KPMG

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

Consolidated Financial Statements
and Supplementary Information

June 30, 2011 and 2010

(With Independent Auditors' Report thereon)

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

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KPMG LLP
1 East Pratt Street
Baltimore, MD 21202-1128

Independent Auditors' Report

The Board of Directors
Western Maryland Health System Corporation:

We have audited the accompanying consolidated balance sheets of Western Maryland Health System Corporation (the Health System) as of June 30, 2011 and 2010 and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Health 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 the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Health System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Western Maryland Health System Corporation as of June 30, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements of the Health System and subsidiaries taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and changes in net assets of the individual companies. The consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

As indicated in note 17, the Health System adopted Accounting Standards Codification Topic 958, *Not-for-Profit Entities: Mergers and Acquisition*.

KPMG LLP

October 24, 2011

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

Consolidated Balance Sheets

June 30, 2011 and 2010

(Dollars in thousands)

Assets		**2011**	**2010**
Current assets:			
Cash and cash equivalents	$	45,019	48,795
Investments		21,158	19,413
Funds on deposit with trustee		15,138	14,933
Accounts receivable, less allowance for uncollectible accounts of $7,539 in 2011 and $7,487 in 2010		44,625	36,592
Pledge receivable, net		1,708	2,326
Other receivables, less allowance for uncollectible accounts of $2,548 in 2011 and $1,616 in 2010		4,968	2,927
Inventories and other current assets		12,533	13,339
Total current assets		145,149	138,325
Funds on deposit with trustee		24,171	22,382
Board designated investments		840	1,012
Other long-term investments		677	721
Investments restricted by donor or grantor		2,865	2,424
Beneficial interest in trustee held Foundation assets		1,789	1,491
Property and equipment, net		373,141	394,732
Unamortized financing fees		4,568	4,881
Investments in affiliates		16,363	13,672
Other assets		392	1,249
Total assets	$	569,955	580,889
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	7,514	7,361
Accounts payable and accrued liabilities		6,968	9,827
Accrued bond interest payable		8,018	8,173
Accrued salaries and benefits		13,067	11,701
Payable to third-party payors		6,051	6,953
Total current liabilities		41,618	44,015
Long-term debt, net of current portion		337,210	345,419
Pension benefits in excess of pension assets		21,501	33,875
Other liabilities		8,582	23,576
Total liabilities		408,911	446,885
Commitments and contingencies			
Net assets:			
Unrestricted:			
Unrestricted net assets		152,651	124,649
Noncontrolling interest in consolidated subsidiaries (see note 17)		2,031	1,916
Total unrestricted net assets		154,682	126,565
Temporarily restricted		4,327	5,702
Permanently restricted		2,035	1,737
Total net assets		161,044	134,004
Total liabilities and net assets	$	569,955	580,889

See accompanying notes to consolidated financial statements.

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

Consolidated Statements of Operations

Years ended June 30, 2011 and 2010

(Dollars in thousands)

		2011	2010
Unrestricted revenues, gains and other support:			
Net patient service revenue	$	291,257	272,442
Other revenue		5,214	4,710
Total revenues, gains and other support		296,471	277,152
Expenses:			
Salaries and wages		100,384	100,743
Employee benefits		34,938	36,880
Professional fees		8,390	9,980
Purchased services		17,865	18,921
Supplies		57,720	60,491
Utilities		5,344	5,563
Insurance		4,833	5,002
Bad debts		5,832	6,680
Interest		16,114	10,336
Depreciation and amortization		29,551	17,883
Other		8,789	6,938
Total expenses		289,760	279,417
Operating income (see note 17)		6,711	(2,265)
Nonoperating income:			
Equity in income of affiliates		4,691	3,576
Investment income, including realized gains on trading portfolio		2,653	2,317
Unrealized gains on trading portfolio		1,277	527
Other		95	922
Total nonoperating income		8,716	7,342
Excess of revenues over expenses (see note 17)	$	15,427	5,077

See accompanying notes to consolidated financial statements.

