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Certified Public Accountants



**Garrett County Memorial
Hospital and Subsidiary**

**Consolidated Audited Financial
Statements**

June 30, 2011 and 2010

Garrett County Memorial Hospital and Subsidiary
Consolidated Audited Financial Statements
June 30, 2011 and 2010

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Independent Auditor's Report

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

We have audited the accompanying consolidated balance sheets of Garrett County Memorial Hospital and subsidiary (collectively, the Company) as of June 30, 2011 and 2010, and the related consolidated statements of operations and other changes in unrestricted net assets, changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform our 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 Company'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, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Garrett County Memorial Hospital and subsidiary as of June 30, 2011 and 2010, and the results of their operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



In accordance with *Government Auditing Standards*, we have also issued our reports dated October 21, 2011 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of these reports is to describe the scope of testing of internal control over financial reporting and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Cohen, Rutherford + Knight, P.C.

October 21, 2011

**Garrett County Memorial Hospital and Subsidiary
Consolidated Balance Sheets**

	June 30	
	<u>2011</u>	<u>2010</u>
<i>ASSETS</i>		
CURRENT ASSETS		
Cash and cash equivalents	\$ 3,820,927	\$ 4,042,810
Short-term investments -- <i>Note B</i>	17,417,996	12,372,837
Patient accounts receivable, net of allowance for doubtful accounts of \$2,088,948 and \$2,249,597 at June 30, 2011 and 2010, respectively -- <i>Note K</i>	4,276,424	4,940,616
Other amounts receivable	248,526	247,291
Assets whose use is limited by donors -- <i>Note B</i>	230,577	268,872
Inventories	1,004,522	989,075
Prepaid expenses	<u>458,881</u>	<u>480,852</u>
TOTAL CURRENT ASSETS	27,457,853	23,342,353
NONCURRENT ASSETS		
Property and equipment -- <i>Note D</i>	20,343,924	21,640,184
Long-term investments -- <i>Note B</i>	3,663,231	3,033,546
Investment in affiliates -- <i>Note C</i>	303,453	305,125
Assets whose use is limited by donors, less current portion -- <i>Note B</i>	349,323	326,869
Assets whose use is limited by board of governors -- <i>Note B</i>	698,073	698,073
Deferred financing costs	<u>26,693</u>	<u>28,046</u>
TOTAL NONCURRENT ASSETS	<u>25,384,697</u>	<u>26,031,843</u>
TOTAL ASSETS	<u>\$ 52,842,550</u>	<u>\$ 49,374,196</u>

(Continued)

**Garrett County Memorial Hospital and Subsidiary
Consolidated Balance Sheets – Continued**

	June 30	
	2011	2010
<i>LIABILITIES AND NET ASSETS</i>		
CURRENT LIABILITIES		
Accounts payable	\$ 965,141	\$ 634,022
Accrued salaries and wages	2,456,674	2,265,077
Advances from third parties	433,983	414,183
Current portion of long-term debt -- <i>Note E</i>	210,452	230,273
Other current liabilities	1,157,860	1,193,321
	<u>5,224,110</u>	<u>4,736,876</u>
TOTAL CURRENT LIABILITIES		
Long-term debt, less current portion -- <i>Note E</i>	3,742,217	3,952,669
Pension obligation -- <i>Note G</i>	6,247,471	7,943,468
	<u>15,213,798</u>	<u>16,633,013</u>
TOTAL LIABILITIES		
NET ASSETS		
Unrestricted	37,073,302	32,156,279
Temporarily restricted -- <i>Note F</i>	520,364	549,818
Permanently restricted -- <i>Note M</i>	35,086	35,086
	<u>37,628,752</u>	<u>32,741,183</u>
TOTAL NET ASSETS		
TOTAL LIABILITIES AND NET ASSETS		
	<u>\$ 52,842,550</u>	<u>\$ 49,374,196</u>

See the accompanying notes to the consolidated financial statements.

**Garrett County Memorial Hospital and Subsidiary
Consolidated Statements of Operations and Other Changes
in Unrestricted Net Assets**

	Year Ended June 30	
	2011	2010
REVENUE		
Net patient service revenue -- <i>Note K</i>	\$ 38,967,085	\$ 40,445,878
Other revenue	592,406	579,964
Net assets released from restriction for use in operations -- <i>Note F</i>	35,970	57,944
TOTAL REVENUE	39,595,461	41,083,786
EXPENSES -- <i>Note L</i>		
Salaries and wages	16,157,560	15,455,503
Employee benefits -- <i>Note G</i>	5,319,123	5,060,449
Supplies	6,348,882	5,971,363
Utilities	614,447	604,746
Purchased services	3,700,599	3,730,379
Depreciation and amortization -- <i>Note D</i>	2,786,678	2,790,495
Interest -- <i>Note E</i>	172,662	210,812
Provision for uncollectible accounts	1,760,509	1,954,207
Other expenses	804,425	786,369
TOTAL OPERATING EXPENSES	37,664,885	36,564,323
GAIN FROM OPERATIONS	1,930,576	4,519,463
OTHER INCOME (LOSS)		
Investment income -- <i>Note B</i>	846,560	535,918
Equity in earnings (loss) of affiliates -- <i>Note C</i>	(1,673)	77,586
Other	39,546	(159,987)
TOTAL OTHER INCOME (LOSS)	884,433	453,517
EXCESS OF REVENUE OVER EXPENSES	2,815,009	4,972,980
Net assets released from restriction for the purchase of property and equipment -- <i>Note F</i>	75,180	330,366
Pension-related changes other than net periodic pension cost -- <i>Note G</i>	2,026,834	(250,603)
INCREASE IN UNRESTRICTED NET ASSETS	\$ 4,917,023	\$ 5,052,743

See the accompanying notes to the consolidated financial statements.

Garrett County Memorial Hospital and Subsidiary Consolidated Statements of Changes in Net Assets

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Assets
BALANCE AT JUNE 30, 2009	\$ 27,103,536	\$ 561,140	\$ 35,086	\$ 27,699,762
Excess revenue over expenses	4,972,980	0	0	4,972,980
Net assets released from restriction for the purchase of property and equipment -- <i>Note F</i>	330,366	(330,366)	0	0
Pension-related changes other than net periodic pension cost -- <i>Note G</i>	(250,603)	0	0	(250,603)
Contributions	0	376,988	0	376,988
Net assets released from restriction for use in operations -- <i>Note F</i>	0	(57,944)	0	(57,944)
INCREASE (DECREASE) IN NET ASSETS	<u>5,052,743</u>	<u>(11,322)</u>	<u>0</u>	<u>5,041,421</u>
BALANCE AT JUNE 30, 2010	32,156,279	549,818	35,086	32,741,183
Excess revenue over expenses	2,815,009	0	0	2,815,009
Net assets released from restriction for the purchase of property and equipment -- <i>Note F</i>	75,180	(75,180)	0	0
Pension-related changes other than net periodic pension cost -- <i>Note G</i>	2,026,834	0	0	2,026,834
Contributions	0	81,696	0	81,696
Net assets released from restriction for use in operations -- <i>Note F</i>	0	(35,970)	0	(35,970)
INCREASE (DECREASE) IN NET ASSETS	<u>4,917,023</u>	<u>(29,454)</u>	<u>0</u>	<u>4,887,569</u>
BALANCE AT JUNE 30, 2011	<u>\$ 37,073,302</u>	<u>\$ 520,364</u>	<u>\$ 35,086</u>	<u>\$ 37,628,752</u>

See the accompanying notes to the consolidated financial statements.

