Grant Thornton

Consolidated Financial Statements, Supplementary Information, and Report of Independent Certified Public Accountants

Meritus Medical Center, Inc.

(formerly Meritus Health, Inc.)

June 30, 2013 and 2012

C O N T E N T S

Audit – Tax – Advisory

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Report of Independent Certified Public Accountants

Board of Directors
Meritus Medical Center, Inc.

We have audited the accompanying consolidated financial statements of Meritus Medical Center, Inc. (formerly Meritus Health, Inc.) ("Meritus"), which comprise the consolidated balance sheets as of June 30, 2013 and 2012, and the related consolidated statements of operations and change in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Meritus Medical Center, Inc. (formerly Meritus Health, Inc.) as of June 30, 2013 and 2012, and the results of its operations and changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplementary Information

The accompanying consolidating balance sheet as of June 30, 2013 and consolidating statement of operations and changes in net assets for the years then ended is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such supplementary information is the responsibility of management and was derived from and relates 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. These additional procedures included comparing and reconciling the 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 auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Grant Thornton LLP

Baltimore, Maryland
September 26, 2013

CONSOLIDATED FINANCIAL STATEMENTS

Meritus Medical Center, Inc.
(formerly Meritus Health, Inc.)

CONSOLIDATED BALANCE SHEETS

June 30,

ASSETS	2013	2012
CURRENT ASSETS		
Cash and cash equivalents	$ 18,808,563	$ 27,253,943
Restricted cash	2,747,487	2,746,240
Short-term investments	10,259,473	3,422,557
Current portion of assets whose use is limited	11,648,408	11,649,864
Accounts receivable, net	63,030,783	51,109,894
Supplies	9,165,678	9,417,836
Prepaid and other current assets	6,969,973	5,956,777
Total current assets	122,630,365	111,557,111
EQUITY INVESTMENTS IN AFFILIATES	22,551,905	24,172,098
ASSETS WHOSE USE IS LIMITED		
Board designated funds	94,196,257	79,257,670
Supplemental retirement benefit investments	4,094,548	3,910,091
Temporarily and permanently restricted donor funds	1,159,895	1,164,123
	99,450,700	84,331,884
Assets held by trustee under bond indenture agreement	18,346,435	18,470,251
Funds designated for insurance purposes	9,460,701	8,801,838
	127,257,836	111,603,973
PROPERTY, PLANT AND EQUIPMENT, net	269,270,634	286,424,041
PLEDGES RECEIVABLE, net	2,862,307	3,070,167
DEFERRED FINANCING COSTS, net	2,515,084	2,663,577
OTHER ASSETS	2,971,783	3,056,314
Total assets	$550,059,914	$542,547,281

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

LIABILITIES AND NET ASSETS	2013	2012
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 13,761,319	$ 14,125,014
Retainage payable	-	183,885
Accrued salaries, wages and withholdings	8,138,663	4,959,925
Accrued compensation benefit	12,092,642	16,751,028
Advances from third-party payors	7,510,014	7,620,630
Accrued interest payable	7,642,631	7,764,019
Current portion of long-term debt	6,444,712	7,650,229
Total current liabilities	55,589,981	59,054,730
LONG-TERM DEBT, net of current portion	254,747,107	261,446,958
ACCRUED RETIREMENT BENEFITS	4,480,453	4,210,694
OTHER LONG-TERM LIABILITIES	6,733,140	6,885,711
Total liabilities	321,550,681	331,598,093
NET ASSETS		
Unrestricted		
Meritus	220,287,217	198,081,263
Non-controlling interest	901,526	2,609,591
Total unrestricted net assets	221,188,743	200,690,854
Temporarily restricted	6,291,872	9,229,716
Permanently restricted	1,028,618	1,028,618
Total net assets	228,509,233	210,949,188
Total liabilities and net assets	$550,059,914	$542,547,281

Meritus Medical Center, Inc.
(formerly Meritus Health, Inc.)

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

Years ended June 30,

	2013	2012
Unrestricted revenue, gains and other support		
Net patient service revenue	$370,863,385	$371,188,105
Less provision for bad debts	(14,416,252)	(13,620,670)
Net patient service revenue less provision for bad debts	356,447,133	357,567,435
Other revenue	13,001,011	13,763,772
Equity earnings in affiliates	2,911,678	7,368,120
Net assets released from restriction used for operations	2,174,772	1,541,749
	374,534,594	380,241,076
Expenses		
Salaries and wages	145,051,579	146,629,910
Employee benefits	38,101,662	40,916,311
Professional fees	8,862,757	8,274,998
Supplies and other	131,933,187	133,825,702
Interest	14,959,202	15,336,562
Depreciation and amortization	24,171,012	26,048,473
	363,079,399	371,031,956
Operating income before other items	11,455,195	9,209,120
Other items		
Demolition and transition costs	-	(620,907)
Pension settlement costs	(11,291,050)	(689,896)
	(11,291,050)	(1,310,803)
Operating income	164,145	7,898,317
Non-operating gains (losses), net		
Investment returns, net	10,380,915	4,959,053
Other, net	(2,596,927)	123,240
Income tax benefit (expense)	1,116,333	(4,644,531)
Excess of revenue over expenses	9,064,466	8,336,079
Deficiency in (excess of) revenue over expenses attributable to non-controlling interest	128,065	(1,448,877)
Excess of revenue over expenses attributable to Meritus	9,192,531	6,887,202

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

	2013	2012
Other changes in unrestricted net assets		
Change in retirement benefit obligation	11,291,050	(88,260)
Change in non-controlling interests	(1,708,065)	1,168,878
Net assets released from restriction for property, plant, and equipment	1,722,373	950,000
Increase in unrestricted net assets	20,497,889	8,917,820
Temporarily restricted net assets		
Contributions	959,301	1,083,675
Net assets released from restriction for property, plant, and equipment	(1,722,373)	(950,000)
Net assets released from restrictions for operations	(2,174,772)	(1,541,749)
Decrease in temporarily restricted net assets	(2,937,844)	(1,408,074)
INCREASE IN NET ASSETS	17,560,045	7,509,746
Net assets		
Beginning of year	210,949,188	203,439,442
End of year	$228,509,233	$210,949,188

Meritus Medical Center, Inc.
(formerly Meritus Health, Inc.)

