COHEN
RUTHERFORD
+ KNIGHT PC
Certified Public Accountants

Audited Consolidated Financial Statements

Calvert Health System, Inc. and Subsidiaries

June 30, 2010 and 2009

Calvert Health System, Inc. and Subsidiaries
Consolidated Financial Statements
Years Ended June 30, 2010 and 2009

-Contents-

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Report of Independent Auditors

Audit Committee of the Board of Directors of
Calvert Health System, Inc.

We have audited the accompanying consolidated statements of financial position of Calvert Health System, Inc. and subsidiaries (the System) as of June 30, 2010 and 2009, and the related consolidated statements of operations and other changes in unrestricted net assets, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statements presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Calvert Health System, Inc. and subsidiaries as of June 30, 2010 and 2009, 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.

Cohen, Rutherford + Knight, P.C.

October 7, 2010
Bethesda, Maryland

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

Calvert Health System, Inc. and Subsidiaries
Consolidated Statements of Financial Position

	June 30 2010	June 30 2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 17,338,200	$ 22,102,121
Short-term investments -- Note 3	5,820	5,045
Patient accounts receivable, net of allowance for uncollectible accounts of $4,867,251 in 2010 and $5,020,338 in 2009 -- Note 10	14,649,690	14,123,160
Inventories	2,387,293	2,604,724
Prepaid expenses and other assets	1,746,393	2,665,079
Assets limited as of use, current -- Note 3	2,340,540	2,335,883
TOTAL CURRENT ASSETS	38,467,936	43,836,012
INVESTMENTS AND OTHER ASSETS		
Investments -- Note 3	37,950,286	33,638,595
Investments in affiliated enterprises -- Note 2	3,748,871	3,698,722
Assets limited as to use -- Notes 3 and 13	6,446,402	6,384,392
Property and equipment, net -- Note 5	89,003,827	87,651,088
Other assets	714,900	697,331
TOTAL ASSETS	$ 176,332,222	$ 175,906,140
LIABILITIES, NONCONTROLLING INTEREST AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 11,807,788	$ 11,590,345
Current portion of long-term debt -- Note 6	815,000	780,000
Advances from third party payers	3,739,286	2,872,675
TOTAL CURRENT LIABILITIES	16,362,074	15,243,020
Long-term debt, less current portion -- Note 6	59,940,445	60,713,425
Accrued pension cost -- Note 7	8,107,723	4,100,313
Other long-term liabilities	3,849,515	3,515,158
TOTAL LIABILITIES	88,259,757	83,571,916
NONCONTROLLING INTEREST	371,524	332,497
NET ASSETS		
Unrestricted - general	83,988,947	88,393,551
Unrestricted - board designated	2,445,747	2,322,647
Temporarily restricted -- Note 4	700,993	778,514
Permanently restricted -- Note 4	565,254	507,015
TOTAL NET ASSETS	87,700,941	92,001,727
TOTAL LIABILITIES, NONCONTROLLING INTEREST AND NET ASSETS	$ 176,332,222	$ 175,906,140

See the accompanying notes to the consolidated financial statements.

Calvert Health System, Inc. and Subsidiaries
Consolidated Statements of Operations and Other Changes in Unrestricted Net Assets

	Year Ended June 30	
	2010	2009
REVENUE		
Net patient service revenue -- Note 10	$ 118,006,396	$ 114,834,777
Rental revenue -- Note 12	2,546,713	1,541,270
Other operating revenue	2,973,727	2,545,931
TOTAL OPERATING REVENUE	123,526,836	118,921,978
EXPENSES -- Note 11		
Salaries and wages	50,881,579	48,981,365
Employee benefits -- Note 7	10,377,985	9,360,245
Supplies	23,219,850	22,201,066
Purchased services	5,571,012	4,753,804
Professional fees	3,568,936	3,347,748
Depreciation and amortization -- Note 5	8,689,465	7,157,897
Interest -- Note 6	3,075,994	2,988,543
Provision for uncollectible accounts	7,318,485	6,058,850
Other -- Note 12	13,950,458	12,675,763
TOTAL OPERATING EXPENSES	126,653,764	117,525,281
(LOSS) INCOME FROM OPERATIONS	(3,126,928)	1,396,697
NONOPERATING GAINS (LOSSES)		
Investment income -- Note 3	(672,164)	(2,768,300)
Income from equity investments -- Note 2	384,303	323,472
NONOPERATING LOSSES, NET	(287,861)	(2,444,828)
LOSS BEFORE NONCONTROLLING INTEREST	(3,414,789)	(1,048,131)
NONCONTROLLING INTEREST IN NET LOSS OF SUBSIDIARIES	(146,827)	(15,009)
EXCESS OF EXPENSES OVER REVENUE	(3,561,616)	(1,063,140)
Net assets released from restrictions for capital acquisitions	256,496	293,076
Pension-related changes other than net periodic pension cost -- Note 7	(4,868,555)	(2,381,659)
Net unrealized gains (losses) on marketable investments -- Note 3	3,892,171	(8,153,824)
DECREASE IN UNRESTRICTED NET ASSETS	$ (4,281,504)	$ (11,305,547)

See the accompanying notes to consolidated financial statements.

Calvert Health System, Inc. and Subsidiaries
Consolidated Statements of Changes in Net Assets

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
NET ASSETS, JUNE 30, 2008	$ 102,021,745	$ 679,232	$ 616,984	$ 103,317,961
Excess of expenses over revenue	(1,063,140)	0	0	(1,063,140)
Transfer of net assets	0	(5,555)	5,555	0
Contributions	0	787,370	0	787,370
Net assets released from restrictions for capital acquisitions	293,076	(293,076)	0	0
Net assets released from restrictions to fund operating programs	0	(389,457)	0	(389,457)
Investment income on restricted net assets -- Note 3	0	0	17,968	17,968
Pension-related changes other than net periodic pension cost -- Note 7	(2,381,659)	0	0	(2,381,659)
Net unrealized losses on marketable investments -- Note 3	(8,153,824)	0	(133,492)	(8,287,316)
Increase (decrease) in net assets	(11,305,547)	99,282	(109,969)	(11,316,234)
NET ASSETS, JUNE 30, 2009	$ 90,716,198	$ 778,514	$ 507,015	$ 92,001,727
Excess of expenses over revenue	(3,561,616)	0	0	(3,561,616)
Transfer of net assets	0	12,750	(12,750)	0
Contributions	0	865,637	0	865,637
Net assets released from restrictions for capital acquisitions	256,496	(256,496)	0	0
Net assets released from restrictions to fund operating programs	0	(699,412)	0	(699,412)
Investment income on restricted net assets -- Note 3	0	0	14,982	14,982
Pension-related changes other than net periodic pension cost -- Note 7	(4,868,555)	0	0	(4,868,555)
Net unrealized gains on marketable investments -- Note 3	3,892,171	0	56,007	3,948,178
Increase (decrease) in net assets	(4,281,504)	(77,521)	58,239	(4,300,786)
NET ASSETS, JUNE 30, 2010	$ 86,434,694	$ 700,993	$ 565,254	$ 87,700,941

See the accompanying notes to the consolidated financial statements.

