

GARRETT REGIONAL MEDICAL CENTER

A PROUD AFFILIATE OF



Consolidated Audited Financial Statements

Years Ended June 30, 2015 and 2014

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Independent Auditors' Report

Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

We have audited the accompanying financial statements of Garrett County Memorial Hospital and subsidiaries, d/b/a Garrett Regional Medical Center, (collectively, the Hospital), which comprise the consolidated balance sheets as of June 30, 2015 and 2014, and the related consolidated statements of operations and other changes in unrestricted net assets, changes in net assets and cash flows for the years then ended, 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 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.

Auditors' 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 and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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 auditors' 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.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Hospital as of June 30, 2015 and 2014, and the consolidated results of their operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Supplementary Schedules

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information is presented for purposes of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual companies and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report September 30, 2015 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

Dixon Hughes Goodman LLP

**Tysons, Virginia
September 30, 2015**

Garrett Regional Medical Center
Consolidated Balance Sheets

	June 30,	
	2015	2014
<i>ASSETS</i>		
CURRENT ASSETS		
Cash and cash equivalents	\$ 10,704,963	\$ 8,143,571
Short-term investments -- <i>Note B</i>	20,937,862	18,911,273
Patient accounts receivable, net of allowance for doubtful accounts of \$2,386,365 and \$2,386,815 at June 30, 2015 and 2014, respectively -- <i>Note K</i>	4,342,516	5,177,670
Other amounts receivable	260,286	326,473
Assets whose use is limited by donors and others -- <i>Note B</i>	143,165	112,582
Inventories	1,017,300	990,630
Prepaid expenses	491,011	465,465
TOTAL CURRENT ASSETS	<u>37,897,103</u>	<u>34,127,664</u>
NONCURRENT ASSETS		
Property and equipment, net -- <i>Note D</i>	27,895,006	20,739,582
Insurance recoverable -- <i>Note J</i>	557,178	588,715
Long-term investments -- <i>Note B</i>	5,141,325	4,955,150
Investment in affiliates -- <i>Note C</i>	340,525	185,950
Assets whose use is limited by donors and others, less current portion -- <i>Note B</i>	500,602	457,585
Assets whose use is limited by board of governors -- <i>Note B</i>	698,073	698,073
Deferred financing costs, net	21,279	22,633
TOTAL NONCURRENT ASSETS	<u>35,153,988</u>	<u>27,647,688</u>
TOTAL ASSETS	<u>\$ 73,051,091</u>	<u>\$ 61,775,352</u>

See the accompanying notes to the consolidated financial statements.

	June 30,	
	2015	2014
<i>LIABILITIES AND NET ASSETS</i>		
CURRENT LIABILITIES		
Accounts payable	\$ 1,963,163	\$ 973,451
Accrued salaries and wages	2,210,638	1,960,742
Advances from third parties	421,081	466,983
Current portion of long-term debt -- <i>Note E</i>	570,359	165,867
Other current liabilities -- <i>Note J</i>	268,052	440,218
TOTAL CURRENT LIABILITIES	<u>5,433,293</u>	<u>4,007,261</u>
Long-term debt, less current portion -- <i>Note E</i>	8,168,531	3,400,857
Pension obligation -- <i>Note G</i>	11,705,380	10,149,757
Other long-term liabilities -- <i>Note J</i>	1,413,494	1,445,031
TOTAL LIABILITIES	<u>26,720,698</u>	<u>19,002,906</u>
 NET ASSETS		
Unrestricted	45,790,935	42,282,088
Temporarily restricted -- <i>Note F</i>	503,197	454,247
Permanently restricted -- <i>Note M</i>	36,261	36,111
TOTAL NET ASSETS	<u>46,330,393</u>	<u>42,772,446</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 73,051,091</u>	<u>\$ 61,775,352</u>

Garrett Regional Medical Center
Consolidated Statements of Operations and Other Changes
in Unrestricted Net Assets

	Year Ended June 30,	
	2015	2014
REVENUE		
Net patient service revenue -- <i>Note K</i>		
Patient service revenue (net of contractual allowances and discounts)	\$ 45,298,311	\$ 42,742,778
Less: provision for uncollectible accounts	(1,680,514)	(1,575,843)
	<u>43,617,797</u>	<u>41,166,935</u>
Other revenue	2,006,996	2,183,038
Net assets released from restriction for use in operations -- <i>Note F</i>	45,629	35,203
TOTAL REVENUE	<u>45,670,422</u>	<u>43,385,176</u>
EXPENSES -- <i>Note L</i>		
Salaries and wages	18,170,040	16,943,308
Employee benefits -- <i>Note G</i>	6,420,976	6,433,065
Supplies	7,159,506	6,675,000
Utilities	648,438	704,650
Purchased services	5,047,595	5,442,102
Depreciation and amortization -- <i>Note D</i>	2,637,883	2,687,542
Interest -- <i>Note E</i>	144,552	150,180
Other expenses	1,368,085	988,117
TOTAL OPERATING EXPENSES	<u>41,597,075</u>	<u>40,023,964</u>
GAIN FROM OPERATIONS	<u>4,073,347</u>	<u>3,361,212</u>
OTHER INCOME		
Investment income -- <i>Note B</i>	275,825	750,271
Equity in earnings of affiliates -- <i>Note C</i>	232,185	29,563
Other	223,966	97,897
TOTAL OTHER INCOME	<u>731,976</u>	<u>877,731</u>
EXCESS OF REVENUE OVER EXPENSES	4,805,323	4,238,943
Net assets released from restriction for the purchase of property and equipment -- <i>Note F</i>	283,562	259,183
Pension-related changes other than net periodic pension cost -- <i>Note G</i>	(1,580,038)	(65,691)
INCREASE IN UNRESTRICTED NET ASSETS	<u>\$ 3,508,847</u>	<u>\$ 4,432,435</u>



