Grant Thornton

Consolidated Financial Statements and Report of Independent Certified Public Accountants

The Washington County Health System, Inc. and Subsidiaries

June 30, 2010 and 2009

CONTENTS

Audit • Tax • Advisory

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Report of Independent Certified Public Accountants

To the Board of Directors
The Washington County Health System, Inc.

We have audited the accompanying consolidated balance sheets of The Washington County Health System, Inc. and its subsidiaries (the "System") at June 30, 2010 and 2009, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of Antietam Healthcare Foundation (the "Foundation"), which statements reflect total assets of approximately two percent of total consolidated assets at June 30, 2010 and 2009 and total revenues of approximately one percent of the related consolidated total revenues for the years then ended of the System. Those statements were audited by other auditors, whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Foundation, is based on the reports of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Washington County Health System, Inc. and its subsidiaries as of June 30, 2010 and 2009, and the results of its operations and changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 of the consolidated financial statements, the System changed the manner in which it accounts for non-controlling interests in 2010.

Grant Thornton LLP

Baltimore, Maryland
September 22, 2010

CONSOLIDATED FINANCIAL STATEMENTS

The Washington County Health System, Inc.
and Subsidiaries

CONSOLIDATED BALANCE SHEETS

June 30,

ASSETS	2010	2009
CURRENT ASSETS		
Cash and cash equivalents	$ 23,025,683	$ 19,781,549
Restricted cash	2,601,651	2,572,167
Short-term investments	4,731,657	4,587,393
Current portion of assets whose use is limited	21,671,087	17,152,451
Accounts receivable, net	41,385,245	45,647,620
Supplies	9,640,469	8,756,508
Prepaid and other current assets	5,749,191	5,608,361
Total current assets	108,804,983	104,106,049
EQUITY INVESTMENTS IN AFFILIATES	17,903,755	13,920,632
ASSETS WHOSE USE IS LIMITED		
Board designated funds	60,171,745	50,718,154
Supplemental retirement benefit investments	2,289,132	1,915,613
Temporarily and permanently restricted donor funds	924,031	813,569
	63,384,908	53,447,336
Assets held by trustee for debt service and construction	59,402,684	164,014,907
Funds designated for insurance purposes	8,565,266	7,347,639
	131,352,858	224,809,882
PROPERTY, PLANT AND EQUIPMENT, net	272,716,066	172,834,984
PLEDGES RECEIVABLE, net	3,484,189	3,796,976
DEFERRED FINANCING COSTS, net	2,937,209	3,183,681
OTHER ASSETS	2,968,844	3,450,947
Total assets	$540,167,904	$526,103,151

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

LIABILITIES AND NET ASSETS	2010	2009
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 13,441,802	$ 9,925,453
Construction and retainage payable	14,166,331	9,647,695
Accrued salaries, wages and withholdings	8,920,979	7,840,016
Accrued compensation benefit	15,014,599	14,313,900
Advances from third-party payors	6,663,875	6,073,679
Accrued interest payable	7,504,756	7,504,756
Current portion of long-term debt	6,067,114	5,532,503
Total current liabilities	71,779,456	60,838,002
LONG-TERM DEBT, net of current portion	273,591,018	275,799,960
ACCRUED RETIREMENT BENEFITS	7,632,028	11,333,898
ASSET RETIREMENT OBLIGATION	1,993,500	1,893,825
OTHER LONG-TERM LIABILITIES	3,500,265	10,056,067
Total liabilities	358,496,267	359,921,752
NET ASSETS		
Unrestricted		
System	170,208,396	153,538,350
Non-controlling interest	1,664,348	1,823,532
Total unrestricted net assets	171,872,744	155,361,882
Temporarily restricted	8,770,275	9,790,899
Permanently restricted	1,028,618	1,028,618
Total net assets	181,671,637	166,181,399
Total liabilities and net assets	$540,167,904	$526,103,151

The Washington County Health System, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS

Years ended June 30,

	2010	2009
Unrestricted revenue, gains and other support		
Net patient service revenue	$301,173,125	$291,062,842
Sales	28,884,376	28,909,335
Rental income, net of expense	2,056,141	1,835,489
(Loss) gain on disposal of assets	(384,413)	148,650
Other revenue	4,795,330	5,436,831
Equity earnings in affiliates	7,231,427	4,153,193
Net assets released from restriction used for operations	1,236,272	981,214
	344,992,258	332,527,554
Expenses		
Salaries and wages	138,625,975	134,329,206
Professional fees	9,781,100	10,427,459
Cost of goods sold	19,558,504	19,537,132
Supplies and other	141,454,848	130,981,438
Interest	621,399	1,085,425
Depreciation and amortization	16,366,229	15,486,584
Provision for bad debts	13,722,835	13,383,940
	340,130,890	325,231,184
Operating income before other items	4,861,368	7,296,370
Other items		
Early retirement costs	(1,451,379)	-
Transition costs	(706,986)	-
	(2,158,365)	-
Operating income	2,703,003	7,296,370
Non-operating gains (losses), net		
Investment returns, net	10,240,301	(9,650,067)
Other, net	(1,545,929)	(117,307)
Income tax expense	(1,194,992)	(1,238,204)
Excess of (deficiency in) revenue over expenses	10,202,383	(3,709,208)
Excess of revenue attributable to non-controlling interest	(300,815)	(378,314)
Excess of (deficiency in) revenue over expenses attributable to the System	9,901,568	(4,087,522)

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

	2010	2009
Other changes in unrestricted net assets		
Transfer from temporarily restricted net assets	2,946,776	119,741
Change in retirement benefit obligation	2,445,987	(12,230,178)
Change in non-controlling interests	(159,184)	365,390
Reversal of accumulated net unrealized gains or losses on investments from the adoption of fair value option	-	(3,266,334)
Other	1,375,715	1,475,891
Increase (decrease) in unrestricted net assets	16,510,862	(17,623,012)
Temporarily restricted net assets		
Contributions	3,142,588	5,181,362
Net realized and unrealized gains and losses on investments	19,836	32,556
Transfer to unrestricted net assets	(2,946,776)	(119,741)
Net assets released from restrictions	(1,236,272)	(981,214)
(Decrease) increase in temporarily restricted net assets	(1,020,624)	4,112,963
INCREASE (DECREASE) IN NET ASSETS	15,490,238	(13,510,049)
Net assets		
Beginning of year	166,181,399	179,691,448
End of year	$181,671,637	$166,181,399

The Washington County Health System, Inc.
and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended June 30,