**Garrett County Memorial Hospital and Subsidiary
Consolidated Statements of Cash Flows – Continued**

	Year Ended June 30	
	2011	2010
CASH AND CASH EQUIVALENTS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	\$ (1,527,643)	\$ (1,902,951)
Net investment in affiliate	0	82,500
Net purchase of trading securities	<u>(5,236,497)</u>	<u>(4,392,405)</u>
NET CASH AND CASH EQUIVALENTS USED IN INVESTING ACTIVITIES	<u>(6,764,140)</u>	<u>(6,212,856)</u>
CASH AND CASH EQUIVALENTS FROM FINANCING ACTIVITIES		
Repayments of long-term debt	(230,273)	(668,100)
Proceeds from restricted contributions	<u>81,696</u>	<u>376,988</u>
NET CASH AND CASH EQUIVALENTS USED IN FINANCING ACTIVITIES	<u>(148,577)</u>	<u>(291,112)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(221,883)	1,070,380
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>4,042,810</u>	<u>2,972,430</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 3,820,927</u>	<u>\$ 4,042,810</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	<u>\$ 172,390</u>	<u>\$ 235,984</u>

See the accompanying notes to the consolidated financial statements.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements

Note A – Organization and Summary of Significant Accounting Principles

Organization

Garrett County Memorial Hospital (the Hospital) is an instrumentality of Garrett County, Maryland. The Hospital was organized for charitable purposes and is exempt from income taxes as an instrumentality of Garrett County. In 2003, the Hospital formed and became the sole member of Professional Emergency Physician Services, LLC, (PEPS) which is a for-profit limited liability company. The purpose of PEPS is to provide professional emergency services solely to the Hospital. In addition, the Hospital owns 100% of the outstanding shares of Garrett Community Health Services (GCHS), which is a for-profit corporation. GCHS has had no activity for the years ended June 30, 2011 and 2010.

Principles of Consolidation

The consolidated financial statements include the accounts of Garrett County Memorial Hospital, Professional Emergency Physician Services, LLC, and Garrett Community Health Services, (collectively referred to as the Company). All significant intercompany accounts and transactions have been eliminated in consolidation.

Basis of Presentation

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law. Contributions, including unconditional promises to give, with no donor-imposed restrictions are recognized as revenues in the period received as increases in unrestricted net assets. Contributions with donor-imposed restrictions are reported as increases in temporarily or permanently restricted net assets. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications between the applicable classes of net assets.

Income and realized net gains (losses) on investments are reported as follows:

- Increases (decreases) in permanently restricted net assets if the terms of the gift or the Hospital's interpretation of relevant state law require that they be added to the principal of a permanent net asset;
- Increases (decreases) in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income;
- Increases (decreases) in unrestricted net assets in all other cases.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note A – Organization and Summary of Significant Accounting Principles – Continued

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, after contractual adjustments. Patient accounts receivable include charges for amounts due from Medicare, Maryland Medical Assistance (Medicaid), Blue Cross, commercial insurers, and self-pay patients (*see Note K*). Contractual adjustments represent the differences between amounts billed as patient service revenue and amounts contracted with third party payers, and are accrued on an estimated basis in the period in which the related services are rendered and adjusted in future periods as final settlements are determined. Contractual adjustments are included in the determination of net patient service revenue as reported in the accompanying consolidated statements of operations, whereas the provision for uncollectible self-pay amounts is reported as an operating expense. Rates charged are based primarily on rates established by the State of Maryland Health Services Cost Review Commission (HSCRC); accordingly, revenue reflects actual charges to patients based on rates in effect during the period in which the services are rendered (*see Note I*).

The Company grants credit without collateral to its patients, most of whom are local residents insured under third-party payer agreements (*see Note K*). Accounts receivable are reported at their net realizable value from third-party payers, patients, residents and others for services rendered. Allowances are provided for third-party payers based on estimated reimbursement rates. Allowances are also provided for bad debts based on an estimate of uncollectible accounts. Write-off of uncollectible accounts is determined on a case-by-case basis after a review of the circumstances surrounding individual patient accounts.

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue.

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. The estimated amount of charges forgone under the Hospital's charity care policy was \$2,766,068 and \$2,259,757 in 2011 and 2010, respectively.

Advertising expense

The Company expenses advertising costs as they are incurred.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note A – Organization and Summary of Significant Accounting Principles – Continued

Cash and Cash Equivalents

Cash and cash equivalents include investments in certain highly liquid debt instruments with maturities of three months or less. The Company has cash holdings in commercial banks that routinely exceed the Federal Deposit Insurance Corporation maximum insurance limit of \$250,000.

Supplies

Supplies consist primarily of drugs and medical supplies and are carried at the lower of cost (first-in, first-out) or market.

Donor-Restricted Funds

Donor-restricted funds are used to differentiate resources, the use of which is limited by the donor, from resources on which the donor places no restriction or which arise as a result of the operation of the Hospital for its stated purposes. Restricted funds for care of needy patients and other temporarily restricted net assets are reflected in operating revenue to the extent restrictions have been met; net assets restricted for property, plant and equipment are reclassified to the unrestricted net assets balance when those assets are acquired.

Assets Whose Use is Limited

Assets limited as to use primarily consist of cash, certificates of deposit, pledges receivable and investments. Assets limited as to use include donor restricted assets, funds held by trustee, and assets designated by the board of governors for future capital improvements, over which the board retains control and may, as its discretion, subsequently use for other purposes.

Property and Equipment

Property and equipment are stated at cost, except for donated items which are recorded at fair value at the date of donation. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets. Equipment under capital lease obligations is amortized on a straight-line basis over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation in the accompanying 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.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note A – Organization and Summary of Significant Accounting Principles – Continued

Property and Equipment - Continued

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are 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.

Deferred Financing Costs

Costs related to issuance of debt are deferred and amortized using the straight-line method, which approximates the interest method.

Investments

Investments and assets whose use is limited, which are invested in marketable securities, are reported at their fair value, based on quoted market prices provided by the asset managers. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities (*see Note B*).