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2011 and 2010

(Dollars in thousands)

		Unrestricted net assets	Temporarily restricted net assets	Permanently restricted net assets	Total net assets
Balance at June 30, 2009	$	128,923	12,474	1,546	142,943
Western Maryland Health System Foundation beginning net assets		4,707	5,735	—	10,442
Excess of revenues over expenses		5,077	—	—	5,077
Investment income		—	24	—	24
Change in unrealized gain on investments		—	—	191	191
Donations		—	348	—	348
Grants		—	2,014	—	2,014
Change in funded status of pension plan		(10,277)	—	—	(10,277)
Net assets released from restrictions used for operations		—	(2,666)	—	(2,666)
Net assets released for purchase of property and equipment		1,785	(1,785)	—	—
Change in beneficial interest of trustee-held and Foundations' assets		—	(10,442)	—	(10,442)
Distributions to noncontrolling interest in consolidated subsidiaries		(3,650)	—	—	(3,650)
Change in net assets		(2,358)	(6,772)	191	(8,939)
Balance at June 30, 2010		126,565	5,702	1,737	134,004
Excess of revenues over expenses		15,427	—	—	15,427
Investment income		—	11	—	11
Donations		—	373	—	373
Grants		15	1,024	—	1,039
Change in funded status of pension plan		14,018	—	—	14,018
Net assets released for purchase of property and equipment		2,783	(2,783)	—	—
Change in beneficial interest of trustee-held Foundation assets		—	—	298	298
Distributions to noncontrolling interest in consolidated subsidiaries		(4,126)	—	—	(4,126)
Change in net assets		28,117	(1,375)	298	27,040
Balance at June 30, 2011	$	154,682	4,327	2,035	161,044

See accompanying notes to consolidated financial statements.

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

Consolidated Statements of Cash Flows

Years ended June 30, 2011 and 2010

(Dollars in thousands)

		2011	2010
Cash flows from operating activities:			
Change in net assets	$	27,040	(8,939)
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		29,551	17,883
Amortization of bond premium		694	421
Change in funded status of pension plan		(14,018)	10,277
Provision for bad debts		5,832	6,680
Distributions to noncontrolling interest holder		4,126	3,650
Equity in income of affiliates		(4,691)	(3,576)
Realized and unrealized gains on investments		2,629	1,701
Change in beneficial interest in trustee held Foundation assets		(298)	(191)
Changes in assets and liabilities:			
Accounts receivable		(13,865)	(9,008)
Other receivables		(2,041)	1,110
Inventories and other current assets		806	(1,890)
Accounts payable and accrued liabilities and accrued salaries and benefits		(1,648)	(11,905)
Payable to third-party payors		(902)	1,605
Other assets, due to affiliates, funded status of pension plan, and other liabilities		(13,881)	11,777
Net cash provided by operating activities		19,334	19,595
Cash flows from investing activities:			
Purchase of long-lived assets		(7,647)	(73,899)
Change in funds on deposit with trustee		(1,994)	86,028
Net change in investments		(4,279)	2,783
Distributions from unconsolidated entities		2,000	—
Net cash provided by investing activities		(11,920)	14,912
Cash flows from financing activities:			
Repayments of long-term debt		(6,990)	(11,360)
Capital lease payments		(372)	(267)
Proceeds from restricted contributions and restricted investment income		298	191
Distributions to noncontrolling interest holder		(4,126)	(3,650)
Net cash used in financing activities		(11,190)	(15,086)
Net increase in cash and cash equivalents		(3,776)	19,421
Cash and cash equivalents at beginning of year		48,795	29,374
Cash and cash equivalents at end of year	$	45,019	48,795
Supplemental disclosure of cash flow information:			
Cash paid for interest	$	16,362	16,487
Accounts payable for fixed asset purchases	$	35	113

See accompanying notes to consolidated financial statements.

(1) Mission and Organization

Western Maryland Health System Corporation (the Health System or WMHS) is a not-for-profit community health system. The mission of the Health System is to improve the health status and quality of life of the individuals and the communities served, especially those in need. The Health System provides patient and family centered services through responsible management of human and fiscal resources. The Health System is a values-driven health system that respects and supports life, preserves the dignity of each individual, and promotes a healthy and just society through collaboration with others who share the Health System's values.

The Health System accepts patients regardless of their ability to pay. Those patients who meet certain criteria under its charity care policies receive services at no charge or at an amount less than full charges. Essentially, these policies define charity services as those services for which no payment is anticipated. In addition to providing charity care, the Health System provides other programs and services for the general community. The Health System offers over 90 community health programs that include programs that target health education programs and health screenings to patients. A wide variety of health screenings are offered throughout the year for the general community that are free of charge or offered for a nominal fee. The Health System provides free education programs on a variety of health topics. The Health System also sponsors an annual community health fair, which provides health screenings, education and activities targeted to health and safety.