	2010	2009
Cash flows from operating activities		
Increase (decrease) in net assets	$ 15,490,238	$ (13,510,049)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	16,366,229	15,486,584
Provision for bad debts	13,722,835	13,383,940
Change in retirement benefit obligation	(2,445,987)	12,230,178
Change in non-controlling interest	159,184	(365,390)
Net realized and unrealized (gains) losses on investments	(7,839,926)	14,181,645
Loss (gain) on disposal of assets	384,413	(148,650)
Equity earnings in affiliates	(7,231,427)	(4,153,193)
Asset retirement obligation	99,675	99,675
Changes in assets and liabilities		
Accounts receivable	(9,460,460)	(15,902,198)
Supplies, prepaid, and other current assets	(1,024,791)	(2,038,058)
Other assets	794,890	(2,403,898)
Accounts payable and accrued expenses	3,516,349	2,346,067
Accrued salaries, wages and withholdings	1,080,963	105,535
Accrued compensation benefit	700,699	1,301,462
Advances from third-party payors	590,196	237,896
Other long-term liabilities	(1,748,312)	731,304
Retirement benefits	(1,255,883)	(1,437,029)
Net cash provided by operating activities	21,898,885	20,145,821
Cash flows from investing activities		
Purchase of property, plant and equipment	(112,494,039)	(73,604,158)
Proceeds from the disposal of assets	217,886	1,088,795
Purchase of restricted cash, short-term investments, and assets whose use is limited	(529,195,760)	(893,383,395)
Sale of restricted cash, short-term investments, and assets whose use is limited	625,800,326	951,614,918
Equity investments to affiliates	3,248,304	2,523,473
Net cash used in investing activities	(12,423,283)	(11,760,367)

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

	2010	2009
Cash flows from financing activities		
Proceeds of long-term debt	700,000	400,000
Payments of long-term debt	(6,931,468)	(5,463,528)
Net cash used in financing activities	(6,231,468)	(5,063,528)
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,244,134	3,321,926
Cash and cash equivalents		
Beginning of year	19,781,549	16,459,623
End of year	$ 23,025,683	$ 19,781,549
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$ 952,024	$ 2,314,889
Cash paid for interest, net of amounts capitalized	621,399	1,085,425
Supplemental disclosure of non-cash investing and financing activities:		
Assets acquired under capital leases	$ 4,557,137	$ 3,495,383
(Decrease) increase in accrual for the purchase of property, plant and equipment	(201,566)	14,367,897

1. DESCRIPTION OF ORGANIZATION

Organization

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

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

Antietam is a for-profit corporation located in Hagerstown, Maryland and serves the residents of western Maryland, southern Pennsylvania, and the panhandle of West Virginia. Antietam is wholly owned by the Parent. Antietam provides ambulatory surgery, laboratory, pharmacy, and other health services.

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

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

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

AIC is a Cayman Island captive insurance company, wholly owned by the Parent that provides primary limits of insurance to the System for professional liability, employed physicians professional liability, and comprehensive general liability risks.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Parent, the Hospital, Antietam, the Fund, the Foundation, and AIC. Antietam owns a 60% interest in Robinwood Surgery Center, LLC, at June 30, 2010 and 2009, 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

The System 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Fair Value Measurements - continued

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

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

The System adopted the fair value option for its investments, excluding those accounted for by the equity method existing at July 1, 2008. Accordingly, the adoption as of June 30, 2009 required $3,266,334 of accumulated unrealized gains and losses previously unrecognized in the performance indicator (excess of (deficiency in) revenue over expenses) to be reclassified into the performance indicator, as a component of investment returns, net and on a go-forward basis record all unrealized gains and losses in the performance indicator, as a component of investment returns, net. This adoption, in 2009, had no effect on the amounts recorded in the consolidated balance sheet or on the decrease in net assets as these investments were previously recorded at fair value.

Allowance for Doubtful Accounts

The System provides an allowance for doubtful accounts for estimated losses resulting from the unwillingness or inability of patients 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 the System 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. The System entered into overnight investment repurchase transactions of $9,622,806 and $9,379,874 as of June 30, 2010 and 2009 respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Assets Whose Use is Limited

Assets whose use is limited include assets set aside by the Board of Directors for specific purposes that can be changed, for supplemental retirement benefit investments, to fulfill donor purposes, assets held by trustees under debt indenture agreements, 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.

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.

Prior to the System's adoption of the fair value option, the accounting for unrealized gains and losses on investments resulting from their measurement at fair value to the extent the losses were deemed temporary were excluded from excess of (deficiency in) revenue over expenses. A reduction in carry amount associated with the decline in fair value of an investment below its cost that was determined to be other-than temporary was charged to non-operating gains losses, net, and a new cost basis for that investment was established.

The System's 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 Antietam are valued at the lower of cost or market, with the cost being recorded on the first-in, first-out method.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Supplies - continued

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

	2010	2009
Durable medical equipment	$ 747,587	$ 502,349
Surgical and medical supplies	4,737,738	4,437,521
Other supplies	1,137,813	906,938
Pharmacy and home care infusion	2,515,780	2,409,310
Medical laboratory	501,551	500,390
	$9,640,469	$8,756,508

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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Property, Plant and Equipment - continued

The System 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, the System 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, 2010.

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, 2010 and 2009 were $588,000 and $1,024,398, respectively.

Compensated Absences

The System 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 the System has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the System in perpetuity.

Excess of (Deficiency in) Revenue over Expenses

The consolidated statements of operations include the excess of (deficiency in) revenue over expenses. Changes in unrestricted net assets that are excluded from the excess of (deficiency in) revenues over expenses, consistent with industry practice, include unrealized gains and losses on assets limited as to use and investments considered other than trading securities, to the extent losses are deemed temporary, prior to the adoption of fair value option of accounting, the change in retirement benefit obligation, change in non-controlling interest and other items.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Net Patient Service Revenue

For services provided at the Hospital campus, all payors are required to pay the Maryland Health Services Cost Review Commission ("HSCRC") approved rates. The major third-party payors, as recognized by the HSCRC, are allowed discounts of up to 6% on approved rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Contractual adjustments to patient service revenue were $82,503,967 and $74,067,152 for the years ended June 30, 2010 and 2009, respectively.

The Hospital's charges are subject to review and approval by the HSCRC. The Hospital management has filed the required forms with the HSCRC and believes the Hospital to be in compliance with HSCRC requirements. The total rate of reimbursement for services to patients under the Medicare and Medicaid programs is based on an arrangement between the Centers for Medicare and Medicaid Service and the HSCRC. Management believes that this program will remain in effect at least through June 30, 2011. The HSCRC methodology is a base period charge per admission that will be adjusted annually to reflect cost inflation plus an incentive factor during years when the net revenue per adjusted admission nationally is greater than cost inflation. For fiscal year 2010 and 2009, this methodology established a charge per admission cap of $8,684 and $8,463, respectively, for the Hospital, which is subject to adjustment for changes in hospital specific and state-wide case mix.