Investments in Affiliates

The Hospital maintains certain investments in unconsolidated entities. These investments are accounted for using the cost or equity method as appropriate (*see Note C*).

Excess of Revenues over Expenses

The statement of operations includes excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on other than trading securities, pension-related changes other than net periodic pension cost, any permanent transfers of assets to and from affiliates for other than goods or services and contributions of long lived assets (including assets required using contributions which by donor restriction were to be used for the purpose of acquiring such assets).

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note A – Organization and Summary of Significant Accounting Principles – Continued

Estimated Malpractice Costs

The costs of professional and general liability insurance include estimates for both reported claims and claims incurred but not reported, based on the evaluation of pending claims and past experience (*see Note J*).

Use of Estimates

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

Income Taxes

The Hospital and PEPS have been recognized by the Internal Revenue Service (IRS) as tax exempt under Section 115 as an instrumentality of a political subdivision of the State of Maryland. GCHS is organized as a for-profit entity and therefore is subject to federal and state income taxes.

The state in which the Hospital operates also provides general exemption from state income taxation for organizations that are exempt from federal income taxation. However, the Hospital 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.

The Hospital had no unrecognized tax benefits or such amounts were immaterial during the periods presented. For tax periods with respect to which no unrelated business income was recognized, no tax return was required. Tax periods for which no return is filed remain open for examination indefinitely. No tax returns were filed for the Hospital during 2011 and 2010.

Management has also considered the impact of unrelated business activities and has concluded that the Hospital is not subject to unrelated business tax or any other taxes that could be imposed by the Internal Revenue Code or state taxing authorities. As such no provision is made for income taxes and no asset or liability has been recognized for deferred taxes.

Subsequent Events

Subsequent events have been evaluated by management through October 21, 2011 which is the date the financial statements were available to be issued.

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note A – Organization and Summary of Significant Accounting Principles – Continued

Recent Changes in Accounting Standards

In August 2010, the Financial Accounting Standards Board (FASB) amended the Accounting Standards Codification (ASC) for Health Care Entities to require that cost be used as the measurement basis for charity care disclosures and that cost be identified as the direct and indirect costs of providing the charity care. This amendment is effective for fiscal years beginning after December 15, 2010. Also, in August 2010, the FASB amended the ASC for Health Care Entities to clarify that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without considerations of insurance recoveries. This amendment is effective for fiscal years and interim periods within those years, beginning after December 15, 2010. In July 2011, the FASB amended the ASC for Health Care Entities to require 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, these entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. This amendment is effective for fiscal years beginning after December 15, 2012. Management is currently evaluating the impact on the Company's future financial statements of adoption of these changes in accounting.

Note B – Investments and Assets Whose Use is Limited

Investments and assets limited as to use consist of the following:

	Investments	Assets whose use is limited by donors	Assets whose use is limited by the Board of Governors	Total
At June 30, 2011:				
Cash and cash equivalents	\$ 290,039	\$ 109,411	\$ 0	\$ 399,450
Certificates of deposit	17,416,193	1,803	698,073	18,116,069
Government securities	93,210	5,961	0	99,171
Corporate bonds	253,292	16,198	0	269,490
Preferred stock	105,626	6,755	0	112,381
Mutual funds	2,395,998	153,223	0	2,549,221
Common stock	526,869	33,373	0	560,242
Pledges receivable, net	0	253,176	0	253,176
	<u>21,081,227</u>	<u>579,900</u>	<u>698,073</u>	<u>22,359,200</u>
Less short-term portion	<u>17,417,996</u>	<u>230,577</u>	<u>0</u>	<u>17,648,573</u>
	<u>\$ 3,663,231</u>	<u>\$ 349,323</u>	<u>\$ 698,073</u>	<u>\$ 4,710,627</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note B – Investments and Assets Whose Use is Limited – Continued

	<u>Investments</u>	<u>Assets whose use is limited by donors</u>	<u>Assets whose use is limited by the Board of Governors</u>	<u>Total</u>
At June 30, 2010:				
Cash and cash equivalents	\$ 137,607	\$ 102,488	\$ 0	\$ 240,095
Certificates of deposit	12,452,837	5,095	698,073	13,156,005
Government securities	203,557	13,846	0	217,403
Corporate bonds	196,977	13,398	0	210,375
Preferred stock	88,054	5,989	0	94,043
Mutual funds	1,921,207	130,682	0	2,051,889
Common stock	406,144	27,286	0	433,430
Pledges receivable, net	0	296,957	0	296,957
	<u>15,406,383</u>	<u>595,741</u>	<u>698,073</u>	<u>16,700,197</u>
Less short-term portion	<u>12,372,837</u>	<u>268,872</u>	<u>0</u>	<u>12,641,709</u>
	<u>\$ 3,033,546</u>	<u>\$ 326,869</u>	<u>\$ 698,073</u>	<u>\$ 4,058,488</u>

Assets whose use is limited include investments and pledges receivable. Board designated funds consist of certificates of deposit at June 30, 2011 and 2010.

Pledges receivable are recorded net of an allowance for uncollectible pledges of \$105,258 and \$99,069 at June 30, 2011 and 2010, respectively. Pledges are recorded at their net present value and are due as follows at June 30, 2011:

2012	\$ 145,049
2013	74,485
2014	33,503
2015	29,000
2016	27,589
After 2016	<u>53,130</u>
	362,756
Present value discount	(4,322)
Allowance for doubtful accounts	<u>(105,258)</u>
	<u>\$ 253,176</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note B – Investments and Assets Whose Use is Limited – Continued

The investment return on the Company’s investments and assets limited as to use consists of the following for the years ended June 30:

	<u>2011</u>	<u>2010</u>
Interest and dividends	\$ 252,011	\$ 244,680
Net realized gains (losses)	171,999	(95,412)
Net unrealized gains	<u>422,550</u>	<u>386,650</u>
	<u>\$ 846,560</u>	<u>\$ 535,918</u>

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 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 Company’s business, its value, or financial position based on the fair value information of financial assets presented below.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note B – Investments and Assets Whose Use is Limited – Continued

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. Furthermore, the disclosed fair values do not reflect any premium or discount that could result from offering for sale at one time an entire holding of a particular financial asset. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

Fair values of the Company's government securities and corporate bonds are based on prices provided by its investment managers, who 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 Company's government securities and corporate bonds portfolio is highly liquid, which allows for a high percentage of the portfolio to be priced through pricing services. Fair values of the Company's certificate of deposits are based on cost plus accrued interest, which in the opinion of management approximates fair value. Fair values of marketable equity securities (mutual funds and stock) have been determined by the Company 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.