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended June 30,

	2013	2012
Cash flows from operating activities		
Increase in net assets	$ 17,560,045	$ 7,509,746
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	24,171,012	26,048,473
Provision for bad debts	14,416,252	13,620,670
Change in retirement benefit obligation	(11,291,050)	88,260
Change in non-controlling interest	1,708,065	(1,168,878)
Net realized and unrealized gains on investments	(7,632,673)	677,614
(Gain) loss on disposal of assets	(673,041)	(243,046)
Equity earnings in affiliates	(2,911,678)	(7,368,120)
Changes in assets and liabilities		
Accounts receivable	(26,337,141)	(18,852,245)
Supplies, prepaid, and other current assets	(761,038)	791,912
Other assets	292,391	93,683
Accounts payable, accrued expenses and long-term liabilities	(2,075,838)	3,386,051
Accrued salaries, wages and withholdings	3,178,738	807,943
Accrued compensation benefit	6,632,664	(1,495,153)
Advances from third-party payors	(110,616)	935,798
Interest payable	(121,388)	(31,225)
Accrued retirement benefits	269,759	310,610
Net cash provided by operating activities	16,314,463	25,112,093
Cash flows from investing activities		
Purchase of property, plant and equipment	(9,638,965)	(11,001,297)
Proceeds from the disposal of assets	3,110,516	3,500,860
Purchase of restricted cash, short-term investments, and assets whose use is limited	(38,547,804)	(98,756,705)
Sale of restricted cash, short-term investments, and assets whose use is limited	23,689,907	92,276,346
Equity distributions from affiliates, net	4,531,871	5,948,313
Net cash used in investing activities	(16,854,475)	(8,032,483)

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

	2013	2012
Cash flows from financing activities		
Proceeds from long-term debt	-	3,230,104
Payments on long-term debt	(7,905,368)	(11,436,469)
Net cash used in financing activities	(7,905,368)	(8,206,365)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(8,445,380)	8,873,245
Cash and cash equivalents		
Beginning of year	27,253,943	18,380,698
End of year	$ 18,808,563	$ 27,253,943
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$ 928,028	$ 3,384,830
Cash paid for interest, net of amounts capitalized	14,959,202	15,336,562
Supplemental disclosure of non-cash investing and financing activities:		
Assets acquired under capital leases	$ -	$ 2,016,780
Decrease in accrual for the purchase of property, plant and equipment	(183,885)	(969,938)

1. DESCRIPTION OF ORGANIZATION

Organization

Until January 31, 2013, Meritus Health, Inc. was the parent corporation of the Meritus Medical Center, Inc., Meritus Enterprises, the Meritus Medical Center Endowment Fund, Inc., the Meritus Healthcare Foundation, Inc., and the Meritus Insurance Company, Ltd.

Effective February 1, 2013, Meritus Health, Inc. completed a corporate reorganization. The goal of the reorganization was to facilitate an improved governance structure. The Meritus Medical Center Endowment Development Company, Inc., the Meritus Medical Center Endowment Fund and Meritus Health, Inc. all merged into Meritus Medical Center, Inc. The surviving organization, Meritus Medical Center, Inc. ("Hospital") is the parent corporation of the Meritus Healthcare Foundation, Inc. ("Foundation"), the Meritus Insurance Company, Ltd. ("MIC") and Meritus Holdings, LLC ("Holdings"), which owns Meritus Enterprises ("MEI"). These entities are collectively referred to as "Meritus".

The Hospital is a not-for-profit acute care hospital located in Hagerstown, Maryland and serves the residents of western Maryland, southern Pennsylvania, and the panhandle of West Virginia. The Hospital currently offers acute general hospital inpatient services including adult medical/surgical care, obstetrics and newborn care, including a family birthing center, cardiac catheterizations, comprehensive inpatient rehabilitation, radiology and diagnostic services, inpatient and outpatient mental health services, a regional Level III Trauma Center, an intensive care unit, a progressive care unit, a coronary care unit, and a pediatric unit. The Hospital also manages gifts, donations or bequests given for the benefit of Meritus and acquires real estate properties for rental to medical provider entities and development opportunities.

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

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

Holdings is a tax-exempt entity that operates a laboratory, urgent care centers, and other health services. The Hospital is the sole member of Holdings.

MEI is a for-profit corporation that operates retail pharmacies, physician practices, and other health services. In addition, MEI holds a 60% interest in Robinwood Surgery Center which provides ambulatory surgery services and a 50% interest in Diagnostic Imaging Services which provides outpatient imaging services.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Hospital, Holdings, MEI, the Foundation, and MIC. MEI owns a 60% interest in Robinwood Surgery Center, LLC, at June 30, 2013 and 2012, which is included in the consolidated financial statements with the related non-controlling interest reported as a component of net assets. All material inter-company balances and transactions have been eliminated in consolidation.

Use of Estimates

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

Fair Value Measurements

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Fair Value Measurements - continued

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

Patient Accounts Receivable / Allowance for Doubtful Accounts

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

Cash and Cash Equivalents

Cash and cash equivalents consist of short-term, highly liquid investments that are readily convertible to cash and have original maturities of three months or less. Cash and cash equivalents are carried at cost which approximates fair value. Meritus had overnight investment repurchase transactions of $15,746,000 as of June 30, 2012.