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 the System's net patient service revenue for the years ended June 30, 2010 and 2009. 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. The System 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.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Charity Care

The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The System does not pursue collection on amounts deemed to qualify as charity. The System estimates that $12,738,000 and $11,551,000 of charity care, based on established rates, was provided for the years ended June 30, 2010 and 2009, respectively.

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

The System 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 the System's policy.

Income Taxes

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

Antietam 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 AIC. In the event that such taxes are levied, AIC has been granted an exemption until September 9, 2023 for any such taxes that might be introduced. AIC intends to conduct its affairs so as not to be liable for taxes in any other jurisdiction.

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

Concentration of Credit Risk

The System 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. The System has experienced no losses on its deposits.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Concentration of Credit Risk - continued

The System 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, the System's patient accounts receivable were made up of the following:

	2010	2009
Health maintenance organizations	2%	6%
Medical assistance HMO	14	10
Medicare	26	28
Commercial insurance and other	23	25
Blue Cross/Blue Shield	18	21
Self-pay	17	10
	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 compensation benefit on the consolidated balance sheets.

Adoption of Accounting Pronouncements

In December 2008, the Financial Accounting Standards Board ("FASB") issued amended authoritative guidance for employers' disclosures about pensions and other postretirement benefits, which requires disclosures to provide users of financial statements an understanding of investment allocation decisions, major categories of plan assets, inputs and valuation techniques used to measure fair value of plan assets, effect of fair value measurements using significant unobservable inputs on changes in plan assets and significant concentrations of risk within plan assets. The guidance is effective for financial statements issued for fiscal years ending after December 15, 2009. The System adopted this guidance as of June 30, 2010 and did not have a material impact on the financial condition and results of operations; however the expanded disclosures are included in Note 10.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Adoption of Accounting Pronouncements - continued

Effective July 1, 2009, the System adopted new guidance related to non-controlling interests in the consolidated financial statements. The System's for profit entity, Antietam, was required to adopt this new standard. The adoption of this standard had no impact of the System's financial position, result of the operations or cash flows. The adoption did impact the System's financial statement presentation as minority interest for the System's for profit entity, Antietam, is now presented as a non-controlling interest as a separate component of net assets in the System's consolidated balance sheets at June 30, 2010 and 2009. Additionally, the excess of revenue attributable to non-controlling interest is reported below excess of (deficiency in) revenues over expenses in the System's consolidated statements of operations and changes in net assets.

Pending Accounting Pronouncements

In August 2010, the FASB issued amended authoritative guidance to reduce the diversity in practice regarding the measurement basis used in the identification and disclosure of charity care by health care entities. The amendments in this guidance require that cost be used as the measurement for charity care disclosure purposes and that cost be identified as the direct and indirect cost of providing the care. The guidance also requires entities to disclose their method used to identify or determine such costs. This authoritative guidance is effective for financial statements issued for fiscal years beginning after December 15, 2010 and should be applied retrospectively to all prior fiscal years presented. Early application is permitted. The System has not early adopted this guidance, but plans to adopt it for the year ending June 30, 2011. The new guidance is not expected to affect the results of operations or financial position, however changes to the charity care disclosures will be required.

In August 2010, the FASB issued amended authoritative guidance to reduce the diversity in practice related to the accounting by health care entities for medical malpractice claims and similar liabilities, and their related expected insurance recoveries. The amendments in this guidance state that insurance claims liabilities should be determined without consideration of any expected insurance recoveries, consistent with practice in other industries, and clarifies that health care entities should no longer net expected insurance recoveries against the related claims liabilities, thus recognizing their gross exposure in the financial statements. This authoritative guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. A cumulative-effect adjustment should be recognized in opening equity in the period of adoption if a difference exists between any liabilities and insurance receivables recorded as a result of applying the amendments in this guidance. Retrospective and early applications are also permitted. The System has not early adopted this guidance, but plans to adopt it for the year ending June 30, 2011. The System is evaluating the impact of adopting this guidance.

Reclassifications

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Subsequent Events

The System evaluated subsequent events through September 22, 2010 the date of these consolidated financial statements were available to be issued. All material matters are disclosed in the footnotes to the consolidated financial statements.

3. INVESTMENTS AND INVESTMENT INCOME

Investments at June 30 consisted of the following:

	2010		2009	
	Cost	Fair Value	Cost	Fair Value
Short-term investments				
U.S. government securities	$ 4,731,657	$ 4,731,657	$ 4,587,393	$ 4,587,393
Assets whose use is limited				
Cash and cash equivalents	$ 1,751,515	$ 1,751,515	$ 1,944,282	$ 1,942,267
Fixed income	25,950,191	26,656,119	18,171,529	13,754,094
Common stock	35,525,615	32,688,142	25,880,678	21,048,108
Mutual funds	2,289,132	2,289,132	20,226,492	16,702,867
	$65,516,453	$63,384,908	$ 66,222,981	$ 53,447,336
Assets held by trustee for debt service and construction				
U.S. government securities	$81,898,999	$81,073,771	$181,066,671	$181,167,358
Funds designated for insurance purposes				
Fixed income	$ 8,180,476	$ 8,565,266	$ 7,276,363	$ 7,347,639

The System had restricted cash of $2,601,651 and $2,572,167 as of June 20, 2010 and 2009, 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.

3. INVESTMENTS AND INVESTMENT INCOME - Continued

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

	2010	2009
Investment returns, net:		
Interest and dividends, net of investment fees of $206,240 and $161,140 in 2010 and 2009, respectively	$ 2,420,211	$ 1,297,800
Net realized losses on investments	(3,171,432)	(3,422,490)
Change in unrealized gains and losses on investments	10,991,522	(10,791,711)
Recognition of accumulated net unrealized gains and losses in investments from the adoption of fair value option	-	3,266,334
	$10,240,301	$ (9,650,067)

4. FAIR VALUE MEASUREMENTS

The following table presents the System's assets measured at fair value on a recurring basis, aggregated by level in the fair value hierarchy within which those measurements fall, as of June 30:

	Fair Value Measurements Using			
	Total	Level 1	Level 2	Level 3
2010:				
Cash and cash equivalents	$ 23,025,683	$ 23,025,683	$ -	$ -
Restricted cash	2,601,651	2,601,651	-	-
Short-term investments	4,731,657	4,731,657	-	-
Assets whose use is limited	153,023,945	153,023,945	-	-
Total assets	$183,382,936	$183,382,936	$ -	$ -
2009:				
Cash and cash equivalents	$ 19,781,549	$ 19,781,549	$ -	$ -
Restricted cash	2,572,167	2,572,167	-	-
Short-term investments	4,587,393	4,587,393	-	-
Assets whose use is limited	241,962,333	220,452,930	21,509,403	-
Total assets	$268,903,442	$247,394,039	$21,509,403	$ -

The System does not have any Level 3 financial instruments as of June 30, 2010 and 2009.