Garrett Regional Medical Center
Consolidated Statements of Changes in Net Assets

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Assets
BALANCE AT JUNE 30, 2013	\$ 37,849,653	\$ 260,393	\$ 35,586	\$ 38,145,632
Excess revenue over expenses	4,238,943	-	-	4,238,943
Net assets released from restriction for the purchase of property and equipment -- <i>Note F</i>	259,183	(259,183)	-	-
Pension-related changes other than net periodic pension cost -- <i>Note G</i>	(65,691)	-	-	(65,691)
Contributions	-	488,240	525	488,765
Net assets released from restriction for use in operations -- <i>Note F</i>	-	(35,203)	-	(35,203)
INCREASE IN NET ASSETS	<u>4,432,435</u>	<u>193,854</u>	<u>525</u>	<u>4,626,814</u>
BALANCE AT JUNE 30, 2014	42,282,088	454,247	36,111	42,772,446
Excess revenue over expenses	4,805,323	-	-	4,805,323
Net assets released from restriction for the purchase of property and equipment -- <i>Note F</i>	283,562	(283,562)	-	-
Pension-related changes other than net periodic pension cost -- <i>Note G</i>	(1,580,038)	-	-	(1,580,038)
Contributions	-	378,141	150	378,291
Net assets released from restriction for use in operations -- <i>Note F</i>	-	(45,629)	-	(45,629)
INCREASE IN NET ASSETS	<u>3,508,847</u>	<u>48,950</u>	<u>150</u>	<u>3,557,947</u>
BALANCE AT JUNE 30, 2015	<u>\$ 45,790,935</u>	<u>\$ 503,197</u>	<u>\$ 36,261</u>	<u>\$ 46,330,393</u>

See the accompanying notes to the consolidated financial statements.

Garrett Regional Medical Center
Consolidated Statements of Cash Flows

	Year Ended June 30,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in net assets	\$ 3,557,947	\$ 4,626,814
Adjustments to reconcile increase in net assets to net cash and cash equivalents provided by operating activities:		
Net unrealized gain	(275,825)	(385,481)
Restricted contributions	(378,291)	(488,240)
Depreciation	2,636,529	2,686,189
Amortization of deferred financing costs	1,354	1,353
Provision for uncollectible accounts	1,680,514	1,575,843
Earnings of affiliate investment	(232,185)	(29,563)
(Gain) / loss on disposal of equipment	(3,690)	23,326
Decrease (increase) in:		
Patient accounts receivable	(845,360)	(1,051,038)
Supplies	(26,670)	84,094
Prepaid expenses	(32,959)	(57,697)
Insurance recoverable	31,537	(37,050)
Other amounts receivable	-	66,577
Increase (decrease) in:		
Accounts payable	989,712	177,280
Accrued salaries and wages	249,896	(136,203)
Advances from third parties	(45,902)	(92,900)
Pension obligation	1,555,623	84,235
Other current liabilities	(203,703)	176,881
PROVIDED BY OPERATING ACTIVITIES	8,658,527	7,224,420

See the accompanying notes to the consolidated financial statements.

	Year Ended June 30	
	2015	2014
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	\$ (9,788,263)	\$ (3,143,949)
Net purchase of trading securities	(1,936,939)	(3,590,249)
Net proceeds (investment) from affiliate investment	77,610	(35,000)
NET CASH AND CASH EQUIVALENTS USED IN INVESTING ACTIVITIES	<u>(11,647,592)</u>	<u>(6,769,198)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from the issuance of long-term debt	\$ 5,336,940	\$ -
Repayments of long-term debt	(164,774)	(159,077)
Proceeds from restricted contributions	378,291	488,240
NET CASH AND CASH EQUIVALENTS PROVIDED BY FINANCING ACTIVITIES	<u>5,550,457</u>	<u>329,163</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,561,392	784,385
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>8,143,571</u>	<u>7,359,186</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$ 10,704,963</u></u>	<u><u>\$ 8,143,571</u></u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	<u>\$ 136,406</u>	<u>\$ 150,487</u>
Equipment under capital lease	<u>\$ -</u>	<u>\$ 5,205</u>

Notes to Consolidated Financial Statements

Note A Organization and Summary of Significant Accounting Principles

Organization

Garrett County Memorial Hospital (the Hospital) is an instrumentality of Garrett County, Maryland. The Hospital was organized for charitable purposes and is exempt from income taxes as an instrumentality of Garrett County. In 2003, the Hospital formed and became the sole member of Professional Emergency Physician Services, LLC, (PEPS) which is a for-profit limited liability company. The purpose of PEPS is to provide professional emergency services solely to the Hospital. In addition, the Hospital owns 100% of the outstanding shares of Garrett Community Health Services (GCHS), which is a for-profit corporation. GCHS had no activity for the years ended June 30, 2015 and 2014. In 2015, the hospital formed and became sole member of Garrett Anesthesia Services, LLC (GAS) and Specialty Physicians of Garrett County, LLC (SPE). GAS was created to provide anesthesia services to patients during surgical procedures at the Hospital. SPE is designed to facilitate and recruitment of physicians to provide specialty services to the Hospital.

Principles of Consolidation

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

Basis of Presentation

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

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

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

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, after contractual adjustments. Patient accounts receivable include charges for amounts due from Medicare, Maryland Medical Assistance (Medicaid), Blue Cross, commercial insurers, and self-pay patients (see Note K). Contractual adjustments represent the differences between amounts billed as patient service revenue and amounts contracted with third party payers, and are accrued on an estimated basis in the period in which the related services are rendered and adjusted in future periods as final settlements are determined.

