COHEN
RUTHERFORD
+ KNIGHT PC
Certified Public Accountants

Consolidated Audited Financial Statements

Atlantic General Hospital Corporation

June 30, 2012 and 2011

Atlantic General Hospital Corporation
Consolidated Audited Financial Statements
June 30, 2012 and 2011

-Contents-

COHEN
RUTHERFORD
+ KNIGHT PC
Certified Public Accountants

Report of Independent Auditors

Board of Directors
Atlantic General Hospital Corporation
Berlin, Maryland

We have audited the accompanying consolidated balance sheets of Atlantic General Hospital Corporation (the Corporation) as of June 30, 2012 and 2011 and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation'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 audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation'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 consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements 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 financial position of Atlantic General Hospital Corporation as of June 30, 2012 and 2011, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As further described in *Note A*, during 2012 the Hospital changed its method of reporting and disclosing charity care provided, and as further described in *Note D*, during 2012 the Hospital changed its method of accounting for malpractice liabilities and related insurance recoveries.

Cohen, Rutherford + Knight, P.C.

October 24, 2012
Bethesda, Maryland

6903 Rockledge Drive, Suite 500, Bethesda, MD 20817 **Tel:** 301.828.1000 **Fax:** 301.530.3625

Atlantic General Hospital Corporation

Consolidated Balance Sheets

	June 30, 2012	June 30, 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 17,259,762	$ 17,698,098
Cash and cash equivalents internally designated for a restricted purpose	66,682	0
Investments	1,576,396	1,593,397
Patient accounts receivable, less uncollectible acccounts of $755,101 and $845,683 for 2012 and 2011, respectively -- *Note G*	9,207,236	8,214,265
Supply inventory	1,955,288	1,668,379
Prepaid expenses and other current assets	1,609,728	1,679,500
TOTAL CURRENT ASSETS	31,675,092	30,853,639
LAND, BUILDINGS, AND EQUIPMENT -- *Note B*	45,148,207	36,650,305
OTHER ASSETS		
Assets whose use is limited:		
Cash and cash equivalents restricted by donor	96,618	91,560
Cash and cash equivalents internally designated for a future endowment	67,385	71,708
Investments internally designated for a future endowment	2,905,229	2,958,369
Trustee held fund	2,441,167	6,048,647
Long-term investments	32,080	41,620
Deferred financing costs, less accumulated amortization of $212,526 for 2012 and $180,635 for 2011 -- *Note C*	291,129	323,020
Other non current assets -- *Note D*	2,945,043	39,517
TOTAL OTHER ASSETS	8,778,651	9,574,441
	$ 85,601,950	$ 77,078,385

Atlantic General Hospital Corporation
Consolidated Balance Sheets

	June 30, 2012	June 30, 2011
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 8,154,772	$ 5,275,205
Salaries, wages, and related items	3,988,677	4,541,303
Interest payable -- *Note C*	63,971	95,127
Advances from third party payers	1,089,863	1,083,321
Line of credit -- *Note C*	0	800,000
Current portion of long term debt -- *Note C*	3,923,368	1,729,700
TOTAL CURRENT LIABILITIES	17,220,651	13,524,656
NONCURRENT LIABILITIES		
Long-term debt, less portion classified as current liability -- *Note C*	26,477,239	26,118,687
Swap contracts -- *Note C*	107,733	420,492
Other liabilities -- *Note D*	2,933,377	0
TOTAL LIABILITIES	46,739,000	40,063,835
COMMITMENTS AND CONTINGENCIES -- *Notes C, D, and E*		
NET ASSETS		
Unrestricted		
General	35,649,871	33,793,531
Board-designated -- *Note I*	2,972,614	3,030,077
Temporarily restricted	240,465	190,942
TOTAL NET ASSETS	38,862,950	37,014,550
	$ 85,601,950	$ 77,078,385

See notes to the consolidated financial statements

Atlantic General Hospital Corporation

Consolidated Statements of Operations

	June 30, 2012	June 30, 2011
REVENUE		
Net patient service revenue--*Note G*	$ 90,671,977	$ 87,527,567
Other operating revenue	813,028	675,145
TOTAL OPERATING REVENUE	91,485,005	88,202,712
OPERATING EXPENSES--*Note F*		
Salaries	38,793,933	37,563,231
Employee benefits and other related expenses--*Note E*	8,511,849	7,569,528
Professional fees and contracted services	8,664,633	8,167,731
Supplies and other expense--*Note E*	19,631,849	18,918,574
Utilities	1,224,886	1,431,298
Maintenance and repairs	3,183,712	2,341,179
Insurance--*Note D*	1,345,605	1,496,082
Interest--*Note C*	1,035,250	1,127,014
Depreciation--*Note B*	4,660,296	4,198,095
Amortization	31,891	77,155
Provision for bad debts	3,991,078	5,172,978
TOTAL OPERATING EXPENSES	91,074,982	88,062,865
INCOME FROM OPERATIONS	410,023	139,847
OTHER INCOME		
Investment income	405,472	462,599
Net unrealized gains (losses) on trading portfolio	(243,816)	385,638
Other	884,439	799,311
TOTAL OTHER INCOME	1,046,095	1,647,548
REVENUE AND GAINS IN EXCESS OF EXPENSES	$ 1,456,118	$ 1,787,395

See notes to the consolidated financial statements

Atlantic General Hospital Corporation

Consolidated Statements of Changes in Net Assets

	Year Ended June 30, 2012		
	Unrestricted	Temporarily Restricted	Total
NET ASSETS, BEGINNING OF YEAR	$ 36,823,608	$ 190,942	$ 37,014,550
Revenue and gains in excess of expenses	1,456,118	0	1,456,118
Restricted contributions	0	132,694	132,694
Change in fair value of swap contract--*Note C*	312,759	0	312,759
Net assets released from restrictions used for operations	0	(53,171)	(53,171)
Net assets released from restrictions used for capital acquisitions	30,000	(30,000)	0
Change in Net Assets	1,798,877	49,523	1,848,400
NET ASSETS, END OF YEAR	$ 38,622,485	$ 240,465	$ 38,862,950

	Year Ended June 30, 2011		
	Unrestricted	Temporarily Restricted	Total
NET ASSETS, BEGINNING OF YEAR	$ 34,383,306	$ 277,898	$ 34,661,204
Revenue and gains in excess of expenses	1,787,395	0	1,787,395
Restricted contributions	0	322,734	322,734
Change in fair value of swap contract--*Note C*	375,694	0	375,694
Net assets released from restrictions used for operations	0	(132,477)	(132,477)
Net assets released from restrictions used for capital acquisitions	277,213	(277,213)	0
Change in Net Assets	2,440,302	(86,956)	2,353,346
NET ASSETS, END OF YEAR	$ 36,823,608	$ 190,942	$ 37,014,550

See notes to the consolidated financial statements

Atlantic General Hospital Corporation
Consolidated Statements of Cash Flows

	Year Ended June 30, 2012	2011
OPERATING ACTIVITIES AND OTHER GAINS		
Change in net assets	$ 1,848,400	$ 2,353,346
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities and other gains:		
Depreciation and amortization expense	4,692,187	4,275,250
Provision for bad debts	3,991,078	5,172,978
Recognition of change in fair value of swap contract	(312,759)	(375,694)
Unrealized losses (gains)	243,816	(385,638)
Decrease (increase) in:		
Patient accounts receivable, net	(4,984,049)	(5,517,579)
Supply inventory	(286,909)	(335,487)
Pledges receivable, net	0	47,200
Prepaid expenses and other assets	69,772	(3,844)
Increase (decrease) in:		
Accounts payable and accrued expenses	2,879,567	853,513
Salaries, wages and related items	(552,626)	333,492
Interest payable	(31,156)	25,449
Third party advances	6,542	311,912
Other liabilities	27,850	0
NET CASH AND CASH EQUIVALENTS PROVIDED BY OPERATING ACTIVITIES AND OTHER GAINS	7,591,713	6,754,898
INVESTING ACTIVITIES		
Net purchase of trading investments	(164,135)	(297,123)
Change in trustee held funds	3,607,480	(6,048,647)
Net purchase of land, building, and equipment	(12,712,373)	(5,403,800)
NET CASH AND CASH EQUIVALENTS USED IN INVESTING ACTIVITIES	$ (9,269,028)	$ (11,749,570)

(Continued)