4. FAIR VALUE MEASUREMENTS - Continued

Pledges receivable are non-recurring fair value measurements. Any multi-year pledge received in fiscal year 2010 and 2009 are recorded at the present value of future cash flows with a discount rate adjusted for any market conditions to arrive at fair value.

5. ACCOUNTS RECEIVABLE

Accounts receivable at June 30 consists of the following:

	2010	2009
Patient accounts	$46,712,574	$52,639,813
Less: Contractual allowance	(5,957,119)	(6,280,941)
Less: Allowance for doubtful accounts	(2,995,908)	(3,995,971)
	37,759,547	42,362,901
Other receivables	3,625,698	3,284,719
	$41,385,245	$45,647,620

Pledges receivable at June 30 consist of the following:

	2010	2009
Capital campaign	$6,718,696	$6,217,294
Other	149,331	197,563
Total unconditional promises to give	6,868,027	6,414,857
Receivable in less than one year	2,563,506	1,461,453
Receivable in one to five years	4,302,521	4,939,118
Receivable in more than five years	2,000	14,286
Total unconditional promises to give	6,868,027	6,414,857
Less discounts to net present value	(604,155)	(693,825)
Less allowance for uncollectible promises	(591,262)	(538,535)
Net unconditional promises to give	$5,672,610	$5,182,497
Pledges receivable, current portion included in other receivables	$2,188,421	$1,385,521
Pledges receivable, net of current portion	3,484,189	3,796,976
	$5,672,610	$5,182,497

6. PROPERTY, PLANT AND EQUIPMENT

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

	2010	2009
Land	$ 12,729,449	$ 10,381,732
Buildings, and improvements used in operations	50,703,933	50,315,775
Buildings used in rental operations	22,008,861	22,008,836
Equipment	139,779,304	134,643,269
	225,221,547	217,349,612
Less accumulated depreciation and amortization	(167,689,232)	(151,362,702)
	57,532,315	65,986,910
Construction in progress	187,591,201	92,983,047
Capitalized interest, net	27,592,550	13,865,027
Property, plant and equipment, net	$272,716,066	$172,834,984

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

	2010	2009
Equipment	$16,951,834	$18,701,588
Less accumulated amortization	(8,456,786)	(6,765,843)
	$ 8,495,048	$11,935,745

Total depreciation and amortization expense for the years ended June 30, 2010 and 2009 was $16,007,992 and $15,486,584, respectively.

The System, through the Hospital is in the construction phase of a replacement hospital, which is expected to open in December 2010. The total project cost is estimated to be $293,836,000, of which $153,300,000 has not been incurred as of June 30, 2010. As part of the transition to the replacement hospital, the Hospital expects to incur costs estimated to be $3,400,000, of which $2,700,000 has not been incurred as of June 30, 2010.

The System has a conditional asset retirement obligation (CARO) of $1,993,500 and $1,893,825 at June 30, 2010 and 2009, respectively, that relates to the removal and disposal of asbestos and 2 underground fuel storage tanks. The current assessment is that the CARO would be triggered within the next 2 years annually there is an accretion of $99,675 made in the consolidated statements of operations and changes in net assets.

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 health care services.

Antietam has a 50% interest in Diagnostic Imaging, which provides radiology imaging services, has a 33.33% interest in Western Maryland Supply, LLC, which provides durable medical equipment for rental or purchase, and has a 33.33% share in Mid-Maryland Medical Transport ("MMMT"), which provides non-emergency medical transports between healthcare facilities as well as to and from patient homes and assisted living facilities. MMMT ceased operations and was sold to a third party in July 2009. Endoscopy Center at Robinwood, LLC, an ambulatory center for gastroenterology procedures, and Endoscopy Real Estate are 50% owned by Robinwood Surgery Center, LLC. GI Real Estate provides rental property to a group of health care practitioners.

Summary financial information as of June 30, 2010 and 2009 and for the years then ended appears below for the significant equity investments:

	Hospital Maryland Care, Inc.		Hospital Tri-State Health Partners	
	2010	2009	2010	2009
Assets	$153,148,063	$123,192,856	$2,938,648	$2,497,021
Liabilities	99,897,376	84,198,775	352,616	203,868
Equity	$ 53,250,687	$ 38,994,081	$2,586,032	$2,293,153
Net income	$ 14,053,869	$ 3,281,451	$ 238,478	$ 71,790

7. EQUITY INVESTMENTS IN AFFILIATES - Continued

	Antietam Diagnostic Imaging Services, LLC		Antietam MMMT	
	2010	2009	2010	2009
Assets	$ 12,124,040	$ 11,559,759	$ 362,673	$ 945,897
Liabilities	4,736,016	4,469,150	218,457	441,779
Equity	$ 7,388,024	$ 7,090,609	$ 144,216	$ 504,118
Net income (loss)	$ 3,697,415	$ 3,510,951	$ 112,442	$ (278,180)

	Antietam Endoscopy Center at Robinwood, LLC		Antietam Endoscopy Real Estate	
	2010	2009	2010	2009
Assets	$ 635,632	$ 925,970	$ 1,206,908	$1,166,143
Liabilities	119,120	169,152	1,269,461	777,674
Equity (deficiency)	$ 516,512	$ 756,818	$ (62,553)	$ 388,469
Net income	$ 2,150,494	$ 1,975,875	$ 74,044	$ 93,106

	Antietam GI Real Estate		Western Maryland Medical Supply, LLC	
	2010	2009	2010	2009
Assets	$ 597,843	$ 627,244	$ 1,343,175	$1,159,443
Liabilities	456,459	501,495	407,122	247,735
Equity	$ 141,384	$ 125,749	$ 936,053	$ 911,708
Net income (loss)	$ 25,635	$ 22,042	$ 24,345	$ (15,743)

8. LONG-TERM DEBT

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

	2010	2009
MHHEFA Revenue Bonds		
Series 2008 4.00% - 6.00% serial bonds	$264,300,000	$264,300,000
2001 Taxable Note B to Bank of America	3,515,169	4,592,784
7.75% mortgage loan	504,000	544,320
City of Hagerstown note	193,824	212,764
Mortgages and equipment loans with banks, with interest rates ranging from 2.3% to 7.5%	2,513,114	2,534,683
Capital lease obligations, with interest rates ranging from 2.9% to 5.0%	9,965,078	10,592,730
Unamortized Series 2008 original issue bond discounts	(1,333,053)	(1,444,818)
	279,658,132	281,332,463
Less current portion of long-term debt	(6,067,114)	(5,532,503)
	$273,591,018	$275,799,960

The System 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 $225,655,000 and $207,748,000 at June 30, 2010 and 2009, respectively.

