes interest, dividends and realized and unrealized gains and losses on assets limited as to use by Board of Directors and funds designated for insurance purposes are recorded as non-operating gains (losses), net, unless the income or loss is restricted by donor or law.

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

Supplies

Supplies for the Hospital are carried at the lower of cost or market on a weighted average basis.

Supplies for MEI are valued at the lower of cost or market, with the cost being recorded on the first-in, first-out method.

Major classes of supplies as of June 30, are as follows:

	2011	2010
Durable medical equipment	$ 751,414	$ 747,587
Surgical and medical supplies	5,631,585	4,737,738
Other supplies	1,017,163	1,137,813
Pharmacy and home care infusion	2,354,710	2,515,780
Medical laboratory	497,320	501,551
	$10,252,192	$9,640,469

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Property, Plant and Equipment

Property, plant and equipment acquisitions are recorded at cost. Those assets acquired by gift are carried at amounts established as fair value at the time of acquisition. Depreciation is provided over the estimated useful life of each class of depreciable assets and is computed using the straight-line method. Equipment under capital lease is amortized by the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Durable medical equipment held for resale is included in supplies. The remainder of durable medical equipment is rented to patients and is included in property, plant and equipment. Assets are retired or disposed of at book value and related gains or losses are recorded for assets sold. Useful lives range as follows:

Land improvements	5 - 25 years
Buildings	10 - 40 years
Equipment	5 - 20 years

Gifts of long-lived assets such as land, buildings, or equipment are reported as other changes in unrestricted net assets unless explicit donor stipulations specify how the donated assets must be used. When applicable, gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long-lived assets must be maintained, expirations of donor restrictions occur when the donated or acquired long-lived assets are placed into service.

Meritus continually evaluates whether events and circumstances have occurred that indicate the remaining estimated useful life of long-lived assets is appropriate, or whether the remaining balance may not be recoverable. When factors indicate that long-lived assets should be evaluated for possible impairment, Meritus uses an estimate of the related undiscounted operating income over the remaining life of the long-lived asset in measuring whether the long-lived asset is recoverable. The impairment loss on these assets is measured as the excess of the carrying amount of the asset over its fair value. Fair value is based upon market prices where available, or discounted cash flows. Management believes that no revision to the remaining useful lives or write-down of long-lived assets is required at June 30, 2011.

Deferred Financing Costs

Financing costs incurred in issuing debt have been capitalized and are being amortized over the life of the debt using the interest method.

Advertising Costs

Advertising costs for the years ended June 30, 2011 and 2010 were $718,165 and $588,000, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Compensated Absences

Meritus records a liability for amounts due to employees for future absences which are attributable to services performed in the current and prior periods. This liability is included in accrued salaries, wages and withholdings on the consolidated balance sheets.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Meritus 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 Meritus in perpetuity.

Excess of Revenue over Expenses

The consolidated statements of operations include the excess of revenue over expenses. Changes in unrestricted net assets that are excluded from the excess of revenues over expenses, consistent with industry practice, include net assets released from restrictions for property, plant and equipment, the change in retirement benefit obligation, change in non-controlling interest and other items.

Net Patient Service Revenue

For services provided at the Hospital campus, all payors are required to pay the Maryland Health Services Cost Review Commission ("HSCRC") approved rates. The major third-party payors, as recognized by the HSCRC, are allowed discounts of up to 6% on approved rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Contractual adjustments to patient service revenue were $82,011,300 and $82,503,967 for the years ended June 30, 2011 and 2010, respectively.

The Hospital's charges are subject to review and approval by the HSCRC. The Hospital management has filed the required forms with the HSCRC and believes the Hospital to be in compliance with HSCRC requirements. The total rate of reimbursement for services to patients under the Medicare and Medicaid programs is based on an arrangement between the Centers for Medicare and Medicaid Service and the HSCRC. Management believes that this program will remain in effect at least through June 30, 2012. Effective July 1, 2010, the Hospital entered into an agreement with the HSCRC under a rate regulation concept called Total Patient Revenue ("TPR") for a three year period. TPR is a revenue constraint methodology which provides for inflation, bad debt, payer differential and adjustments for population growth, but excludes case mix and volume changes. For fiscal year 2011, the regulated revenue cap was $275,699,700. For fiscal year 2010, the HSCRC methodology was a base period charge per admission that was adjusted annually to reflect cost inflation plus an incentive factor during years when the net revenue per adjusted admission nationally is greater than cost inflation. For fiscal year 2010, this methodology established a charge per admission cap of $8,684, for the Hospital, which was subject to adjustment for changes in hospital specific and state-wide case mix.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Net Patient Service Revenue - continued

Services not located on the Hospital campus are not regulated by the HSCRC. Medicare and Medicaid pay the revenues associated with these services based upon established fee schedules. Commercial payors pay at negotiated rates for these services.

Net patient service revenue is reported as estimated net realizable amounts from patients, third-party payors, and others for services rendered and include estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

Net revenues from the Medicare and Medicaid programs collectively constitute approximately 48% of Meritus' net patient service revenue for the years ended June 30, 2011 and 2010. Laws and regulations governing the HSCRC, Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Meritus believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action.

Charity Care

Meritus provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Meritus does not pursue collection on amounts deemed to qualify as charity. Meritus estimates that $14,525,095 and $12,738,000 of charity care, based on established rates, was provided for the years ended June 30, 2011 and 2010, respectively.

Meritus' patient acceptance policy is based upon its mission statement and its charitable purposes. This policy results in Meritus' assumption of higher-than-normal credit risk from its patients. To the extent that Meritus realizes additional losses resulting from such higher credit risks and clients are not identified or do not meet Meritus' defined charity care policy, such additional losses are included in the provision for bad debt.

Meritus also sponsors certain other charitable programs, which provide substantial benefit to the broader community. Such programs include services to needy and elderly populations that require special support, as well as health and education for the general community welfare. In addition, all other uncollectable amounts resulting from the patients' inability to pay are recorded as a reduction to net patient service, consistent with Meritus' policy.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Income Taxes

The Internal Revenue Service has ruled that the Parent, the Hospital, the Fund, the Development Company and the Foundation qualify under Section 501(c)(3) of the Internal Revenue Code and are, therefore, not subject to tax under present income tax regulations.

MEI accounts for income taxes through the current recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between tax bases and financial reporting bases of other assets and liabilities.