Atlantic General Hospital Corporation

Consolidated Statements of Cash Flows - Continued

	Year Ended June 30, 2012	2011
FINANCING ACTIVITIES		
Payment on long-term debt	$ (3,567,308)	$ (1,432,716)
Net payments on short-term financing	(800,000)	(700,000)
Proceeds from long-term debt	5,673,704	10,000,000
Payment for financing costs	0	(57,584)
NET CASH AND CASH EQUIVALENTS PROVIDED BY FINANCING ACTIVITIES	1,306,396	7,809,700
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(370,919)	2,815,028
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	17,861,366	15,046,338
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 17,490,447	$ 17,861,366
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$ 1,066,406	$ 1,152,461
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITY		
Equipment acquired with issuance of capital lease agreements	$ 445,826	$ 47,988

See notes to the consolidated financial statements

Note A - Organization and Summary of Significant Accounting Policies

Organization

Atlantic General Hospital Corporation (the Corporation) is a non-stock, non-profit Maryland Corporation organized on April 4, 1989, primarily for the purpose of constructing, owning and operating Atlantic General Hospital (the Hospital) in Worcester County, Maryland. On May 21, 1993, the Hospital commenced operations as a full-service acute care inpatient and outpatient health care facility. Admitting physicians are primarily practitioners in the local area. Prior to May 21, 1993, the Corporation's primary activity was the planning and development of the Hospital. During 2006, the Corporation formed Atlantic ImmediCare, LLC (the LLC), for the purpose of providing urgent care services to Ocean City, Maryland residents and visitors. For tax purposes, the Corporation considers Atlantic ImmediCare, LLC to be a disregarded entity.

Use of Estimates

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

Basis of Presentation

The Corporation prepares its consolidated financial statements on the accrual basis of accounting. The consolidated financial statements of the Corporation include the accounts of the Hospital and the LLC. All significant intercompany transactions have been eliminated.

Board-Designated Unrestricted Net Assets

Board-designated unrestricted net assets represent assets whose use by the Hospital has been designated by the Board of Directors for a particular purpose. The Board of Directors may remove or modify the designations at any time. Board-designated unrestricted net assets as of June 30, 2012 and 2011 are reported as cash and cash equivalents and investments internally designated for a future endowment in the accompanying consolidated balance sheets and are comprised of the following:

	2012	2011
Cash and cash equivalents	$ 67,385	$ 71,708
Investments	2,905,229	2,958,369
	$ 2,972,614	$ 3,030,077

Note A - Organization and Summary of Significant Accounting Policies - Continued

Board-Designated Unrestricted Net Assets - Continued

The Hospital's Board of Directors has determined that any investment income on the future endowment will be internally designated as follows: In fiscal year 2011, 20% of the interest earned on the endowment will be used to increase the endowment, and the remaining 80% will be used to fund physician practice development in the community. Beginning in FY 2012, AGH began using a three year rolling average market value method and remove 3% annually; 100% of these proceeds will be used to fund physician practice development.

Temporarily Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors or grantors to a specific time period or purpose. Temporarily restricted net assets as of June 30 are restricted for community and education programs and operations.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital 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 on the earlier of the date the condition is satisfied or 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 consolidated 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 revenue and support in the accompanying consolidated financial statements.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Risk Factors

The Hospital's ability to maintain and/or increase future revenues could be adversely affected by: (1) the growth of managed care organizations promoting alternative methods for health care delivery and payment of services such as discounted fee-for-service networks and capitated fee arrangements (the rate setting process in the State of Maryland prohibits hospitals from entering into discounted fee arrangements, however, managed care contracts may provide for exclusive service arrangements); (2) proposed and/or future changes in the laws, rules, regulations, and policies relating to the definition, activities, and/or taxation of not-for-profit tax-exempt entities; (3) the outcome of the federal budget debate, and the enactment into law of all or any part of the current budget resolutions under consideration by Congress related to Medicare and Medicaid reimbursement methodology and/or further reductions in payments to hospitals and other health care providers; (4) the ultimate impact of the federal Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act of 2010 (5) the future of Maryland's certificate of need program, where future deregulation could result in the entrance of new competitors, or future additional regulation may eliminate the Hospital's ability to expand or add new services; and (6) the future of the Maryland Health Services Cost Review Commission's authority to regulate rates, where future changes could result in reductions to revenues since payers would be free to negotiate discounts not currently allowed.

The Joint Commission, a non-governmental privately owned entity, provides accreditation status to hospitals and other health care organizations in the United States of America. Such accreditation is based upon a number of requirements including undergoing periodic surveys conducted by Joint Commission personnel. Certain managed care payers require hospitals to have appropriate Joint Commission accreditation in order to participate in those programs. In addition, the Center for Medicare and Medicaid Services of the U.S. Department of Health and Human Services (CMS), the agency with oversight of the Medicare and Medicaid programs, provides "deemed status" for facilities having Joint Commission accreditation. In other words, by being Joint Commission accredited, facilities are "deemed" to be in compliance with the Medicare and Medicaid conditions of participation. Termination as a Medicare provider or exclusion from any or all of these programs/payers would have a materially negative impact on the future financial position, operating results and cash flows of the Corporation. The Hospital's has been accredited by the Joint Commission through October 2012, and has extended accreditation through a date to be determined, pending compliance responses.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Risk Factors - continued

During September 2008, certain large U.S. financial institutions failed, primarily as a result of holdings in troubled subprime loans or assets collateralized with such distressed loans. These institutional failures, and the negative economic conditions that contributed to these failures, generated substantial volatility in global financial markets and substantial uncertainty regarding access to capital and the continued viability of many other financial institutions. These conditions create uncertainty regarding the future valuation of the Corporation's invested funds, and the resulting impact on the future financial position, results of operations and cash flows of the Corporation could be material.

Cash and Cash Equivalents

The Corporation invests excess cash in financial instruments, which are converted into cash as needed to meet the Corporation's obligations. Cash equivalents are highly liquid financial instruments with original maturities of less than ninety days or containing provisions for early redemption without penalty, and are recorded at cost, which approximates fair market value. The Corporation has cash holding in commercial banks that routinely exceed the Federal Deposit Insurance Corporation maximum insurance limit of $250,000.

The composition of cash and cash equivalents at June 30 is as follows:

	2012	2011
Cash and cash equivalents, classified as a current asset	$ 17,259,762	$ 17,698,098
Amounts internally designated for a restricted purpose	66,682	0
Amounts restricted by donor	96,618	91,560
Amounts internally designated for a future endowment	67,385	71,708
Total cash and cash equivalents (as reported in the accompanying consolidated statements of cash flows)	$ 17,490,447	$ 17,861,366

Note A - Organization and Summary of Significant Accounting Policies – Continued

Investments

Investments are measured at fair value in the consolidated balance sheets based on quoted market prices. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in other income, unless the income or loss is restricted by donor or law. Other investments represent charitable gift annuities recorded at the present value of the expected gift and investment in a captive insurance company (see *Note D*).

The composition of investments at June 30 is as follows:

	2012	2011
Investments		
Common stock	$ 2,351,051	$ 1,471,238
Mutual funds	722,610	1,675,708
Fixed maturity	1,392,969	1,389,824
	4,466,630	4,536,770
Other	47,075	56,616
	4,513,705	4,593,386
Less investments internally designated for a future endowment	2,905,229	2,958,369
Less long-term investments	32,080	41,620
Undesignated investments	$ 1,576,396	$ 1,593,397

Investment return for the years ended June 30 consists of:

	2012	2011
Investment income		
Interest and dividends	$ 253,305	$ 263,306
Realized gains	152,167	199,293
Total investment income	$ 405,472	$ 462,599

Note A - Organization and Summary of Significant Accounting Policies - Continued

Investments – Continued

During 2008, the Corporation joined Maryland e-Care, LLC, a joint venture formed by six Maryland hospitals to provide remote monitoring technology with clinical decision support and physician/nursing services for their use in the intensive care units and other clinical areas within their respective hospitals. The Corporation maintains a 5.64% interest in this joint venture.

Fair Value Measurements

Current accounting standards define fair value as the price 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, and establish a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, as follows:

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Observable input other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted market prices that are traded less frequently than exchange-traded instruments.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The following discussion describes the valuation methodologies used for financial assets measured at fair value. The techniques utilized in estimating the fair values are affected by the assumptions used, including discount rates, and estimates of the amount and timing of future cash flows. Care should be exercised in deriving conclusions about the Corporation's business, its value, or financial position based on the fair value information of financial assets presented below.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset, including estimates of the timing, amount of expected future cash flows, and the credit standing of the issuer. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial asset.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Fair Value Measurements - Continued

Fair values for the Corporation's fixed maturity securities are based on prices provided by its investment managers and its custodian bank. Both the investment managers and the custodian bank use a variety of pricing sources to determine market valuations. Each designate specific pricing services or indexes for each sector of the market based upon the provider's experience. The Corporation's fixed maturity securities portfolio is highly liquid, which allows for a high percentage of the portfolio to be priced through pricing services.