Garrett Regional Medical Center
Notes to Consolidated Financial Statements

Rates charged are based primarily on rates established by the State of Maryland Health Services Cost Review Commission (HSCRC); accordingly, revenue reflects actual charges to patients based on rates in effect during the period in which the services are rendered (see Note I).

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

Allowance for Doubtful Accounts

The provision for doubtful accounts is based upon management's judgmental assessment of historical and expected net collections considering business and general economic conditions in its service area, trends in healthcare coverage, and other collection indicators. On a relatively continuous basis, management assesses the adequacy of the allowance for doubtful accounts based upon its review of accounts receivable payer category, payer agreement rate changes and other factors. The results of these assessments are used to make modifications to the provision for bad debts and to establish an appropriate allowance for doubtful accounts.

For self-pay patients, the provision is based on an analysis of past experience related to collection rates of self-pay balances. The Company follows established guidelines for placing certain past-due patient balances with external collection agencies.

Charity Care

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

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. Under current accounting standards, the Hospital is required to report the cost of providing charity care. The cost of charity care provided by the Hospital totaled \$2,016,127 and \$2,512,558 for the years ended June 30, 2015 and 2014, respectively. Rates charged by the Hospital for regulated services are determined based on an assessment of direct and indirect cost calculated pursuant to the methodology established by the HSCRC (see Note I), and therefore the cost of charity services noted above for the Hospital are equivalent to its established rates for those services.

For any charity services rendered by the Company other than the regulated services of the Hospital, the cost of charity care is calculated by applying the estimated total cost-to-charge ratio for the non-Hospital services to the total amount of charges for services provided to patients benefitting from the charity care policies of the Company's non-Hospital affiliates.

The HSCRC established an uncompensated care fund whereby all hospitals are required to contribute 0.75% of revenues to this fund to help provide for the cost associated with uncompensated care for certain Maryland hospitals above the State average. In December 2008, the Commission modified this mechanism to finance uncompensated care statewide. The policy implemented 100% pooling and all Maryland hospitals have the same percentage of uncompensated care in rates. High uncompensated care hospitals receive funds and low uncompensated care hospitals provide funding. The Hospital had net receipts of \$1,369,530 and \$1,024,026 for 2015 and 2014, respectively, related to its participation in the uncompensated care fund mechanism.

Advertising Expense

The Company expenses advertising costs as they are incurred.

Garrett Regional Medical Center
Notes to Consolidated Financial Statements

Cash and Cash Equivalents

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

Inventories

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

Donor-Restricted Funds

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

Assets Whose Use is Limited

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

Property and Equipment

Property and equipment are stated at cost, except for donated items which are recorded at fair value at the date of donation. Expenditures less than \$500 are expensed when incurred. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets. Equipment under capital lease obligations is amortized on a straight-line basis over the shorter period of the lease terms or the estimated useful lives of the equipment. Such amortization is included in depreciation in the accompanying consolidated financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Deferred Financing Costs

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

Investments

Investments are exposed to certain risks such as interest rate, credit and overall market volatility. Due to the level of risk associated with certain investment securities, changes in the value of investment securities could occur in the near term, and these changes could materially differ from the amounts reported in the accompanying consolidated financial statements. Investments and assets whose use is limited, which are invested in marketable securities, are reported at their fair value, based on quoted market prices provided by the asset managers. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains

Garrett Regional Medical Center
Notes to Consolidated Financial Statements

and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities (see Note B).

Investments in Affiliates

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

Excess of Revenue over Expenses

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

Meaningful Use Incentive

Under the provisions of the American Recovery and Reinvestment Act of 2009, incentive payments are available to certain healthcare providers that can demonstrate "meaningful use" of certified electronic health records technology. The Hospital recognized these incentive payments when reasonably assured of the ability to successfully demonstrate compliance with meaningful use criteria. The Hospital recognized approximately \$1,074,759 and \$1,517,000 of these incentive payments in other operating revenue in the accompanying consolidated financial statements for the periods ended 2015 and 2014, respectively.

Estimated Malpractice Costs

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

Use of Estimates

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

Income Taxes

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

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

The Hospital had no unrecognized tax benefits or such amounts were immaterial during the periods presented. For tax periods with respect to which no unrelated business income was recognized, no tax return was required. Tax periods for which no return is filed remain open for examination indefinitely. No tax returns were filed for the Hospital during 2015 and 2014.

Garrett Regional Medical Center
Notes to Consolidated Financial Statements

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

Subsequent Events

Management has evaluated the effect subsequent events would have on financial statements through September 30, 2015, which is the date the financial statements were available to be issued. See Note N.

Note B Investments and Assets Whose Use is Limited

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

	<u>Investments</u>	<u>Assets whose use is limited by donors</u>	<u>Assets whose use is limited by the Board of Governors</u>	<u>Total</u>
At June 30, 2015:				
Cash and cash equivalents	\$ 233,795	\$ 6,348	\$ -	\$ 240,143
Certificates of deposit	20,972,689	594	698,073	21,671,356
Corporate bonds	95,011	1,650	-	96,661
Mutual funds	3,396,811	58,996	-	3,455,807
Common stock	1,370,959	23,724	-	1,394,683
Preferred stock	9,922	176	-	10,098
Pledges receivable, net	-	552,279	-	552,279
	<u>26,079,187</u>	<u>643,767</u>	<u>698,073</u>	<u>27,421,027</u>
Less short-term portion	<u>20,937,862</u>	<u>143,165</u>	<u>-</u>	<u>21,081,027</u>
	<u>\$ 5,141,325</u>	<u>\$ 500,602</u>	<u>\$ 698,073</u>	<u>\$ 6,340,000</u>