Calvert Health System, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Decrease in net assets	$ (4,300,786)	$ (11,316,234)
Adjustments to reconcile decrease in net assets to net cash and cash equivalents provided by operating activities:		
Provision for uncollectible accounts	7,318,485	6,058,850
Depreciation and amortization	8,689,465	7,157,897
Cash donations restricted for capital acquisition	(462,709)	(404,960)
Equity in earnings of affiliated enterprises	(384,303)	(323,472)
Investment income on restricted assets	(14,982)	(17,968)
Realized net losses on investments	933,885	3,272,739
Unrealized net (gains) losses on investments	(3,948,178)	8,287,316
Noncontrolling interest in net loss of subsidiaries	146,827	15,009
Pension-related changes other than net periodic pension cost	4,868,555	2,381,659
Increase in patient accounts receivable	(7,824,485)	(6,390,350)
Decrease in inventories	217,431	43,611
Decrease in prepaid expenses and other assets	625,759	173,241
Increase (decrease) in accounts payable, accrued expenses & other liabilities	599,286	(196,210)
NET CASH AND CASH EQUIVALENTS PROVIDED BY OPERATING ACTIVITIES	6,464,250	8,741,128
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(17,828,880)	(9,467,360)
Sales of investments	16,728,555	13,384,142
Net (increase) decrease in assets limited as to use	(44,257)	2,158,011
Purchases of property and equipment	(10,007,634)	(14,340,527)
NET CASH AND CASH EQUIVALENTS USED IN INVESTING ACTIVITIES	(11,152,216)	(8,265,734)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term debt	(780,000)	(745,000)
Proceeds from issuance of new long-term debt	0	7,000,000
Total cash received restricted for capital acquisitions	462,709	404,960
Distributions to noncontrolling interests	(107,800)	0
Net distributions from investees	334,154	93,311
Investment income on restricted assets	14,982	17,968
NET CASH AND CASH EQUIVALENTS (USED IN) PROVIDED BY FINANCING ACTIVITIES	(75,955)	6,771,239
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(4,763,921)	7,246,633
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	22,102,121	14,855,488
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 17,338,200	$ 22,102,121

See accompanying notes to the consolidated financial statements.

Calvert Health System, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements

Note 1 - Organization and Summary of Significant Accounting Policies

Organization

Calvert Health System, Inc. and subsidiaries (the System), a Maryland corporation formed on January 1, 2000, is the sole member of Calvert Memorial Hospital of Calvert County (the Hospital), CMH Holding Company (Holding Co. I) and CMH II Holding Company (Holding Co. II).

The System and the Hospital are nonprofit, nonstock membership corporations formed under the laws of the State of Maryland, organized for charitable purposes and exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC).

Holding Co. I and Holding Co. II are nonprofit, nonstock membership corporations formed under the laws of the State of Maryland, organized for charitable purposes and exempt from Federal income taxes under Section 501(c)(2) of the IRC. Holding Co. I owns an interest in a medical office building on the Hospital's campus and a medical office building in Solomon's Island, Maryland. Holding Company II owns a medical office building on the Hospital's campus and owns a 100% interest in Calvert Medical Arts Center, LLC (CMAC) which owns the Calvert Medical Arts building on the Hospital's campus.

The Hospital has four wholly owned or controlled subsidiaries: Calvert Memorial Hospital Foundation, Inc. (the Foundation); Calvert Health Ventures (CHV); Calvert Physician Associates, LLC (CPA); and Calvert Community Health, Inc. (CCH). The Foundation is a non-profit corporation which holds and manages certain investment assets for the benefit of the Hospital. CHV is a for-profit corporation that owns and manages investments in certain health care related entities, including Calvert Medical Management, LLC (CMM), an imaging center, a physical therapy and sports rehabilitation center, and a medical office building in Dunkirk, Maryland. CPA is a limited liability company which employs physicians who provide health care services for the residents of Calvert County and the surrounding area. CMM is a medical service organization that supports CPA's operations and the Hospital's ambulatory electronic health record project. CCH is the Hospital's for-profit organization to establish managed care contracts. CCH is currently inactive.

CHV holds a 51% indirect interest in Calvert Physical Therapy and Sports Fitness Center (CPTSFC), a joint venture between CHV, Kubb Physical Therapy Partnership (Kubb) and NRH Ambulatory Services, Inc. (NRH). The Hospital's consolidated financial statements include CPTSFC as a consolidated subsidiary and reflect Kubb's and NRH's noncontrolling interests in CPTSFC's net assets and net income.

Principles of Consolidation

At June 30, 2010 and 2009, the System's consolidated financial statements include the accounts of the Hospital and its wholly owned or controlled subsidiaries, Holding Co. I and Holding Co. II. All material intercompany transactions are eliminated.

Note 1 - Organization and Summary of Significant Accounting Policies - Continued

Basis of Presentation

The System classifies net assets, revenues, expenses, gains and losses, based on the existence or absence of donor-imposed restrictions; accordingly, net assets of the System and changes therein are classified and reported as follows:

> *Unrestricted net assets* - Net assets that are not subject to donor-imposed stipulations.
>
> *Temporarily restricted net assets* - Net assets subject to donor-imposed stipulations that may or will be met either by actions of the System and/or the passage of time.
>
> *Permanently restricted net assets* - Net assets subject to donor-imposed stipulations that will be maintained permanently by the System. Generally, the donors of these assets permit the System to use all or part of the income earned on related investments for general or specific purposes.