Fair values of common stock and mutual funds have been determined by the Corporation from observable market quotations, when available. Private placement securities and other equity securities where a public quotation is not available are valued by using broker quotes.

The fair value of the Corporation's interest rate swap is based on the proprietary model of a third party valuation specialist. The fair value takes into consideration the prevailing interest rate environment and the specific terms and conditions of the swap, and considers the credit risk of the Corporation and the counterparty. The method used to determine the fair value calculates the estimated future payments required by the swap and discounts these payments using an appropriate discount rate. The value represents the estimated exit price that the Corporation would pay to terminate the agreement.

Note A - Organization and Summary of Significant Accounting Policies - Continued

The following table presents the Corporation's fair value hierarchy for assets and liabilities measured at fair value on a recurring basis as of June 30, 2012.

	Level 1	Level 2	Level 3	Total Fair Value
Fixed maturity				
Corporate bonds	$ 0	$ 320,751	$ 0	$ 320,751
US government agency bonds/notes	0	9,766	0	9,766
Municpal bonds	0	52,423	0	52,423
Mutual funds				
Intermediate government	0	82,702	0	82,702
Intermediate-term bond	0	620,593	0	620,593
Short-term bond	0	124,114	0	124,114
World bond	0	182,621	0	182,621
Equities				
Mutual funds				
Small cap	11,870	0	0	11,870
Foreign small/mid growth	73,794	0	0	73,794
Foreign large blend	34,360	0	0	34,360
Large value	33,444	0	0	33,444
Mid-Cap value	19,180	0	0	19,180
Mid-Cap growth	121,927	0	0	121,927
Diversified emerging markets	198,153	0	0	198,153
Large growth	34,117	0	0	34,117
Real estate	115,327	0	0	115,327
Commodities broad basket	80,437	0	0	80,437
Common stocks				
Basic materials	213,562	0	0	213,562
Conglomerates	4,254	0	0	4,254
Consumer goods	125,754	0	0	125,754
Financial	161,893	730,540	0	892,433
Healthcare	142,134	0	0	142,134
OTC markets	0	201,101	0	201,101
Industrial goods	150,272	0	0	150,272
Real estate	3,059	0	0	3,059
Utilities	11,828	0	0	11,828
Services	329,783	0	0	329,783
Technology	276,871	0	0	276,871
Total Assets	$ 2,142,019	$ 2,324,611	$ 0	$ 4,466,630
Interest rate swap	$ 0	$ 0	$ (107,733)	$ (107,733)
Total Liabilities	$ 0	$ 0	$ (107,733)	$ (107,733)

Note A - Organization and Summary of Significant Accounting Policies - Continued

The following table presents the Corporation's fair value hierarchy for assets and liabilities measured at fair value on a recurring basis as of June 30, 2011.

	Level 1	Level 2	Level 3	Total Fair Value
Fixed maturity				
Corporate bonds	$ 0	$ 1,082,135	$ 0	$ 1,082,135
US government agency bonds/notes	0	13,972	0	13,972
Foreign bonds/notes	0	293,717	0	293,717
Equities				
Mutual funds				
Mid-Cap value	123,228	0	0	123,228
Large blend	63,230	0	0	63,230
Foreign small/mid growth	66,068	0	0	66,068
Foreign large blend	454,812	0	0	454,812
Mid-Cap value	113,836	0	0	113,836
Mid-Cap growth	237,798	0	0	237,798
Small cap	230,665	0	0	230,665
Diversified emerging markets	191,917	0	0	191,917
Utilities	6,361	0	0	6,361
Real estate	114,754	0	0	114,754
Commodities broad basket	73,040	0	0	73,040
Common stocks				
Basic materials	111,167	0	0	111,167
Consumer goods	55,714	0	0	55,714
Financial	114,094	751,140	0	865,234
Healthcare	91,283	0	0	91,283
Industrial goods	46,324	0	0	46,324
Services	125,615	0	0	125,615
Technology	175,901	0	0	175,901
Total Assets	$ 2,395,807	$ 2,140,964	$ 0	$ 4,536,771
Interest rate swap	$ 0	$ 0	$ (420,492)	$ (420,492)
Total Liabilities	$ 0	$ 0	$ (420,492)	$ (420,492)

There were no significant transfers between fair value hierarchy levels for the years ended June 30, 2012 and 2011.

Note A - Organization and Summary of Significant Accounting Policies - Continued

The following table summarizes the activity for fair value measurements using significant unobservable inputs (Level 3) for 2012 and 2011:

	2012	2011
Balance, beginning of year	$ (420,492)	$ (796,186)
Net unrealized gains on swap	312,759	375,694
Balance, end of year	$ (107,733)	$ (420,492)

Supply Inventory

Supply inventory is stated at the lower of cost or market, with cost determined principally by the first-in, first-out method.

Land, Buildings, and Equipment

Land, buildings, and equipment are carried at cost, including net interest on related borrowings capitalized during periods of construction. Donated items are recorded at fair value at the date of the donation. Capital leases are carried at the lower of the present value of their net minimum lease payments or the fair value of the leased properties at the inception of the lease less accumulated amortization. Expenditures that materially increase values, change capacities, or extend useful lives are capitalized. The carrying amounts of significant assets sold, retired, or otherwise disposed of and the related allowances for depreciation are eliminated from the accounts.

Depreciation, which includes amortization of equipment under capital leases, is recorded on the straight-line basis using the half-year convention over the estimated useful lives (or lease term if shorter) of 10 to 40 years for buildings and improvements and 5 to 10 years for equipment. Any acquisitions from July 1, 1999 and forward that are in excess of $100,000 are depreciated on the straight-line basis without using the half-year convention.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from revenue and gains in excess of expenses and losses. 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 those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Deferred Financing Costs

Deferred financing costs related to the Corporation's 2001, 2002, and 2010 Series Revenue Bonds and the 2008 commercial mortgage loan are being amortized over the remaining period that such bonds are outstanding (see *Note C*). Amortization of deferred financing costs of $31,891 and $37,155 was charged to operations for 2012 and 2011, respectively.

Trustee Held Funds

Trustee held funds represent funds held by a trustee in accordance with the Corporation's 2010 Series Revenue Bonds and are held in an M&T Bank (formerly Wilmington Trust) money market fund (see *Note C*).

Net Patient Service Revenue and Patient Accounts Receivable

Net patient service revenue is reported at estimated net realizable amounts from patients, third party payers, and others for services rendered. Patient accounts receivable include hospital and physician charges for accounts due from Medicare, Maryland Medical Assistance (Medicaid), CareFirst, commercial and managed care insurers, and self-paying patients (see *Note G*).

Net Patient Service Revenue and Patient Accounts Receivable - continued

Deducted from patient accounts receivable are estimates of allowances for the excess of charges over the payments on patient accounts to be received from third party payers and uncollectible amounts related to self-paying patients. These estimates are calculated by management based on historical collection experience and analysis of financial class and age of groups of accounts receivable. These estimates of allowances are included in net patient service revenue, whereas the provision for uncollectible accounts is reported as an operating expense.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Charity Care

The Hospital provides care to patients who meet certain criteria under its financial assistance policy without charge or at amounts less than its established rates. Such patients are identified based on financial information obtained from the patient (or their guarantor) and subsequent analysis, and use of the Federal poverty limits as guidelines. Since the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as a component of net patient service revenue or patient accounts receivable.

Under current accounting standards, the Corporation is required to report the cost of providing charity care. The cost of charity care provided by the Hospital totaled $1,922,841 and $1,135,586 for the years ended June 30, 2012 and 2011, respectively. Rates charged by the Hospital for regulated services are determined based on an assessment of direct and indirect cost calculated pursuant to the methodology established by the Maryland Health Services Cost Review Commission (the Commission). For any charity services rendered by the Corporation, the cost of charity care is calculated by applying the estimated total cost-to-charge ratio for the Hospital services to the total amount of charges for services provided to patients benefitting from the charity care policies of the Hospital.