	<u>Investments</u>	<u>Assets whose use is limited by donors</u>	<u>Assets whose use is limited by the Board of Governors</u>	<u>Total</u>
At June 30, 2014:				
Cash and cash equivalents	\$ 259,796	\$ 6,914	\$ -	\$ 266,710
Certificates of deposit	18,911,273	-	698,073	19,609,346
Government securities	70,224	17,868	-	88,092
Corporate bonds	602,341	-	-	602,341
Mutual funds	3,185,066	69,136	-	3,254,202
Common stock	837,723	39,326	-	877,049
Pledges receivable, net	-	436,923	-	436,923
	<u>23,866,423</u>	<u>570,167</u>	<u>698,073</u>	<u>25,134,663</u>
Less short-term portion	<u>18,911,273</u>	<u>112,582</u>	<u>-</u>	<u>19,023,855</u>
	<u>\$ 4,955,150</u>	<u>\$ 457,585</u>	<u>\$ 698,073</u>	<u>\$ 6,110,808</u>

Assets whose use is limited include investments and pledges receivable. Board designated funds consist of certificates of deposit at June 30, 2015 and 2014.

Garrett Regional Medical Center
Notes to Consolidated Financial Statements

Pledges receivable are recorded net of an allowance for uncollectible pledges of \$29,917 and \$27,968 at June 30, 2015 and 2014, respectively. Pledges are recorded at their net present value and are due as follows at June 30, 2015:

2016	\$	148,121
2017		120,872
2018		113,269
2019		78,674
2020		39,362
After 2020		<u>94,580</u>
		594,878
Present value discount, at 1.0%		(12,682)
Allowance for uncollectible pledges		<u>(29,917)</u>
		<u>\$ 552,279</u>

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

	<u>2015</u>	<u>2014</u>
Interest and dividends	\$ 134,518	\$ 182,025
Net realized gain	259,823	182,765
Net unrealized (loss) / gain	<u>(118,516)</u>	<u>385,481</u>
	<u>\$ 275,825</u>	<u>\$ 750,271</u>

Current accounting standards define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, and establish a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, as follows:

- Level 1: Quoted prices in active markets for identical assets or liabilities.
- Level 2: Observable input other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

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

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

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offering for sale at one time an entire holding of a particular financial asset. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

Fair values of the Company's government securities and corporate bonds are based on prices provided by its investment managers, who use a variety of pricing sources to determine market valuations. Each designate specific pricing services or indexes for each sector of the market based upon the provider's experience. The Company's government securities and corporate bonds portfolio is highly liquid, which allows for a high percentage of the portfolio to be priced through pricing services. Fair values of the Company's certificate of deposits are based on cost plus accrued interest, which in the opinion of management approximates fair value. Fair values of marketable equity securities (mutual funds and stock) have been determined by the Company from observable market quotations, when available. Private placement securities and other equity securities where a public quotation is not available are valued by using broker quotes.

The following table presents the Company's fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2015:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and cash equivalents	\$ 240,143	\$ -	\$ 240,144
Certificates of deposit	21,671,356	-	21,671,356
Corporate bonds	-	96,661	96,661
Mutual funds	3,455,807	-	3,455,807
Common stock	1,394,683	-	1,139,683
Preferred stock	<u>10,098</u>	<u>-</u>	<u>10,098</u>
	<u>\$ 26,772,087</u>	<u>\$ 96,661</u>	<u>\$ 26,868,748</u>

The following table presents the Company's fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2014:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and cash equivalents	\$ 266,710	\$ -	\$ 266,710
Certificates of deposit	19,609,346	-	19,609,346
Government securities	-	88,092	88,092
Corporate bonds	-	602,341	602,341
Mutual funds	3,254,202	-	3,254,202
Stocks	<u>877,049</u>	<u>-</u>	<u>877,049</u>
	<u>\$ 24,007,307</u>	<u>\$ 690,433</u>	<u>\$ 24,697,740</u>

There were no transfers between levels during 2015 and 2014.

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Note C Investments in Affiliates

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

<u>Joint Venture</u>	<u>Type of organization</u>	<u>Business purpose</u>	<u>Percentage ownership</u>	
			<u>2015</u>	<u>2014</u>
Oakland MRI Center, LLC (OMRI)	For Profit	MRI and Dexa scan services	50%	50%
Freestate Healthcare Insurance Company, Ltd. (Freestate)	For-profit	Malpractice and professional liability insurance	20%	20%
Western Maryland Medical Supply, LLC (WMMS)	For-profit	Durable medical equipment services	33.3%	33.3%

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

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

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

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

	<u>Investment balance</u>		<u>Income in earnings</u>	
	<u>2015</u>	<u>2014</u>	<u>2015</u>	<u>2014</u>
OMRI	\$ 270,025	\$ 239,853	\$ 100,172	\$ 91,784
Freestate	20,542	20,542	-	-
WMMS	49,958	(74,445)	124,404	8,537
Other	-	-	7,609	(70,758)
	<u>\$ 340,525</u>	<u>\$ 185,950</u>	<u>\$ 232,185</u>	<u>\$ 29,563</u>