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

The long-term debt related to the Series 2008 bonds is reflected in the consolidated financial statements net of the unamortized original issue bond discounts. The original issue bond discounts are being amortized over the life of the debt and is 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 the System, except restricted donations and contributions. In connection with the Series 2008 Bonds, MHHEFA has a Security interest in existing facilities of the System. All bonds require the Obligated Group, which consists of the System, the Hospital, and the Fund, to maintain certain financial ratios and stipulated insurance coverage as defined. The System was in compliance with these covenants at June 30, 2010 and 2009.

8. LONG-TERM DEBT - Continued

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

The 2001 Taxable Note B to Bank of America was issued for the construction of the Robinwood Medical Center III. The taxable portion of the debt requires monthly principal payments of $82,701 through February 1, 2014. The interest is calculated and payable monthly based upon the outstanding principal balance at the time. The variable interest rates were 1.35% and 1.31%, as of June 30, 2010 and 2009, respectively. The bonds may be repaid, at the option of the System, in part or in full at any time with 30 days notice. The bonds are collateralized by a mortgage of the real property of both the Fund and the Hospital.

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

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
2011	$ 1,862,918	$ 4,535,836
2012	4,972,624	3,955,771
2013	4,861,631	1,034,899
2014	4,496,877	554,377
2015	4,059,418	182,377
Thereafter	250,772,639	306,481
	$271,026,107	10,569,741
Less amount representing interest		(604,663)
		$ 9,965,078

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, 2010 and 2009.

8. LONG-TERM DEBT - Continued

Antietam 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, 2010 and 2009.

Capitalized Interest

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

	2010	2009
Interest cost:		
Capitalized	$15,076,522	$15,067,352
Investment income:		
Capitalized	$ 1,348,999	$ 6,090,891

9. INCOME TAXES

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

	2010	2009
Current:		
Federal	$1,325,274	$1,120,174
State	401,702	332,525
	1,726,976	1,452,699
Deferred:		
Federal	(461,437)	(214,495)
State	(70,547)	-
	(531,984)	(214,495)
	$1,194,992	$ 1,238,204

9. INCOME TAXES - Continued

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

	2010	2009
Deferred tax asset:		
Accrued vacation	$1,200,527	$1,212,844
Deferred compensation	451,881	780,736
Captive insurance premiums	169,798	222,617
Allowance for bad debts	512,394	124,959
Other	216,635	355,842
	2,551,235	2,696,998
Deferred tax liabilities:		
Fixed assets and intangible assets	(673,520)	(611,073)
Partnership basis	(33,472)	(14,515)
	(706,992)	(625,588)
	$1,844,243	$2,071,410

10. POST RETIREMENT BENEFIT PLANS

The Hospital has a 403(b) defined contribution plan available to all employees. Employees can receive up to 50% matching contributions, up to 6% of employee's salary based upon meeting years of service requirements, subject to the annual IRS limitations. Contributions made to the plan by the Hospital on behalf of employees were $3,264,242 and $2,123,071 in 2010 and 2009, respectively.

Antietam has an employee savings plan under Section 401(k) of the Internal Revenue Code available to all employees. Antietam matches employee contributions for an amount up to 6% of each employee's base salary, subject to limitations, depending upon the length of service with Antietam. Antietam's contributions vest after the first three years of service. Amounts charged to expense were $1,837,989 and $1,740,843 in 2010 and 2009, respectively. Antietam also makes discretionary contributions to eligible employees of 1.0% of total compensation in 2010 and 2009, which also vests after the first three years of service. In 2010 and 2009, this amount was $330,263 and $309,599, respectively.

Antietam maintains an employee funded supplemental non-qualified retirement plan for certain employees. The plan requires the benefits be paid upon termination, retirement or death. The related liability is $2,453,016 and $1,989,428 at June 30, 2010 and 2009, respectively. Management has designated investments for the intended purpose of funding the liability when payable.

10. POST RETIREMENT BENEFIT PLANS - Continued

The System maintains a cash balance pension plan ("Plan"), that was frozen for all participants, effective March 31, 2009. The Plan covered substantially all current Hospital employees and maintains the balance for Antietam employees previously employed by the Hospital. Benefits under the plan are generally based on the participant's age, years of service and compensation levels. Annual contributions are made to the plan in accordance with the Employee Retirement Income Security Act of 1974 ("ERISA") regulations. Employees are fully vested after five years of service.

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

	2010	2009
Change in benefit obligation:		
Benefit obligation at beginning of year	$43,649,864	$40,632,559
Curtailment gain	-	(738,684)
Amendment	-	246,634
Service cost	-	1,525,103
Interest cost	2,642,651	2,645,874
Actuarial loss	1,504,560	1,652,908
Benefits paid	(1,954,306)	(2,314,530)
Benefit obligation at end of year	$45,842,769	$43,649,864
Change in plan assets:		
Fair value of plan assets at beginning of year	$34,305,409	$42,084,321
Actual return on plan assets	5,687,654	(7,964,382)
Contributions	2,625,000	2,500,000
Benefits paid	(1,954,306)	(2,314,530)
Fair value of plan assets at end of year	$40,663,757	$34,305,409
Amounts recognized in the consolidated balance sheet consist of:		
Net amount recognized - accrued retirement benefits	$ (5,179,012)	$ (9,344,455)
Amounts recognized in unrestricted net assets consist of:		
Net actuarial loss	$11,685,043	$ 13,901,212
Prior service cost	232,053	461,856
Net amount recognized in unrestricted net assets	$11,917,096	$ 14,363,068
Change in amounts recognized in unrestricted net assets	$ 2,445,972	$(12,230,178)

The accumulated benefit obligation is $45,842,769 and $43,649,864 at June 30, 2010 and 2009, respectively.

10. POST RETIREMENT BENEFIT PLANS - Continued

Amounts in unrestricted net assets expected to be recognized as components of net periodic benefit cost for the year ending June 30, 2011 are prior service costs of $229,803 and actuarial losses of $824,555.