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 with no donor-imposed restrictions are recognized as revenues in the period received as increases in unrestricted net assets. Contributions with donor-imposed restrictions are reported as increases in temporarily or permanently restricted net assets unless such contributions are expended in the same fiscal year, in which case they are recorded as unrestricted contributions. 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 net assets released from restriction and reclassified between the applicable classes of net assets. In accordance with applicable accounting standards, assets that have been released to support the Hospital's operating programs are reported as a component of other operating revenue in the accompanying consolidated statements of operations; whereas assets that are released for the acquisition of property and equipment are reported as a direct increase to unrestricted net assets in the accompanying consolidated statements of changes in net assets.

Income and realized net gains/losses on investments are reported as:

- Increases in permanently restricted net assets if the terms of the gift or the System’s interpretation of relevant state law require that they be added to the principal of a permanent endowment fund;

- Increases in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income;

- Increases in unrestricted net assets in all other cases.

Note 1 - Organization and Summary of Significant Accounting Policies - Continued

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 period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of highly liquid, unrestricted, short-term investments in U.S. Treasury bills, commercial paper, and other interest bearing deposits with maturities of less than one year from the date of purchase. Primarily all of the System's cash and cash equivalents are maintained in one commercial bank, of which an aggregate maximum of $250,000 is insured by the Federal Deposit Insurance Corporation (FDIC). The System's cash balance routinely exceeds the maximum amount insured by the FDIC.

Investments

Investments in debt and equity securities are recorded at market value which approximates fair value. Investment income, realized gains and losses and unrealized gains and losses on trading securities are reported in the consolidated statements of operations unless restricted by the donor, in which case they are reported as an addition to, or deduction from, the fund balance of the appropriate donor-restricted fund. In accordance with applicable accounting standards, unrealized gains and losses on securities classified as other than trading are reported as a direct charge to net assets in the accompanying consolidated statements of changes in net assets. The specific identification method is used to compute realized gains or losses on sales of investments. Other investments, when acquired by gift or bequest, are recorded at fair value at the date received and adjusted in future periods to reflect the fair market value of the assets. Approximately $2,391,000 and $1,926,000 of the investments balance at June 30, 2010 and 2009, respectively, has been designated to fund an executive severance and deferred compensation plan that has been established to provide benefits to the System's executive management team.

The System periodically evaluates whether any declines in the fair value of investments are other-than-temporary. This evaluation consists of a review of several factors, including but not limited to: length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; the near term prospects for recovery of the fair value of a security; and the intent and ability of the System to hold the security until the fair value recovers. Declines in fair value below cost that are deemed to be other-than-temporary result in realized losses with the market value becoming the new cost basis for the security.

Note 1 - Organization and Summary of Significant Accounting Policies - Continued

Investments in Affiliated Enterprises

Investments in affiliated, non-controlled enterprises are accounted for using the equity method of accounting.

Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under indenture agreements and designated assets set aside by the Board of Trustees for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes. These assets are stated at market value, which approximates fair value. This balance also reflects the discounted net present value of pledges receivable reported by the Foundation (*see Notes 3 and 13*).

Property and Equipment

Property and equipment acquisitions are recorded at cost, except for donated items, which are recorded at fair value at the date of donation. Renovations, alterations, and improvements that increase the useful lives or the functionality of the related assets are capitalized and subsequently depreciated over the remaining useful life of each class of depreciable assets. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets. Useful lives range from 20-40 years for buildings, 5-10 years for equipment and 10-20 years for leasehold improvements. Interest cost incurred on borrowed funds during the construction period of capital assets is capitalized as a component of the cost of acquiring those assets.

Other Assets

Other assets consist of deferred financing costs, long term prepaid rent, and long term other receivables. Gross deferred financing costs are amortized over the life of the related bonds and amounted to $885,867 at June 30, 2010 and 2009. Accumulated amortization of such costs amounted to $339,257 and $305,227 at June 30, 2010 and 2009, respectively.

Third Party Advances

The Hospital receives advances from third party payers to provide working capital for services rendered to the beneficiaries of such services. These advances are subject to periodic adjustment, and are principally determined based on the timing difference between the provision of care and the anticipated payment date of the claim for service.

Consolidated Statements of Operations

For purposes of display, transactions deemed by management to be ongoing, major or central to the provision of health care services are reported as revenue and expenses. Peripheral or incidental transactions are reported as non-operating gains and losses.

Note 1 - Organization and Summary of Significant Accounting Policies - Continued

Excess of Revenue over Expenses

The consolidated statements of operations and other changes in unrestricted net assets report excess of revenue over expenses. Changes in unrestricted net assets which are excluded from this performance indicator, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, contributions of (and assets released from donor restrictions related to) long-lived assets.

Net Patient Service Revenue and Patient Accounts Receivable

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 10*). Contractual adjustments represent the differences between amounts billed as patient service revenue and amounts allowed by third party payers, and are accrued on an estimated basis in the period in which the related services are rendered and adjusted in future periods as final settlements are determined. Contractual adjustments are included in the determination of net patient service revenue as reported in the accompanying consolidated statements of operations, whereas the provision for uncollectible self-pay amounts is reported as an operating expense. Rates charged are based primarily on rates established by the State of Maryland Health Services Cost Review Commission (HSCRC); accordingly, revenue reflects actual charges to patients based on rates in effect during the period in which the services are rendered (*see Notes 9 and 10*).

The Hospital grants credit without collateral to its patients, most of whom are local residents insured under third-party payer agreements (see *Note 10*). 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 on an estimate of uncollectible accounts. Write-off of uncollectible accounts is determined on a case-by-case basis after a review of the circumstances surrounding individual patient accounts.

Charity Care

The System provides care to patients regardless of their ability to pay. In identifying charity care, the System assesses the patient's ability to pay, utilizing generally recognized poverty income levels for the community, and identifies certain cases where incurred charges are considered to be beyond the patient's ability to pay. Because the System does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as a component of net patient service revenue or patient accounts receivable (*see Note 10*).

Note 1 - Organization and Summary of Significant Accounting Policies - Continued

Charity Care - Continued

The System maintains records to identify and monitor the level of charity care it provides. These records represent the amount of charges forgone under its charity care policy and amounted to approximately $2,021,100 in 2010 and $1,500,600 in 2009. The charity policy of the System provides free care to patients up to 200% of the federal poverty level and provides free care on a sliding scale up to 300% of the federal poverty level.