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note B – Investments and Assets Whose Use is Limited – Continued

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

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and cash equivalents	\$ 399,450	\$ 0	\$ 399,450
Certificates of deposit	18,116,069	0	18,116,069
Government securities			
Maturity 1 - 10 years	0	25,848	25,848
Maturity > 10 years	0	73,323	73,323
Corporate bonds			
Maturity 1 - 10 years	0	78,553	78,553
Maturity > 10 years	0	190,937	190,937
Mutual funds			
Short Government	53,164	0	53,164
Bank Loan	72,222	0	72,222
Diversified Emerging Markets	52,454	0	52,454
Foreign Large Blend	401,939	0	401,939
High Yield Bond	131,109	0	131,109
Intermediate-Term Bond	347,922	0	347,922
Large Blend	301,945	0	301,945
Large Growth	134,520	0	134,520
Large Value	196,403	0	196,403
Mid-Cap Blend	98,957	0	98,957
Mid-Cap Growth	122,539	0	122,539
Short-Term Bond	88,817	0	88,817
Technology	64,646	0	64,646
World Bond	67,958	0	67,958
Other	414,626	0	414,626
Stocks			
Basic Materials	100,818	0	100,818
Conglomerates	31,794	0	31,794
Consumer Goods	44,609	0	44,609
Financial	39,589	0	39,589
Healthcare	84,464	0	84,464
Industrial goods	15,699	0	15,699
Preferred Stock	106,339	0	106,339
Services	108,364	0	108,364
Technology	108,787	0	108,787
Utilities	32,160	0	32,160
	<u>\$ 21,737,363</u>	<u>\$ 368,661</u>	<u>\$ 22,106,024</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note B – Investments and Assets Whose Use is Limited – Continued

The following table presents the Company’s fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2010:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and cash equivalents	\$ 240,095	\$ 0	\$ 240,095
Certificates of deposit	13,156,005	0	13,156,005
Government securities	0	217,403	217,403
Corporate bonds	0	210,375	210,375
Mutual funds	2,051,889	0	2,051,889
Stocks	<u>527,473</u>	<u>0</u>	<u>527,473</u>
	<u>\$ 15,975,462</u>	<u>\$ 427,778</u>	<u>\$ 16,403,240</u>

There were no transfers between levels during 2011.

Note C – Investments in Affiliates

The Hospital maintains investments in joint ventures at June 30 as follows:

<u>Joint Venture</u>	<u>Method of Accounting</u>	<u>Type of organization</u>	<u>Business purpose</u>	<u>Percentage ownership</u>	
				<u>2011</u>	<u>2010</u>
Garrett Rehabilitation Services (GRS)	Equity	For-profit	Medical, rehabilitative and therapy services	50%	50%
Oakland MRI Center, LLC (OMRI)	Equity	For-profit	MRI and DEXA scan services	50%	50%
Freestate Healthcare Insurance Company, Ltd. (Freestate)	Equity	For-profit	Malpractice and professional liability insurance	16.7%	16.7%
Western Maryland Medical Supply, LLC (WMMS)	Cost	For-profit	Durable medical equipment services	33.3%	33.3%

GRS is a joint venture in which the Hospital and Select Medical of Maryland, Inc. have invested equally. GRS provides physical therapy, speech pathology, occupational therapy and general rehabilitation services in an outpatient clinical setting. GRS also provides inpatient rehabilitation services for the Hospital. Such services to the Hospital approximated \$398,161 in 2011 and \$362,556 in 2010. The investment is recorded under the equity method in the accompanying consolidated financial statements.

In April 2004, the Hospital formed OMRI with Premier Imaging, LLC. The purpose of this joint venture is to provide MRI and DEXA Scan services to the local and surrounding communities. The Hospital made an initial capital contribution of \$162,000 in 2005. OMRI began operations in January 2006.

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note C – Investments in Affiliates – Continued

In December 2004, the Hospital joined Freestate along with seven other community hospitals from Maryland. Freestate is a Cayman Islands corporation formed for the purpose of providing insurance coverage to its members, their affiliates and their respective employees (see *Note J*). The Hospital contributed \$15,000 of equity to Freestate during 2005.

In April 2009, the Hospital joined Western Maryland Medical Supply, LLC (WMMS). WMMS provides durable medical equipment to the local and surrounding communities. The Hospital initially contributed \$201,403 in 2009.

The Hospital's investment balance and equity in earnings of these joint ventures as of June 30 are as follows:

	<u>Investment balance</u>		<u>Equity (loss) in earnings</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
GRS	\$ 149,679	\$ 118,300	\$ 31,379	\$ 48,278
OMRI	(46,125)	(27,694)	(18,431)	20,732
Freestate	20,493	20,493	0	154
WMMS	179,406	194,026	(14,621)	8,422
	<u>\$ 303,453</u>	<u>\$ 305,125</u>	<u>\$ (1,673)</u>	<u>\$ 77,586</u>

Summary combined financial information (unaudited) for these joint ventures as of and for the year ended June 30 was as follows:

	<u>2011</u>	<u>2010</u>
Current assets	\$ 17,053,663	\$ 9,099,463
Noncurrent assets	19,579,293	27,975,006
TOTAL ASSETS	<u>36,632,956</u>	<u>37,074,469</u>
Current liabilities	961,281	933,130
Noncurrent liabilities	34,285,239	34,743,720
Net worth	1,386,436	1,397,619
TOTAL LIABILITIES AND NET WORTH	<u>\$ 36,632,956</u>	<u>\$ 37,074,469</u>
Total operating revenue	\$ 8,592,129	\$ 10,517,948
Total operating expense	9,700,468	10,283,430
NET INCOME	<u>\$ (1,108,339)</u>	<u>\$ 234,518</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note D – Property, Plant and Equipment

Property, plant and equipment and their related estimated useful lives as of June 30 are summarized as follows:

	Estimated useful life	2011	2010
Land improvements	10 - 40 years	\$ 672,151	\$ 646,773
Buildings and improvements	15 - 40 years	27,402,021	27,379,746
Fixed equipment	5 - 20 years	3,561,551	3,410,260
Movable equipment	3 - 20 years	13,940,561	13,672,514
Equipment under capital lease	lease term	<u>559,572</u>	<u>559,572</u>
		46,135,856	45,668,865
Less accumulated depreciation		<u>27,511,661</u>	<u>25,308,753</u>
		18,624,195	20,360,112
Land		1,162,039	1,162,039
Construction in progress		<u>557,690</u>	<u>118,033</u>
		<u>\$ 20,343,924</u>	<u>\$ 21,640,184</u>

Depreciation expense for the years ended June 30, 2011 and 2010 was \$2,785,325 and \$2,783,111, respectively. Depreciation expense includes amortization expense of \$97,401 related to leased equipment for the years ended June 30, 2011 and 2010. Accumulated amortization of capital leases was \$467,734 and \$370,333 in June 30, 2011 and 2010, respectively.