The Health System is comprised of the following wholly or partially owned, and controlled, consolidated subsidiaries in Cumberland, Maryland:

(a) Acute Care Hospitals

Western Maryland Regional Medical Center – opened November 21, 2009

The Memorial Hospital and Medical Center of Cumberland, Inc. (Memorial) – ceased serving patients November 21, 2009

Braddock Hospital Corporation – ceased serving patients November 21, 2009

(b) Long-Term Care

Frostburg Nursing and Rehabilitation Center (Frostburg)

(c) Other

Western Maryland Health System Foundation, Inc.
Western Maryland Insurance Company, Ltd. (WMIC)
Haystack Consolidated Services Inc. (Haystack)
Cumberland Properties, Inc.
Memorial Medical Center Services, Inc. (MMCS)
Johnson Heights Medical Building Partnership (Johnson Heights)
Haystack Imaging Services, LLC (Haystack Imaging)

In addition, the Health System has investments in several unconsolidated affiliates which are accounted for on the cost or equity methods of accounting, as appropriate (see note 6).

(2) Summary of Significant Accounting Policies

(a) Principles of Consolidation

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles, and include the accounts of the Health System and its subsidiaries and controlled entities. Significant intercompany accounts and transactions have been eliminated in consolidation. The Health System's consolidated financial statements reflect the respective interests of the minority investors in the joint ventures' net assets and changes in net assets.

(b) Investments in Affiliates

Investments in certain joint ventures, which are not controlled by the Health System are accounted for using the cost or equity method of accounting as appropriate (see note 6). These investments are included as investments in affiliates in the accompanying consolidated balance sheets. The Health System's proportionate share of income or loss of the unconsolidated joint ventures is included in nonoperating income in the accompanying consolidated statements of operations.

(c) Cash Equivalents

Cash equivalents consist primarily of temporary investments with maturities of three months or less when purchased and certain overnight repurchase agreements. Overnight repurchases are principally unsecured and are subject to normal credit risk.

(d) Accounts Receivable

Patient accounts receivable are stated at estimated net realizable amounts from patients, third-party payors and other insurers when services are provided. The Health System bills the insurer directly for services provided. Insurance coverage and credit information is obtained from patients when available. No collateral is obtained for accounts receivable.

(e) Inventories

Inventories primarily consist of medical supplies and drugs and are carried at lower of cost or market. Cost is determined principally using the average cost method, which approximates the first-in first-out (FIFO) method.

(f) Investments

The Health System's investment portfolio, including board designated investments and investments restricted by donor or grantor, is considered a trading portfolio and is classified as current or noncurrent assets based on management's intention as to use. Accordingly, realized and unrealized gains and losses are included in investment income in the accompanying consolidated statements of

(Continued)

operations. Dividend and interest income, as well as realized gains on sales of securities, are included in investment income.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheet. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities.

(g) Property and Equipment

Property and equipment are stated at cost or, if donated, at fair market value at date of gift. Depreciation is determined using a straight-line basis over the estimated useful lives of the related assets. Repairs and maintenance are expensed as incurred.

Gifts of long-lived assets, such as land, building or equipment, or cash gifts to be used for purchase of long-lived assets, 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 reported are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as temporarily restricted net assets. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported as released from restrictions when the donated or acquired long-lived assets are placed in service.

The Health System opened a 275-bed, state-of-the-art hospital on November 21, 2009, at which time Braddock and Memorial Hospitals ceased serving patients. Adjacent to the new hospital is a 120,000-square-foot medical office building (MOB) previously owned and operated by a third-party medical office building developer (note 15) until the purchase of the MOB by WMHS on February 17, 2011. The MOB includes both hospital services and physicians’ office space. For fiscal year 2010, the Health System determined that due to certain costs as paid for by the Health System, that the Health System is required to be treated, for accounting purposes, as the “owner” of the MOB, in accordance with Emerging Issues Task Force (EITF) No. 97-10, *The Effect of Lessee Involvement in Asset Construction*.

(h) Impairment of Long-Lived Assets

Management regularly evaluates whether events or changes in circumstances have occurred that could indicate an impairment in the value of long-lived assets. In accordance with the provisions of ASC Subtopic 360-10, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*, if there is an indication that the carrying amount of an asset is not recoverable, the Health System projects undiscounted cash flows, excluding interest, to determine if an impairment loss should be recognized. The amount of impairment loss is determined by comparing the historical carrying value of the asset to its estimated fair value. Estimated fair value is determined through an evaluation of recent and projected financial performance using discounted cash flows.