	2010	2009
Net periodic benefit cost:		
Service cost	$ -	$ 1,525,103
Interest cost	2,642,651	2,645,874
Expected return on plan assets	(2,770,060)	(3,334,741)
Prior service cost	1,032,938	229,803
	$ 905,529	$ 1,066,039

Assumptions

	2010	2009
Weighted-average assumptions used to determine benefit obligations as of June 30:		
Discount rate	5.65%	6.25%
Rate of compensation increase	N/A	4.00%
Measurement date	June 30	June 30
Weighted-average assumptions used to determine net periodic benefit cost for the years ended June 30:		
Discount rate	6.25%	6.58%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase	N/A	4.00%

Basis for Expected Long-Term Rate of Return

	Target Allocation	Expected Return	Weighted Return
Asset class:			
Equities	60%	9.5%	5.7%
Fixed income	40%	5.5%	2.2%
Total Expected Return			7.9%

10. POST RETIREMENT BENEFIT PLANS - Continued

Plan Assets

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

	2010	2009
Asset category:		
Equity securities	54%	52%
Fixed income	45%	47%
Cash and cash equivalent	1%	1%
	100%	100%

Description of Investment Policies and Strategies

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

The Investment Manager May Not

1. Hold more than 20% of the Investment Account's equity portion in securities of issuers deemed to be in the same industry group (as defined by Standard and Poor's Corporation).

2. Hold any one single equity security whose allocation represents more than 10% of the total Investment Account's market value or more than 10% of the equity portion of the Investment Account's market value.

3. When fully vested, hold less than 15 different equity securities.

4. Purchase private placements or letter stock.

5. Hold any non-U.S. dollar equity or fixed income securities.

6. Sell any securities short or trade on margin.

10. POST RETIREMENT BENEFIT PLANS - Continued

The Investment Manager May Not - continued

7. Hold any real estate.

8. Hold or purchase any tobacco company securities after 1/1/97 unless held in co-mingled funds, including the following:

   a. Philip Morris
   b. R.J. Reynolds Holdings
   c. American Brands
   d. B.A.T. Industries
   e. Culbro Corporation
   f. Imasco Ltd.
   g. UST Inc.
   h. Universal Corp.

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 as of June 30, 2010:

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

(1) The three valuation techniques available to be used by the System are as follows: market approach ("M"), cost approach ("C"), and income approach ("I").

Contributions

Expected contributions to the plan for the year ending June 30, 2011 are $2,700,000.

10. POST RETIREMENT BENEFIT PLANS - Continued

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid from the Plan in years ending June 30:

2011	$ 2,291,539
2012	2,716,236
2013	3,572,699
2014	2,648,660
2015	3,967,500
2016 - 2020	17,752,621
	$32,949,255

11. INSURANCE COVERAGE

The Parent established a wholly owned insurance captive, AIC to provide primary limits of insurance of $1 million per occurrence/$3 million aggregate for professional and general liability. The professional liability coverage is provided on a claims-made basis. In addition, AIC purchased reinsurance from an A rated re-insurer in the amount of $15 million to cover any potential liabilities above the $1 million/$3 million primary limits, which were covered by AIC. The self-insured liabilities for professional and general are discounted at 4% as determined by an actuary were $4,911,145 and $3,369,039 as of June 30, 2010 and 2009, respectively and are included in other liabilities in the consolidated balance sheets.

11. INSURANCE COVERAGE - Continued

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.

	2010	2009
Reserves for losses and loss adjustment expenses at beginning of year	$3,369,039	$2,723,498
Less: reinsurance recoverable on unpaid claims	(451,099)	(401,593)
Net reserves for losses and loss adjustment expenses at beginning of year	2,917,940	2,321,905
Incurred related to:		
Current year	1,273,608	1,017,517
Prior years	1,056,876	251,698
Total losses and loss adjustment expenses incurred, net of reinsurance recoverable	2,330,484	1,269,215
Paid related to:		
Current year	(86,750)	(2,016)
Prior years	(837,254)	(671,164)
Total losses and loss adjustment expenses paid	(924,004)	(673,180)
Net reserves for losses and loss adjustment expenses at end of year	4,324,420	2,917,940
Add: reinsurance recoverable on unpaid claims	586,725	451,099
Reserves for losses and loss adjustment expenses at end of year	$4,911,145	$3,369,039

12. COMMITMENTS AND CONTINGENCIES

Operating Lease Obligations

The System leases equipment under non-cancelable lease arrangements. In addition, the System leases office space in several locations under operating leases. Some of the leases provide for renewal options. Rent expense under all operating leases was $5,217,465 and $3,661,539 for the years ended June 30, 2010 and 2009, respectively.

12. COMMITMENTS AND CONTINGENCIES - Continued

Operating Lease Obligations - continued

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

2011	$ 5,037,399
2012	4,267,714
2013	3,518,832
2014	2,348,131
2015	1,564,627
Total minimum payments	$16,736,703

Rental Properties

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

2011	$221,233
2012	92,254
2013	44,944
2014	44,944
2015	18,727
Total	$422,102

Litigation

The System 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 the System’s 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:

	2010	2009
Temporarily restricted for financial support of patients and hospital programs	$4,827,012	$5,033,747
Capital campaign	3,943,263	4,757,152
	$8,770,275	$9,790,899
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

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose of indigent care in the amounts of $74,376 and $47,604 in 2010 and 2009, respectively.

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose of health care education in the amounts of $664,694 and $477,646 in 2010 and 2009, respectively.

14. FUNCTIONAL EXPENSES

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

	2010	2009
Health care services	$321,733,868	$309,012,050
Fundraising	329,366	421,694
Administration	18,067,656	15,797,440
Total expenses	$340,130,890	$325,231,184

SUPPLEMENTARY INFORMATION

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Report of Independent Certified Public Accountants
Supplementary Information

To the Board of Directors
Washington County Health System, Inc.

Our audit of the consolidated financial statements of The Washington County Health System, Inc. and its subsidiaries for the year ended June 30, 2010 was conducted for the purpose of forming an opinion on the consolidated financial statements. The following consolidating balance sheet and consolidating statement of operations and changes in net assets are presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, are fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Grant Thornton LLP