Assets Whose Use is Limited

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

Investments and Investment Income

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Investments and Investment Income - continued

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

Supplies

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

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

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

	2013	2012
Hospital:		
Surgical and medical supplies	$4,351,832	$4,521,316
Other supplies	855,238	986,857
	5,207,070	5,508,173
Holdings and MEI:		
Durable medical equipment	470,604	531,204
Surgical and medical supplies	507,531	387,216
Pharmacy and home care infusion	2,257,508	2,474,863
Medical laboratory	722,965	516,380
	3,958,608	3,909,663
	$9,165,678	$9,417,836

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Property, Plant and Equipment

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

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

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

Meritus continually evaluates whether events and circumstances have occurred that indicate the remaining estimated useful life of long-lived assets is appropriate, or whether the remaining balance may not be recoverable. When factors indicate that long-lived assets should be evaluated for possible impairment, Meritus uses an estimate of the related undiscounted operating income over the remaining life of the long-lived asset in measuring whether the long-lived asset is recoverable. The impairment loss on these assets is measured as the excess of the carrying amount of the asset over its fair value. Fair value is based upon market prices, where available, or discounted cash flows. Management believes that no revision to the remaining useful lives or write-down of long-lived assets is required at June 30, 2013.

Deferred Financing Costs

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

Advertising Costs

Advertising costs for the years ended June 30, 2013 and 2012 were $1,073,028 and $1,649,730, respectively, and are recorded within supplies and other expenses.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Compensated Absences

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

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Meritus have been limited by donors to a specific time period or purpose. When donor restrictions expire, that is, when a time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified into unrestricted net assets and reported as net assets released from restrictions.

Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions if for operating purposes and as other changes in unrestricted net assets if for capital purposes in the consolidated statements of operations and changes in net assets. Permanently restricted net assets have been restricted by donors to be maintained by Meritus in perpetuity.

Excess of Revenue over Expenses

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

Net Patient Service Revenue

For services provided at the Hospital campus, all payors are required to pay the Maryland Health Services Cost Review Commission ("HSCRC") approved rates. The major third-party payors, as recognized by the HSCRC, are allowed discounts of up to 6% on approved rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered.

The Hospital's charges are subject to review and approval by the HSCRC. The Hospital management has filed the required forms with the HSCRC and believes the Hospital to be in compliance with HSCRC requirements. The total rate of reimbursement for services to patients under the Medicare and Medicaid programs is based on an arrangement between the Centers for Medicare and Medicaid Service and the HSCRC. Management believes that this program will remain in effect at least through June 30, 2014. The Hospital has an agreement with the HSCRC under a rate regulation concept called Total Patient Revenue ("TPR") which was renewed for another 3 years for a three year period ending June 30, 2016. TPR is a revenue constraint methodology which provides for inflation, bad debt, payor differential and adjustments for population growth, but excludes case mix and volume changes. For the years ended June 30, 2013 and 2012, the regulated revenue cap was $299,989,323 and $294,592,054 respectively. For the year ending June 30, 2014, the regulated revenue cap is $304,542,896.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Net Patient Service Revenue - continued

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

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

Net revenues from the Medicare and Medicaid programs collectively constitute approximately 48% of Meritus' net patient service revenue for the years ended June 30, 2013 and 2012. Laws and regulations governing the HSCRC, Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Meritus believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action.

Accounts receivable are reduced by an allowance for doubtful accounts. Meritus' allowance for doubtful accounts totaled $6,371,936 and $3,934,805 at June 30, 2013 and 2012, respectively. In evaluating the collectibility of accounts receivable, Meritus analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, Meritus analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients, Meritus records a significant provision for bad debts on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. For the year ended June 30, 2013, there was a positive charge in estimate related to certain self-pay patient receivables that are on structured payment plans, which provided an increase to net patient service revenue less provision for bad debts of approximately $875,000. The difference between the billed rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts. Meritus has not experienced significant changes in write-off trends and has not changed its charity care policy for the year ended June 30, 2013.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Net Patient Service Revenue - continued

Patient service revenue for the year ended June 30, 2013 and 2012, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources based on primary insurance designation, is as follows:

	Third-Party Payors	Self-Pay	Total all Payors
2013:			
Patient service revenue, net of contractual allowances and discounts	$323,003,543	$33,443,590	$356,447,133
2012:			
Patient service revenue, net of contractual allowances and discounts	$330,527,178	$27,040,257	$357,567,435

Deductibles and copayments under third-party payment programs within the third-party payor amount above are the patients' responsibility and Meritus considers these amounts in its determination of the provision for bad debts based on collection experience.

Charity Care

Meritus provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Meritus does not pursue collection on amounts deemed to qualify as charity. Meritus also estimates that the direct and indirect cost of services and supplies furnished to patients eligible for charity care using a ratio of cost to gross charges based on internal data is $19,582,829 and $15,421,891 for the years ended June 30, 2013 and 2012, respectively.

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

Other Revenue

Other revenue is comprised of investment income on assets whose use is limited under bond indenture agreement, rental income, gains and losses on disposal of assets, incentive payments related to the implementation and meaningful use of certified electronic health records and other miscellaneous items.

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments for eligible hospitals and professionals that implement and achieve meaningful use of certified electronic health record ("EHR") technology. For Medicare and Medicaid EHR incentive payments Meritus utilizes a grant accounting model to recognize these revenues. Under this accounting policy, EHR incentive payments were recognized as revenues when attestation that the EHR meaningful use criteria for the required period of time was demonstrated. Accordingly, Meritus recognized $1,063,113 and $1,885,293 of EHR revenues for the years ended June 30, 2013 and 2012. These amounts are included in other revenue in the consolidated statements of operations and changes in net assets. Meritus' attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. Additionally, Medicare EHR incentive payments received are subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated.

Income Taxes

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

Holdings is considered a disregarded entity for tax purposes and is reported through the Hospital.

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

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

Meritus follows the accounting guidance for uncertainties in income tax positions, which requires that a tax position be recognized or derecognized based on a "more likely than not" threshold. This applies to positions taken or expected to be taken in a tax return. Meritus does not believe its consolidated financial statements include any material uncertain tax positions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Concentration of Credit Risk

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

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

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

	2013	2012
Health maintenance organizations	2%	2%
Medical assistance HMO	14	12
Medicare	27	32
Commercial insurance and other	23	22
Blue Cross/Blue Shield	15	17
Self-pay	19	15
	100%	100%

457(b) Deferred Compensation Plan

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

Subsequent Events

Meritus evaluated subsequent events through September 26, 2013, the date these consolidated financial statements were available to be issued. All material matters are disclosed in the footnotes to the consolidated financial statements.