In addition to consideration of impairment upon the events or changes in circumstances described above, management regularly evaluates the remaining lives of its long-lived assets. If estimates are changed, the carrying value of affected assets is allocated over the remaining lives.

In estimating the future cash flows for determining whether an asset is impaired and if expected future cash flows used in measuring assets are impaired, the Health System groups the assets at the lowest level for which there are identifiable cash flows independent of other groups of assets. If such assets are impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

(i) Financing Costs

Financing costs incurred in issuing long-term debt have been deferred and are shown separately on the balance sheet. These costs are being amortized using the effective interest method over the term of the related debt. The unamortized balances were $4,568 and $4,881 at June 30, 2011 and 2010, respectively.

(j) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are limited as to use by donors to a specific time period or purpose. Permanently restricted net assets are to be held in perpetuity at the instruction of the donor. Income from permanently restricted net assets is used as defined by the donor.

(k) Net Patient Service Revenue

Patient service revenue of the Western Maryland Regional Medical Center, Memorial and Braddock (the Hospitals) is recorded at rates established by the State of Maryland Health Services Cost Review Commission (HSCRC) and, accordingly, reflects actual charges to patients based on rates in effect during the period in which the services are rendered. Prior to fiscal year 2011, the Hospitals had charge per case (CPC) agreements with the HSCRC which were renewed annually. These CPC agreements established a prospectively approved average charge per inpatient case (defined as hospital admissions plus births) and an estimated case mix index. These approved CPC targets were adjusted during the rate year for actual changes in case mix. The CPC agreements allowed hospitals to adjust approved unit rates, within certain limits, to achieve the average charge per case target for each rate year ending June 30.

On November 16, 2010, The System and the HSCRC agreed to a three-year contract for the System to implement the Total Patient Revenue (TPR) methodology, effective July 1, 2010. The TPR agreement establishes a prospective, fixed revenue base, the “TPR cap”, for the upcoming year. This includes both inpatient and outpatient regulated services. Under TPR, the System’s revenue for all HSCRC regulated services is predetermined for the upcoming year, regardless of changes in volume, service mix intensity, or mix of inpatient or outpatient services that occurred during the year. The TPR agreement allows the System to adjust unit rates, within certain limits, to achieve the overall revenue base for the System at year end. Any overcharge or undercharge versus the TPR cap is prospectively added to the subsequent year’s TPR cap. Although the TPR cap does not adjust for changes in volume or service mix, the TPR cap is adjusted annually for inflation, and for changes in payor mix and uncompensated care. Beginning in year three of the three-year contract, the System will receive an annual adjustment to its cap for the change in population in the System's service area. TPR is designed to encourage hospitals to operate efficiently by reducing utilization and managing patients in the appropriate care delivery setting.

Contractual adjustments, which represent the difference between amounts billed as patient service revenue and amounts paid by third-party payors, are accrued in the period in which the related services are rendered. Because the Health System does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue.

The Maryland Medicaid program is administered primarily through independent licensed managed care organizations. The State of Maryland has contracts with these independent managed care organizations to manage the care to eligible participants. Amounts due from the Medicaid program in Maryland are primarily due from the independent managed care organizations.

(l) Excess of Revenues over Expenses

The statement of operations includes the performance indicator, excess of revenues over expenses. Changes in unrestricted net assets, which are excluded from excess of revenues over expenses, include unrealized gains and losses on other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

(m) Charity Care

The Health System, as an integral part of its mission, accepts and treats all patients without regard to their ability to pay. A patient is classified as a charity patient in accordance with established criteria. Charity care is the recognition of services rendered for which no payment is expected.

(n) Donations

Unconditional donations are included in income when pledged or received. Donations restricted as to use by the donor are reflected as additions to temporarily or permanently restricted net assets. Expenditures of temporarily restricted net assets are transferred to unrestricted net assets if for capital additions, or reported as other revenue if for operating purposes.

(o) Income Taxes

The Health System, the Western Maryland Regional Medical Center, Health System Memorial, Braddock, Frostburg, and Cumberland Properties, Inc. are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code.