Other Operating Revenue

Other operating revenue of the System includes cafeteria income, grant income, and revenue from instructional classes and other operating programs.

Tax-Exempt Status

The System is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code as a public charity. The System is entitled to rely on this determination as long as there are no substantial changes in its character, purposes, or methods of operation. Management has concluded that there have been no such changes and therefore the System's status as a public charity exempt from federal income taxation remains in effect.

The state in which the System operates also provides general exemption from state income taxation for organizations that are exempt from federal income taxation. However, the System 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 System 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. Although information returns were filed, no tax returns were filed during 2010 and 2009.

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.

Inventories

Inventories consist primarily of drugs and medical supplies and are carried at the lower of cost or market, as determined principally by the first-in, first-out method.

Note 1 - Organization and Summary of Significant Accounting Policies - Continued

Subsequent Events

Subsequent events have been evaluated by management through October 7, 2010, which is the date the financial statements were available to be issued.

Recent Changes in Accounting Standards

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

Note 2 - Investments in Affiliated Enterprises

A summary of investments in affiliated enterprises at June 30 follows:

	2010		2009	
	Investment	Income	Investment	Income
Calvert Medical Imaging Center	$ 1,059,530	$ 176,936	$ 1,182,594	$ 125,791
NRH/CPT Regional Rehab, LLC	63,998	29,589	67,375	28,488
Chesapeake-Potomac Healthcare Alliance, LLC	2,462,192	187,470	2,274,722	216,671
Chesapeake Physical Medicine, LLC	18,237	(3,915)	22,152	883
Freestate Healthcare Insurance Company, LTD	20,339	0	15,339	(18,109)
Maryland eCare, LLC	(4,699)	522	(5,221)	(11,221)
Calvert Medical Office Building Limited Partnership	129,274	(6,299)	141,761	(19,031)
	$ 3,748,871	$ 384,303	$ 3,698,722	$ 323,472

Note 2 - Investments in Affiliated Enterprises - Continued

An overview of these organizations is presented in this note. Because the Hospital's investment in Calvert Medical Imaging Center (CMIC) represents approximately 28% and 33% and the Hospital's investment in Chesapeake-Potomac Healthcare Alliance (the Alliance) represents approximately 66% and 64% of the reported investment balance in affiliates as of June 30, 2010 and 2009, respectively, summarized financial information for CMIC and the Alliance is also presented in this note.

Calvert Medical Imaging Center

Calvert Medical Imaging Center (CMIC) is a joint venture between CHV and American Radiology Services, Inc. which operates diagnostic imaging facilities. CHV maintains a 50% interest in CMIC.

Summarized unaudited financial information of CMIC as of and for the years ended June 30 is presented below:

	2010	2009
Total assets	$ 7,556,993	$ 5,497,336
Total liabilities	5,491,780	3,102,443
Partners' capital	2,065,213	2,394,893
Total liabilities and partners' capital	$ 7,556,993	$ 5,497,336

	2010	2009
Total revenue	$ 6,521,874	$ 5,541,253
Net income	346,933	192,091

Note 2 - Investments in Affiliated Enterprises - Continued

NRH/CPT Regional Rehab, LLC

CHV invested in NRH/CPT Regional Rehab, LLC (NRH/CPT) for the purpose of providing comprehensive and coordinated physical therapy and rehabilitation services in St. Mary's and Charles counties. CHV maintains a 15% interest in NRH/CPT.

Chesapeake-Potomac Healthcare Alliance, LLC

Chesapeake-Potomac Healthcare Alliance, LLC (the Alliance) is a joint venture in which the Hospital and two other hospitals have invested equally. It was created to provide certain healthcare services to the population of southern Maryland. The Alliance is a 60% owner of Chesapeake Potomac Regional Cancer Center, LLC (CPRCC), a limited liability company which owns and operates two outpatient radiation oncology centers. The other 40% of CPRCC is owned by Holy Cross Hospital of Silver Spring and Adventist Healthcare, Inc. The Alliance is also one of two members in Chesapeake-Potomac Home Health Agency, Inc., a Maryland non-stock corporation that was formed in 1995 for the purpose of providing home health care and other health care services to individuals in need of such services in Calvert, Charles and St. Mary's counties.

Summarized unaudited financial information of the Alliance as of and for the years ended June 30 is presented below:

	2010	2009
Total assets	$ 15,206,913	$ 15,267,561
Total liabilities	6,039,130	7,016,073
Members' equity	9,167,783	8,251,488
Total liabilities and members' equity	$ 15,206,913	$ 15,267,561

	2010	2009
Total revenue	$ 12,043,126	$ 13,747,506
Net income	916,295	1,199,918

Note 2 - Investments in Affiliated Enterprises - Continued

Chesapeake Physical Medicine, LLC

Chesapeake Physical Medicine, LLC is a joint venture of CHV and a group of medical professionals created to provide outpatient chiropractic services to the population of Calvert County. CHV maintains a 25% interest in this joint venture.

Freestate Healthcare Insurance Company, LTD

Freestate Healthcare Insurance Company, LTD is a captive insurance company formed in the Cayman Islands. It is owned by eight Maryland hospitals. Freestate provides insurance coverage to its shareholders for professional liability and comprehensive general liability (*see Note 8*).

Maryland eCare, LLC

Maryland eCare, LLC is a joint venture formed by seven Maryland hospitals to provide remote monitoring technology with clinical decision support and physician/nursing services for their use in intensive care units and other clinical areas within their respective hospitals. The Hospital maintains a 7.8% interest in this joint venture.

Calvert Medical Office Building Limited Partnership

Holding Co. I has a 7.6% limited partnership interest in Calvert Medical Office Building Limited Partnership.