At present, no income, profit or capital gain taxes are levied in the Cayman Islands and accordingly, no provision for taxation has been made for MIC. In the event that such taxes are levied, MIC has been granted an exemption until September 9, 2023 for any such taxes that might be introduced. MIC intends to conduct its affairs so as not to be liable for taxes in any other jurisdiction.

Meritus follows the accounting guidance for uncertainties in income tax positions which requires that a tax position be recognized or derecognized based on a “more likely than not” threshold. This applies to positions taken or expected to be taken in a tax return.

Concentration of Credit Risk

Meritus invests its excess cash, investments, and assets in financial institutions which are federally insured under the Federal Deposit Insurance Act (“FDIA”). Deposits in certain accounts exceed federally insured deposit limits. Meritus has experienced no losses on its deposits.

Meritus grants credit without collateral to the patients it serves who primarily live in the tri-state area. The majority of these patients have either insurance through Blue Cross, another insurance company or a health maintenance organization or qualify for the Maryland Medical Assistance or the Centers for Medicare and Medicaid Services (“CMS”) programs.

At June 30, Meritus’ patient accounts receivable were made up of the following:

	2011	2010
Health maintenance organizations	3%	2%
Medical assistance HMO	14	14
Medicare	30	26
Commercial insurance and other	23	23
Blue Cross/Blue Shield	18	18
Self-pay	12	17
	100%	100%

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

457(b) Deferred Compensation Plan

The Hospital is party to a 457(b) deferred compensation plan intended to provide retirement benefits to certain eligible employees. Assets are deposited with the plan managers, pursuant to this agreement, such that the value of the assets determined by the fair value approximately equals the related accrued deferred compensation liability. The funds are placed into a range of investment strategies from conservative to aggressive. The liability associated with this plan is included in accrued retirement benefits on the consolidated balance sheets.

Pending Accounting Pronouncements

In August 2010, the FASB issued amended authoritative guidance to reduce the diversity in practice regarding the measurement basis used in the identification and disclosure of charity care by healthcare entities. The amendments in this guidance require that cost be used as the measurement for charity care disclosure purposes and that cost be identified as the direct and indirect cost of providing the care. The guidance also requires entities to disclose their method used to identify or determine such costs. This authoritative guidance is effective for financial statements issued for fiscal years beginning after December 15, 2010 and should be applied retrospectively to all prior fiscal years presented. Early application is permitted. Meritus has not early adopted this guidance, but plans to adopt it for the year ending June 30, 2012. The new guidance is not expected to affect the results of operations or financial position; however, changes to the charity care disclosures will be required.

In August 2010, the FASB issued amended authoritative guidance to reduce the diversity in practice related to the accounting by healthcare entities for medical malpractice claims and similar liabilities, and their related expected insurance recoveries. The amendments in this guidance state that insurance claims liabilities should be determined without consideration of any expected insurance recoveries, consistent with practice in other industries, and clarifies that healthcare entities should no longer net expected insurance recoveries against the related claims liabilities, thus recognizing their gross exposure in the financial statements. This authoritative guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. A cumulative-effect adjustment should be recognized in opening equity in the period of adoption if a difference exists between any liabilities and insurance receivables recorded as a result of applying the amendments in this guidance. Retrospective and early applications are also permitted. Meritus has not early adopted this guidance, but plans to adopt it for the year ending June 30, 2012. Meritus is evaluating the impact of adopting this guidance.

In July 2011, the FASB issued authoritative guidance to provide amendments to the presentation of the statement of operations for certain healthcare entities and enhanced disclosure about net patient service revenue and the related allowance for doubtful accounts. These amendments require certain healthcare entities to present their provision for bad debts associated with patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts). These amendments also require disclosure of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. Additionally, healthcare entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Pending Accounting Pronouncements - continued

The guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011, with early adoption permitted. The amendments to the presentation of the provision for bad debts related to patient service revenue in the statement of operations should be applied retrospectively to all prior periods presented. The disclosures required by the amendments in this update should be provided for the period of adoption and subsequent reporting periods. Meritus is evaluating the impact of adopting this guidance on its results of operations and financial position.

Reclassifications

Certain prior year amounts in the accompanying consolidated financial statements have been reclassified to conform to current year presentation. These reclassifications had no impact on total assets, total liabilities, and net assets or excess of revenue over expenses previously reported.

Subsequent Events

Meritus evaluated subsequent events through September 26, 2011, the date of these consolidated financial statements were available to be issued. All material matters are disclosed in the footnotes to the consolidated financial statements.

3. INVESTMENTS AND INVESTMENT INCOME

Investments at June 30 consisted of the following:

	2011		2010	
	Cost	Fair Value	Cost	Fair Value
Short-term investments:				
U.S. government securities	$ 4,399,794	$ 4,399,794	$ 4,731,657	$ 4,731,657
Assets whose use is limited:				
Cash and cash equivalents	$ 190,552	$ 190,552	$ 1,751,515	$ 1,751,515
Fixed income	29,264,585	29,891,730	26,630,529	27,336,457
Common stock	43,771,897	47,521,106	35,525,616	32,688,142
Mutual funds	2,656,935	2,656,935	2,289,132	2,289,132
	$75,883,969	$80,260,323	$66,196,792	$64,065,246
Assets held by trustee for debt service and construction:				
U.S. government securities	$27,731,117	$27,776,762	$81,898,999	$81,073,771
Funds designated for insurance purposes:				
Fixed income	$ 8,338,296	$ 8,568,573	$ 8,180,476	$ 8,565,266

3. INVESTMENTS AND INVESTMENT INCOME - Continued

Meritus had restricted cash of $2,614,437 and $2,601,651 as of June 20, 2011 and 2010, respectively, for unemployment insurance collateral and workers' compensation collateral, in compliance with the self-insurance requirement under the regulations of the State of Maryland Employment Security Administration and Workers' Compensation Administration.