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

	<u>2015</u>	<u>2014</u>
Current assets	\$ 41,081,598	\$ 43,171,869
Noncurrent assets	<u>3,941,847</u>	<u>2,224,103</u>
Total assets	<u>\$ 45,023,445</u>	<u>\$ 45,395,972</u>
Current liabilities	\$ 697,342	\$ 1,106,449
Noncurrent liabilities	43,533,453	43,587,023
Net worth	<u>792,650</u>	<u>702,500</u>
Total liabilities and net worth	<u>\$ 45,023,445</u>	<u>\$ 45,395,972</u>
Total operating revenue	\$ 4,172,867	\$ 8,264,511
Total operating expense	<u>3,985,473</u>	<u>7,583,163</u>
Net income	<u>\$ 187,394</u>	<u>\$ 681,348</u>

Garrett Regional Medical Center
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Note D Property and Equipment

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

	<u>Estimated Useful life</u>	<u>2015</u>	<u>2014</u>
Land improvements	10 – 40 years	\$ 479,327	\$ 775,233
Buildings and improvements	15 – 40 years	25,309,303	28,338,866
Fixed equipment	5 – 20 years	4,682,551	5,131,805
Movable equipment	3 – 20 years	16,870,917	16,539,182
Equipment under capital lease	lease term	<u>144,211</u>	<u>144,211</u>
		47,486,309	50,929,297
Less accumulated depreciation		<u>(30,453,597)</u>	<u>(32,907,155)</u>
		17,032,712	18,022,142
Land		1,162,039	1,162,039
Construction in progress		<u>9,700,255</u>	<u>1,555,401</u>
		<u>\$ 27,895,006</u>	<u>\$ 20,739,582</u>

Depreciation expense for the years ended June 30, 2015 and 2014 was \$2,629,492 and \$2,686,189, respectively. Accumulated amortization of capital leases was \$73,521 and \$44,679 in June 30, 2015 and 2014, respectively.

In August 2014, the Hospital signed a construction management contract for approximately \$16 million of which approximately \$9.6 million has been incurred by the Hospital for various renovations including an additional wing to the Hospital. Construction is expected to be completed by spring 2017.

Note E Long-Term Debt

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

	<u>2015</u>	<u>2014</u>
Series 2014 bonds	\$ 5,336,940	\$ -
USDA bonds	2,519,013	2,588,149
Series 2004 bonds	807,484	874,492
Capital lease obligation	<u>75,453</u>	<u>104,083</u>
	8,738,890	3,566,724
Less current portion	<u>570,359</u>	<u>165,867</u>
	<u>\$ 8,168,531</u>	<u>\$ 3,400,857</u>

Series 2014 Bonds

On November 26, 2014, the Hospital issued the Garrett County Memorial Hospital Refunding Bonds, Series 2014 (Series 2014 Bonds) for the purpose of renovating and constructing a new wing of the hospital. The Series 2014 Bonds represent a supplemental loan agreement between the Hospital and Garrett County for amounts that are equal to the loan principal of the County's Series 2014 Bonds. Series 2014 Bonds incur interest at a fixed interest rate of 3.53% per annum. Interest accrues based on the average outstanding principal balance and is paid semi-annually. Annual principal payments are due on the anniversary date of issuance based on a twenty-five year amortization period. On November 26, 2029 the Series 2014 Bonds matures and all outstanding principal balances are due.

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United States Department of Agriculture (USDA) Bonds

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

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

Series 2004 Bonds

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

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

Capital Leases

The Hospital periodically enters into various leases for equipment that meet the criteria for capitalization under current accounting standards.

Aggregate maturities of all long-term debt as of June 30, 2015 are as follows:

2016	\$	570,359
2017		577,335
2018		568,817
2019		559,881
2020		481,836
After 2020		<u>5,980,662</u>
	\$	<u>8,738,890</u>

The Company is subject to certain restrictive covenants defined in various agreements with lenders. In the opinion of management, the Company was in compliance with all applicable restrictive covenants as of June 30, 2015 and 2014.

Note F Temporarily Restricted Net Assets

Temporarily restricted net assets of \$503,197 and \$193,854 at June 30, 2015 and 2014, respectively, are restricted primarily for property replacement, expansion, and health care clinical services.

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

	<u>2015</u>	<u>2014</u>
Health care clinical services	\$ 45,629	\$ 35,203
Plant replacement and expansion	<u>283,562</u>	<u>259,183</u>
	<u>\$ 329,191</u>	<u>\$ 294,386</u>

Note G Pension Plan

The Hospital has a noncontributory defined benefit pension plan (the Plan) covering all employees of the Hospital who work at least twenty hours per week. Benefits are based on the participants' credited service and average monthly earnings. The Hospital's funding policy is to contribute an amount annually that is equal to the normal cost plus interest on the unfunded accrued liability. The Internal Revenue Service classifies the Plan as a government plan, and the Plan, as such, is exempt from the requirements of the Employee Retirement Income Security Act of 1974. The Hospital uses a June 30 measurement date for the Plan. The Hospital intends to contribute \$1,250,000 for fiscal year 2016. The assumption change in the table below represents change in the discount rate and rate of compensation increase for 2015 and 2014.