Note 3 - Investments

Unrestricted investments, stated at market value, which approximates fair value at June 30 include:

	2010	2009
Equity mutual funds	$ 24,925,686	$ 16,091,876
Fixed income mutual funds	9,314,246	9,437,178
Alternative investments	3,716,174	8,114,586
	37,956,106	33,643,640
Less short-term investments	5,820	5,045
Long-term investments	$ 37,950,286	$ 33,638,595

Note 3 – Investments - Continued

Assets limited as to use, stated at fair value, at June 30 include:

	2010	2009
Internally designated for capital acquisition and scholarships:		
Cash and cash equivalents	$ 598,924	$ 609,667
Net pledges receivable (see Note 13)	102,079	168,847
Equity mutual funds	2,010,991	1,829,662
	2,711,994	2,608,176
Held by trustee under indenture agreement:		
Cash and cash equivalents	2,419,668	3,286,088
U.S. Government issues	3,655,280	2,826,011
	$ 8,786,942	$ 8,720,275

Assets held by a trustee under indenture agreements consist of the following funds at June 30:

	2010	2009
Debt service fund	$ 2,340,540	$ 2,335,883
Debt service reserve fund	3,734,408	3,776,216
	$ 6,074,948	$ 6,112,099

The debt service fund is comprised of principal and interest funds held by a trustee in accordance with the Hospital's bond indentures. The debt service fund is classified as a current asset in the accompanying consolidated statements of financial position.

The System's investments include investments in limited partnerships and other alternative investments, which are made in accordance with the System's investment policies. The limited partnerships acquire, hold, invest, manage, dispose of, and otherwise deal in and with securities of all kinds and descriptions. Publicly traded securities are generally valued by reference to closing market prices on one or more national securities exchange or generally accepted pricing services selected by the fund managers of the limited partnership. Securities not valued by such pricing services will be valued upon bid quotations obtained from independent dealers in the securities. In the absence of any independent quotations, securities will be valued by the fund managers on the basis of data obtained from the best available sources. Investments in limited partnerships are accounted for under the equity method. The equity in earnings or losses from these investments is recorded as a component of investment income in the consolidated statement of operations. Although the various fund managers use their best judgment at estimating the fair value of the alternative investments, there are inherent limitations in any valuation technique. Therefore, the value is not necessarily indicative of the amount that could be realized in a current transaction. Future events will also affect the estimates of fair value, and the effect of such events on the estimates of the fair value could be material.

Note 3 - Investments - Continued

Investment income and gains for assets limited as to use, cash equivalents and other investments are comprised of the following for the years ended June 30:

	2010	2009
Income:		
Interest and dividend income	$ 738,313	$ 920,479
Realized losses	(1,395,495)	(3,670,811)
Total investment income	$ (657,182)	$ (2,750,332)
Unrealized gains (losses) on investments	$ 3,948,178	$ (8,287,316)

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 framework for measuring fair value, 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(s) 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.

Note 3 - Investments – Continued

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 System'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 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 for System's fixed maturity securities 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. System's fixed maturity securities portfolio is highly liquid, which allows for a high percentage of the portfolio to be priced through pricing services.

Fair values of equity securities have been determined by System 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.

System's investments include investments in limited partnerships and other alternative investments, which are made in accordance with System's investment policies. The limited partnerships acquire, hold, invest, manage, dispose of, and otherwise deal in and with securities of all kinds and descriptions. Publicly traded securities are generally valued by reference to closing market prices on one or more national securities exchange or generally accepted pricing services selected by the fund managers of the limited partnership. Securities not valued by such pricing services will be valued upon bid quotations obtained from independent dealers in the securities.

Calvert Health System, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements - Continued

Note 3 - Investments – Continued

The following table presents System's fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2010 and 2009:

2010	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 3,018,582	$ 0	$ 0
Equity mutual funds	26,936,677	0	0
Fixed income mutual funds	9,314,246	0	0
Alternative investments	0	2,385,379	1,330,795
U.S. Government issues	3,655,280	0	0
	$ 42,924,785	$ 2,385,379	$ 1,330,795

2009	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 3,895,755	$ 0	$ 0
Equity mutual funds	17,921,538	0	0
Fixed income mutual funds	9,437,178	0	0
Alternative investments	0	4,401,845	3,712,741
U.S. Government issues	2,826,011	0	0
	$ 34,080,482	$ 4,401,845	$ 3,712,741

The following table presents the activity during 2010 for the Level 3 funds:

Market value at June 30, 2009	$ 3,712,741
Net realized losses	(786,768)
Disbursements	(2,634,685)
Unrealized gains	1,039,507
Market value at June 30, 2010	$ 1,330,795

The following table presents the activity during 2009 for the Level 3 funds:

Market value at June 30, 2008	$ 5,242,223
Net realized losses	(64,227)
Disbursements	(185,939)
Unrealized losses	(1,279,316)
Market value at June 30, 2009	$ 3,712,741

Note 4 - Temporarily and Permanently Restricted Net Assets

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

	2010	2009
Purchase of equipment	$ 466,583	$ 502,116
Health education	12,485	13,793
Health care services	221,925	262,605
	$ 700,993	$ 778,514

Permanently restricted net assets at June 30 are restricted to:

	2010	2009
Investments to be held in perpetuity, the income from which is expendable to support health education	$ 565,254	$ 507,015

Note 5 - Property and Equipment

A summary of property and equipment at June 30 follows:

	2010	2009
Land improvements	$ 2,440,120	$ 2,429,480
Buildings	65,845,930	64,561,843
Building improvements	31,848,421	31,186,167
Fixed equipment	4,309,823	4,112,418
Movable equipment	46,908,126	42,396,481
	151,352,420	144,686,389
Less accumulated depreciation and amortization	70,176,361	63,167,632
	81,176,059	81,518,757
Land	5,658,386	5,406,046
Construction in progress	2,169,382	726,285
Property and equipment, net	$ 89,003,827	$ 87,651,088

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. Interest capitalized for the years ended June 30, 2010 and 2009 amounted to $0 and $86,779, respectively.

Depreciation expense for the years ended June 30, 2010 and 2009 amounted to $8,654,895 and $7,123,275 respectively.