3. INVESTMENTS AND INVESTMENT INCOME

Investments at June 30 consisted of the following:

	2013	2012
Short-Term Investments:		
U.S. government securities	$10,259,473	$ 3,422,557
Asset whose use is limited:		
Cash and cash equivalents	$ 1,284,750	$ 6,553,559
Fixed income	39,303,969	31,618,734
Common stock	55,845,158	45,922,290
Mutual funds	3,016,823	237,301
	$99,450,700	$84,331,884
Assets held by trustee under debt agreement:		
U.S. government securities	$29,044,843	$29,170,115
Funds designated for insurance purposes:		
Fixed income	$10,410,701	$ 9,751,838

Meritus had restricted cash of $2,747,487 and $2,746,240 as of June 20, 2013 and 2012, respectively, for unemployment insurance collateral and workers' compensation collateral, in compliance with the self-insurance requirement under the regulations of the State of Maryland Employment Security Administration and Workers' Compensation Administration.

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

	2013	2012
Investment returns, net:		
Interest and dividends, net of investment fees of $221,088 and $234,905 in 2013 and 2012, respectively	$ 2,748,241	$ 5,636,667
Net realized gains on investments	2,013,469	988,290
Change in unrealized gains and losses on investments	5,619,205	(1,665,904)
	$10,380,915	$ 4,959,053

4. FAIR VALUE MEASUREMENTS

The following table presents Meritus' assets measured at fair value on a recurring basis using the market approach, as of June 30:

	Level 1	Level 2	Level 3	Total
2013:				
Cash and cash equivalents	$ 18,808,563	$ -	$ -	$ 18,808,563
Restricted cash	2,747,487	-	-	2,747,487
Short-term investments	10,259,473	-	-	10,259,473
Assets whose use is limited	134,046,438	4,859,806	-	138,906,244
Total assets	$165,861,961	$4,859,806	$ -	$170,721,767
2012:				
Cash and cash equivalents	$ 27,253,943	$ -	$ -	27,253,943
Restricted cash	2,746,240	-	-	2,746,240
Short-term investments	3,422,557	-	-	3,422,557
Assets whose use is limited	116,746,346	6,507,491	-	123,253,837
Total assets	$150,169,086	$6,507,491	$ -	$156,676,577

Meritus does not have any Level 3 financial instruments as of June 30, 2013 and 2012.

Pledges receivable are non-recurring fair value measurements. Any multi-year pledge received in fiscal year 2013 and 2012 is recorded at the present value of future cash flows with a discount rate adjusted for any market conditions to arrive at fair value. These are classified as Level 2 within the fair value hierarchy.

5. ACCOUNTS RECEIVABLE

Accounts receivable at June 30 consist of the following:

	2013	2012
Patient accounts receivable	$73,236,076	$57,524,421
Less:		
Contractual allowance	(8,769,110)	(8,101,830)
Allowance for doubtful accounts	(6,371,936)	(3,934,805)
	58,095,030	45,487,786
Other receivables	4,935,753	5,622,108
	$63,030,783	$51,109,894

5. ACCOUNTS RECEIVABLE - Continued

Pledges receivable at June 30 consist of the following:

	2013	2012
Capital campaign	$4,799,317	$5,455,065
Other	1,125,427	942,737
Total unconditional promises to give	$5,924,744	$6,397,802
Receivable in less than one year	$2,423,117	$2,511,620
Receivable in one to five years	2,843,601	3,099,601
Receivable in more than five years	658,026	786,581
Total unconditional promises to give	5,924,744	6,397,802
Less:		
Discounts to net present value	(449,019)	(619,575)
Allowance for uncollectible promises	(653,932)	(623,998)
Net unconditional promises to give	$4,821,793	$5,154,229
Pledges receivable, current portion included in other receivables	$1,959,486	$2,084,062
Pledges receivable, net of current portion	2,862,307	3,070,167
	$4,821,793	$5,154,229

6. PROPERTY, PLANT AND EQUIPMENT

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

	2013	2012
Land	$ 25,667,355	$ 25,484,072
Buildings, and improvements used in operations	175,494,738	179,590,443
Buildings used in rental operations	29,092,410	22,695,770
Equipment	185,792,343	184,246,286
	416,046,846	412,016,571
Less accumulated depreciation and amortization	(147,400,204)	(125,793,519)
	268,646,642	286,223,052
Construction in progress	623,992	200,989
Property, plant and equipment, net	$ 269,270,634	$ 286,424,041

6. PROPERTY, PLANT AND EQUIPMENT - Continued

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

	2013	2012
Equipment	$ 5,798,045	$12,941,606
Less accumulated amortization	(3,335,108)	(7,782,072)
	$ 2,462,937	$ 5,159,534

Total depreciation and amortization expense for property, plant and equipment for the years ended June 30, 2013 and 2012 was $23,795,988 and $25,906,476, respectively.

Meritus had a conditional asset retirement obligation ("CARO") that related to the removal and disposal of asbestos and two underground fuel storage tanks. Demolition payments for the year ended June 30, 2012 was $2,229,857, which included payments for the CARO of $1,608,950.

7. EQUITY INVESTMENTS IN AFFILIATES

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

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

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

MEI has a 50% interest in Diagnostic Imaging, which provides radiology imaging services, and has a 33.33% interest in Western Maryland Supply, LLC, which provides durable medical equipment for rental or purchase. For the year ended June 30, 2011, the Endoscopy Center at Robinwood, LLC ("Endoscopy Center"), an ambulatory center for gastroenterology procedures, and Endoscopy Real Estate are 50% owned by Robinwood Surgery Center, LLC ("RSC"). During the year ended June 30, 2012, RSC sold its 50% share in Endoscopy Center for $3,300,000 resulting in a gain of $3,008,500. During the year ended June 30, 2013, RSC sold its 50% share in Endoscopy Real Estate for $384,000 resulting in a gain of $422,309. GI Real Estate provides rental property to a group of healthcare practitioners and is 50% owned by MEI.