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

	<u>2015</u>	<u>2014</u>
Projected benefit obligation at beginning of year	\$ 34,323,968	30,780,349
Service cost	1,150,638	1,004,186
Interest	1,497,298	1,482,410
Assumption change	751,178	2,082,041
Benefits paid	<u>(1,162,022)</u>	<u>(1,025,018)</u>
Projected benefit obligation at end of year	<u>\$ 36,561,060</u>	<u>\$ 34,323,968</u>

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

	<u>2015</u>	<u>2014</u>
Fair value of Plan assets at beginning of year	\$ 24,174,211	\$ 20,714,827
Actual return on Plan assets	683,350	3,254,178
Employer contribution	1,160,141	1,230,224
Benefits paid	<u>(1,162,022)</u>	<u>(1,025,018)</u>
Fair value of Plan assets at end of year	<u>\$ 24,855,680</u>	<u>\$ 24,174,211</u>
Funded status	<u>\$ (11,705,380)</u>	<u>\$ (10,149,757)</u>
Net loss included in unrestricted net assets	<u>\$ 10,066,649</u>	<u>\$ 8,486,610</u>
Accumulated benefit obligation	<u>\$ 31,455,857</u>	<u>\$ 29,302,297</u>

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

	<u>2015</u>	<u>2014</u>
Service cost	\$ 1,150,638	\$ 1,004,186
Interest cost	1,497,298	1,482,410
Expected return on assets held in the plan	(1,952,817)	(1,662,445)
Amortization of net loss	<u>440,607</u>	<u>424,617</u>
	<u>\$ 1,135,726</u>	<u>\$ 1,248,768</u>

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

	<u>2015</u>	<u>2014</u>
Discount rate	4.39%	4.39%
Rate of compensation increase	3.45%	3.89%

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

	<u>2015</u>	<u>2014</u>
Discount rate	4.39%	4.39%
Rate of compensation increase	3.45%	3.89%
Expected long-term return on plan assets	8.00%	8.00%

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

	<u>2015</u>	<u>2014</u>
Equity securities	58%	56%
Fixed maturity securities	41%	42%
Other	<u>1%</u>	<u>2%</u>
Total plan assets	<u>100%</u>	<u>100%</u>

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

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

2016	\$ 1,373,000
2017	1,476,000
2018	1,697,000
2019	1,780,000
2020	1,874,000
2021-2025	<u>14,084,000</u>
	<u>\$ 22,284,000</u>

The fair values of the Hospital's Plan assets as of June 30, 2015 by asset category are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and Cash equivalents	\$ 138,580	\$ -	\$ 138,580
Fixed Income			
Corporate Bonds	-	5,329,456	5,329,456
Municipal Bonds	-	1,677,187	1,677,187
Mutual funds	2,133,732	-	2,133,732
Equity Securities			
Mutual Funds	6,258,861	-	6,258,861
Common Stocks	5,543,095	-	5,543,095
Exchange Traded Funds	<u>3,699,575</u>	<u>-</u>	<u>3,699,575</u>
	<u>\$ 17,753,843</u>	<u>\$ 7,006,643</u>	<u>\$ 24,760,486</u>

The fair values of the Hospital's Plan assets as June 30, 2014 by asset category are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and Cash equivalents	\$ 802,661	\$ -	\$ 802,661
Fixed Income			
Corporate Bonds	-	4,668,390	4,668,390
Municipal Bonds	-	1,475,221	1,475,221
Mutual funds	2,053,865	-	2,053,865
Equity Securities			
Mutual Funds	7,134,014	-	7,134,014
Common Stocks	4,588,476	-	4,588,476
Exchange Traded Funds	<u>3,358,151</u>	<u>-</u>	<u>3,358,151</u>
	<u>\$ 17,937,167</u>	<u>\$ 6,143,611</u>	<u>\$ 24,080,778</u>

There were no transfers between levels during 2015 and 2014.

Note H Certain Significant Risks and Uncertainties

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

- Dependence on revenues derived from reimbursement by the Federal Medicare and state Medicaid programs (see Note K);

Garrett Regional Medical Center Notes to Consolidated Financial Statements

- Regulation of hospital rates by the State of Maryland Health Services Cost Review Commission (see Note I);
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes; and
- Lawsuits alleging malpractice and related claims (see Note J).

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

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

The healthcare industry is subject to numerous laws and regulation from federal, state and local governments, and the government has increased enforcement of Medicare and Medicaid anti-fraud and abuse laws, as well as physician self-referral laws (STARK law and regulation). The Company's compliance with these laws and regulations is subject to periodic governmental review, which could result in enforcement actions unknown or unasserted at this time.

As a result of recently enacted and pending federal healthcare reform legislation, substantial changes are anticipated in the healthcare system. Such legislation includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursement to healthcare providers and the legal obligations of health insurers, providers and employers. These provisions are currently slated to take effect at specified times over the next decade.

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

Note I Maryland Health Services Cost Review Commission

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

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

The Commission has jurisdiction over hospital reimbursement in Maryland by agreement with the Centers for Medicare and Medicaid Services (CMS). This agreement is based on a waiver from the Medicare Prospective Payment System reimbursement principles granted under Section 1814(b) of the Social Security Act. On January 10, 2014 Maryland's All-Payer Hospital System Modernization was approved by CMS. This is a five year demonstration where Maryland agreed to permanently shift away from its current statutory waiver, which is based on Medicare payment per inpatient admission, in exchange for the new CMS model based on Medicare per capita total hospital cost growth.

Note J Insurance

Malpractice Insurance

The Company is involved in litigation arising in the normal course of business. Claims alleging malpractice have been asserted against the Company and are currently in various stages of litigation. Additional claims may be asserted against the Company arising from services provided through June 30, 2015. Management believes that no material loss will result from any pending or threatened litigation or from incidents incurred but not reported.

In accordance with current accounting standards, the Company reports gross insurance recoveries separately from the related claims liability for professional liability claims already reported to its insurance carrier. As of June 30, 2015 and 2014, the Company recorded insurance recoverable and professional claim liability of \$557,178 and \$588,715, respectively, as both an asset and a liability in the accompanying consolidated financial statements.

An estimated liability for incurred but not reported professional liability claims has been recorded in the amount of approximately \$694,000 for the years ended June 30, 2015 and 2014. This amount is included in other long-term liabilities in the accompanying consolidated financial statements. Management believes this accrual is adequate to provide for all professional liability claims that have been incurred through June 30, 2015, but not reported to its insurance carrier.