Investment returns, net on investments included in the consolidated statements of operations and changes in net assets are comprised of the following for the years ended June 30:

	2011	2010
Investment returns, net:		
Interest and dividends, net of investment fees of $234,905 and $206,240 in 2011 and 2010, respectively	$ 2,226,518	$ 2,420,211
Net realized gains (losses) on investments	4,217,673	(3,171,432)
Change in unrealized gains and losses on investments	6,318,368	10,991,522
	$12,762,559	$10,240,301

4. FAIR VALUE MEASUREMENTS

The following table presents Meritus' assets measured at fair value on a recurring basis using the market approach, all of which are Level 1 financial instruments, as of June 30:

	2011	2010
Cash and cash equivalents	$ 18,380,698	$ 23,025,683
Restricted cash	2,614,437	2,601,651
Short-term investments	4,399,794	4,731,657
Assets whose use is limited	116,605,658	153,704,283
Total assets	$142,000,587	$184,063,274

Meritus does not have any Level 2 or 3 financial instruments as of June 30, 2011 and 2010.

Pledges receivable are non-recurring fair value measurements. Any multi-year pledge received in fiscal year 2011 and 2010 are recorded at the present value of future cash flows with a discount rate adjusted for any market conditions to arrive at fair value.

5. ACCOUNTS RECEIVABLE

Accounts receivable at June 30 consist of the following:

	2011	2010
Patient accounts	$52,034,966	$46,712,574
Less: Contractual allowance	(5,857,365)	(5,957,119)
Less: Allowance for doubtful accounts	(3,676,453)	(2,995,908)
	42,501,148	37,759,547
Other receivables	3,377,171	3,625,698
	$45,878,319	$41,385,245

Pledges receivable at June 30 consist of the following:

	2011	2010
Capital campaign	$6,915,922	$6,718,696
Other	298,879	149,331
Total unconditional promises to give	7,214,801	6,868,027
Receivable in less than one year	2,328,567	2,563,506
Receivable in one to five years	4,197,227	4,302,521
Receivable in more than five years	689,007	2,000
Total unconditional promises to give	7,214,801	6,868,027
Less discounts to net present value	(718,414)	(604,155)
Less allowance for uncollectible promises	(630,017)	(591,262)
Net unconditional promises to give	$5,866,370	$5,672,610
Pledges receivable, current portion included in other receivables	$1,973,208	$2,188,421
Pledges receivable, net of current portion	3,893,162	3,484,189
	$5,866,370	$5,672,610

6. PROPERTY, PLANT AND EQUIPMENT

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

	2011	2010
Land	$ 24,845,055	$ 12,729,449
Buildings, and improvements used in operations	177,838,850	78,296,483
Buildings used in rental operations	22,083,494	22,008,861
Equipment	180,542,923	139,779,304
	405,310,322	252,814,097
Less accumulated depreciation and amortization	(103,081,471)	(167,689,232)
	302,228,851	85,124,865
Construction in progress	1,311,341	187,591,201
Property, plant and equipment, net	$ 303,540,192	$272,716,066

The following equipment is held under capital leases, included in the equipment category of property, plant and equipment:

	2011	2010
Equipment	$14,670,518	$16,951,834
Less accumulated amortization	(2,651,757)	(8,456,786)
	$12,018,761	$ 8,495,048

Total depreciation and amortization expense for the years ended June 30, 2011 and 2010 was $22,153,445 and $16,366,229, respectively.

Meritus has a conditional asset retirement obligation (CARO) of $1,608,950 and $1,993,500 at June 30, 2011 and 2010, respectively (2011 included in accounts payable and accrued expenses, 2010 included in other long-term liabilities), that relates to the removal and disposal of asbestos and 2 underground fuel storage tanks. Total accretion for the years ended 2011 and 2010 was $165,960 and $99,675, respectively. Payments for the year ended June 30, 2011 were $550,510.

7. EQUITY INVESTMENTS IN AFFILIATES

The following investments, recorded under the equity method of accounting, are included in the consolidated balance sheets.

The Hospital holds a 25% equity interest in Maryland Care, Inc. Maryland Care, Inc. is a managed care organization ("MCO") that was established to serve Maryland's Medicaid population as a result of the State's requirement for Medicaid patients to be a member of an MCO.

7. EQUITY INVESTMENTS IN AFFILIATES - Continued

The Hospital holds a 50% equity interest in Tri-State Health Partners. Tri-State Health Partners is a physician hospital organization ("PHO") established to organize, assemble and facilitate the provision of cost effective healthcare services.

MEI has a 50% interest in Diagnostic Imaging, which provides radiology imaging services, and has a 33.33% interest in Western Maryland Supply, LLC, which provides durable medical equipment for rental or purchase. Endoscopy Center at Robinwood, LLC, an ambulatory center for gastroenterology procedures, and Endoscopy Real Estate are 50% owned by Robinwood Surgery Center, LLC. GI Real Estate provides rental property to a group of healthcare practitioners and is 50% owned by MEI.

Summary financial information as of June 30, 2011 and 2010 and for the years then ended appears below for the significant equity investments:

	Hospital Maryland Care, Inc.		Hospital Tri-State Health Partners	
	2011	2010	2011	2010
Assets	$150,200,000	$153,148,063	$2,903,609	$2,938,648
Liabilities	86,300,000	99,897,376	52,852	352,616
Equity	$ 63,900,000	$ 53,250,687	$2,850,757	$2,586,032
Net income	$ 18,033,088	$ 14,053,869	$ 194,869	$ 238,478

	MEI Diagnostic Imaging Services, LLC		MEI Endoscopy Center at Robinwood, LLC	
	2011	2010	2011	2010
Assets	$ 11,505,376	$ 12,124,040	$ 591,356	$ 635,632
Liabilities	3,920,254	4,736,016	28,924	119,120
Equity	$ 7,585,122	$ 7,388,024	$ 562,432	$ 516,512
Net income	$ 2,697,098	$ 3,697,415	$1,915,919	$2,150,494

7. EQUITY INVESTMENTS IN AFFILIATES - Continued

	MEI Endoscopy Real Estate		MEI GI Real Estate	
	2011	2010	2011	2010
Assets	$1,261,915	$1,206,908	$ 580,726	$ 597,843
Liabilities	1,231,860	1,269,461	408,977	456,459
Equity	$ 30,055	$ (62,553)	$ 171,749	$ 141,384
Net income	$ 92,609	$ 74,044	$ 30,365	$ 25,635

	MEI - Western Maryland Medical Supply, LLC	
	2011	2010
Assets	$1,312,866	$1,343,175
Liabilities	420,869	407,122
Equity	$ 891,997	$ 936,053
Net (loss) income	$ (44,056)	$ 24,345