7. EQUITY INVESTMENTS IN AFFILIATES - Continued

Summary financial information as of June 30, 2013 and 2012 and for the years then ended appears below for the significant equity investments:

	Hospital Maryland Care, Inc.		Hospital Tri-State Health Partners	
	2013	2012	2013	2012
Assets	$190,761,317	$194,501,638	$2,943,756	$3,387,984
Liabilities	118,154,824	127,042,207	120,909	292,440
Equity	$ 72,606,493	$ 67,459,431	$2,822,847	$3,095,544
Net income	$ 2,007,880	$ 16,444,597	$ (300,910)	$ 189,346

	MEI Diagnostic Imaging Services, LLC		MEI General Surgery Real Estate, LLC	
	2013	2012	2013	2012
Assets	$ 9,879,708	$10,484,787	$ 571,285	$ 594,541
Liabilities	3,113,840	3,358,394	479,301	506,859
Equity	$ 6,765,868	$ 7,126,393	$ 91,984	$ 87,682
Net income	$ 3,131,721	$ 3,441,271	$ 14,302	$ 10,593

	MEI GI Real Estate		MEI - Western Maryland Medical Supply, LLC	
	2013	2012	2013	2012
Assets	$ 545,139	$ 574,483	$1,301,660	$ 948,719
Liabilities	300,562	367,700	1,200,403	770,346
Equity	$ 244,577	$ 206,783	$ 101,257	$ 178,373
Net income (loss)	$ 43,794	$ 35,034	$ (77,117)	$ (713,624)

7. EQUITY INVESTMENTS IN AFFILIATES - Continued

	MEI Endoscopy Center at Robinwood, LLC		MEI Endoscopy Real Estate	
	2013	2012	2013	2012
Assets	$ -	$ 602,725	$ -	$1,072,385
Liabilities	-	20,236	-	1,170,134
Equity (deficiency)	$ -	$ 582,489	$ -	$ (97,749)
Net income	$ -	$ 1,853,057	$ -	$ 97,195

8. LONG-TERM DEBT

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

	2013	2012
MHHEFA Revenue Bonds:		
Series 2008 4.00% - 6.00% serial bonds, net of original issue discounts $1,214,539 and $1,273,796, respectively	$256,309,718	$259,750,461
2001 Taxable Note B to Bank of America	537,947	1,530,354
City of Hagerstown note	140,748	159,295
2011 Bank of America Note - 2.13% interest rate	386,667	1,013,333
Mortgages and equipment loans with banks, with interest rates ranging from 2.3% to 7.75%	1,792,014	2,646,433
Capital lease obligations, with interest rates ranging from 2.9% to 5.0%	2,024,725	3,997,311
	261,191,819	269,097,187
Less current portion of long-term debt	(6,444,712)	(7,650,229)
	$254,747,107	$261,446,958

Meritus uses current market prices in determining the fair value of its Revenue Bonds. The carrying value of other long-term debt approximates fair value. The fair value of total long-term debt, excluding capital lease obligations, was approximately $270,967,000 and $288,853,000 at June 30, 2013 and 2012, respectively.

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

8. LONG-TERM DEBT - Continued

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

All bonds are collateralized by a first lien and claims on all receipts of Meritus, except restricted donations and contributions. In connection with the Series 2008 Bonds, MHHEFA has a security interest in existing facilities of Meritus. All bonds require the Hospital to maintain certain financial ratios and stipulated insurance coverage as defined. Meritus was in compliance with these covenants at June 30, 2013 and 2012.

The 2001 Taxable Note B to Bank of America was issued for the construction of the Robinwood Medical Center III. The taxable portion of the debt requires monthly principal payments of $82,701 through February 1, 2014 with remaining principal due at that time. The interest is calculated and payable monthly based upon the outstanding principal balance at the time. The variable interest rates were 1.19% and 1.35%, as of June 30, 2013 and 2012, respectively. The bonds may be repaid, at the option of Meritus, in part or in full at any time with 30 days' notice. The bonds are collateralized by a mortgage of the real property of the Hospital.

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

	Long-term Debt	Capital Lease Obligations
2014	$ 5,219,415	$1,303,770
2015	4,221,471	562,919
2016	4,198,077	266,326
2017	4,236,216	1,447
2018	4,444,022	-
Thereafter	236,847,893	-
	$259,167,094	2,134,462
Less amount representing interest		(109,737)
		$2,024,725

The Hospital maintains a line of credit with a financial institution which is renewed annually in the amount of $1,000,000, bearing interest on the drawn portion at the bank's prime interest rate. The line was not in use at June 30, 2013 and 2012.

8. LONG-TERM DEBT - Continued

MEI maintains a line of credit with a financial institution which is renewed annually in the amount of $500,000, bearing interest on the drawn portion at the bank's prime interest rate plus 2%. The line was not in use at June 30, 2013 and 2012.

9. INCOME TAXES

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

	2013	2012
Current:		
Federal	$1,212,298	$(3,379,649)
State	273,284	(843,138)
	1,485,582	(4,222,787)
Deferred:		
Federal	(332,424)	(363,301)
State	(36,746)	(58,443)
	(369,170)	(421,744)
	$1,116,412	$(4,644,531)

On July 1, 2011, MEI completed a structural realignment to include the formation of Holdings. The realignment included the conversion of taxable subsidiaries of MEI resulting in a net federal and state conversion tax of $4,000,000. The above conversion tax was repeated for both book and tax for the year ended June 30, 2013.

9. INCOME TAXES - Continued

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

	2013	2012
Deferred tax asset:		
Accrued vacation	$ 650,109	$ 847,399
Deferred compensation	1,264,490	1,074,769
Captive insurance premiums	17,775	-
Allowance for bad debts	222,888	497,885
Other	247,100	292,844
	2,402,362	2,712,897
Deferred tax liabilities:		
Fixed assets and intangible assets	(1,191,089)	(1,123,726)
Captive insurance premiums	-	(6,346)
Partnership basis	(18,604)	(20,986)
	(1,209,693)	(1,151,058)
	$ 1,192,669	$ 1,561,839

10. POST RETIREMENT BENEFIT PLANS

Defined Contribution Plans

Meritus has a 401(k) Savings Plan. The plan is available to all Meritus employees. Meritus matches employee contributions for an amount up to 6% of each employee's base salary, subject to limitations.