Effective March 1, 2005, the Hospital became a shareholder of the newly formed Freestate Healthcare Insurance Company, Ltd. (Freestate), a captive insurance company formed in the Cayman Islands by eight Maryland hospitals. The Hospital became a shareholder of Freestate when the Hospital's insurance company decided not to continue to write insurance policies for hospitals within the State of Maryland effective March 1, 2005. The Hospital believes that becoming a shareholder of the captive insurance company provides the best long-term solution to providing insurance coverage that is cost effective and predictable. Freestate provides insurance coverage on a claims-made basis to its owners for professional liability claims and comprehensive general liability of \$1,000,000 for each and every claim. Freestate has entered into reinsurance and excess policy agreements with independent insurance companies to limit its losses for professional liability and comprehensive general liability claims. Freestate has \$2,000,000 of additional insurance in the aggregate through such reinsurance arrangements which is applicable to the Company. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insureds under the policy. Each named insured's assessment or credit is based on the percentage of their actual exposure to the actual exposure of all named insureds. In management's opinion, the assets of Freestate are sufficient to meet its obligations as of June 30, 2015. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the payment of such claims would be the responsibility of the member hospitals. The estimated cost of claims is actuarially determined based upon past experience and discounted using a discount rate of 3.5% in 2015 and 2014. Effective September 1, 2014 the policy was expanded to include the operations of GAS and SPE.

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

Health Insurance

The Company is self-insured for employee health claims. Under the self-insurance plan, the Company has accrued a liability of \$185,626 and \$278,716 for the years ended June 30, 2015 and 2014 for incurred but not reported claims. Management believes that the accruals are adequate to provide for all employee health claims that have been incurred for the years ended June 30, 2015 and 2014.

Note K Business and Credit Concentrations

The Company provides health care services through its inpatient and outpatient care facilities located in Oakland, Maryland. The Company grants credit to patients, substantially all of whom are local residents. The Company generally does not require collateral or other security in extending credit; however, it routinely obtains assignment

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of (or is otherwise entitled to receive) patients' benefits receivable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, health maintenance organizations (HMOs) and commercial insurance policies).

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

	<u>2015</u>	<u>2014</u>
Self-pay and others	\$ 2,121,621	2,038,934
Medicare	1,686,490	2,455,270
Commercial insurance and HMOs	1,367,516	913,233
Medicaid	1,159,434	1,380,320
Blue Cross	<u>393,820</u>	<u>776,728</u>
	6,728,881	7,564,485
Allowance for doubtful accounts	<u>(2,386,365)</u>	<u>(2,386,815)</u>
	<u>\$ 4,342,516</u>	<u>\$ 5,177,670</u>

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

	<u>2015</u>	<u>2014</u>
Medicare	47%	46%
Commercial insurance and HMOs	19%	15%
Blue Cross	11%	15%
Medicaid	20%	18%
Self-pay and others	<u>3%</u>	<u>6%</u>
	<u>100%</u>	<u>100%</u>

Note L Functional Expenses

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

	<u>2015</u>	<u>2014</u>
Health care services	\$ 33,395,169	\$ 32,470,427
General and administrative	<u>8,194,742</u>	<u>7,553,537</u>
	<u>\$ 41,589,911</u>	<u>\$ 40,023,964</u>

Note M Endowment

Current accounting standards provide guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and additional disclosures about an organization's endowment funds. The State of Maryland has adopted UPMIFA.

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

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

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

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

From time to time, the fair value of assets associated with the endowment fund may fall below the level that the donor or SPMIFA required the Company to retain as a fund of perpetual duration. There were no such deficiencies as of June 30, 2015 or 2014.

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

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

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

	2015			2014		
	Permanently Unrestricted	Endowment Restricted	Endowment Total	Unrestricted	Permanently Restricted	Endowment Total
Beginning balance	\$ 12,266	\$ 36,111	\$ 48,377	\$ 10,965	\$ 35,586	\$ 46,551
Interest and dividends	2,001	-	2,001	1,301	-	1,301
Contributions	-	150	150	-	525	525
Ending Balance	<u>\$ 14,267</u>	<u>\$ 36,261</u>	<u>\$ 50,528</u>	<u>\$ 12,266</u>	<u>\$ 36,111</u>	<u>\$ 47,377</u>

Note N Subsequent Events

On August 1, 2015 the Hospital executed a clinical program affiliation agreement with a tertiary care teaching hospital located in Monongalia County, West Virginia. The affiliated parties agree to mutually explore, develop and implement opportunities for clinical and operational collaboration deemed to be in the mutual best interest of the surrounding community they serve. Parties intend to develop on-site specialty services in Garrett County, develop tele-medicine opportunities, collaborate recruitment efforts for physicians to the Hospital, jointly develop strategies to prepare for population health opportunities, increase clinical integration between both organizations and physicians, and develop a quality reporting infrastructure designed to facilitate and support better patient incomes and reduce expenses.