Note 6 - Long-Term Debt

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

	2010	2009
Maryland Health and Higher Educational Facilities Authority Revenue Bonds (1998 Revenue Bonds); maturing in varying amounts from July 1, 1999 to July 1, 2028; interest due semi-annually at rates ranging from 3.9% to 5.25%; (4.80% and 4.75% at June 30, 2010 and 2009, respectively).	$ 21,855,000	$ 22,540,000
Maryland Health and Higher Educational Facilities Authority Revenue Bonds (2004 Revenue Bonds); maturing in varying amounts from July 1, 2008 to July 1, 2039; interest due semi-annually at rates ranging from 3.5% to 5.5%; (4.0% at June 30, 2010 and 2009).	32,735,000	32,830,000
Maryland Bank & Trust Company term loan payable, commencing on November 21, 2008 interest due monthly at variable rates based on the LIBOR Rate (1.99% and 1.968% at June 30, 2010 and 2009, respectively); due September 2015.	7,000,000	7,000,000
	61,590,000	62,370,000
Less current portion	815,000	780,000
	60,775,000	61,590,000
Less amortized original issue discount	834,555	876,575
	$ 59,940,445	$ 60,713,425

Series 1998 Revenue Bonds

The 1998 Revenue Bonds were issued by the Maryland Health and Higher Educational Facilities Authority (the Authority) on June 11, 1998 for the purpose of financing and refinancing the costs of acquisition, construction, renovation and equipping of certain hospital facilities. The Obligated Group for the 1998 Revenue Bonds is composed of Calvert Memorial Hospital and Calvert Health System. As security for the performance of its obligations under the related Loan Agreement, the Obligated Group members have granted a security interest in its receipts, revenues, rental income and other moneys received by or on behalf of any Obligated Group member to the Authority. The Obligated Group is required to maintain certain deposits in the form of a debt service reserve fund with a trustee. Such deposits are included in assets limited as to use. The revenue bonds also place limits on the incurrence of additional borrowings. The required debt service coverage ratio is 1.10. Annual payments (ranging from $870,000 in 2014 to $1,640,000 in 2027) to a sinking fund relating to the revenue bonds will commence in 2014 with a final balance of $1,720,000 on July 1, 2028. Series 1998 bonds maturing on or after July 1, 2009, are subject to redemption prior to maturity beginning on July 1, 2008, at the option of the Authority upon the direction of the Hospital. Management believes it is in compliance with all applicable covenants.

Note 6 - Long-Term Debt - Continued

Series 2004 Revenue Bonds

The 2004 Revenue Bonds were issued by the Authority on July 8, 2004 for the purpose of financing the costs of acquisition, construction, renovation and equipping of certain hospital facilities. The Obligated Group for the 2004 Revenue Bonds is composed of Calvert Memorial Hospital and Calvert Health System. As security for the performance of its obligations under the related Loan Agreement, the Obligated Group members have granted a security interest in its receipts, revenues, rental income and other moneys received by or on behalf of any Obligated Group member to the Authority. The Obligated Group is required to maintain certain deposits in the form of a debt service reserve fund with a trustee. Such deposits are included in assets limited as to use. The revenue bonds also place limits on the incurrence of additional borrowings. The required debt service coverage ratio is 1.10. Annual payments (ranging from $145,000 in 2019 to $3,320,000 in 2038) to a sinking fund relating to the revenue bonds will commence in 2019 with a final balance of $3,500,000 on July 1, 2039. Series 2004 bonds maturing on or after July 1, 2015 are subject to redemption prior to maturity beginning on July 1, 2014 at the option of the Authority upon the direction of the Hospital. Management believes it is in compliance with all applicable covenants.

Commercial loan

In November 2008, the System obtained a loan from a commercial bank for the purpose of financing a portion of the construction of the Calvert Medical Arts Center. Principal payments are payable in 23 consecutive monthly payments payable on the first day on each month beginning October 2013 (the conversion date). The System is required to make principal payments in the amount necessary to fully amortize the balance over a period of twenty-five years from the conversion date.

The System is required to pay the unpaid balance plus all accrued interest thereon, on September 1, 2015. Interest is required to be paid monthly. The interest rate is calculated using the LIBOR rate in effect from time to time, plus 1.65% per annum.

Principal payments due under all debt instruments as of June 30, 2010 are as follows:

2011	$ 815,000
2012	850,000
2013	895,000
2014	935,000
2015	985,000
and thereafter	57,110,000
Total	$ 61,590,000

Interest paid on indebtedness by the System was $3,033,269 and $3,031,138 in 2010 and 2009, respectively.

Note 7 - Employee Pension Plans

The Hospital has a defined contribution plan whereby contributions are made on an annual basis by participating employees and the Hospital. Substantially all employees are eligible to participate, subject to meeting the criteria specified by the plan. Participating employees are permitted to contribute up to 20% of their annual compensation, not to exceed a maximum threshold as set forth by the IRS on an annual basis. The Hospital provides a matching contribution not to exceed 2% of each employee's base annual compensation. Employees hired January 1, 2008 and later are only eligible to participate in the defined contribution plan. They receive an employer contribution of 2.5% of their annual W-2 wages. They may receive an additional employer matching contribution of up to 2% based upon the participant's own contribution.

Additionally, the Hospital has a qualified non-contributory defined benefit pension plan covering substantially all employees who were employed by the Hospital prior to January 1, 2008, as well as certain employees of the System who meet certain age and service requirements. Effective January 1, 2008, the Hospital instituted a "soft freeze" of the defined benefit plan. The plan was amended effective January 1, 1993 from a defined benefit plan, the benefits of which were calculated primarily upon age and employee compensation near retirement, to a cash balance defined benefit plan, which calculates benefits based upon age and years of service. The Hospital makes annual contributions to the plan based on the advice of consulting actuaries. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The Hospital used a June 30 measurement date for its plan in 2010 and 2009.

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

	2010	2009
Benefit obligation at beginning of year	$ 19,979,289	$ 20,028,035
Service cost	797,824	851,700
Interest cost	1,373,393	1,544,596
Amendments	0	(159,534)
Changes in assumptions	5,390,576	(753,513)
Actuarial loss (gain)	538,813	(912,310)
Benefits paid	(495,116)	(619,685)
Benefit obligation at end of year	$ 27,584,779	$ 19,979,289

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

	2010	2009
Fair value of plan assets at beginning of year	$ 15,878,976	$ 18,806,844
Actual return on plan assets	1,758,196	(2,933,183)
Employer contributions	2,335,000	625,000
Actual benefits paid	(495,116)	(619,685)
Fair value of plan assets at end of year	$ 19,477,056	$ 15,878,976

Calvert Health System, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements - Continued

Note 7 - Employee Pension Plans – Continued

In accordance with current standards, the Hospital recognized the full extent of the underfunded (a liability) status of the plan, which is measured as the difference between the fair value of the Plan assets and the projected benefit obligation. As of June 30, 2010 and 2009, the plan's projected benefit obligation exceeded the fair value of the Plan's assets by $8,107,723 and $4,100,313, respectively. The Plan's accumulated benefit obligation was $26,225,218 and $18,427,227 as of June 30, 2010 and 2009, respectively.