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note E – Long-Term Debt

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

	<u>2011</u>	<u>2010</u>
USDA bond	\$ 2,780,027	\$ 2,838,467
Series 2004 Bonds	1,062,900	1,120,751
Capital lease obligation	<u>109,742</u>	<u>223,724</u>
	3,952,669	4,182,942
Less current portion	<u>210,452</u>	<u>230,273</u>
	<u>\$ 3,742,217</u>	<u>\$ 3,952,669</u>

United States Department of Agriculture (USDA) Bonds

In June 2007, Garrett County issued the Garrett County Memorial Hospital Refunding Bonds, Series 2007 (Series 2007 Bonds), for the purpose of providing funding for the Hospital’s Emergency Room/Same Day Surgery/Admissions construction and renovation project. The Series 2007 Bonds represent a supplemental loan agreement between the Hospital and Garrett County Maryland for amounts that are equal to the loan principal of the Garrett County Series 2007 Bonds. The funds were provided to Garrett County from the USDA. Funding from the bonds was also used to refinance other outstanding indebtedness.

The Series 2007 Bonds bear interest at an average rate of approximately 4.125%. Bond principal and interest payments are made in monthly installments to a trustee to meet the payment schedule stipulated in the loan agreement. The bonds mature June 28, 2037.

Series 2004 Bonds

In November 2004, Garrett County issued County Commissioners of Garret County Hospital Refunding Bonds, Series 2004 (Series 2004 Bonds) refunding bonds for the purpose of refunding a portion other outstanding indebtedness. The Series 2004 Bonds represent a supplemental loan agreement between the Hospital and Garrett County for amounts that are equal to the loan principal of the County’s Series 2004 Bonds.

The Series 2004 Bonds incur interest at a rate of 4.12% per annum. Bond principal and interest payments are made in semiannual installments to a trustee to meet the payment schedule stipulated in the loan agreement. The loan matures on November 19, 2024.

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note E – Long-Term Debt – Continued

Capital Leases

The Hospital periodically enters into various leases for equipment that meet the criteria for capitalization under current accounting standards. Interest expense related to the leases for the years ended June 30, 2011 and 2010 was \$11,090 and \$18,590, respectively and is reported in the accompanying consolidated statements of operations and other changes in unrestricted net assets.

Aggregate maturities of all long-term debt as of June 30, 2011 are as follows:

2012	\$	210,452
2013		146,682
2014		131,517
2015		137,023
2016		142,759
After 2016		<u>3,184,236</u>
	\$	<u><u>3,952,669</u></u>

The Company is subject to certain restrictive covenants defined in various agreements with lenders. In the opinion of management, the Company was in compliance with all applicable restrictive covenants as of June 30, 2011 and 2010.

Note F – Temporarily Restricted Net Assets

Temporarily restricted net assets of \$520,364 and \$549,818 at June 30, 2011 and 2010, respectively, are restricted primarily for plant replacement, expansion, and health care clinical services.

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors as follows during the years ended June 30:

	<u>2011</u>	<u>2010</u>
Health care clinical services	\$ 35,970	\$ 57,944
Plant replacement and expansion	<u>75,180</u>	<u>330,366</u>
	<u><u>\$ 111,150</u></u>	<u><u>\$ 388,310</u></u>

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note G – Pension Plan

The Hospital has a noncontributory defined benefit pension plan (the Plan) covering all employees of the Hospital who work at least twenty hours per week. Benefits are based on the participants' credited service and average monthly earnings. The Hospital's funding policy is to contribute an amount annually that is equal to the normal cost plus interest on the unfunded accrued liability. The Internal Revenue Service classifies the Plan as a government plan, and the Plan, as such, is exempt from the requirements of the Employee Retirement Income Security Act of 1974. The Hospital uses a June 30 measurement date for the Plan. The Hospital plans to contribute \$1.1 million to the Plan in 2011. The assumption change in the table below represents changes in the discount rate and rate of compensation increase for 2011 and change in the discount rate for 2010.

The following table sets forth the changes in the benefit obligation at June 30:

	2011	2010
Projected benefit obligation at beginning of year	\$ 22,204,178	\$ 19,680,938
Service cost	956,384	795,776
Interest	1,214,638	1,203,429
Assumption change	(1,145,533)	1,177,371
Actuarial loss	1,226,986	0
Benefits paid	(695,252)	(653,336)
Projected benefit obligation at end of year	\$ 23,761,401	\$ 22,204,178

The following table sets forth the changes in the Plan assets at June 30:

	2011	2010
Fair value of Plan assets as beginning of year	\$ 14,260,711	\$ 12,356,510
Actual return on Plan assets	2,871,132	1,549,851
Employer contribution	1,077,340	1,007,686
Benefits paid	(695,252)	(653,336)
Fair value of Plan assets as end of year	\$ 17,513,931	\$ 14,260,711
Funded status	\$ (6,247,470)	\$ (7,943,467)
Net loss included in unrestricted net assets	\$ 5,270,774	\$ 7,297,608
Accumulated benefit obligation	\$ 20,524,665	\$ 17,215,862

The components of the net periodic benefit cost consist of the following at June 30:

	2011	2010
Service cost	\$ 956,384	\$ 795,776
Interest cost	1,214,638	1,203,429
Expected return on assets held in the plan	(1,158,888)	(1,005,530)
Amortization of net loss	396,043	382,448
	\$ 1,408,177	\$ 1,376,123

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note G – Pension Plan – Continued

The assumptions used in the accounting for the benefit obligation are as follows at June 30:

	<u>2011</u>	<u>2010</u>
Discount rate	5.83%	5.56%
Rate of compensation increase	3.56%	3.22%

The weighted average assumptions used in the accounting for the net periodic benefit cost are as follows for the years ended June 30:

	<u>2011</u>	<u>2010</u>
Discount rate	5.83%	5.56%
Rate of compensation increase	3.56%	3.22%
Expected long-term return on plan assets	8.00%	8.00%

The Hospital’s weighted average asset allocations for Plan assets are as follows at June 30:

	<u>2011</u>	<u>2010</u>
Equity securities	55%	54%
Fixed maturity securities	38%	41%
Other	7%	5%
Total plan assets	<u>100%</u>	<u>100%</u>

Plan assets are invested in accordance with the investment policy statement objectives in an attempt to maximize return with reasonable and prudent levels of risk. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce a sufficient level of overall diversification and total investment return. The Hospital periodically reviews performance to test progress toward attainment of longer-term targets, compare results to appropriate indices and peer groups, and assess overall investment risk levels. The target weighted-average asset allocation of pension investments is 55% equity securities, 40% debt securities and 5% other. Fixed maturity securities primarily include corporate bonds. Equity securities primarily include investments in large-cap and mid-cap companies and common stock which are valued by observable market quotations.