Amounts charged to expense for the years ended June 30, 2013 and 2012 were $5,933,171 and $5,046,653, respectively.

The Hospital has frozen a 403(b) plan. Effective July 1, 2011, the plan was frozen to future contributions.

The Hospital and MEI each maintain an employee funded supplemental non-qualified retirement plan for certain employees. The plan requires the benefits be paid upon termination, retirement or death. The related liability is $4,480,453 and $4,210,695 at June 30, 2013 and 2012, respectively. Management has designated investments for the intended purpose of funding the liability when payable. Amounts charged to expense for the years ended June 30, 2013 and 2012 were $29,321 and $23,080, respectively.

10. POST RETIREMENT BENEFIT PLANS - Continued

Defined Benefit Plan

Meritus maintained a cash balance pension plan ("Plan") that was fully liquidated as of January 31, 2013, which was terminated for all participants, effective June 30, 2011. The Plan covered substantially all current Hospital employees and maintained the balance for MEI employees previously employed by the Hospital. Benefits under the plan were generally based on the participant's age, years of service and compensation levels. Annual contributions were made to the plan in accordance with the Employee Retirement Income Security Act of 1974 ("ERISA") regulations. Employees were fully vested after three years of service.

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

	2013	2012
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 43,103,556	$44,527,620
Interest cost	427,799	324,829
Actuarial (gain) loss	(86,261)	1,091,759
Benefits paid	(43,445,094)	(2,840,652)
Benefit obligation at end of year	$ -	$43,103,556
Change in plan assets:		
Fair value of plan assets at beginning of year	39,794,100	$42,579,753
Actual return on plan assets	(33,208)	54,999
Contributions	3,684,202	-
Benefits paid	(43,445,094)	(2,840,652)
Fair value of plan assets at end of year	$ -	$39,794,100
Net amount recognized - accrued compensation benefit	$ -	$ (3,309,456)
Amounts recognized in unrestricted net assets consist of:		
Net actuarial loss	$ -	$11,128,092
Prior service cost	-	162,958
Net amount recognized in unrestricted net assets	$ -	$11,291,050

10. POST RETIREMENT BENEFIT PLANS - Continued

The accumulated benefit obligation is $0 and $43,103,556 at June 30, 2013 and 2012, respectively.

	2013	2012
Net periodic benefit cost:		
Interest cost	$ 427,799	$ 324,829
Expected return on plan assets	(29,041)	(324,942)
Prior service cost	12,203	20,919
Actuarial loss	(36,215)	562,654
	374,746	583,460
Settlement costs	11,291,050	689,896
	11,665,796	1,273,356
Change in amounts recognized in unrestricted net assets	(11,291,050)	88,260
	$ 374,746	$1,361,616

Assumptions

	2013	2012
Weighted-average assumptions used to determine benefit obligations as of June 30:		
Discount rate	N/A	3.430%
Rate of compensation increase	N/A	N/A
Measurement date	N/A	June 30
Weighted-average assumptions used to determine net periodic benefit cost for the years ended June 30:		
Discount rate	3.430%	3.408%
Expected return on plan assets	0.25%	0.80%
Rate of compensation increase	N/A	N/A

Basis for Expected Long-Term Rate of Return

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

Plan Assets

The Plan's weighted-average asset allocation at June 30, 2012 was 100% cash and cash equivalents.

10. POST RETIREMENT BENEFIT PLANS - Continued

Description of Investment Policies and Strategies

As a result of the plan termination, the plan assets were invested in cash and cash equivalents.

Fair Value of Plan Assets

The following fair value hierarch table presents information about each major category of the Plan's financial assets measured at fair value on a recurring basis using the market approach as of June 30, 2012:

	Total	(Level 1)
Asset category:		
Cash and cash equivalents	$43,177,461	$43,177,461
	$43,177,461	$43,177,461

There are no plan assets that are Level 2 or 3 at June 30, 2012.

11. INSURANCE COVERAGE

Meritus has a wholly-owned insurance captive, MIC, to provide primary limits of insurance of $1,000,000 per occurrence/$3,000,000 aggregate for professional and general liability. The professional liability coverage is provided on a claims-made basis. In addition, MIC purchased reinsurance from an A rated re-insurer in the amount of $15,000,000 to cover any potential liabilities above the $1,000,000/$3,00,000 primary limits, which were covered by MIC. The self-insured liabilities determined by an actuary for professional and general are discounted at 4%, and are included in other long-term liabilities in the consolidated balance sheets.

In addition, MIC provides stop loss health insurance coverage to Meritus for the medical expenses of its employees. Coverage is for expenses in excess of the deductible amount of 300,000 per individual. MIC purchased reinsurance for amounts in excess of $600,000 per individual to fully reinsure this exposure. The reimbursement maximum under this reimbursement is $400,000 per individual with no lifetime maximum per individual.

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

11. INSURANCE COVERAGE - Continued

	2013	2012
Reserves for losses and loss adjustment expenses at beginning of year	$ 5,734,653	$ 5,476,000
Less reinsurance recoverable on unpaid claims	(1,229,261)	(1,145,437)
Net provision for losses and loss adjustment expenses at beginning of year	4,505,392	4,330,563
Incurred related to:		
Current fiscal year	1,293,856	1,398,660
Prior fiscal years - change in estimates	(251,755)	(293,817)
Total losses and loss adjustment expenses incurred, net of reinsurance recoverable	1,042,101	1,104,843
Paid related to:		
Current fiscal year	(5,184)	(156,599)
Prior fiscal years	(1,073,239)	(773,415)
Total losses and loss adjustment expenses paid, net of reinsurance recoverable	(1,078,423)	(930,014)
Net provision for losses and loss adjustment expenses at end of year	4,469,070	4,505,392
Add reinsurance recoverable on unpaid claims	1,075,976	1,229,261
Reserves for losses and loss adjustment expenses at end of year	$ 5,545,046	$ 5,734,653

12. COMMITMENTS AND CONTINGENCIES

Operating Lease Obligations

Meritus leases equipment under non-cancelable lease arrangements. In addition, Meritus leases office space in several locations under operating leases. Some of the leases provide for renewal options. Rent expense under all operating leases was $5,491,473 and $5,445,697 for the years ended June 30, 2013 and 2012, respectively.