Net periodic pension cost for the years ended June 30 include the following components:

	2010	2009
Service cost	$ 797,824	$ 851,700
Interest cost	$ 1,373,393	1,544,596
Expected return on plan assets	(1,401,951)	(1,967,662)
Amortization of prior service cost	(29,633)	(42,674)
Recognized net actuarial loss	734,222	736,504
Net periodic benefit cost	$ 1,473,855	$ 1,122,464

The following table sets forth the weighted average assumptions used to determine benefit obligations as of June 30:

	2010	2009
Discount rate	5.66%	6.75%
Rate of compensation increase	3.00%	4.00%

The following table sets forth the weighted average assumptions used to determine net periodic benefit costs for the years ended June 30:

	2010	2009
Discount rate	6.75%	6.30%
Expected return on plan assets	8.50%	8.50%
Rate of compensation increase	4.00%	4.00%

Amounts recognized in unrestricted net assets as of June 30 consist of:

	2010	2009
Net loss	$ 12,094,825	$ 7,255,903
Prior service cost	(151,715)	(181,348)
Total	$ 11,943,110	$ 7,074,555

Note 7 - Employee Pension Plans – Continued

The investment of pension assets is guided by the pension investment policy. Pension assets are invested to ensure that the pension plan has the ability to pay all benefit and expense obligations when due, to maximize return within prudent levels of risk for pension assets and to maintain a funding cushion for unexpected developments. The target weighted-average asset allocation of pension investments is 60% equities and 40% debt securities and cash. Equity securities primarily include investments in large-cap and mid-cap companies. Fixed income securities primarily include corporate bonds. Mutual funds (fixed income and equity) are valued by observable market quotations. The guaranteed deposit account is valued at contract value, (which include contributions made, adjusted for interest earned, participant withdrawals, and administrative expenses) which approximates fair value.

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

	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 25,340	$ 0	$ 0
Equity mutual funds	11,088,979	0	0
Fixed income mutual funds	5,010,055	0	0
Guaranteed deposit account	0	0	3,352,682
	$ 16,124,374	$ 0	$ 3,352,682

The following table presents the activity during 2010 for the Level 3 funds:

Balance, beginning of year	$ 2,978,896
Interest, disbursements, benefit payments	373,786
Balance, end of year	$ 3,352,682

The Hospital expects to contribute $2 million to its pension plan for fiscal year ending June 30, 2011. The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

2011	$ 636,046
2012	694,830
2013	765,165
2014	860,316
2015	1,001,533
2016-2020	7,310,011
Total expected benefit payments	$ 11,267,901

Note 8 - Malpractice Insurance

Prior to March 1, 2005, the Hospital maintained a professional liability insurance policy on a claims-made basis. Under this insurance policy, the Hospital was insured for individual claims up to $1,000,000 with a total annual aggregate of $3,000,000 with no deductible for claims made. The Hospital also had excess coverage of up to $10,000,000 for individual claims and in the aggregate.

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. As of June 30, 2010, the Hospital maintains a 12.5% shareholder interest in Freestate. The Hospital decided to become 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 a 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 and their affiliates for professional liability claims and comprehensive general liability of $1,000,000 for each and every claim. Freestate has entered into reinsurance and excess policy agreements with independent insurance companies to limit its losses for professional liability and comprehensive general liability claims. The Hospital has $10,000,000 of additional insurance in the aggregate through such reinsurance arrangements. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insureds under the policy. Each named insured's assessment or credit is based on the percentage of their actual exposure to the actual exposure of all named insureds. In management's opinion, the assets of Freestate are sufficient to meet its obligations as of June 30, 2010. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the responsibility to pay those claims would return to the member hospitals.

CPTSFC maintains a professional liability insurance policy on a claims-made basis. CPTSFC is insured for individual claims up to $1,000,000 with a total annual aggregate of $3,000,000 with no deductible.

The Hospital is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. Additional claims may be asserted against the Hospital arising from services provided through June 30, 2010. Management believes that no material loss will result from any pending or threatened litigation or from incidents incurred but not reported.

Note 9 - Maryland Health Services Cost Review Commission

Patient service revenue is recorded at rates established by the HSCRC. Under the HSCRC rate system, the Hospital's inpatient charges are subject to an inpatient charge per case target (adjusted for case mix) and unit rates for outpatient centers. Annually, both the charge per case and outpatient rates are adjusted by the update formula, rate compliance and case mix. Effective July 1, 2010, the Hospital entered into a Total Patient Revenue (TPR) rate agreement with the HSCRC. Under the TPR system, the Hospital is provided a fixed revenue (CAP) amount under which it must operate each year. The CAP is adjusted annually for inflation, change in the Hospital's payer mix and uncompensated care, and change in population.

Note 10 - Concentration of Credit and Business Risk

The System provides health care services to residents located primarily in Calvert, St. Mary's, southern Anne Arundel and Charles counties. The System generally does not require collateral or other security in extending credit; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits receivable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, health maintenance organizations and commercial insurance policies).

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

	2010		2009	
Medicare	$ 5,303,636	22.3 %	$ 5,123,783	22.2 %
Medicaid (including managed care)	2,887,198	12.2	2,482,820	10.8
Blue Cross	4,153,351	17.5	3,866,881	16.8
Commercial and other	2,492,378	10.5	1,969,933	8.5
HMO	4,327,599	18.2	4,904,240	21.2
Self-pay	4,574,990	19.3	4,734,210	20.5
	$ 23,739,152	100.0 %	$ 23,081,867	100.0 %
Less contractual adjustments	(4,222,211)		(3,938,369)	
	$ 19,516,941		$ 19,143,498	

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

	2010		2009	
Medicare	$ 50,291,550	35.1 %	$ 47,097,499	34.6 %
Medicaid (including managed care)	16,337,606	11.4	14,254,052	10.5
Blue Cross	26,953,335	18.8	23,919,735	17.6
Commercial and other	7,806,116	5.4	7,317,587	5.4
HMO	35,071,842	24.4	36,562,995	26.9
Self-pay	7,016,633	4.9	7,013,827	5.2
	$ 143,477,082	100.0 %	$ 136,165,695	100.0 %
Less contractual adjustments	(23,449,547)		(19,830,353)	
Less charity care	(2,021,139)		(1,500,565)	
	$ 118,006,396		$ 114,834,777	