The following benefit payments, which reflect expended future service, as appropriate, are expected to be paid:

2012	\$	723,000
2013		775,000
2014		890,000
2015		984,000
2016		1,087,000
2018-2022		<u>10,514,000</u>
		<u>\$ 14,973,000</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note G – Pension Plan – Continued

The fair value of the Hospital's Plan assets as June 30, 2011 by asset category are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and Cash Equivalents			
Cash	\$ 89,228	\$ 0	\$ 89,228
Money market funds	1,192,951	0	1,192,951
Fixed Income			
U.S. Government Agency Bonds/Notes (Maturity 1 to 10 years)	0	704,717	704,717
Corporate Bonds			
Maturity 1 to 10 years	0	1,510,949	1,510,949
Maturity > 10 years	0	1,164,597	1,164,597
Municipal Bonds			
Maturity 1 to 10 years	0	246,392	246,392
Maturity > 10 years	0	1,064,079	1,064,079
Mutual Funds			
Trust Originated Preferred Securities	49,660	0	49,660
Capital Trust	396,064	0	396,064
Bank Loan	149,953	0	149,953
World Bond	340,308	0	340,308
Inflation-Protected Bond	149,597	0	149,597
Intermediate Government	151,863	0	151,863
High Yield Bond	422,119	0	422,119
Intermediate-Term Bond	201,258	0	201,258
Equity Securities			
Mutual Funds			
Diversified Emerging Markets	89,567	0	89,567
Financial	76,825	0	76,825
Foreign Large Blend	210,680	0	210,680
Foreign Large Growth	107,407	0	107,407
Foreign Large Value	54,170	0	54,170
Foreign Small/Mid Growth	137,152	0	137,152
Large Blend	487,778	0	487,778
Large Growth	635,077	0	635,077
Large Value	877,259	0	877,259
Mid-Cap Blend	340,823	0	340,823
Mid-Cap Growth	626,963	0	626,963
Mid-Cap Value	201,876	0	201,876
Natural Resources	56,789	0	56,789
Small Blend	92,538	0	92,538
Small Growth	316,283	0	316,283
Small Value	255,105	0	255,105
Technology	229,728	0	229,728

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note G – Pension Plan – Continued

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
	<i>(continued)</i>		
Common Stocks			
Basic Materials	511,436	0	511,436
Conglomerates	158,970	0	158,970
Consumer Goods	271,853	0	271,853
Financial	297,399	0	297,399
Healthcare	316,366	0	316,366
Industrial Goods	138,355	0	138,355
Services	654,071	0	654,071
Technology	413,650	0	413,650
Utilities	183,306	0	183,306
Exchange Traded Funds			
Diversified Emerging Markets	47,600	0	47,600
Health	103,292	0	103,292
Industrials	97,960	0	97,960
Large Growth	152,200	0	152,200
Large Value	204,840	0	204,840
Mid-Cap Value	109,825	0	109,825
PowerShares	511,750	0	511,750
Real-estate	90,450	0	90,450
Small Blend	41,400	0	41,400
Small Growth	85,365	0	85,365
Small Value	80,751	0	80,751
SPDR	315,807	0	315,807
Technology	97,530	0	97,530
	<u>\$ 12,823,197</u>	<u>\$ 4,690,734</u>	<u>\$ 17,513,931</u>

The fair value of the Hospital's pension plan assets as June 30, 2010 by asset category are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash	\$ 789,705	\$ 0	\$ 789,705
Fixed maturity securities	2,497,473	3,256,829	5,754,302
Equities	7,716,704	0	7,716,704
	<u>\$ 11,003,882</u>	<u>\$ 3,256,829</u>	<u>\$ 14,260,711</u>

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note H – Certain Significant Risks and Uncertainties

The Hospital provides general acute health care services in Garrett County, Maryland. The Company and other health care providers in Maryland are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the Federal Medicare and state Medicaid programs (*see Note K*);
- Regulation of hospital rates by the State of Maryland Health Services Cost Review Commission (*See Note I*);
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes; and
- Lawsuits alleging malpractice and related claims (*See Note J*).

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

The Medicare and state Medicaid reimbursement programs represent a substantial portion of the Company's revenues and the Company's operations are subject to a variety of other Federal, state and local regulatory requirements. Failure to maintain required regulatory approvals and licenses and/or changes in such regulatory requirements could have a significant adverse effect on the Company. Changes in Federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on the Company. Also, the Company is from time to time subject to malpractice and related claims and lawsuits, which arise in the normal course of business and which could have a significant effect on the Company.

The Company is subject to certain legal proceedings and claims arising in the ordinary course of business. After consultation with legal counsel, it is management's opinion that the ultimate resolution of these claims will not have a material adverse effect on the Company's financial position or changes in net assets.

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. Despite the federal legislative initiatives to ameliorate these conditions, global credit markets remain volatile and the health of the global economy continues to be uncertain. These conditions create uncertainty regarding the future valuation of the Company's invested funds and the resulting impact on the future financial position, results of operations and cash flows of the Company could be material.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note I – Maryland Health Services Cost Review Commission

The Hospital's rate structure is subject to review and approval by the Maryland Health Services Cost Review Commission (HSCRC). The Hospital has entered into a Total Patient Revenue (TPR) System with the HSCRC. Under TPR, gross patient service revenue is determined prospectively for each rate year ending on June 30. TPR-approved revenue and rates are adjusted annually for the effect of cost of inflation, growth of the population area served by the Hospital and variances between TPR-approved revenue versus the actual revenue charged to patients during the prior rate year. Under TPR, the Hospital has the ability (within limits) to adjust rates to charge patients more or less than the gross patient service revenue approved for each year.

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

The current rate of reimbursement for services to patients under the Medicare program is based on an agreement between the Centers of Medicare and Medicaid Services (CMS) and the HSCRC. This agreement is based upon a waiver from Medicare prospective payment system reimbursement principles granted under Section 1814(b) of the Social Security Act.

Note J – Insurance

Malpractice Insurance

The Company is involved in litigation arising in the normal course of business. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. Additional claims may be asserted against the Company arising from services provided through June 30, 2011. Management believes that no material loss will result from any pending or threatened litigation or from incidents incurred but not reported.

An estimated liability for incurred but not reported professional liability claims has been recorded in the amount of approximately \$694,000 for the years ended June 30, 2011 and 2010. This amount is included in accounts payable and accrued liabilities in the accompanying consolidated financial statements. Management believes this accrual is adequate to provide for all professional liability claims that have been incurred through June 30, 2011, but not reported to its insurance carrier.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note J – Insurance – Continued

Malpractice Insurance -- Continued

Effective March 1, 2005, the Hospital became a shareholder of the newly formed Freestate Healthcare Insurance Company, Ltd. (Freestate), a captive insurance company formed in the Cayman Islands by eight Maryland hospitals. The Hospital became a shareholder of Freestate when the Hospital's insurance company decided not to continue to write insurance policies for hospitals within the State of Maryland effective March 1, 2005. The Hospital believes that becoming a shareholder of the captive insurance company provides the best long-term solution to providing insurance coverage that is cost effective and predictable. Freestate provides insurance coverage on a claims-made basis to its owners for professional liability claims and comprehensive general liability of \$1,000,000 for each and every claim. Freestate has entered into reinsurance and excess policy agreements with independent insurance companies to limit its losses for professional liability and comprehensive general liability claims. The Hospital has \$2,000,000 of additional insurance in the aggregate through such reinsurance arrangements. 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 Freestate are sufficient to meet its obligations as of June 30, 2011. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the payment of such claims would be the responsibility of the member hospitals.