Baltimore, Maryland
September 22, 2010

The Washington County Health System, Inc. and Subsidiaries

CONSOLIDATING BALANCE SHEET

June 30, 2010

ASSETS	The Washington County Hospital Association, Inc.	The Washington County Hospital Endowment Fund, Inc.	The Washington County Health System, Inc.	Washington County Heath Systems Obligated Group Consolidating Adjustments	Washington County Heath Systems Obligated Group	Antietam Health Services, Inc. and Subsidiaries	Antietam Insurance Company, Ltd.	Antietam Healthcare Foundation	Eliminations	The Washington County Health System, Inc. and Subsidiaries
CURRENT ASSETS										
Cash and cash equivalents	$ 12,892,774	$ 1,019,177	$ 99,615	$ (10,956)	$ 14,000,610	$ 7,885,455	$ 994,894	$ 133,768	$ 10,956	$ 23,025,683
Restricted cash	2,601,651	-	-	-	2,601,651	-	-	-	-	2,601,651
Short-term investments	4,731,657	-	-	-	4,731,657	-	-	-	-	4,731,657
Current portion of assets whose us is limited	21,671,087	-	-	-	21,671,087	-	-	-	-	21,671,087
Accounts receivable, net	32,272,912	-	4,610,896	(494,640)	36,389,168	7,350,527	68,025	2,188,421	(4,610,896)	41,385,245
Due from related parties, net	661,379	-	-	-	661,379	926,599	-	-	(1,587,978)	-
Supplies	5,534,418	-	-	-	5,534,418	4,106,051	-	-	-	9,640,469
Prepaid expenses and other current assets	2,693,526	296,015	-	-	2,989,541	2,625,140	113,566	20,944	-	5,749,191
Total current assets	83,059,404	1,315,192	4,710,511	(505,596)	88,579,511	22,893,772	1,176,485	2,343,133	(6,187,918)	108,804,983
EQUITY INVESTMENTS IN AFFILIATES	13,106,936	-	3,378,009	20,252,781	36,737,726	4,271,979	-	-	(23,105,950)	17,903,755
ASSETS WHOSE USE IS LIMITED										
Board designated funds	23,529,032	28,736,761	1,975,914	-	54,241,707	-	-	5,930,038	-	60,171,745
Supplemental retirement benefit investments	-	-	-	-	-	2,289,132	-	-	-	2,289,132
Temporarily and permanently restricted donor funds	924,031	-	-	-	924,031	-	-	-	-	924,031
	24,453,063	28,736,761	1,975,914	-	55,165,738	2,289,132	-	5,930,038	-	63,384,908
Assets held by trustee for debt service fund construction	59,402,684	-	-	-	59,402,684	-	-	-	-	59,402,684
Funds designated for insurance purposes	-	-	-	-	-	-	8,565,266	-	-	8,565,266
	83,855,747	28,736,761	1,975,914	-	114,568,422	2,289,132	8,565,266	5,930,038	-	131,352,858
PROPERTY, PLANT AND EQUIPMENT, net	242,146,761	19,782,634	-	(2,347,717)	259,581,678	10,760,248	-	26,423	2,347,717	272,716,066
PLEDGES RECEIVABLE, net	-	-	-	-	-	-	-	3,484,189	-	3,484,189
DEFERRED FINANCING COSTS, net	2,902,099	35,110	-	-	2,937,209	-	-	-	-	2,937,209
OTHER ASSETS	2,209,338	-	-		2,209,338	172,781	586,725	-	-	2,968,844
DUE FROM RELATED PARTIES	8,680,885	-	-	(4,913,092)	3,767,793	-	-	-	- (3,767,793)	-
Total assets	$435,961,170	$49,869,697	$10,064,434	$12,486,376	$508,381,677	$40,387,912	$10,328,476	$11,783,783	$(30,713,944)	$540,167,904

The Washington County Health System, Inc. and Subsidiaries

CONSOLIDATING BALANCE SHEET - CONTINUED

June 30, 2010

LIABILITIES AND NET ASSETS	The Washington County Hospital Association, Inc.	The Washington County Hospital Endowment Fund, Inc.	The Washington County Health System, Inc.	Washington County Heath Systems Obligated Group Consolidating Adjustments	Washington County Heath Systems Obligated Group	Antietam Health Services, Inc. and Subsidiaries	Antietam Insurance Company, Ltd.	Antietam Healthcare Foundation	Eliminations	The Washington County Health System, Inc. and Subsidiaries
CURRENT LIABILITIES										
Accounts payable and accrued expenses	$ 7,234,063	$ 232,662	$ 4,991	$ -	$ 7,471,716	$ 3,736,493	$ 1,946,253	$ 287,340	$ -	$ 13,441,802
Construction and retainage payable	14,166,331	-	-	-	14,166,331	-	-	-	-	14,166,331
Due to related parties, net	-	39,870	146,385	-	186,255	288	-	25,334	(211,877)	-
Accrued salaries, wages and withholdings	6,719,329	-	-	-	6,719,329	2,201,650	-	-	-	8,920,979
Accrued compensation benefits	10,792,726	-	-	-	10,792,726	4,185,359	-	36,514	-	15,014,599
Advances from third-party payors	6,663,875	-	-	-	6,663,875	-	-	-	-	6,663,875
Accrued interest payable	7,504,756	-	-	-	7,504,756	-	-	-	-	7,504,756
Current portion of long-term debt	4,222,043	1,527,367	-	(534,960)	5,214,450	1,000,494	-	-	(147,830)	6,067,114
Total current liabilities	57,303,123	1,799,899	151,376	(534,960)	58,719,438	11,124,284	1,946,253	349,188	(359,707)	71,779,456
LONG-TERM DEBT, net of current portion	268,903,804	7,899,534	-	(5,376,772)	271,426,566	2,013,841	-	-	150,611	273,591,018
ACCRUED RETIREMENT BENEFITS	5,179,012	-	-	-	5,179,012	2,453,016	-	-	-	7,632,028
ASSET RETIREMENT OBLIGATION	1,993,500	-	-	-	1,993,500	-	-	-	-	1,993,500
OTHER LONG-TERM LIABILITIES	-	-	-	-	-	-	8,111,161	-	(4,610,896)	3,500,265
Total liabilities	333,379,439	9,699,433	151,376	(5,911,732)	337,318,516	15,591,141	10,057,414	349,188	(4,819,992)	358,496,267
STOCKHOLDERS' EQUITY										
Common stock	-	-	-	-	-	700,000	120,000	-	(820,000)	-
Paid-in capital	-	-	-	-	-	1,150,080	-	-	(1,150,080)	-
Retained earnings	-	-	-	-	-	21,282,343	151,062	-	(21,433,405)	-
Non-controlling interest	-	-	-	-	-	1,664,348	-	-	(1,664,348)	-
Total stockholders' equity	-	-	-	-	-	24,796,771	271,062	-	(25,067,833)	-
NET ASSETS										
Unrestricted										
System	97,723,567	40,170,264	9,913,058	18,398,108	166,204,997	-	-	2,726,073	1,277,326	170,208,396
Non-controlling interest	-	-	-	-	-	-	-	-	1,664,348	1,664,348
Total unrestricted net assets	97,723,567	40,170,264	9,913,058	18,398,108	166,204,997	-	-	2,726,073	2,941,674	171,872,744
Temporarily restricted	3,829,546	-	-	-	3,829,546	-	-	8,708,522	(3,767,793)	8,770,275
Permanently restricted	1,028,618	-	-	-	1,028,618	-	-	-	-	1,028,618
Total net assets	102,581,731	40,170,264	9,913,058	18,398,108	171,063,161	-	-	11,434,595	(826,119)	181,671,637
Total liabilities and net assets	$435,961,170	$49,869,697	$10,064,434	$12,486,376	$508,381,677	$40,387,912	$10,328,476	$11,783,783	$(30,713,944)	$540,167,904

The Washington County Health System, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS

Year end June 30, 2010

	The Washington County Hospital Association, Inc.	The Washington County Hospital Endowment Fund, Inc.	The Washington County Health System, Inc.	Washington County Heath Systems Obligated Group Consolidating Adjustments	Washington County Heath Systems Obligated Group	Antietam Health Services, Inc. and Subsidiaries	Antietam Insurance Company, Ltd.	Antietam Healthcare Foundation	Eliminations	The Washington County Health System, Inc. and Subsidiaries
Unrestricted revenue, gains and other support										
Net patient service revenue	$249,825,207	$ -	$ -	$ -	$249,825,207	$ 61,486,791	$ -	$ -	$(10,138,873)	$301,173,125
Sales	-	-	-	-	-	33,064,754	-	-	(4,180,378)	28,884,376
Rental income, net of expense	-	2,056,141	-	-	2,056,141	-	-	-	-	2,056,141
(Loss) gain on disposal of assets	(385,872)	-	-	-	(385,872)	1,459	-	-	-	(384,413)
Other revenue	2,326,841	-	(362,067)	-	1,964,774	3,274,387	1,495,061	1,136,416	(3,075,308)	4,795,330
Equity earnings in affiliates	3,712,134	-	657,351	1,315,722	5,685,207	2,861,942	-	-	(1,315,722)	7,231,427
Net assets released from restriction used for operations	459,878	-	-	-	459,878	-	-	1,307,585	(531,191)	1,236,272
	255,938,188	2,056,141	295,284	1,315,722	259,605,335	100,689,333	1,495,061	2,444,001	(19,241,472)	344,992,258
Expenses										
Salaries and wages	101,808,554	-	-	-	101,808,554	36,306,033	-	511,388	-	138,625,975
Professional fees	8,781,293	-	-	-	8,781,293	999,807	-	-	-	9,781,100
Cost of goods sold	-	-	-	-	-	23,195,433	-	-	(3,636,929)	19,558,504
Supplies and other	116,737,420	449,808	220,315	455,675	117,863,218	34,856,647	2,122,564	(13,353)	(13,374,228)	141,454,848
Interest	485,925	7,300	-	(40,622)	452,603	128,174	-	-	40,622	621,399
Depreciation and amortization	13,877,188	890,284	-	-	14,767,472	1,592,257	-	6,500	-	16,366,229
Provision for bad debts	12,369,458	-	-	-	12,369,458	1,353,377	-	-	-	13,722,835
	254,059,838	1,347,392	220,315	415,053	256,042,598	98,431,728	2,122,564	504,535	(16,970,535)	340,130,890
Operating income (loss) before other items	1,878,350	708,749	74,969	900,669	3,562,737	2,257,605	(627,503)	1,939,466	(2,270,937)	4,861,368
Other items										
Early retirement costs	(1,337,668)	-	-	-	(1,337,668)	(113,711)	-	-	-	(1,451,379)
Transition costs	(706,986)	-	-	-	(706,986)	-	-	-	-	(706,986)
Operating income (loss)	(166,304)	708,749	74,969	900,669	1,518,083	2,143,894	(627,503)	1,939,466	(2,270,937)	2,703,003
Non-operating gains (losses)										
Investment returns, net	3,508,372	4,174,130	290,481	(9)	7,972,974	642,221	627,503	997,594	9	10,240,301
Other, net	(325,095)	-	(661,881)	480,709	(506,267)	25,414	-	(1,954,635)	889,559	(1,545,929)
Income tax expense	-	-	-	-	-	(1,194,992)	-	-	-	(1,194,992)
Excess of (deficiency in) excess of revenue over expenses	3,016,973	4,882,879	(296,431)	1,381,369	8,984,790	1,616,537	-	982,425	(1,381,369)	10,202,383
Excess of revenue attributable to non-controlling interest	-	-	-	-	-	(300,815)	-	-	-	(300,815)
Excess of (deficiency in) revenue over expenses attributable to the System	3,016,973	4,882,879	(296,431)	1,381,369	8,984,790	1,315,722	-	982,425	(1,381,369)	9,901,568

The Washington County Health System, Inc. and Subsidiaries

CONSOLIDATED STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS - CONTINUED

Year end June 30, 2010

	The Washington County Hospital Association, Inc.	The Washington County Hospital Endowment Fund, Inc.	The Washington County Health System, Inc.	Washington County Heath Systems Obligated Group Consolidating Adjustments	Washington County Heath Systems Obligated Group	Antietam Health Services, Inc. and Subsidiaries	Antietam Insurance Company, Ltd.	Antietam Healthcare Foundation	Eliminations	The Washington County Health System, Inc. and Subsidiaries
Other change in unrestricted net assets										
Transfer from temporarily restricted net assets	2,946,776	-	-	-	2,946,776	-	-	-	-	2,946,776
Change in pension benefit obligation	2,445,987	-	-	-	2,445,987	-	-	-	-	2,445,987
Change in non-controlling interest	-	-	-	-	-	(159,184)	-	-	-	(159,184)
Other	-	-	-	-	-	1,375,715	-	-	-	1,375,715
Increase (decrease) in unrestricted net assets	8,409,736	4,882,879	(296,431)	1,381,369	14,377,553	2,532,253	-	982,425	(1,381,369)	16,510,862
Temporarily restricted net assets										
Contributions	413,859	-	-	-	413,859	-	-	3,259,920	(531,191)	3,142,588
Net realized and unrealized gains and (losses) on investments	19,839	-	(3)	-	19,836	-	-	-	-	19,836
Net assets held by AHF, Inc.	(1,160,244)	-	-	-	(1,160,244)	-	-	-	1,160,244	-
Transfer to unrestricted net assets	(2,946,776)	-	-	-	(2,946,776)	-	-	-	-	(2,946,776)
Contribution to building fund	2,946,776	-	-	-	2,946,776	-	-	(2,946,776)	-	-
Net assets released from restrictions	(459,878)	-	-	-	(459,878)	-	-	(1,307,585)	531,191	(1,236,272)
(Decrease) increase in temporarily restricted net assets	(1,186,424)	-	(3)	-	(1,186,427)	-	-	(994,441)	1,160,244	(1,020,624)
INCREASE (DECREASE) IN NET ASSETS	7,223,312	4,882,879	(296,434)	1,381,369	13,191,126	2,532,253	-	(12,016)	(221,125)	15,490,238
Net assets										
Beginning of year	95,358,419	35,287,385	10,209,492	17,016,739	157,872,035	22,264,518	271,062	11,446,611	(25,672,827)	166,181,399
End of year	$102,581,731	$40,170,264	$ 9,913,058	$18,398,108	$171,063,161	$24,796,771	$ 271,062	$11,434,595	$(25,893,952)	$181,671,637

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