8. LONG-TERM DEBT

Long-term debt at June 30 consists of the following:

	2011	2010
MHHEFA Revenue Bonds		
Series 2008 4.00% - 6.00% serial bonds, net of original issue discounts of $1,273,796 and $1,333,053, respectively	$263,026,204	$262,966,947
2001 Taxable Note B to Bank of America	2,522,762	3,515,169
City of Hagerstown note	177,475	193,824
Mortgages and equipment loans with banks, with interest rates ranging from 2.3% to 7.75%	3,260,239	3,017,114
Capital lease obligations, with interest rates ranging from 2.9% to 5.0%	6,300,092	9,965,078
	275,286,772	279,658,132
Less current portion of long-term debt	(9,140,210)	(6,067,114)
	$266,146,562	$273,591,018

8. LONG-TERM DEBT - Continued

Meritus uses current market prices in determining the fair value of its Revenue Bonds. The carrying value of other long-term debt approximates fair value. The fair value of total long-term debt, excluding capital lease obligations, was approximately $269,175,000 and $225,655,000 at June 30, 2011 and 2010, respectively.

In February 2008, Meritus issued Maryland Health and Higher Educational Facilities Authority ("MHHEFA") Revenue Bonds Washington County Hospital Issue Series 2008 for the construction of a replacement hospital, funding of the debt service reserve and capitalized interest funds, and to refinance various previously outstanding debt. The Series 2008 Bonds are due in annual principal installments beginning in January 2012 and will mature in 2043. Interest is due semi-annually in January and July.

The long-term debt related to the Series 2008 bonds is reflected in the consolidated financial statements net of the unamortized original issue bond discounts. The original issue bond discounts are being amortized over the life of the debt and are included in amortization expense in the consolidated statements of operations and changes in net assets.

All bonds are collateralized by a first lien and claims on all receipts of Meritus, except restricted donations and contributions. In connection with the Series 2008 Bonds, MHHEFA has a Security interest in existing facilities of Meritus. All bonds require the Obligated Group, which consists of Meritus, the Hospital, and the Fund, to maintain certain financial ratios and stipulated insurance coverage as defined. Meritus was in compliance with these covenants at June 30, 2011 and 2010.

The Fund has entered into guaranty agreements with MHHEFA for the Series 2008 Bonds. Under the terms of these agreements, the Fund guarantees the payment of the principal and interest on the Series 2008 Bonds and the payment of any and all Reserve Fund Loans. In accordance with the provisions of this guaranty agreement, only the unrestricted donations, bequests, and other assets held or owned by the Fund would be available for payment. The terms of the guaranty agreements restrict the Fund's ability to transfer, lease, sell or otherwise dispose of certain assets or to create additional indebtedness, liens, or encumbrances on non-restricted assets.

The 2001 Taxable Note B to Bank of America was issued for the construction of the Robinwood Medical Center III. The taxable portion of the debt requires monthly principal payments of $82,701 through February 1, 2014. The interest is calculated and payable monthly based upon the outstanding principal balance at the time. The variable interest rates were 1.35% and 1.31%, as of June 30, 2011 and 2010, respectively. The bonds may be repaid, at the option of Meritus, in part or in full at any time with 30 days notice. The bonds are collateralized by a mortgage of the real property of both the Fund and the Hospital.

The 7.75% mortgage loan was issued in September 2002 to acquire land adjacent to the Robinwood Medical Center. Principal on the outstanding balance is paid semi-annually and interest is paid monthly. The loan is collateralized by a mortgage on the property and is due in the year 2022.

8. LONG-TERM DEBT - Continued

Scheduled principal repayments on long-term debt including payments on capital lease obligations are as follows for the next five years as of June 30:

	Long-Term Debt	Capital Lease Obligations
2012	$ 5,026,782	$4,179,235
2013	5,111,706	1,694,188
2014	4,751,742	578,944
2015	4,330,293	124,000
2016	3,751,478	-
Thereafter	247,288,475	-
	$270,260,476	6,576,367
Less amount representing interest		(276,275)
		$6,300,092

The Hospital maintains a line of credit with a financial institution which is renewed annually in the amount of $1,000,000, bearing interest on the drawn portion at the bank's prime interest rate. The line was not in use at June 30, 2011 and 2010.

MEI maintains a line of credit with a financial institution which is renewed annually in the amount of $500,000, bearing interest on the drawn portion at the bank's prime interest rate plus 2%. The line was not in use at June 30, 2011 and 2010.

Capitalized Interest

A summary of interest cost and investment income on borrowed funds held by the trustee under the Series 2008 Revenue Bonds for the years ended June 30, is as follows:

	2011	2010
Interest cost:		
Expense	$ 8,500,000	$ -
Capitalized	6,825,828	15,076,522
	$15,325,828	$15,076,522

8. LONG-TERM DEBT - Continued

Capitalized Interest - continued

	2011	2010
Investment income:		
Other income	$126,358	$ -
Capitalized	618,172	1,348,999
	$744,530	$1,348,999

9. INCOME TAXES

MEI and its subsidiaries file a consolidated federal return and separate state returns. The income tax expense for the years ended June 30, consists of:

	2011	2010
Current:		
Federal	$ 174,845	$1,325,274
State	139,130	401,702
	313,975	1,726,976
Deferred:		
Federal	(120,031)	(461,437)
State	(19,309)	(70,547)
	(139,340)	(531,984)
	$ 174,635	$1,194,992

9. INCOME TAXES - Continued

The significant components of the deferred tax assets, which are included in prepaid and other current assets and other assets at June 30, are as follows:

	2011	2010
Deferred tax asset:		
Accrued vacation	$ 1,280,507	$1,200,527
Deferred compensation	843,062	451,881
Captive insurance premiums	-	169,798
Allowance for bad debts	578,305	512,394
Other	316,561	216,635
	3,018,435	2,551,235
Deferred tax liabilities:		
Fixed assets and intangible assets	(967,973)	(673,520)
Deferred compensation	(4,082)	(33,472)
Captive insurance premiums	(27,174)	-
Partnership basis	(35,623)	-
	(1,034,852)	(706,992)
	$ 1,983,583	$1,844,243

10. POST RETIREMENT BENEFIT PLANS

The Hospital has a 403(b) defined contribution plan available to all employees. Employees can receive up to 50% matching contributions, up to 6% of employee's salary based upon meeting years of service requirements, subject to the annual IRS limitations. Contributions made to the plan by the Hospital on behalf of employees were $3,065,514 and $3,264,242 in 2011 and 2010, respectively.