PEPS' malpractice insurance is provided by a commercial insurance carrier. The policy provides coverage of \$1,000,000 for each event, with a physician aggregate of \$3,000,000 and a \$5,000,000 policy aggregate.

Health Insurance

In fiscal year 2003, the Company became self-insured for employee health claims. Under the self-insurance plan, the Company has accrued a liability of \$254,508 and \$323,672 for the years ended June 30, 2011 and 2010 for incurred but not reported claims. Management believes that the accruals are adequate to provide for all employee health claims that have been incurred for the years ended June 30, 2011 and 2010.

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note K – Business and Credit Concentrations

The Company provides health care services through its inpatient and outpatient care facilities located in Oakland, Maryland. The Company grants credit to patients, substantially all of whom are local residents. The Company generally does not require collateral or other security in extending credit; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits receivable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, health maintenance organizations (HMOs) and commercial insurance policies).

At June 30, the Company had patient accounts receivable, net of contractual allowances from third-party payers and others, as follows:

	<u>2011</u>	<u>2010</u>
Self-pay and others	\$ 1,245,683	\$ 1,471,940
Medicare	1,788,247	2,522,169
Commercial insurance and HMOs	1,253,267	1,175,725
Medicaid	861,268	631,221
Blue Cross	<u>1,216,907</u>	<u>1,389,158</u>
	6,365,372	7,190,213
Allowance for doubtful accounts	<u>(2,088,948)</u>	<u>(2,249,597)</u>
	<u>\$ 4,276,424</u>	<u>\$ 4,940,616</u>

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

	<u>2011</u>	<u>2010</u>
Medicare	45%	47%
Commercial insurance and HMOs	15%	16%
Blue Cross	16%	15%
Medicaid	16%	16%
Self-pay and others	<u>8%</u>	<u>6%</u>
	<u>100%</u>	<u>100%</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note L – Functional Expenses

The Company provides general health care services to residents within its geographic location. Expenses related to providing these services, based on management’s estimates of expense allocations, are as follows for the years ended June 30:

	<u>2011</u>	<u>2010</u>
Health care services	\$ 30,087,798	\$ 28,956,231
General and administrative	7,577,087	7,608,092
	<u>\$ 37,664,885</u>	<u>\$ 36,564,323</u>

Note M – Endowment

Current accounting standards provide guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and additional disclosures about an organization’s endowment funds. The State of Maryland has adopted UPMIFA. The adoption of UPMIFA had no impact on the accounting for the Company’s endowment.

The Company’s endowment consists of one donor-restricted fund. Net assets associated with the endowment fund are classified and reported based on the existence of absence or donor-imposed restrictions.

The board of governors of the Company has interpreted the Maryland State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Company classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets (if any) is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by SPMIFA.

Garrett County Memorial Hospital and Subsidiary Notes to the Consolidated Financial Statements – Continued

Note N – Endowment - Continued

In accordance with SPMIFA, the Company considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. The duration and preservation of the fund
2. The purposes of the Company and the donor-restricted endowment fund
3. General economic conditions
4. The possible effect of inflation and deflation
5. The expected total return from income and the appreciation of investments
6. Other resources of the Company
7. The investment policies of the Company

From time to time, the fair value of assets associated with the endowment fund may fall below the level that the donor or SPMIFA required the Company to retain as a fund of perpetual duration. There were no such deficiencies as of June 30, 2011 or 2010.

The Company has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity. Under this policy, as approved by the board of governors, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the Lehman Intermediate Government/Corporate Bond index while assuming a moderate level of investment risk. The Company expects its endowment funds, over time, to provide an average rate of return of approximately 8% percent annually. Actual returns in any given year may vary from this amount.

To satisfy its long-term rate-of-return objectives, the Company relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Company targets a diversified asset allocation that places a greater emphasis on highly liquid investments such as money market accounts to achieve its long-term return objectives within prudent risk constraints.

The endowment's net asset composition and the changes therein were as follows:

	2011			2010		
	Unrestricted	Permanently Restricted	Endowment Total	Unrestricted	Permanently Restricted	Endowment Total
Beginning balance	\$ 11,930	\$ 35,086	\$ 47,016	9,721	\$ 35,086	\$ 44,807
Interest and dividends	1,763	0	1,763	2,209	0	2,209
Ending Balance	\$ 13,693	\$ 35,086	\$ 48,779	\$ 11,930	\$ 35,086	\$ 47,016

Report of Independent Auditors on Other Financial Information and the Schedule of Expenditures of Federal Awards

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

The 2011 and 2010 consolidated audited financial statements of Garrett County Memorial Hospital and Subsidiary and our report thereon are presented in the preceding section of this report. Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The schedule of consolidated balance sheet information and consolidated statement of operations information as of and for the year ended June 30, 2011 on pages 35 - 37 are presented for the purpose of additional analysis of the basic financial statements and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is also presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards general accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Cohen, Rutherford + Knight, P.C.

October 21, 2011

**Garrett County Memorial Hospital
Consolidating Balance Sheet Information
As of June 30, 2011**

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Elimination Entries	Consolidated
<i>ASSETS</i>				
CURRENT ASSETS				
Cash and cash equivalents	\$ 3,751,711	\$ 69,216	\$ 0	\$ 3,820,927
Short-term investments	17,417,996	0	0	17,417,996
Patient accounts receivable, net	4,183,374	93,050	0	4,276,424
Other amounts receivable	247,995	531	0	248,526
Assets whose use is limited by donors	230,577	0	0	230,577
Inventories	1,003,705	817	0	1,004,522
Prepaid expenses	380,370	78,511	0	458,881
Due from affiliates	99,343	0	(99,343)	0
TOTAL CURRENT ASSETS	27,315,071	242,125	(99,343)	27,457,853
NONCURRENT ASSETS				
Property and equipment	20,343,924	0	0	20,343,924
Long-term investments	3,663,231	0	0	3,663,231
Investment in affiliates	303,453	0	0	303,453
Assets whose use is limited by donors, less current portion	349,323	0	0	349,323
Assets whose use is limited by board of governors	698,073	0	0	698,073
Deferred financing costs, net	26,693	0	0	26,693
TOTAL NONCURRENT ASSETS	25,384,697	0	0	25,384,697
TOTAL ASSETS	\$ 52,699,768	\$ 242,125	\$ (99,343)	\$ 52,842,550

See the accompanying report of independent auditors on other financial information and the schedule of expenditures of federal awards.