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

2014	$5,306,580
2015	3,549,853
2016	2,930,408
2017	1,786,215
2018	845,127

12. COMMITMENTS AND CONTINGENCIES - Continued

Rental Properties

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

2014	$51,045
2015	31,136
2016	7,784

Litigation

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

13. TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

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

	2013	2012
Temporarily restricted for financial support of patients and hospital programs	$1,656,395	$4,331,637
Capital campaign	4,635,477	4,898,079
	$6,291,872	$9,229,716
Permanently restricted investments are to be held in perpetuity, the income of which is expendable to support charity care and health care education	$1,028,618	$1,028,618

14. FUNCTIONAL EXPENSES

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

	2013	2012
Health care services	$341,402,901	$348,987,854
Fundraising	719,503	837,706
Administration	20,956,995	21,206,396
	$363,079,399	$371,031,956

SUPPLEMENTARY INFORMATION

Meritus Medical Center, Inc.
(formerly Meritus Health, Inc.)

CONSOLIDATING BALANCE SHEET

June 30, 2013

ASSETS	Meritus Medical Center	Meritus Holdings Consolidated	Meritus Insurance Company	Meritus Healthcare Foundation	Total	Consolidating Entries	Consolidated Total
CURRENT ASSETS							
Cash and cash equivalents	$ 8,652,894	$ 8,114,374	$ 1,529,398	$ 511,897	$ 18,808,563	$ -	$ 18,808,563
Restricted cash	2,747,487	-	-	-	2,747,487	-	2,747,487
Short-term investments	10,259,473	-	-	-	10,259,473	-	10,259,473
Current portion of assets whose use is limited	10,698,408	-	950,000	-	11,648,408	-	11,648,408
Accounts receivable, net	57,675,750	9,609,768	99,618	2,067,064	69,452,200	(6,421,417)	63,030,783
Supplies	5,207,070	3,958,608	-	-	9,165,678	-	9,165,678
Prepaid and other current assets	3,198,471	3,527,655	242,347	1,500	6,969,973	-	6,969,973
Due from related organizations	5,368,673	269	-	(671,659)	4,697,283	(4,697,283)	-
Total current assets	103,808,226	25,210,674	2,821,363	1,908,802	133,749,065	(11,118,700)	122,630,365
EQUITY INVESTMENTS IN AFFILIATES	43,572,099	3,466,391	-	-	47,038,490	(24,486,585)	22,551,905
ASSETS WHOSE USE IS LIMITED							
Board designated funds	87,897,438	-	-	6,298,819	94,196,257	-	94,196,257
Supplemental retirement benefit investments	1,264,796	2,829,752	-	-	4,094,548	-	4,094,548
Temporary and permanently restricted donor funds	1,159,895	-	-	-	1,159,895	-	1,159,895
	90,322,129	2,829,752	-	6,298,819	99,450,700	-	99,450,700
Assets held by trustee under bond indenture agreement	18,346,435	-	-	-	18,346,435	-	18,346,435
Funds designated for insurance purposes	-	-	9,460,701	-	9,460,701	-	9,460,701
	108,668,564	2,829,752	9,460,701	6,298,819	127,257,836	-	127,257,836
PROPERTY, PLANT AND EQUIPMENT, net	259,303,017	9,945,379	-	22,238	269,270,634	-	269,270,634
PLEDGES RECEIVABLE, net	-	-	-	2,862,307	2,862,307	-	2,862,307
DEFERRED FINANCING COSTS, net	2,515,084	-	-	-	2,515,084	-	2,515,084
OTHER ASSETS	2,618,680	1,438,107	1,054,376	-	5,111,163	(2,139,380)	2,971,783
Total assets	$520,485,670	$42,890,303	$13,336,440	$11,092,166	$587,804,579	$(37,744,665)	$550,059,914

Meritus Medical Center, Inc.
(formerly Meritus Health, Inc.)

CONSOLIDATING BALANCE SHEET - CONTINUED

June 30, 2013

LIABILITIES AND NET ASSETS	Meritus Medical Center	Meritus Holdings Consolidated	Meritus Insurance Company	Meritus Healthcare Foundation	Consolidating Total	Consolidating Entries	Consolidated Total
CURRENT LIABILITIES							
Accounts payable and accrued expenses	$ 9,791,539	$ 2,815,226	$ 1,120,516	$ 34,038	$ 13,761,319	$ -	$ 13,761,319
Accrued salaries, wages and withholdings	6,532,890	1,605,773	-	-	8,138,663	-	8,138,663
Accrued compensation benefit	9,353,430	2,739,837	-	(625)	12,092,642	-	12,092,642
Advances from third-party payors	7,397,488	112,526	-	-	7,510,014	-	7,510,014
Accrued interest payable	7,642,631	-	-	-	7,642,631	-	7,642,631
Current portion of long-term debt	5,477,486	967,226	-	-	6,444,712	-	6,444,712
Due to related organizations	-	4,693,439	-	-	4,693,439	(4,693,439)	-
Total current liabilities	46,195,464	12,934,027	1,120,516	33,413	60,283,420	(4,693,439)	55,589,981
LONG-TERM DEBT, net of current portion	253,889,197	857,910	-	-	254,747,107	-	254,747,107
ACCRUED RETIREMENT BENEFITS	1,264,796	3,215,657	-	-	4,480,453	-	4,480,453
OTHER LONG-TERM LIABILITIES	-	1,209,694	11,944,863	-	13,154,557	(6,421,417)	6,733,140
Total liabilities	301,349,457	18,217,288	13,065,379	33,413	332,665,537	(11,114,856)	321,550,681
STOCKHOLDERS' EQUITY							
Common stock	-	700,000	120,000	-	820,000	(820,000)	-
Paid-in capital	-	1,150,080	-	-	1,150,080	(1,150,080)	-
Retained earnings	-	20,559,164	151,061	-	20,710,225	(20,710,225)	-
Total stockholders' equity	-	22,409,244	271,061	-	22,680,305	(22,680,305)	-
NET ASSETS							
Unrestricted							
Meritus	215,146,450	1,362,245	-	4,018,611	220,527,306	(240,089)	220,287,217
Non-controlling interest	-	901,526	-	-	901,526	-	901,526
Total unrestricted net assets	215,146,450	2,263,771	-	4,018,611	221,428,832	(240,089)	221,188,743
Temporary restricted	2,961,145	-	-	7,040,142	10,001,287	(3,709,415)	6,291,872
Permanent restricted	1,028,618	-	-	-	1,028,618	-	1,028,618
Total net assets	219,136,213	2,263,771	-	11,058,753	232,458,737	(3,949,504)	228,509,233
Total liabilities and net assets	$520,485,670	$42,890,303	$13,336,440	$11,092,166	$587,804,579	$(37,744,665)	$550,059,914