MEI has an employee savings plan under Section 401(k) of the Internal Revenue Code available to all employees. MEI matches employee contributions for an amount up to 6% of each employee's base salary, subject to limitations, depending upon the length of service with MEI. MEI's contributions vest after the first three years of service. Amounts charged to expense were $1,868,975 and $1,837,989 in 2011 and 2010, respectively. MEI also makes discretionary contributions to eligible employees of 1.0% of total compensation in 2011 and 2010, which also vests after the first three years of service. In 2011 and 2010, this amount was $0 and $330,263, respectively. During plan year 2011, MEI Savings Plan failed to satisfy one of the operational requirements of maintaining a qualified retirement plan. To resolve this issue, MEI adopted a resolution for the Hospital to provide a profit sharing allocation under the plan to 575 selected employees. This contribution was paid April 2011 in the amount of $122,656.

10. POST RETIREMENT BENEFIT PLANS - Continued

MEI maintains an employee funded supplemental non-qualified retirement plan for certain employees. The plan requires the benefits be paid upon termination, retirement or death. The related liability is $883,062 and $2,453,016 at June 30, 2011 and 2010, respectively. Management has designated investments for the intended purpose of funding the liability when payable.

Meritus maintains a cash balance pension plan ("Plan"), which was terminated for all participants, effective June 30, 2011. Meritus is in the termination process which ends with the distribution of plan assets to participants and is expected to be complete by June 30, 2012. Disclosure assumptions reflect the termination and pending settlement of the benefit obligations. The Plan covered substantially all current Hospital employees and maintains the balance for MEI employees previously employed by the Hospital. Benefits under the plan are generally based on the participant's age, years of service and compensation levels. Annual contributions are made to the plan in accordance with the Employee Retirement Income Security Act of 1974 ("ERISA") regulations. Employees are fully vested after three years of service.

The change in benefit obligation, plan assets, and funded status of the Plan are shown below:

	2011	2010
Change in benefit obligation:		
Benefit obligation at beginning of year	$45,842,769	$43,649,864
Interest cost	2,374,753	2,642,651
Actuarial loss	2,601,926	1,504,560
Benefits paid	(6,291,828)	(1,954,306)
Benefit obligation at end of year	$44,527,620	$45,842,769
Change in plan assets:		
Fair value of plan assets at beginning of year	$40,663,757	$34,305,409
Actual return on plan assets	5,907,824	5,687,654
Contributions	2,300,000	2,625,000
Benefits paid	(6,291,828)	(1,954,306)
Fair value of plan assets at end of year	$42,579,753	$40,663,757
Net amount recognized:		
Accrued compensation benefits - current	$ (1,947,867)	$ -
Accrued retirement benefits - non-current	-	(5,179,012)
	$ (1,947,867)	$ (5,179,012)
Amounts recognized in unrestricted net assets consist of:		
Net actuarial loss	$11,018,940	$11,685,043
Prior service cost	183,877	232,053
Net amount recognized in unrestricted net assets	$11,202,817	$11,917,096
Change in amounts recognized in unrestricted net assets	$ 714,279	$ 2,445,987

10. POST RETIREMENT BENEFIT PLANS - Continued

The accumulated benefit obligation is $44,527,620 and $45,842,769 at June 30, 2011 and 2010, respectively.

Amounts in unrestricted net assets expected to be recognized as components of net periodic benefit cost for the year ending June 30, 2012 are prior service costs of $48,176 and actuarial losses of $593,687.

	2011	2010
Net periodic benefit (income) cost:		
Interest cost	$ 2,374,753	$ 2,642,651
Expected return on plan assets	(3,168,040)	(2,770,060)
Prior service cost	576,421	1,032,938
	$ (216,866)	$ 905,529

Assumptions

	2011	2010
Weighted-average assumptions used to determine benefit obligations as of June 30:		
Discount rate	3.41%	5.65%
Rate of compensation increase	N/A	N/A
Measurement date	June 30	June 30
Weighted-average assumptions used to determine net periodic benefit cost for the years ended June 30:		
Discount rate	5.65%	6.25%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase	N/A	N/A

Basis for Expected Long-Term Rate of Return

The expected long-term rate of return reflects the expected return for each major asset class and the weighting of each asset class.

10. POST RETIREMENT BENEFIT PLANS - Continued

Plan Assets

The Plan's weighted-average asset allocations at June 30, are as follows:

	2011	2010
Asset category:		
Equity securities	0%	54%
Fixed income	0%	45%
Cash and cash equivalent	100%	1%
	100%	100%

Description of Investment Policies and Strategies

Asset Class	Range	Target	Benchmark
Equities:	45 - 65%	60%	
Large Company	30 - 50%	40%	S&P 500 and Russell 1000 Value
Mid/Small Company	5 - 15%	11%	Russell 2000
International	5 - 15%	9%	MSCI EAFE
Fixed income	25 - 55%	40%	Lehman Aggregate Bond
Cash	0 - 15%	0%	Salomon 3-Mo T-Bill

As a result of the plan termination, during fiscal year 2011, Meritus modified its strategy to protect fund assets from market fluctuations. As such, the plan assets were invested in cash and cash equivalents.

Fair Value of Plan Assets

The following fair value hierarch table presents information about each major category of the Plan's financial assets measured at fair value on a recurring basis using the market approach as of June 30:

10. POST RETIREMENT BENEFIT PLANS - Continued

Fair Value of Plan Assets - continued

	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
2011:				
Assets				
Cash and cash equivalents	$42,579,753	$42,579,753	$ -	$ -
	$42,579,753	$42,579,753	$ -	$ -
2010:				
Assets				
Cash and cash equivalents	$ 267,540	$ 267,540	$ -	$ -
Fixed income	18,471,758	18,471,758	-	-
Equity securities	21,924,459	21,924,459	-	-
	$40,663,757	$40,663,757	$ -	$ -

Contributions

Contributions to the plan for the year ending June 30, 2012 are expected to be less than $2,000,000.

Estimated Future Benefit Payments

Benefit payments are expected to be paid from the Plan in year ending June 30, 2012 of $44,527,620.