A Maryland hospital either receives payments from or makes payments to the Commission with respect to an Uncompensated Care Fund ("UCC") established for rate-regulated hospitals in Maryland. The UCC is intended to provide Maryland hospitals with funds to support the provision of uncompensated care at those hospitals. The Hospital paid $1,093,344 for 2012 and $1,483,352 for 2011 into the UCC.

Revenue and Gains in Excess of Expenses

The consolidated statements of operations include revenue and gains in excess of expenses. Changes in unrestricted net assets, which are excluded from revenue and gains in excess of expenses, consistent with industry practice, include contributions of (and assets released from donor restrictions related to) long-lived assets and other items that are required by accounting principles generally accepted in the United States of America to be reported separately.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Maryland Health Services Cost Review Commission

Certain of the Hospital's charges are subject to review and approval by the Commission. The Hospital has filed the required reports with the Commission and believes it is in compliance with the Commission's requirements. The current rate of reimbursement for principally all inpatient services and certain other services to patients under the Medicare and Medicaid programs is based on an agreement between the Center for Medicare and Medicaid Services and the Commission. This agreement is based upon a waiver from Medicare prospective payment system reimbursement principles granted to the State of Maryland under Section 1814(b) of the Social Security Act and will continue as long as Medicare and Medicaid do not pay rates any higher than those offered to other third-party payers and the rate of increase for costs per hospital inpatient admission in Maryland is below the national average. Management expects this agreement will remain in effect at least through June 30, 2013.

The Hospital's policy is to accrue revenue based on actual rates charged for services to patients in the year in which the services are performed and are billable.

Advertising and Marketing Costs

The Hospital expenses advertising and marketing costs as they are incurred. Advertising and marketing expenses were approximately $964,000 and $1,085,000 for the fiscal years ended June 30, 2012 and 2011, respectively, and is reported as supplies and other expense in the accompanying consolidated statements of operations. No advertising or marketing costs have been capitalized in the accompanying consolidated balance sheets.

Income Taxes

The Corporation is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code as a public charity. Federal tax law requires that the Corporation be operated in a manner consistent with its initial exemption application in order to maintain its exempt status. Management has analyzed the operations of the Corporation and concluded that it remains in compliance with the requirements for exemption.

The state in which the Corporation operates also provides general exemption from state income taxation for organizations that are exempt from federal income taxation. However, the Corporation is subject to both federal and state income taxation at corporate tax rates on its unrelated business income. Exemption from other state taxes, such as real and personal property taxes, is separately determined.

Note A - Organization and Summary of Significant Accounting Policies - Continued

Income Taxes - continued

The Corporation had no unrecognized tax benefits or such amounts were immaterial during the periods presented. Tax periods for which no tax return is filed remain open for examination indefinitely.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

Subsequent Events

Subsequent events have been evaluated by management through October 24, 2012, which the date the consolidated financial statements were available to be issued.

Recent Changes in Accounting Standards

In July 2011, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) No. 2011-7, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. ASU 2011-7 affects entities within the scope of Topic 954, Health Care Entities that recognize significant amounts of patient service revenue at the time services are rendered even though the entities do not assess a patient's ability to pay. ASU 2011-7 requires certain health care entities to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, those health care entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. ASU 2011-7 also requires disclosure of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowances for doubtful accounts. This is effective for fiscal years beginning after December 15, 2011 for public entities and for the first annual period ending after December 15, 2012 for non-public entities (early adoption permitted). Application for periods presented in the statement of operations would be retrospective; however, the disclosures required by the amendments would be prospective. Management is currently evaluating the impact on the Corporation's future consolidated financial statements of adoption of this change in accounting.

Note B - Land, Buildings, and Equipment

Land, buildings, and equipment are comprised of the following as of June 30:

	2012	2011
Land, buildings, and improvements	$ 34,775,595	$ 34,101,590
Fixed equipment	15,341,192	14,245,900
Movable equipment	18,485,143	15,638,010
Capital lease equipment	1,413,093	1,388,079
	70,015,023	65,373,579
Less accumulated depreciation	33,370,412	29,253,807
	36,644,611	36,119,772
Work in process	8,503,596	530,533
	$ 45,148,207	$ 36,650,305

Accumulated amortization of the leased equipment as of June 30, 2012 and 2011 was $299,511 and $282,818, respectively.

Note C - Non-current Liabilities

Long-term debt as of June 30 is comprised of the following:

	2012	2011
$9,978,700 Berlin, Maryland Hospital Refunding Revenue Bonds (Atlantic General Hospital Facility), Series 2001; interest is determined by taking the weighted BMA index plus 1.65% per annum; the BMA index range was 0.06% to 0.26% and 0.07% to 0.29% during fiscal year 2012 and 2011, respectively; principal and interest payments are due monthly commencing December 20, 2001 through December 20, 2026. Additionally, the Corporation entered into an interest rate swap and the combination of the two debt instruments effectively fixed this interest rate at 6.13% through December 1, 2011.	$ 7,504,801	$ 7,815,716
$5,000,000 Berlin, Maryland Hospital Revenue Bond (Atlantic General Hospital Facility), Series 2002; interest is currently the weighted BMA index plus 1.65% per annum, with an option to change quarterly to 65% of the prime rate; the interest rate during fiscal year 2012 was an average of 1.8% and for 2011 was 1.9%; payable in monthly principal and interest installments of $11,111 commencing October 1, 2008; matures September 18, 2027.	2,033,333	2,166,667
$472,500 loan payable from Bank of Ocean City, secured by deposit accounts and property, with interest of 4.83%; payable in monthly principal and interest installments of $3,835, due January 2016.	147,899	185,768
$1,570,000 loan payable to M&T Bank with an interest rate of 30 day LIBOR + 1.85%; payable in monthly principal installments of $26,167; due April 9, 2013. The 30 day LIBOR rate was 0.24% and 0.19% at June 30, 2012 and 2011, respectively. The Corporation entered into an interest rate swap that effectively fixes the rate at 5.15%	261,667	575,667
$5,172,000 loan payable to M&T Bank with an interest rate of 30 day LIBOR + 1.85%; payable in 59 monthly principal installments of $17,240 and one final payment made on April 9, 2013. The 30 day LIBOR rate was 0.24% and 0.19% at June 30, 2012 and 2011, respectively. The Corporation entered into an interest rate swap that effectively fixes the rate at 5.30% for the 59 monthly payments. The final interest payment will be calculated on the unpaid principal balance at an interest based on the 30 day LIBOR + 1.85%.	4,310,000	4,516,880
$32,325 non-interest bearing loan payable to GMAC; payable in 36 monthly principal installments of $898 and one final payment made on November 13, 2012.	4,490	15,263

(Continued)

Note C - Non-current Liabilities – Continued

	2012	2011
$2,200,000 loan payable to M&T Bank with a fixed interest rate of 5.19%, which was based on the 10 year point on the S43 MUNI Swaps Curve + 2.44% until June 30, 2020. Beginning July 1, 2020 to and including its maturity or prepayment in full, the loan will bear interest at a rate equals to the Weighted SIFMA Calculation + 1.65%. Principal and interest payments are due monthly commencing August 1, 2010 through July 1, 2025.	$ 1,918,889	$ 2,065,556
$2,600,000 loan payable to M&T Bank with a fixed interest rate of 5.08% through June 30, 2020 and a variable rate equal to the weighted SIFMA Calculation + 1.65%. Principal and interest payments are due monthly commencing January 1, 2011 through July 1, 2025.	2,345,977	2,525,287
$7,400,000 loan payable to M&T Bank with a variable interest rate equal to the Weighted SIFMA Calculation through December 31, 2012 and a fixed rate calculated as the 7-year point on the S43 Muni Swaps Curve + 2.44% from January 1, 2013 though June 30, 2020; thereafter, a variable rate equal to the SIFMA rate. Principal and interest payments are due monthly commencing August 1, 2011 through July 1, 2025.	7,196,672	7,400,000
$5,673,704 loan payable for financing of Allscripts Perks Inpatient Clinical System with a fixed interest rate of 2.00% secured by the associated equipment.	3,849,679	0
Capital leases payable, with interest ranging from 4.00% to 8.10%, secured by selected equipment.	827,200	581,583
	30,400,607	27,848,387
Less current portion	3,923,368	1,729,700
	$ 26,477,239	$ 26,118,687

Maturities of long-term debt, including capital leases, for years ending June 30 are as follows:

	2013	2014	2015	2016	2017	After 2017
Future minimum lease payments	$ 285,929	$ 285,929	$ 265,189	$ 126,802	$ 0	$ 0
Less interest	64,119	44,586	23,204	4,736	0	0
	221,810	241,343	241,985	122,066	0	0
Notes/loans payable	2,417,996	615,898	631,166	623,684	614,975	3,670,013
Bonds payable	1,283,562	1,365,052	1,387,014	1,014,020	1,014,019	14,936,004
	$3,923,368	$2,222,293	$2,260,165	$1,759,770	$1,628,994	$18,606,017

Note C - Non-current Liabilities - Continued

2001 Series Refunding Revenue Bond

On December 20, 2001, pursuant to a loan and financing agreement (the Financing Agreement) between the Corporation, the Mayor and Council of Berlin, Maryland (the Issuer), and M&T Bank (formerly Wilmington Trust Company (the Lender)), the Town of Berlin issued a $9,978,700 Hospital Refunding Revenue Bond (Atlantic General Hospital Facility), 2001 Series (the 2001 Bond) dated December 1, 2001, to refund the then-existing 1992 Series Revenue Bonds (the Prior Bonds), provide for the payment of accrued and unpaid interest and premium on the Prior Bonds, and provide for the payment of a portion of the costs of issuance of the 2001 Bond. The Financing Agreement requires monthly payments by the Corporation sufficient to meet the principal and interest requirements of the 2001 Bond through its maturity on December 20, 2026. There is no trustee for the 2001 Bond; the Corporation makes all payments of principal and interest on the 2001 Bond directly to the Lender.

In accordance with the terms of the Financing Agreement, the Corporation has entered into various covenants imposing restrictions on the transfer or disposition of property and incurrence of additional indebtedness, restrictions on the acquisition of real property and equipment beyond specified limits, the achievement of certain pre-established financial indicators, monthly reporting of financial information, and the granting of a security interest in all property and unrestricted revenues of the Corporation. In the opinion of management, the Corporation was in compliance with the aforementioned covenants as of June 30, 2012 and 2011.

The Corporation's obligations are evidenced by the Financing Agreement, a deed of trust, and other documents executed and delivered for the purpose of securing the loan. The Corporation has assigned a continuing security interest in its receipts, equipment collateral, personal property, any judgments or awards, any insurance settlements, all rents, and all right and title and interest in property leases and subleases. Upon the occurrence of an event of default under the Financing Agreement, the interest on the outstanding principal balance will be increased 2% per annum in excess of the tax-exempt rate or the taxable rate, as applicable, until such time that the default is cured.

Note C - Non-current Liabilities - Continued

The 2001 Bond is subject to redemption prior to the scheduled December 1, 2026 maturity in different ways:

(1) Optional redemption in whole or in part, at the direction of the Hospital and if approved by the Issuer, with partial redemptions applied to unpaid interest, premiums, and then principal installments in the inverse order of the installment payment dates:

Redemption Period	Redemption Price (on principal)
December 1, 2006 - November 30, 2007	104%
December 1, 2007 - November 30, 2008	103%
December 1, 2008 - November 30, 2009	102%
December 1, 2009 - November 30, 2010	101%
December 1, 2010 and thereafter	100%

(2) Mandatory redemption in whole but not in part, at the sole option of the Lender, at a redemption price equal to the unpaid principal amount together with unpaid interest through redemption. Redemption without premium or penalty is available on the following dates: December 1, 2011; December 1, 2016; or December 1, 2021. The lender must give 180 days' notice for mandatory redemption and they can only do so in the years 2012, 2017 and 2022. On July 30, 2009, the Lender waived the December 31, 2011 put option.

(3) Special mandatory redemption given certain circumstances, in whole or in part as the case may be, at redemption price equal to the principal amount together with all unpaid interest through redemption plus applicable penalties.

2001 Series Swap Agreement

In connection with the issuance of the 2001 Bond, the Corporation entered into an ISDA Master Agreement with the Lender to reduce the Corporation's exposure to future variable cash flows caused by fluctuations in the 2001 Bond's interest rate (the Swap Agreement). The Swap Agreement qualified as a cash flow hedge, which management has determined to be fully effective. Under the terms of the Swap Agreement, the Corporation paid a fixed rate of 6.13% on the outstanding principal balance of the 2001 Bond during the period February 1, 2002 through December 1, 2011. Payments made to the counterparty to the Swap Agreement were approximately $168,258 and $335,387 for the years ended June 30, 2012 and 2011, respectively.

Note C - Non-current Liabilities - Continued

The fair value of the Swap Agreement as of June 30, 2011 (as determined by the investment hedging consultants, based on the present value of cash flow differences over the life of the Swap Agreement between the interest rate calculated on the swap at inception and rates available on similar swap agreements as of June 30) is a liability totaling $167,580. Because management considered the Swap Agreement to be fully effective, the change in the fair value of the liability has been recognized as a direct charge to net assets rather than as a component of total operating expenses. Since the Swap Agreement was fully effective, no gains or losses were reclassified into earnings. During 2012, the Swap Agreement was terminated.

2002 Series Revenue Bond

On September 18, 2002, pursuant to a loan and financing agreement (Second Financing) between the Corporation, the Issuer, and the Lender, the Town of Berlin issued a qualified tax-exempt $5,000,000 Berlin, Maryland Corporation Revenue Bond (Atlantic General Hospital Facility), 2002 Series (the 2002 Bond) dated September 1, 2002. Its proceeds were used to finance a portion of the cost of the acquisition, construction and equipping of an expansion of the existing hospital facility for additional emergency, surgical, and outpatient service capacity. The Second Financing requires monthly payments by the Corporation directly to the Lender sufficient to meet the principal and interest requirements of the 2002 Bond through its maturity on September 18, 2027. Initially, interest was paid at 65% of the prime rate; however, from January 1, 2003 until such time that the Corporation enters into a swap arrangement, the Corporation has the option to direct a change in the interest rate between the initial rate and the weighted BMA calculation plus 165 basis points on any quarterly conversion date.

The Bond is subject to redemption prior to the September 18, 2027 maturity in different ways:

(1) Optional redemption in whole or in part, at the direction of the Corporation and if approved by the Issuer, with partial redemptions applied to unpaid interest, premiums, and then principal installments in the inverse order of the installment payment dates:

Redemption Period	Redemption Price (on principal)
September 2, 2006 - September 1, 2007	104%
September 2, 2007 - September 1, 2008	103%
September 2, 2008 - September 1, 2009	102%
September 2, 2009 - September 1, 2010	101%
September 2, 2010 and thereafter	100%

Note C - Non-current Liabilities - Continued

(2) Mandatory redemption in whole but not in part, at the sole option of the Lender, at a redemption price equal to the unpaid principal amount together with unpaid interest through redemption. Redemption without premium or penalty is available on the following dates: September 1, 2012; September 1, 2017; or September 1, 2022. On July 30, 2009, the Lender waived the September 1, 2012 put option.

(3) Special mandatory redemption given certain circumstances, in whole or in part as the case may be, at redemption price equal to the principal amount together with all unpaid interest through redemption plus applicable penalties.

The 2002 Bond is collateralized by the pledged receipts, property, and revenues of the Hospital. The 2002 Bond also imposes certain restrictive covenants on the Corporation, for which noncompliance could cause accelerated demand for payment. In the opinion of management, the Corporation was in compliance with the aforementioned covenants as of June 30, 2012 and 2011.

In July 2009, the Corporation received written notification from the Lender agreeing to waive the put options for the 2001 Series Refunding Revenue Bond and 2002 Series Revenue Bond, subject to a formal amendment of the bond documents.

Line of Credit

In conjunction with the Second Financing, on September 18, 2002, the Corporation obtained a $1,500,000 line of credit from the Lender to be used for the construction renovations at the Corporation. As of June 30, 2011, the Corporation drew down $800,000 on the line of credit, which was fully paid during the year ended June 30, 2012.

2008 Term Loan

During 2008, the Corporation obtained a $1.570 million term loan from a commercial bank for the purposes of paying off old debt and to purchase equipment for a medical office building. The loan is secured by all equipment owned or hereafter acquired by the Corporation. The Corporation has agreed to comply with certain restrictive covenants, and in the opinion of management, the Corporation was in compliance with the aforementioned covenants as of June 30, 2012 and 2011.

2008 Commercial Mortgage Loan

During 2008, the Corporation obtained a $5.172 million commercial mortgage from a commercial bank for the purposes of paying off old debt and completing construction work on a medical office building. The loan is collateralized by a mortgage lien against the Hospital property as well as certain units in the medical office building. The Corporation has agreed to comply with certain restrictive covenants, and in the opinion of management, the Corporation was in compliance with the aforementioned covenants as of June 30, 2012 and 2011.