Meritus Medical Center, Inc.

(formerly Meritus Health, Inc.)

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS

Year end June 30, 2013

	Meritus Medical Center	Meritus Holdings Consolidated	Meritus Insurance Company	Meritus Healthcare Foundation	Consolidating Total	Consolidating Entries	Consolidated Total
Unrestricted revenue, gains and other support:							
Net patient revenue	$292,884,909	$94,382,229	$ -	$ -	$387,267,138	$(16,403,753)	$370,863,385
Less provision for bad debts	(11,461,474)	(2,954,778)	-	-	(14,416,252)	-	(14,416,252)
Net patient service revenue less provision for bad debts	281,423,435	91,427,451	-	-	372,850,886	(16,403,753)	356,447,133
Other revenue	12,776,152	1,592,102	2,670,348	416,946	17,455,548	(4,454,537)	13,001,011
Equity earnings in affiliates	2,649,009	1,624,913	-	-	4,273,922	(1,362,244)	2,911,678
Net assets released from restriction used for operations	102,223	-	-	2,332,331	2,434,554	(259,782)	2,174,772
	296,950,819	94,644,466	2,670,348	2,749,277	397,014,910	(22,480,316)	374,534,594
Operating expenses							
Salaries and wages	108,219,378	36,543,710	-	288,491	145,051,579	-	145,051,579
Employee benefits	30,694,730	8,323,652	-	93,556	39,111,938	(1,010,276)	38,101,662
Professional fees	8,862,757	-	-	-	8,862,757	-	8,862,757
Supplies and other	100,471,678	48,567,857	2,652,035	333,379	152,024,949	(20,091,762)	131,933,187
Interest	14,901,396	55,187	-	-	14,956,583	2,619	14,959,202
Depreciation and amortization	22,736,407	1,423,260	-	11,345	24,171,012	-	24,171,012
	285,886,346	94,913,666	2,652,035	726,771	384,178,818	(21,099,419)	363,079,399
Operating income (loss) before other items	11,064,473	(269,200)	18,313	2,022,506	12,836,092	(1,380,897)	11,455,195
Other items							
Pension settlement costs	(11,291,050)	-	-	-	(11,291,050)	-	(11,291,050)
	(11,291,050)	-	-	-	(11,291,050)	-	(11,291,050)
Operating (loss) income	(226,577)	(269,200)	18,313	2,022,506	1,545,042	(1,380,897)	164,145
Non-operating gains (losses), net							
Investment returns, net	9,867,533	386,967	(18,313)	144,728	10,380,915	-	10,380,915
Other, net	(524,527)	-	-	(2,063,128)	(2,587,655)	(9,272)	(2,596,927)
Income tax benefit (expense)	(79)	1,116,412	-	-	1,116,333	-	1,116,333
Excess of revenue over expenses	9,116,350	1,234,179	-	104,106	10,454,635	(1,390,169)	9,064,466
Deficiency in revenue over expenses attributable to non-controlling interest	-	128,065	-	-	128,065	-	128,065
Excess of revenue over expenses attributable to Meritus	9,116,350	1,362,244	-	104,106	10,582,700	(1,390,169)	9,192,531

Meritus Medical Center, Inc.

(formerly Meritus Health, Inc.)

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS - CONTINUED

Year end June 30, 2013

	Meritus Medical Center	Meritus Holdings Consolidated	Meritus Insurance Company	Meritus Healthcare Foundation	Consolidating Total	Consolidating Entries	Consolidated Total
Other changes in unrestricted net assets							
Change in retirement benefit obligation	11,291,050	-	-	-	11,291,050	-	11,291,050
Change in non-controlling interest	-	(1,708,065)	-	-	(1,708,065)	-	(1,708,065)
Net assets released from restriction for property, plant and equipment	1,722,373	-	-	-	1,722,373	-	1,722,373
Increase (decrease) in unrestricted net assets	22,129,773	(345,821)	-	104,106	21,888,058	(1,390,169)	20,497,889
Temporarily restricted net assets							
Contributions	1,824,596	-	-	959,301	2,783,897	(1,824,596)	959,301
Net assets held by Meritus Healthcare Foundation, Inc.	(1,670,668)	-	-	-	(1,670,668)	1,670,668	-
Net assets released from restriction for property, plant and equipment	(1,722,373)	-	-	-	(1,722,373)	-	(1,722,373)
Net assets released from restriction for operations	(102,223)	-	-	(2,332,331)	(2,434,554)	259,782	(2,174,772)
(Decrease) increase in temporary restricted net assets	(1,670,668)	-	-	(1,373,030)	(3,043,698)	105,854	(2,937,844)
INCREASE (DECREASE) IN NET ASSETS	20,459,105	(345,821)	-	(1,268,924)	18,844,360	(1,284,315)	17,560,045
Net assets							
Beginning of year	198,677,109	25,018,835	271,061	12,327,677	236,294,682	(25,345,494)	210,949,188
End of year	$219,136,214	$24,673,014	$271,061	$11,058,753	$255,139,042	$(26,629,809)	$228,509,233

GrantThornton