11. INSURANCE COVERAGE

The Parent has a wholly-owned insurance captive, MIC, to provide primary limits of insurance of $1 million per occurrence/$3 million aggregate for professional and general liability. The professional liability coverage is provided on a claims-made basis. In addition, MIC purchased reinsurance from an A rated re-insurer in the amount of $15 million to cover any potential liabilities above the $1 million/$3 million primary limits, which were covered by MIC. The self-insured liabilities for professional and general are discounted at 4%, as determined by an actuary, were $5,476,000 and $4,911,145 as of June 30, 2011 and 2010, respectively and are included in other liabilities in the consolidated balance sheets.

11. INSURANCE COVERAGE - Continued

For the year ended June 30, 2011, MIC applied a retrospective premium credit which reduced premiums by $1,480,680 which has been eliminated in the consolidation process.

Consistent with most companies with similar insurance operations, the liability for losses is ultimately based on management's reasonable expectations of future events. It is reasonably possible that the expectations associated with these amounts could change in the near term (i.e., within one year) and that the effect of such changes could be material to the consolidated financial statements.

	2011	2010
Reserves for losses and loss adjustment expenses at beginning of year	$ 4,911,145	$3,369,039
Less: reinsurance recoverable on unpaid claims	(586,725)	(451,099)
Net reserves for losses and loss adjustment expenses at beginning of year	4,324,420	2,917,940
Incurred related to:		
Current year	1,586,107	1,273,608
Prior years	108,493	1,056,876
Total losses and loss adjustment expenses incurred, net of reinsurance recoverable	1,694,600	2,330,484
Paid related to:		
Current year	(267,688)	(86,750)
Prior years	(1,420,769)	(837,254)
Total losses and loss adjustment expenses paid	(1,688,457)	(924,004)
Net reserves for losses and loss adjustment expenses at end of year	4,330,563	4,324,420
Add: reinsurance recoverable on unpaid claims	1,145,437	586,725
Reserves for losses and loss adjustment expenses at end of year	$ 5,476,000	$4,911,145

12. COMMITMENTS AND CONTINGENCIES

Operating Lease Obligations

Meritus leases equipment under non-cancelable lease arrangements. In addition, Meritus leases office space in several locations under operating leases. Some of the leases provide for renewal options. Rent expense under all operating leases was $6,264,981 and $5,217,465 for the years ended June 30, 2011 and 2010, respectively.

12. COMMITMENTS AND CONTINGENCIES

Operating Lease Obligations - continued

Future minimum lease payments under these non-cancelable operating leases as of June 30 are as follows:

2012	$4,766,910
2013	4,062,858
2014	2,828,059
2015	1,760,054
2016	1,155,714

Rental Properties

The Fund's real estate is used for rental operations. The leases have five-year terms plus renewal options and include provisions for increased operating costs and taxes. The minimum future rental amounts from unrelated entities, based on non-cancelable leases, exclusive of any future renewal options, as of June 30 are as follows:

2012	$162,736
2013	96,986
2014	74,224
2015	48,007
2016	7,320

Litigation

Meritus is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without a material adverse effect on Meritus' financial position or results of operations.

13. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily and permanently restricted net assets at June 30 are restricted for the following purposes:

	2011	2010
Temporarily restricted for financial support of patients and hospital programs	$ 2,610,889	$4,827,012
Capital campaign	5,595,548	3,683,263
Endowment campaign	2,431,353	260,000
	$10,637,790	$8,770,275
Permanently restricted investments are to be held in perpetuity, the income of which is expendable to support charity care and healthcare education	$ 1,028,618	$1,028,618

14. FUNCTIONAL EXPENSES

Meritus provides general healthcare services to residents within its geographic location. Expenses related to providing these services for the years ended June 30 are as follows:

	2011	2010
Healthcare services	$343,137,420	$321,733,868
Fundraising	225,581	329,366
Administration	20,455,700	18,067,656
Total expenses	$363,818,701	$340,130,890

SUPPLEMENTARY INFORMATION

Audit – Tax – Advisory

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Report of Independent Certified Public Accountants
Supplementary Information

To the Board of Directors
Meritus Health, Inc.

Our audit of the consolidated financial statements of Meritus Health, Inc. (formerly The Washington County Health System, Inc. and Subsidiaries) for the year ended June 30, 2011 was conducted for the purpose of forming an opinion on the consolidated financial statements. The following consolidating balance sheet and consolidating statement of operations and changes in net assets are presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, are fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Grant Thornton LLP

Baltimore, Maryland
September 26, 2011

Meritus Health, Inc.

(Formerly The Washington County Health System, Inc. and Subsidiaries)