Note 11 - Functional Expenses

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

	2010	2009
Health care services	$ 104,723,849	$ 99,516,272
General and administrative	21,929,915	18,009,009
	$ 126,653,764	$ 117,525,281

Note 12 - Lease Obligations

The System is obligated under various operating, leases for several office facilities and equipment leases. Total office rent and equipment lease expense was $1,467,679 and $1,036,304 for the years ended June 30, 2010 and 2009, respectively, and is reported as a component of other expenses in the accompanying consolidated statements of operations and other changes in unrestricted net assets. The future minimum lease payments expected to be made to non-affiliated parties under non-cancelable operating leases are as follows for the years ended June 30:

2011	$ 1,095,177
2012	885,408
2013	806,327
2014	307,949
2015	57,407
	$ 3,152,268

The System is the owner of four medical office buildings. Rents to be received in the future from affiliated enterprises and other tenants are as follows for the years ended June 30:

	Affiliates	Other	Total
2011	$ 757,477	$ 1,657,130	$ 2,414,607
2012	736,269	1,608,453	2,344,722
2013	630,426	1,474,549	2,104,975
2014	544,212	1,500,213	2,044,425
2015	6,761	307,386	314,147
	$ 2,675,145	$ 6,547,731	$ 9,222,876

Rental income totaling $2,546,713 and $1,541,270 has been recognized in the accompanying consolidated statements of operations and other changes in unrestricted net assets for the years ended June 30, 2010 and 2009, respectively.

Note 13 - Pledges Receivable

During 2004, the Hospital commenced a capital campaign. Contributions from the campaign are being used to fund major equipment purchases for various construction projects. At June 30, 2010 pledges receivable was $198,093 less an allowance for uncollectible pledges of $92,008 and a discount of $4,006. The discount rate used was 1.80% for the years ended June 30, 2012, 2013 and 2014.

The payment terms of the pledges receivable at June 30, 2010 are as follows:

2011	$	99,313
2012		74,853
2013		15,852
2014		8,075
		198,093
Less allowance for uncollectible accounts		(92,008)
Less discount		(4,006)
	$	102,079

The entire pledges receivable balance is reported as a non-current asset in the accompanying consolidated statements of financial position because it is temporarily restricted for the acquisition of property, plant, and equipment.

Note 14 - Certain Risks and Uncertainties

The Hospital's ability to maintain and/or increase future revenues could be adversely affected by: (1) proposed and/or future changes in the laws, rules, regulations, and policies relating to the definition, activities, and/or taxation of not-for-profit tax-exempt entities; (2) the enactment into law of all or any part of the current budget resolutions under consideration by Congress related to Medicare and Medicaid reimbursement methodology and/or further reductions in payments to hospitals and other health care providers; (3) the medical malpractice crisis which may force physicians on the medical staff to leave the practice of medicine in the State of Maryland; (4) limited supply of physicians nationally which may limit the Hospital's ability to meet the healthcare demands of the population within its primary and secondary service areas 5) the ultimate impact of the federal Patient Protection and Affordable Care Act and the Health Care Education Affordability Reconciliation Act of 2010.

The Joint Commission a non-governmental privately owned entity, provides accreditation status to hospitals and other health care organizations in the United States. Such accreditation is based upon a number of requirements such as undergoing periodic surveys conducted by Joint Commission personnel. Certain managed care payers require hospitals to have appropriate Joint Commission accreditation in order to participate in those programs. In addition, the Center for Medicare and Medicaid Services (CMS), the agency with oversight of the Medicare and Medicaid programs,

Note 14 - Certain Risks and Uncertainties – Continued

provides "deemed status" for facilities having Joint Commission accreditation. By being Joint Commission accredited, facilities are "deemed" to be in compliance with the Medicare and Medicaid conditions of participation. Termination as a Medicare provider or exclusion from any or all of these programs/payers would have a materially negative impact on the future financial position, operating results and cash flows of the Hospital. In November 2008 the Hospital was surveyed Joint Commission and received a full three-year Joint Commission accreditation through December 2011.

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

Note 15 - Fair Value of Financial Instruments

The carrying amounts reported in the consolidated statements of financial position for cash and cash equivalents, investments, patient accounts receivable, assets limited as of use, accounts payable and accrued expenses, and third party advances approximate the related fair values. The composition and related fair values of assets limited as to use and investments are disclosed in Note 3. The fair value of the System's outstanding long-term obligations as of June 30, 2010 and 2009 was approximately $54,583,267 and $51,967,247, respectively.

Note 16 - Endowment

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

Note 16 – Endowment - Continued

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

The Board of Directors of the System 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 Hospital 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 System 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 System 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 System
7. The investment policies of the System

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 System to retain as a fund of perpetual duration. There were no such deficiencies as of June 30, 2010 or 2009.

The System 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 Directors, 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 System 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.

Calvert Health System, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements - Continued

Note 16 – Endowment - Continued

To satisfy its long-term rate-of-return objectives, the System 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 System 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 as of June 30, 2010 and 2009 and the changes therein were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted
Donor-restricted endowment	$ 0	$ 0	$ 565,254

Changes in Endowment Net Assets
for the Fiscal Year June 30, 2010

	Unrestricted	Temporarily Restricted	Permanently Restricted
Endowment net assets, beginning of year	$ 0	$ 0	$ 507,015
Investment return:			
Net appreciation (realized and unrealized)	0	0	70,989
Other changes:			
Transfer to temporarily restricted net assets	0	0	(12,750)
Endowment net assets, end of year	$ 0	$ 0	$ 565,254

	Unrestricted	Temporarily	Permanently
Donor-restricted endowment	$ 0	$ 0	$ 507,015

Changes in Endowment Net Assets
for the Fiscal Year June 30, 2009

	Unrestricted	Temporarily	Permanently
Endowment net assets, beginning of year	$ 0	$ 0	$ 540,762
Investment return:			
Net appreciation (realized and unrealized)	0	0	(115,523)
Other changes:			
Transfer of net assets from unrestricted	0	0	76,221
Transfer from temporarily restricted net assets	0	0	5,555
Endowment net assets, end of year	$ 0	$ 0	$ 507,015