Note C - Non-current Liabilities - Continued

2008 Series Swap Agreement

In connection with the issuance of the 2008 term loan and commercial loan, the Corporation entered into an ISDA Master Agreement with the Lender to reduce the Corporation's exposure to future variable cash flows caused by fluctuations in the interest rate (the 2008 Swap Agreement). The 2008 Swap Agreement qualifies as a cash flow hedge, which management has determined to be fully effective. Under the terms of the 2008 Swap Agreement, the Corporation will pay a fixed rate of 5.30% and 5.15% on the outstanding principal balance of the 2008 Commercial Mortgage Loan and the 2008 Term loan, respectively, during the period April 2008 to March 2013.

The fair value of the 2008 Swap Agreement as of June 30, 2012 and 2011 (as determined by the investment hedging consultants, based on the present value of cash flow differences over the life of the 2008 Swap Agreement between the interest rate calculated on the swap at inception and rates available on similar swap agreements as of June 30) is a liability totaling $104,517 and $252,912, respectively. Payments made to the counterparty to the 2008 Swap Agreement were $157,996 and $171,959 for the years ended June 30, 2012 and 2011, respectively. Because management considers the 2008 Swap Agreement to be fully effective, the change in fair value of the swap contract has been recognized as a direct charge to net assets rather than as a component of total operating expenses. As long as the 2008 Swap Agreement continues to be fully effective, no existing gains or losses will be reclassified into earnings. The Corporation is exposed to credit loss in the event of nonperformance by the counterparty on the 2008 Swap Agreement, but does not anticipate nonperformance by the counterparty.

Vehicle Loan

During 2010, the Corporation obtained a non-interest bearing loan for purchase of a vehicle in the amount of $32,325. The term of the loan is 36 months and principal payments are due in monthly installments with the final payment to be made on November 13, 2012.

2010 Series Revenue Bonds

Pursuant to a Commitment Letter dated June 21, 2010, M&T Bank approved financing in the aggregate principal amount not to exceed $12,200,000 for the Corporation by the issuance of three series of bonds (Series A, Series B and Series C), collectively, the 2010 Series Revenue Bonds issued by the Mayor and Council of Berlin (the Issuer). On June 29, 2010, pursuant to a loan and financing agreement (the "2010 Loan and Financing Agreement") between the Corporation, the Issuer, and M&T Bank (the Lender), the Issuer issued the Hospital Revenue Bonds (Atlantic General Hospital Facility) 2010 Series A in the amount of $2,200,000. The Series B Bond and Series C Bond were issued on December 13, 2010 in the amounts of $2,600,000 and $7,400,000, respectively. Proceeds of each Series of the Bonds have been used to finance a portion of cost of the acquisition, installation and improvement of various improvements, equipment and furnishings at the main hospital campus, equipment at the billing office, and equipment at the Atlantic Health Center.

Note C - Non-current Liabilities - Continued

The Financing requires monthly payments by the Corporation directly to the Lender sufficient to meet the principal and interest requirements of the 2010 Bonds through its maturity on July 1, 2025. Repayment began on August 1, 2010 for Series A Bond and February 1, 2011 for Series B Bond and August 1, 2011 for the Series C Bond.

The Series A and B Bonds shall bear interest from the date of its issuance to and including June 30, 2020 at a fixed rate which is equal to the rate of 10-year point on the S43 MUNI Swaps Curve plus 244 basis points. For the Series A Bond and B Bond, the interest rate is 5.19% and 5.08%, respectively. Beginning July 1, 2020 to and including its maturity or repayment in full, the Bonds shall bear interest at a rate which is equal to the Weighted SIFMA Calculation plus 165 basis points. The Series C Bond shall bear interest from the date of its issuance to and including December 31, 2012 at a variable rate which is equal to the Weighted SIFMA Calculation plus 165 basis points. From and after January 1, 2013 to and including June 30, 2020, the Series C Bond shall bear interest at the fixed rate of 7-year point on the S43 MUNI Swaps Curve plus 244 basis points. From and after July 1, 2020 to and including its maturity or repayment in full, the Series C Bond shall bear interest at a variable rate which is equal to the Weighted SIFMA Calculation plus 165 basis points. There will be no swaps or other interest rate hedging arrangement with respect to any Series of the Bonds.

The Bonds are subject to redemption prior to the July 1, 2025 maturity in different ways:

(1) Optional redemption in whole or in part, at the direction of the Corporation and if approved by the Issuer, with partial redemptions applied to unpaid interest, premiums, and then principal installments in the inverse order of the installment payment dates:

Redemption Period	Redemption Price (on principal)
June 30, 2010 - June 30, 2015	105%
July 1, 2015 - June 30, 2016	104%
July 1, 2016 - June 30, 2017	103%
July 1, 2017 - June 30, 2018	102%
July 1, 2019 - June 30, 2020	101%
July 1, 2010 and thereafter	100%

(2) Mandatory redemption prior to maturity from Receipts Requiring Mandatory Redemption.

(3) Mandatory redemption prior to maturity at the option of the Holder.

(4) Mandatory redemption prior to maturity upon the occurrence of a Determination of Taxability.

Note C - Non-current Liabilities - Continued

The 2010 Bonds are collateralized by the pledged receipts, property, and the revenues of the Hospital. The 2010 Bonds also impose certain restrictive covenants on the Corporation, for which noncompliance could cause accelerated demand for payment. The Corporation has agreed to comply with certain restrictive covenants, and in the opinion of management, the Corporation was in compliance with the aforementioned covenants as of June 30, 2012 and 2011.

The Bonds are also subject to a put option which with at least 270 days prior written notice to the Borrower, whereby the Lender at its sole option may put any one or more of the Bonds to the Borrower as of July 1, 2020, and be paid the unpaid principal balance of such Bond or Bonds selected for such put option, plus interest accrued thereon to such put date.

Note D - Professional Liability Insurance Coverage

The Corporation is presently exposed to asserted and unasserted potential legal claims encountered in the ordinary course of business. In the opinion of management, the resolution of such matters will not have a material adverse impact on the Corporation's June 30, 2012 financial position or the results of operations for the year then ended.

Prior to 2005, the Corporation had claims-made professional liability insurance through a commercial insurance carrier covering claims arising from the performance of professional services and brought against the Corporation while the policy was in force. Insurable limits under this policy were $1 million per claim and $3 million annual aggregate shared limit basis. In addition, the Corporation maintained an umbrella policy of $15,000,000 per occurrence and aggregate. No accrual for possible losses attributable to incidents that may have occurred but that have not been identified under the incident reporting system has been made because any such amount is not reasonably estimable.

During 2005, the Hospital, in conjunction with eight other Maryland hospitals, (collectively, the "Shareholders") formed Freestate Healthcare Insurance Company, Ltd. (the "Captive"), a Cayman Islands company, to provide claims-made professional and general liability coverage for the risks of the Shareholders, their controlled affiliates, and their respective employees. Each of the Shareholders is a Maryland nonprofit corporation, exempt from federal income taxation under Section 501(a) of the Internal Revenue Code of 1986, as amended (the "Code" or "IRC"), as an organization described in Section 501(c)(3) of the Code. The Shareholders are not affiliated with one another through common ownership or control. As of June 30, 2012, the Captive had six Shareholders.

Note D - Professional Liability Insurance Coverage - Continued

Each of the Shareholders contributed $15,000 in capital to the Captive and holds 15,000 shares of the Captive, with the total capitalization of the Captive standing at $135,000. The Captive's insurance program commenced January 1, 2005; three Shareholders became insured on that date; four more shareholders became insured in the first and second quarters of 2005 (the Corporation became insured on March 15, 2005) and the remaining Shareholder became insured on July 1, 2005. During 2007, a new member became a Shareholder in the Captive. The Captive provides primary coverage to the Shareholders and their affiliates with limits of liability of $1,000,000 for each and every claim (the "Retained Layer"), and writes an excess policy with various limits of liability which is fully reinsured through commercial carriers. The Corporation has $10,000,000 of additional reinsurance in the aggregate through such reinsurance arrangements. The estimated unpaid loss liability reserved by the captive for the Hospital was $2,933,377 and $4,570,462 at June 30, 2012 and 2011, respectively. In accordance with current accounting standards, the June 30, 2012 unpaid loss liability is recorded as a non current liability, and the related insurance recovery was reported as a non current asset, in the accompanying consolidated balance sheets.