CONSOLIDATING BALANCE SHEET

June 30, 2011

ASSETS	Meritus Medical Center, Inc.	Meritus Medical Center, Endowment Fund, Inc.	Meritus Health, Inc.	Meritus Health Obligated Group Consolidating Adjustments	Meritus Health Obligated Group	Meritus Enterprises, Inc. and Subsidiaries	Meritus Insurance Company, Ltd.	Meritus Healthcare Foundation	Eliminations	Consolidated Meritus Health, Inc.
CURRENT ASSETS										
Cash and cash equivalents	$ 10,692,132	$ 217,912	$ 514,669	$ (85,268)	$ 11,339,445	$ 5,746,475	$ 176,277	$ 1,033,233	$ 85,268	$ 18,380,698
Restricted cash	2,614,437	-	-	-	2,614,437	-	-	-	-	2,614,437
Short-term investments	4,399,794	-	-	-	4,399,794	-	-	-	-	4,399,794
Current portion of assets whose use is limited	9,311,433	-	-	-	9,311,433	-	920,621	-	-	10,232,054
Accounts receivable, net	37,340,076	-	3,647,507	(1,018,643)	39,968,940	7,526,444	57,234	1,973,208	(3,647,507)	45,878,319
Due from related parties, net	651,686	-	-	-	651,686	816,608	-	5,034	(1,473,328)	-
Supplies	6,270,491	-	-	-	6,270,491	3,981,701	-	-	-	10,252,192
Prepaid expenses and other current assets	2,571,036	282,845	-	-	2,853,881	2,840,057	206,621	13,774	-	5,914,333
Total current assets	73,851,085	500,757	4,162,176	(1,103,911)	77,410,107	20,911,285	1,360,753	3,025,249	(5,035,567)	97,671,827
EQUITY INVESTMENTS IN AFFILIATES	17,427,553	-	3,348,559	20,734,074	41,510,186	4,441,572	-	-	(23,199,467)	22,752,291
ASSETS WHOSE USE IS LIMITED										
Board designated funds	31,240,567	34,975,950	2,361,988	-	68,578,505	-	-	6,976,685	-	75,555,190
Supplemental retirement benefit investments	883,062	-	-	-	883,062	2,656,935	-	-	-	3,539,997
Temporarily and permanently restricted donor funds	1,165,136	-	-	-	1,165,136	-	-	-	-	1,165,136
	33,288,765	34,975,950	2,361,988	-	70,626,703	2,656,935	-	6,976,685	-	80,260,323
Assets held by trustee for debt service and construction	18,465,329	-	-	-	18,465,329	-	-	-	-	18,465,329
Funds designated for insurance purposes	-	-	-	-	-	-	7,647,952	-	-	7,647,952
	51,754,094	34,975,950	2,361,988	-	89,092,032	2,656,935	7,647,952	6,976,685	-	106,373,604
PROPERTY, PLANT AND EQUIPMENT, net	273,326,365	18,943,816	-	(2,287,717)	289,982,464	11,250,782	-	19,229	2,287,717	303,540,192
PLEDGES RECEIVABLE, net	-	-	-	-	-	-	-	3,893,162	-	3,893,162
DEFERRED FINANCING COSTS, net	2,773,094	32,480	-	-	2,805,574	-	-	-	-	2,805,574
OTHER ASSETS	-	-	-	-	-	138,532	1,145,437	8,180	-	1,292,149
DUE FROM RELATED PARTIES	9,132,303	-	-	(3,894,451)	5,237,852	-	-	-	(5,237,852)	-
Total assets	$428,264,494	$54,453,003	$9,872,723	$13,447,995	$506,038,215	$39,399,106	$10,154,142	$13,922,505	$(31,185,169)	$538,328,799

Meritus Health, Inc.

(Formerly The Washington County Health System, Inc. and Subsidiaries)

CONSOLIDATING BALANCE SHEET - CONTINUED

June 30, 2011

LIABILITIES AND NET ASSETS	Meritus Medical Center, Inc.	Meritus Medical Center, Endowment Fund, Inc.	Meritus Health, Inc.	Meritus Health Obligated Group Consolidating Adjustments	Meritus Health Obligated Group	Meritus Enterprises, Inc. and Subsidiaries	Meritus Insurance Company, Ltd.	Meritus Healthcare Foundation	Eliminations	Consolidated Meritus Health, Inc.
CURRENT LIABILITIES										
Accounts payable and accrued expenses	$ 10,242,085	$ 253,399	$ 4,991	$ -	$ 10,500,475	$ 2,917,200	$ 1,680,194	$ 53,333	$ -	$ 15,151,202
Construction and retainage payable	1,153,823	-	-	-	1,153,823	-	-	-	-	1,153,823
Due to related parties, net	-	33,584	1,113,921	-	1,147,505	32,005	-	-	(1,179,510)	-
Accrued salaries, wages and withholdings	3,051,694	-	-	-	3,051,694	1,100,288	-	-	-	4,151,982
Accrued compensation benefits	11,873,509	-	-	-	11,873,509	4,325,933	-	10,597	-	16,210,039
Advances from third-party payors	6,684,832	-	-	-	6,684,832	-	-	-	-	6,684,832
Accrued interest payable	7,795,244	-	-	-	7,795,244	-	-	-	-	7,795,244
Current portion of long-term debt	7,333,582	2,051,370	-	(1,058,963)	8,325,989	962,051	-	-	(147,830)	9,140,210
Total current liabilities	48,134,769	2,338,353	1,118,912	(1,058,963)	50,533,071	9,337,477	1,680,194	63,930	(1,327,340)	60,287,332
LONG-TERM DEBT, net of current portion	262,170,189	5,848,164	-	(4,317,810)	263,700,543	2,335,729	-	-	110,290	266,146,562
ACCRUED RETIREMENT BENEFITS	883,077	-	-	-	883,077	3,017,007	-	-	-	3,900,084
OTHER LONG-TERM LIABILITIES	-	-	-	-	-	-	8,202,886	-	(3,647,507)	4,555,379
Total liabilities	311,188,035	8,186,517	1,118,912	(5,376,773)	315,116,691	14,690,213	9,883,080	63,930	(4,864,557)	334,889,357
STOCKHOLDERS' EQUITY										
Common stock	-	-	-	-	-	700,000	120,000	-	(820,000)	-
Paid-in capital	-	-	-	-	-	1,150,080	-	-	(1,150,080)	-
Retained earnings	-	-	-	-	-	21,418,100	151,062	-	(21,569,162)	-
Non-controlling interest	-	-	-	-	-	1,440,713	-	-	(1,440,713)	-
Total stockholders' equity	-	-	-	-	-	24,708,893	271,062	-	(24,979,955)	-
NET ASSETS										
Unrestricted										
Meritus	110,748,543	46,266,486	8,753,811	18,824,768	184,593,608	-	-	3,282,231	2,456,482	190,332,321
Non-controlling interest	-	-	-	-	-	-	-	-	1,440,713	1,440,713
Total unrestricted net assets	110,748,543	46,266,486	8,753,811	18,824,768	184,593,608	-	-	3,282,231	3,897,195	191,773,034
Temporarily restricted	5,299,298	-	-	-	5,299,298	-	-	10,576,344	(5,237,852)	10,637,790
Permanently restricted	1,028,618	-	-	-	1,028,618	-	-	-	-	1,028,618
Total net assets	117,076,459	46,266,486	8,753,811	18,824,768	190,921,524	-	-	13,858,575	(1,340,657)	203,439,442
Total liabilities and net assets	$428,264,494	$54,453,003	$9,872,723	$13,447,995	$506,038,215	$39,399,106	$10,154,142	$13,922,505	$(31,185,169)	$538,328,799

Meritus Health, Inc.