Garrett County Memorial Hospital
Consolidating Balance Sheet Information – Continued
As of June 30, 2011

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Elimination Entries	Consolidated
<i>LIABILITIES AND NET ASSETS</i>				
CURRENT LIABILITIES				
Accounts payable	958,669	\$ 6,472	\$ 0	\$ 965,141
Accrued salaries and wages	2,300,947	155,727	0	2,456,674
Due to affiliates	0	99,343	(99,343)	0
Advances from third parties	433,983	0	0	433,983
Current portion of long-term debt	210,452	0	0	210,452
Other current liabilities	996,106	161,754	0	1,157,860
TOTAL CURRENT LIABILITIES	<u>4,900,157</u>	<u>423,296</u>	<u>(99,343)</u>	<u>5,224,110</u>
Long-term debt, less current portion	3,742,217	0	0	3,742,217
Pension obligation	6,247,471	0	0	6,247,471
TOTAL LIABILITIES	<u>14,889,845</u>	<u>423,296</u>	<u>(99,343)</u>	<u>15,213,798</u>
NET ASSETS				
Unrestricted	37,254,473	(181,171)	0	37,073,302
Temporarily restricted	520,364	0	0	520,364
Permanently restricted	35,086	0	0	35,086
TOTAL NET ASSETS	<u>37,809,923</u>	<u>(181,171)</u>	<u>0</u>	<u>37,628,752</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 52,699,768</u>	<u>\$ 242,125</u>	<u>\$ (99,343)</u>	<u>\$ 52,842,550</u>

See the accompanying report of independent auditors on other financial information and the schedule of expenditures of federal awards.

**Garrett County Memorial Hospital
Consolidating Statement of Operations Information
For the Year Ended June 30, 2011**

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Elimination Entries	Consolidated
REVENUE				
Net patient service revenue	\$ 36,803,874	\$ 2,163,211	\$ 0	\$ 38,967,085
Other revenue	741,334	453	(149,381)	592,406
Net assets released from restriction for use in operations	35,970	0	0	35,970
TOTAL REVENUE	37,581,178	2,163,664	(149,381)	39,595,461
EXPENSES				
Salaries and wages	15,099,823	1,057,737	0	16,157,560
Employee benefits	5,153,080	166,043	0	5,319,123
Supplies	6,346,563	2,319	0	6,348,882
Utilities	612,168	2,279	0	614,447
Purchased services	3,387,974	312,625	0	3,700,599
Depreciation and amortization	2,786,678	0	0	2,786,678
Interest	172,662	0	0	172,662
Provision for uncollectible accounts	1,273,069	487,440	0	1,760,509
Management fees	0	149,381	(149,381)	0
Other expenses	774,122	30,303	0	804,425
TOTAL EXPENSES	35,606,139	2,208,127	(149,381)	37,664,885
GAIN (LOSS) FROM OPERATIONS	1,975,039	(44,463)	0	1,930,576
OTHER INCOME (LOSS)				
Investment income (loss)	846,459	101	0	846,560
Equity in earnings of affiliates	(1,673)	0	0	(1,673)
Other	39,546	0	0	39,546
TOTAL OTHER INCOME	884,332	101	0	884,433
EXCESS REVENUE OVER EXPENSES (EXPENSES OVER REVENUE)	\$ 2,859,371	\$ (44,362)	\$ 0	\$ 2,815,009

See the accompanying report of independent auditors on other financial information and the schedule of expenditures of federal awards.

Garrett County Memorial Hospital
Schedule of Expenditures of Federal Awards
 For the Year Ended June 30, 2011

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
 GARRETT COUNTY MEMORIAL HOSPITAL
 FOR THE YEAR ENDED JUNE 30, 2011**

<u>Federal Grantor / Program Title</u>	<u>Federal CFDA Number</u>	<u>Identification Number</u>	<u>Federal Expenditures</u>
MAJOR PROGRAM			
U.S. Department of Agriculture Rural Development Rural Housing Service Community Facilities Direct Loan Program	10.766	Loan 97-08	\$ 2,780,027
TOTAL MAJOR PROGRAM			<u>2,780,027</u>
TOTAL EXPENDITURES			<u><u>\$ 2,780,027</u></u>

The schedule of expenditures of federal awards includes the federal grant activity of Garrett County Memorial Hospital and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirement of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic consolidated financial statements.

**Independent Auditor's Report on Internal Control
Over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial
Statements Performed In Accordance with
*Government Auditing Standards***

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

We have audited the consolidated financial statements of Garrett County Memorial Hospital and subsidiary (collectively, the Company) as of and for the year ended June 30, 2011, and have issued our report thereon dated October 21, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Company's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statement will not be prevented or detected and corrected on a timely basis.



Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Board of Governors, management, others within the Company, and the United States Department of Agriculture, and is not intended to be and should not be used by anyone other than these specified parties.

Cohen, Rutherford + Knight, P.C.

October 21, 2011



**Independent Auditor's Report on Compliance with
Requirements That Could Have a Direct and Material
Effect on Each Each Major Federal Program and on
Internal Control Over Compliance in Accordance With
OMB Circular A-133**

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

Compliance

We have audited the compliance of Garrett County Memorial Hospital and Subsidiary (the Company) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on the major federal program for the year ended June 30, 2011. The Company's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Company's compliance with those requirements. In our opinion, the Company complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2011.





Internal Control Over Compliance

The management of the Company is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Company's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the Board of Governors, management, others within the Company, the Department of Agriculture, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Cohen, Rutherford + Knight, P.C.

October 21, 2011

Garrett County Memorial Hospital
Schedule of Findings and Questioned Costs
 For the Year Ended June 30, 2011

SECTION I - SUMMARY OF AUDITOR'S RESULTS

FINANCIAL STATEMENTS

Type of Auditor's Report Issued:	Unqualified
Internal Control Over Financial Reporting?	
Material Weakness(es) Identified?	None reported
Significant Deficiency(ies) Identified	None reported
Noncompliance Material to the Financial Statements Noted?	None reported

FEDERAL AWARDS

Internal Control Over Major Program:	
Material Weakness(es) Identified?	None reported
Significant Deficiency(ies) Identified	None reported
Type of Auditors' Report Issued on Compliance for Major Programs?	Unqualified
Any Audit Findings Disclosed That Are Required To Be Reported in Accordance with Section 510(a) of OMB Circular A-133?	None reported

Identification of Major Program:

CFDA Number/Identification Number	Name of Federal Program
10.766 Loan 97-08	USDA Loan
Dollar Threshold to Distinguish between Type A and Type B Programs?	\$300,000
Auditee Qualified as Low-Risk Auditee?	Yes

SECTION II - FINANCIAL STATEMENT FINDINGS

No matters were reported

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No matters were reported