Other Financial Information

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

The Board of Governors

Oakland, Maryland

We have audited the consolidated financial statements of Garrett County Memorial Hospital and subsidiaries, d/b/a Garrett Regional Medical Center, (collectively, the Hospital), which comprise the consolidated balance sheets, the related consolidated statements of operations and other changes in unrestricted net assets, changes in net assets and cash flows for the year ended June 30, 2015 and have issued our report thereon dated September 30, 2015. We conducted our audit in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purposes of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Dixon Hughes Goodman LLP

**Tysons, Virginia
September 30, 2015**

Garrett Regional Medical Center
Consolidating Balance Sheet Information
As of June 30, 2015



	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Garrett Anesthesia Services, LLC	Specialty Physicians of Garrett County, LLC	Elimination Entries	Consolidated
<i>ASSETS</i>						
CURRENT ASSETS						
Cash and cash equivalents	\$ 10,415,837	\$ 171,599	\$ 58,306	\$ 59,221	\$ -	\$ 10,704,963
Short-term investments	20,937,862	-	-	-	-	20,937,862
Patient accounts receivable, net	3,917,521	224,094	177,783	23,118	-	4,342,516
Other amounts receivable	256,212	4,074	-	-	-	260,286
Assets whose use is limited by donors	143,165	-	-	-	-	143,165
Inventories	1,016,472	828	-	-	-	1,017,300
Prepaid expenses	431,451	56,060	-	3,500	-	491,011
Due from affiliates	2,204,366	-	-	-	(2,204,366)	-
TOTAL CURRENT ASSETS	39,322,886	456,655	236,089	85,839	(2,204,366)	37,897,103
NONCURRENT ASSETS						
Property and equipment	27,710,064	-	-	184,942	-	27,895,006
Insurance recoverable	557,178	-	-	-	-	557,178
Long-term investments	5,141,325	-	-	-	-	5,141,325
Investment in affiliates	340,525	-	-	-	-	340,525
less current portion	500,602	-	-	-	-	500,602
governors	698,073	-	-	-	-	698,073
Deferred financing costs, net	21,279	-	-	-	-	21,279
TOTAL NONCURRENT ASSETS	34,969,046	-	-	184,942	-	35,153,988
TOTAL ASSETS	\$ 74,291,932	\$ 456,655	\$ 236,089	\$ 270,781	\$ (2,204,366)	\$ 73,051,091
<i>LIABILITIES AND NET ASSETS</i>						
CURRENT LIABILITIES						
Accounts payable	\$ 1,861,201	\$ 7,954	\$ 79,137	\$ 14,871	\$ -	\$ 1,963,163
Accrued salaries and wages	2,038,034	172,604	-	-	-	2,210,638
Due to affiliates	-	1,242,298	623,588	338,480	(2,204,366)	-
Advances from third parties	421,081	-	-	-	-	421,081
Current portion of long-term debt	570,359	-	-	-	-	570,359
Other current liabilities	247,745	2,886	-	17,421	-	268,052
TOTAL CURRENT LIABILITIES	5,138,420	1,425,742	702,725	370,772	(2,204,366)	5,433,293
Long-term debt, less current portion	8,168,531	-	-	-	-	8,168,531
Pension obligation	11,705,380	-	-	-	-	11,705,380
Other long-term liabilities	1,250,754	162,740	-	-	-	1,413,494
TOTAL LIABILITIES	26,263,085	1,588,482	702,725	370,772	(2,204,366)	26,720,698
NET ASSETS						
Unrestricted	47,489,389	(1,131,827)	(466,636)	(99,991)	-	45,790,935
Temporarily restricted	503,197	-	-	-	-	503,197
Permanently restricted	36,261	-	-	-	-	36,261
TOTAL NET ASSETS	48,028,847	(1,131,827)	(466,636)	(99,991)	-	46,330,393
TOTAL LIABILITIES AND NET ASSETS	\$ 74,291,932	\$ 456,655	\$ 236,089	\$ 270,781	\$ (2,204,366)	\$ 73,051,091

Garrett Regional Medical Center
Consolidating Statement of Operations Information
As of June 30, 2015

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Garrett Anesthesia Services, LLC	Specialty Physicians of Garrett County, LLC	Elimination Entries	Consolidated
REVENUE						
Net patient service revenue						
Patient service revenue (net of contractual allowances and discounts)	\$ 42,369,605	\$ 2,144,676	\$ 783,580	\$ 450	\$ -	\$ 45,298,311
Less: provision for uncollectible accounts	(1,281,162)	(325,198)	(74,154)	-	-	(1,680,514)
	41,088,443	1,819,478	709,426	450	-	43,617,797
Other revenue	2,205,266	7	-	101	(198,378)	2,006,996
Net assets released from restriction for use in operations	45,629	-	-	-	-	45,629
TOTAL REVENUE	43,339,338	1,819,485	709,426	551	(198,378)	45,670,422
EXPENSES						
Salaries and wages	15,808,363	1,300,866	1,019,717	41,094	-	18,170,040
Employee benefits	6,221,253	199,723	-	-	-	6,420,976
Supplies	7,100,814	2,069	56,623	-	-	7,159,506
Utilities	611,170	326	-	36,942	-	648,438
Purchased services	4,754,951	292,644	-	-	-	5,047,595
Depreciation and amortization	2,636,232	-	-	1,651	-	2,637,883
Interest	144,552	-	-	-	-	144,552
Management fees	-	175,181	20,429	2,768	(198,378)	-
Other expenses	1,228,985	41,720	79,293	18,087	-	1,368,085
TOTAL EXPENSES	38,506,320	2,012,529	1,176,062	100,542	(198,378)	41,597,075
GAIN (LOSS) FROM OPERATIONS	4,833,018	(193,044)	(466,636)	(99,991)	-	4,073,347
OTHER INCOME						
Investment income	275,728	97	-	-	-	275,825
Equity in earnings of affiliates	232,185	-	-	-	-	232,185
Other	223,966	-	-	-	-	223,966
TOTAL OTHER INCOME	731,879	97	-	-	-	731,976
EXCESS REVENUE OVER EXPENSES (EXPENSES OVER REVENUE)	\$ 5,564,897	\$ (192,947)	\$ (466,636)	\$ (99,991)	\$ -	\$ 4,805,323

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