Premiums are calculated by an actuary under a retrospectively rated policy and are based primarily on the experience of the Shareholders. The total premium is allocated to each of the Shareholder's based on their experience. Premiums for the Corporation's professional and general liability insurance of approximately $1,150,000 and $1,219,000 were charged to operations during fiscal years 2012 and 2011. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insureds under the policy. Each named insured's assessment or credit is based on the percentage of their actual exposure to the actual exposure of all named insureds. In management's opinion, the assets of Captive are sufficient to meet its obligations as of June 30, 2012. If the financial condition of Captive were to materially deteriorate in the future, and Captive was unable to pay its claim obligations, the responsibility to pay those claims would return to the member hospitals.

Note E - Commitments

Employment Agreements

The Corporation has entered into various employee agreements with certain physicians whereby the Corporation has agreed to pay reasonable expenses of the physicians' practices in addition to compensation for services rendered. These agreements are generally for a period of two years.

Note E - Commitments - Continued

Lease Agreements

The Corporation has entered into various office lease agreements for equipment and facilities. Most lease arrangements contain a renewal option. Total rent expense for the years ended June 30, 2012 and 2011 was approximately $1,303,000 and $1,286,000, respectively. Future minimum payments on noncancellable office leases, with initial or remaining terms of one year or more, for years ending June 30 are as follows:

2013	$	590,647
2014		350,103
2015		276,498
2016		139,331
2017		127,906
	$	1,484,485

Retirement Plans

On September 7, 2000, the Board of Directors adopted resolutions to implement 401(a) and 403(b) retirement plans, retroactively effective January 1, 2000. The 401(a) plan maintained employer match contributions and earnings thereon, while the 403(b) plan maintained participant salary deferral contributions and earnings thereon. The 401(a) plan was subject to the Employee Retirement Income Security Act of 1974, as amended, and permitted participants' investment direction of their accounts, thereby limiting fiduciary liability of the Plan Sponsor for participant investment instructions. Under the 401(a) plan, the Corporation regularly declared a 50% match of the first 5% of participants' elective deferrals to the 403(b) plan. Participants become 100% vested in employer contributions after three years of continuous service.

In June 2002, the Board of Directors adopted a resolution to convert the 401(a) plan to an employer 403(b) plan for administrative benefits, effective June 30, 2002. The employer 403(b) plan was designed to mirror the 401(a) plan except that funding and eligibility requirements were modified to quarterly provisions. After January 1, 2002 through June 30, 2002 match contributions were made to the 401(a) plan, and non-vested forfeitures were identified and transferred into a forfeiture account for future refunding to the Corporation, all participant account balances in the terminating 401(a) plan were declared fully vested and then transferred into identical investment accounts within the 403(b) plan. Plan expenses were $534,000 and $508,606, for the years ended June 30, 2012 and 2011, respectively.

Note E - Commitments - Continued

Effective January 31, 2003, the Corporation entered into an agreement to sponsor a Section 457 deferred compensation plan. All contributions to the Section 457 plan are from participating employees; however, all assets of the Section 457 plan are the sole property of the Corporation and are fully subject to claims by the Corporation's general creditors.

Self-Insured Plans

Effective May 1, 2002, the Hospital joined the Maryland Hospital Association (MHA) Workers' Compensation Self-Insurance Group to self-insure for worker's compensation benefits. The annual premium for worker's compensation is calculated based on the Hospital's payroll estimate and MHA rates per payroll classification. The MHA rates are determined based on past experience. Amounts charged to operations for workers' compensation expense were $205,057 and $103,587 for the years ended June 30, 2012 and 2011, respectively.

In lieu of paying unemployment tax premiums to the State of Maryland, the Hospital secured a letter of credit with M&T Bank, effective May 21, 2004. As of June 30, 2012 the letter of credit was in the amount of $1,961,128. Additionally, the Hospital paid actual Maryland unemployment claims in the amount of $65,433.

The Hospital maintains an agreement with a third party to administer a self-insured health plan that benefits Hospital associates and their dependents. On behalf of participating associates, the Hospital pays the cost of health claims and an administration fee for each subscriber associate. The participating associates share in the cost by remitting a pre-established premium through payroll deductions. Additionally, the Hospital obtains stop loss insurance to cover possible claims in excess of expected claims. The stop loss insurance agreements are annual agreements, subject to annual renewals. The Hospital submits a claim for reimbursement of stop loss insurance when claims exceed a pre-established ceiling. The Hospital's net health benefit expense for the fiscal years ended June 30, 2012 and 2011, net of premiums received from associates during the fiscal years, ($965,125 and $835,654, respectively), were $4,777,354 and $4,087,146, respectively.

Note E - Commitments - Continued

Effective January 1, 2003, the Corporation entered into an agreement with a third party to coordinate the administration of dental health benefits to Hospital employees and their dependants. This is an annual agreement, subject to annual renewals. On behalf of participating employees, the Hospital pays the cost of claims and a fee for each subscriber employee, and the participating employees remit a portion of the Hospital's cost through a pre-established schedule of payroll deductions.

Line of Credit

In April 2009, the Hospital entered into a line of credit agreement with the Chesapeake Eye Center, PA (Eye Center) in the amount of $300,000. The Hospital entered into this agreement to assist the Eye Center with the provision of health care services to the community served by the Hospital. All requests for draws on the line of credit must be submitted in writing to the Hospital. The initial term of the line of credit was one year and automatically renews for up to two additional years unless the Hospital provides written notice of its intention to terminate the line of credit at least 30 days before the end of any term. At the end of the line of credit term, all outstanding amounts are due and payable in full. The entire indebtedness was due and payable in full on April 10, 2012, however during 2012, the Hospital and the Eye Center entered into a loan repayment agreement, which revised the outstanding unpaid principal to be due in full by May 1, 2013. The outstanding unpaid principal balance will accrue interest at the prime rate of interest as published in the Wall Street Journal. The interest rate will be adjusted quarterly on the first days of January, April, July and October of each year as long as any funds remain outstanding. The line of credit is guaranteed by the owners of the Eye Center and secured by the Eye Center's assets. As of June 30, 2012, the outstanding principal amount of the line of credit is $175,113.

Allscripts Perks Inpatient Clinical System

In September 2011, the Corporation entered into a seven year agreement for an electronic medical records system and support services for approximately $8.8 million.

Note F - Functional Expenses

The Corporation provides general health care services to residents within its geographic area. Expenses related to providing these services are as follows for the years ended June 30, 2012 and 2011:

	2012	2011
Health care services	$ 70,671,089	$ 69,468,532
General and administrative	20,403,893	18,594,333
	$ 91,074,982	$ 88,062,865

Note G - Business and Credit Concentrations

The Corporation grants credit to patients, many of whom are local residents. The Corporation 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.

At June 30, the Corporation had gross accounts receivable from third party payers and others as follows:

	2012	2011
Medicare	$ 4,452,326	$ 3,834,465
Medicaid	754,394	652,958
Commercial insurance and HMOs	3,019,521	2,840,947
CareFirst	2,048,051	2,134,445
Self-pay and others	6,327,167	5,728,659
	$ 16,601,459	$ 15,191,474

Gross patient service revenue, by payer class, consisted of the following for the years ended June 30:

	2012	2011
Medicare	53%	53%
Medicaid	8%	7%
Commercial insurance and HMOs	15%	18%
CareFirst	17%	16%
Self-pay and others	7%	6%
	100%	100%

Note H - Related Party Transactions

The Hospital periodically advances funds to certain members of the Hospital's medical staff or associated ventures. These advances are held as interest bearing promissory. Under the established terms of these notes, the loan balances may be (and periodically have been) forgiven based on the achievement of certain service levels.

Note I - Beneficiary to an Estate

During 2001, the Hospital was named beneficiary in a portion of an estate pursuant to a will that became irrevocable on the testator's death in January 2001. The will identified the Hospital as a 30% beneficiary of annual net income from the residual trust and a 30% beneficiary of the assets of the trust, with final distribution of trust assets no later than January 2006.

Following probate, on November 28, 2001, the estate was appraised at a value of $8,293,470. Therefore, during 2002, the Hospital recognized 30% of the estate's value $2,487,995 as temporarily restricted revenue and support. In March 2002, the trustee made a partial distribution of the trust assets, to which the Hospital received approximately $300,000 cash and $1,088,000 in stock certificates, which the Hospital recorded as net assets released from restrictions. In May 2002 the Board of Directors designated all current and future proceeds of the bequest for a future endowment, so the Hospital's interest at June 30, 2002, adjusted for market activity, was reported as a non-current asset in the accompanying consolidated balance sheets.