(Formerly The Washington County Health System, Inc. and Subsidiaries)

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS

Year end June 30, 2011

	Meritus Medical Center, Inc.	Meritus Medical Center, Endowment Fund, Inc.	Meritus Health, Inc.	Meritus Health Obligated Group Consolidating Adjustments	Meritus Health Obligated Group	Meritus Enterprises, Inc. and Subsidiaries	Meritus Insurance Company, Ltd.	Meritus Healthcare Foundation	Eliminations	Consolidated Meritus Health, Inc.
Unrestricted revenue, gains and other support										
Net patient service revenue	$273,822,984	$ -	$ -	$ -	$273,822,984	$ 63,231,744	$ -	$ -	$(10,008,221)	$327,046,507
Sales	-	-	-	-	-	31,536,573	-	-	(3,727,080)	27,809,493
Rental income, net of expense	-	1,932,293	-	(6,641)	1,925,652	-	-	-	6,641	1,932,293
(Loss) gain on disposal of assets	(210,079)	-	-	-	(210,079)	12,892	-	-	-	(197,187)
Other revenue	3,059,681	-	(963,389)	-	2,096,292	3,302,938	4,531,906	879,178	(1,044,803)	9,765,511
Equity earnings in affiliates	4,741,117	-	-	369,407	5,110,524	2,353,660	-	-	(369,407)	7,094,777
Net assets released from restriction used for operations	444,468	-	-	-	444,468	-	-	1,085,351	(682,004)	847,815
	281,858,171	1,932,293	(963,389)	362,766	283,189,841	100,437,807	4,531,906	1,964,529	(15,824,874)	374,299,209
Expenses										
Salaries and wages	103,152,879	-	-	-	103,152,879	38,015,664	-	386,874	-	141,555,417
Professional fees	8,696,248	-	-	-	8,696,248	924,502	-	-	-	9,620,750
Cost of goods sold	-	-	-	-	-	22,313,107	-	-	(3,242,560)	19,070,547
Supplies and other	117,260,145	439,524	268,261	600,229	118,568,159	35,357,547	4,795,379	86,999	(11,152,780)	147,655,304
Interest	8,909,404	177,947	-	(37,498)	9,049,853	124,955	-	-	37,498	9,212,306
Depreciation and amortization	19,587,835	877,211	-	-	20,465,046	1,681,211	-	7,188	-	22,153,445
Provision for bad debts	12,904,290	-	-	-	12,904,290	1,646,642	-	-	-	14,550,932
	270,510,801	1,494,682	268,261	562,731	272,836,475	100,063,628	4,795,379	481,061	(14,357,842)	363,818,701
Operating income (loss) before other items	11,347,370	437,611	(1,231,650)	(199,965)	10,353,366	374,179	(263,473)	1,483,468	(1,467,032)	10,480,508
Other items										
Demolition costs	(954,579)	-	-	-	(954,579)	-	-	-	-	(954,579)
Early retirement costs	(461,643)	-	-	-	(461,643)	(108,299)	-	-	-	(569,942)
Transition costs	(2,797,289)	-	-	-	(2,797,289)	-	-	-	-	(2,797,289)
	(4,213,511)	-	-	-	(4,213,511)	(108,299)	-	-	-	(4,321,810)
Operating income (loss)	7,133,859	437,611	(1,231,650)	(199,965)	6,139,855	265,880	(263,473)	1,483,468	(1,467,032)	6,158,698
Non-operating gains (losses), net										
Investment returns, net	5,208,794	5,658,611	392,757	-	11,260,162	240,195	263,473	998,729	-	12,762,559
Other, net	(31,956)	-	(320,354)	626,625	274,315	15,373	-	(1,926,039)	2,510,431	874,080
Income tax expense	-	-	-	-	-	(174,635)	-	-	-	(174,635)
Excess of (deficiency in) revenue over expenses	12,310,697	6,096,222	(1,159,247)	426,660	17,674,332	346,813	-	556,158	1,043,399	19,620,702
Excess of revenue attributable to non-controlling interest	-	-	-	-	-	(296,365)	-	-	-	(296,365)
Excess of (deficiency in) revenue over expenses attributable to Meritus	12,310,697	6,096,222	(1,159,247)	426,660	17,674,332	50,448	-	556,158	1,043,399	19,324,337

Meritus Health, Inc.

(Formerly The Washington County Health System, Inc. and Subsidiaries)

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS - CONTINUED

Year end June 30, 2011

	Meritus Medical Center, Inc.	Meritus Medical Center, Endowment Fund, Inc.	Meritus Health, Inc.	Meritus Health Obligated Group Consolidating Adjustments	Meritus Health Obligated Group	Meritus Enterprises, Inc. and Subsidiaries	Meritus Insurance Company, Ltd.	Meritus Healthcare Foundation	Eliminations	Consolidated Meritus Health, Inc.
Other changes in unrestricted net assets										
Change in retirement benefit obligation	714,279	-	-	-	714,279	-	-	-	-	714,279
Change in non-controlling interest	-	-	-	-	-	(223,635)	-	-	-	(223,635)
Other	-	-	-	-	-	85,309	-	-	-	85,309
Increase (decrease) in unrestricted net assets	13,024,976	6,096,222	(1,159,247)	426,660	18,388,611	(87,878)	-	556,158	1,043,399	19,900,290
Temporarily restricted net assets										
Contributions	396,363	-	-	-	396,363	-	-	2,953,173	(682,004)	2,667,532
Net realized and unrealized gains and (losses) on investments	47,798	-	-	-	47,798	-	-	-	-	47,798
Net assets held by MHF	1,470,059	-	-	-	1,470,059	-	-	-	(1,470,059)	-
Net assets released from restrictions for operations	(444,468)	-	-	-	(444,468)	-	-	(1,085,351)	682,004	(847,815)
Increase (decrease) in temporarily restricted net assets	1,469,752	-	-	-	1,469,752	-	-	1,867,822	(1,470,059)	1,867,515
INCREASE (DECREASE) IN NET ASSETS	14,494,728	6,096,222	(1,159,247)	426,660	19,858,363	(87,878)	-	2,423,980	(426,660)	21,767,805
Net assets										
Beginning of year	102,581,731	40,170,264	9,913,058	18,398,108	171,063,161	24,796,771	271,062	11,434,595	(25,893,952)	181,671,637
End of year	$117,076,459	$46,266,486	$ 8,753,811	$18,824,768	$190,921,254	$24,708,893	$ 271,062	$13,858,575	$(26,320,612)	$203,439,442

Grant Thornton