In October 2002, the trustee of the estate notified the Hospital that the estate was valued at $8,764,216 as of October 14, 2002 and that the trustee would be making the final distribution of the trust assets, whereby the Hospital could expect to receive approximately $264,000 in cash and $877,000 in stock certificates and treasury securities. In March 2003, the Hospital received cash, stock, and treasury securities in the aggregate amount of $1,184,228, which was recorded as net assets released from restrictions with a corresponding board designation for a future endowment.

Note J - Grant Awards

In January 2002, the Hospital received notice indicating it was a recipient of a conditional award of up to $750,000 through the Perdue Kresge Challenge for the Community, an endowment challenge grant program for nonprofit organizations serving the Lower Eastern Shore of Maryland. This grant was contingent upon the Hospital's ability to raise, at a minimum, slightly more than two-thirds of the $750,000 match ($502,500) in qualified gifts in the Hospital's named agency-restricted endowment fund (the Fund). During 2005, the Hospital met the full challenge and Purdue Kresge matched the $750,000. By Board designation, all of the income distributed from the Perdue Kresge Challenge endowment will be used to fund physician practice development in the community.

On January 15, 2002, an endowment fund (the Fund) was established in the Hospital's name in order for the Hospital to participate in the Perdue Kresge Challenge for the Community. The Fund is held by and accounted for in the financial statements of the Community Foundation of the Eastern Shore. An unrelated third party actively manages the investments, which are invested currently in various bonds, mutual funds, and equities. All realized gains and losses are reinvested in the Fund. The Fund has no minimum value requirement. All gifts to the Fund will be invested in perpetuity. The Hospital, as sole beneficiary to any interest earned on the Fund, will receive income distributions earned on the assets of the Fund with no external restrictions regarding use; however, the Board of Directors has designated all investment income from this endowment fund for funding physician practice development in the community. Income distributions will be made on an annual basis. Fund activity is presented below for the years ended June 30, 2012 and 2011:

	2012	2011
Beginning fund balance	$ 1,770,445	$ 1,463,015
Interest and dividends	43,726	40,785
Net realized and unrealized gains	(66,330)	349,721
Administrative and management fees	(17,825)	(17,828)
Annual income distributions	(67,100)	(65,248)
Ending fund balance	$ 1,662,916	$ 1,770,445

COHEN
RUTHERFORD
+ KNIGHT PC
Certified Public Accountants

Report of Independent Auditors on Accompanying Consolidating Information

Board of Directors
Atlantic General Hospital Corporation
Berlin, Maryland

The 2012 audited consolidated financial statements of Atlantic General Hospital Corporation and our report thereon are presented in the preceding section of this report. That audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The consolidating information presented hereinafter as of and for the year ended June 30, 2012 is presented for purposes of additional analysis of the basic consolidated financial statements rather than to present the financial position and results of operations of the individual companies, and is not a required part of the basic consolidated financial statements. Such information is the responsibility of management and was derived from and related directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with the auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation the consolidated financial statements as a whole.

Cohen, Rutherford + Knight, P.C.

October 24, 2012
Bethesda, Maryland

6903 Rockledge Drive, Suite 500, Bethesda, MD 20817 **Tel:** 301.828.1000 **Fax:** 301.530.3625

Atlantic General Hospital Corporation
Consolidating Balance Sheet
June 30, 2012

	AGH	Atlantic Immedicare	Eliminations	Consolidated AGH Corporation
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	$ 17,002,827	$ 256,935	$ 0	$ 17,259,762
Cash and cash equivalents internally designated for a restricted purpose	66,682	0	0	66,682
Investments	1,576,396	0	0	1,576,396
Due from affiliates	4,010,505	0	(4,010,505)	0
Patient accounts receivable, less estimated allowances	9,202,908	4,328	0	9,207,236
Supply inventory	1,948,333	6,955	0	1,955,288
Prepaid expenses and other current assets	1,606,329	3,399	0	1,609,728
TOTAL CURRENT ASSETS	35,413,980	271,617	(4,010,505)	31,675,092
LAND, BUILDINGS, AND EQUIPMENT--*Note B*	45,079,511	68,696	0	45,148,207
OTHER ASSETS				
Assets whose use is limited:				
Cash and cash equivalents restricted by donor	96,618	0	0	96,618
Cash and cash equivalents internally designated for a future endowment	67,385	0	0	67,385
Investments internally designated for a future endowment	2,905,229	0	0	2,905,229
Trustee held fund	2,441,167	0	0	2,441,167
Long-term investments	32,080	0	0	32,080
Deferred financing costs, less accumulated amortization	291,129	0	0	291,129
Other non current assets	2,945,043	0	0	2,945,043
TOTAL OTHER ASSETS	8,778,651	0	0	8,778,651
	$ 89,272,142	$ 340,313	$ (4,010,505)	$ 85,601,950

Atlantic General Hospital Corporation
Consolidating Balance Sheet - Continued
June 30, 2012

	AGH	Atlantic Immedicare	Eliminations	Consolidated AGH Corporation
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES				
Accounts payable and accrued expenses	$ 8,139,301	$ 15,471	$ 0	$ 8,154,772
Salaries, wages, and related items	3,988,677	0	0	3,988,677
Due to affiliate	0	4,010,505	(4,010,505)	0
Interest payable--*Note C*	63,971	0	0	63,971
Advances from third party payers	1,089,863	0	0	1,089,863
Current portion of long term debt--*Note C*	3,923,368	0	0	3,923,368
TOTAL CURRENT LIABILITIES	17,205,180	4,025,976	(4,010,505)	17,220,651
NONCURRENT LIABILITIES				
Long-term debt, less portion classified as current liability--*Note C*	26,477,239	0	0	26,477,239
Swap contract--*Note C*	107,733	0	0	107,733
Other liabilities	2,933,377	0	0	2,933,377
TOTAL LIABILITIES	46,723,529	4,025,976	(4,010,505)	46,739,000
COMMITMENTS AND CONTINGENCIES--*Notes C, D, and E*				
NET ASSETS (DEFICIT)				
Unrestricted				
General	39,335,534	(3,685,663)	0	35,649,871
Board-designated	2,972,614	0	0	2,972,614
Temporarily restricted	240,465	0	0	240,465
TOTAL NET ASSETS	42,548,613	(3,685,663)	0	38,862,950
	$ 89,272,142	$ 340,313	$ (4,010,505)	$ 85,601,950

Atlantic General Hospital Corporation
Consolidating Statement of Operations
June 30, 2012

	AGH	Atlantic Immedicare	Eliminations	Total
REVENUE				
Net patient service revenue--*Note G*	$ 90,272,981	$ 398,996	$ 0	$ 90,671,977
Other operating revenue	1,421,685	0	(608,657)	813,028
TOTAL OPERATING REVENUE	91,694,666	398,996	(608,657)	91,485,005
OPERATING EXPENSES				
Salaries	38,793,933	0	0	38,793,933
Employee benefits and other related expenses--*Note E*	8,511,849	0	0	8,511,849
Professional fees and contracted services	8,533,595	803,117	(672,079)	8,664,633
Supplies and other expense--*Note E*	19,359,500	208,927	63,422	19,631,849
Utilities	1,211,156	13,730	0	1,224,886
Maintenance and repairs	3,182,997	715	0	3,183,712
Insurance--*Note D*	1,337,884	7,721	0	1,345,605
Interest--*Note C*	1,035,250	0	0	1,035,250
Depreciation--*Note B*	4,537,730	122,566	0	4,660,296
Amortization	31,891	0	0	31,891
Provision for bad debts	3,978,151	12,927	0	3,991,078
TOTAL OPERATING EXPENSES	90,513,936	1,169,703	(608,657)	91,074,982
INCOME (LOSS) FROM OPERATIONS	1,180,730	(770,707)	0	410,023
OTHER INCOME				
Investment income	405,472	0	0	405,472
Net unrealized loss on trading portfolio	(243,816)	0	0	(243,816)
Other	884,439	0	0	884,439
TOTAL OTHER INCOME	1,046,095	0	0	1,046,095
REVENUE AND GAINS IN EXCESS OF EXPENSES AND LOSSES (EXPENSES AND LOSSES IN EXCESS OF REVENUE AND GAINS)	$ 2,226,825	$ (770,707)	$ 0	$ 1,456,118