Johnson Heights is a general partnership and Haystack Imaging is a limited liability company and both are not directly subject to income taxes. The results of their operations are included in the tax returns of their partners. Haystack and MMCS are taxable for-profit entities and a provision for income taxes is recognized in accordance with ASC Topic 740, *Income Taxes*.

(p) Use of Estimates

The preparation of 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 amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

(q) Western Maryland Health System Foundation

During fiscal year 2010, control of the Foundation was consolidated under the Health System and their assets, liabilities, net assets and results of operations are now consolidated within the Health System.

(r) Beneficial Interest in Trustee Held Assets

The Health System records a beneficial interest in several trusts (the assets of which are to be held in perpetuity) for which a portion of the income is to be distributed to the Health System. These changes in the fair value of the trusts are recorded as unrealized gains/losses in permanently restricted net assets.

(s) Pension Plan

For employees hire prior to July 1, 2011, the Health System has a noncontributory defined benefit pension plan covering substantially all of its employees upon their retirement. The benefits are based on age, years of service and the level of compensation during the five years before retirement. Effective July 1, 2011, employees hired or rehired will not participate in the plan. These employees will participate in a new defined contribution plan that has been developed.

For the defined benefit pension plan, the Health System records annual amounts relating to its pension plan based on calculations that incorporate various actuarial and other assumptions including, discount rates, mortality, assumed rates of return, compensation increases, turnover rates and healthcare cost trend rates. The Health System reviews its assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is appropriate to do so. The Health System believes that the assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions.

(t) Reclassifications

Certain prior year amounts have been reclassified to conform to current period presentation, the effect of which is not material.

(u) New Accounting Pronouncements

In December 2010, the FASB issued ASU No. 2010-29, *Business Combinations* (Topic 805), *Disclosure of Supplementary Pro Forma Information for Business Combinations* (ASU 2010-29), which requires an entity to disclose pro forma information for material business combinations that occurred in the current reporting period. If comparative financial statements are presented, the disclosures should include pro forma revenue and earnings of the combined entity as though the business combinations that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period. The adoption of ASU 2010-29 is effective for business combinations on or after July 1, 2011. The adoption of ASU 2010-29 is not expected to have an impact on the Health System's consolidated financial statements.

In January 2010, FASB issued ASU No. 2010-07, *Not-for-Profit Entities* (Topic 958), *Not-for Profit Entities: Mergers and Acquisition* (ASU 2010-07), which codified previous guidance on accounting for a combination of not-for-profit entities and applies to a combination that meets the definition of either a merger of not-for-profit entities or an acquisition by a not-for-profit entity. ASU 2010-07 also amends previous guidance for the reporting of goodwill and other intangibles and noncontrolling interests in consolidated financial statements to make their provisions fully applicable to not-for-profit entities. This guidance establishes that goodwill be tested annually for impairment and an impairment loss be recognized if it is determined that the carrying amount of the reporting unit's net assets exceed its fair value. Beginning on July 1, 2010, the Health System applied the transition provisions of the guidance which requires the Health System to cease amortization of previously recognized goodwill and to test goodwill for impairment annually or more frequently if events or circumstances indicate that the carrying value of an asset may not be recoverable. The Health System completed a transitional and annual goodwill impairment test. No adjustments to the carrying value of previously recognized goodwill were recorded during the year ended June 30, 2011. The guidance also requires the presentation of noncontrolling interests in the net assets of consolidated subsidiaries be reported as a separate component of the appropriate class of net assets in the consolidated balance sheets and the amount of consolidated excess of revenues over expenses attributable to the Health System and to the noncontrolling interest be disclosed. The provisions of the standard related to the presentation and disclosure of noncontrolling interests are to be applied retrospectively to all periods presented. The adoption of this standard did not have a material impact on the Health System's consolidated financial statements, other than the following:

a) Noncontrolling interests were reclassified from other long-term liabilities to unrestricted net assets, separate from the Health System's unrestricted net assets.

b) Consolidated excess of revenues over expenses includes excess of revenues over expenses attributable to both the Health System and noncontrolling interests.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements*. ASU 2010-06 amends ASC Topic 820, *Fair Value Measurements and Disclosures*, to require a number of additional disclosures regarding fair value measurements. Effective fiscal year 2010, ASU 2010-06 required disclosure of the amounts of significant transfers between Level I and Level II investments and the reasons for such transfers, the reasons for any transfers in or out of Level III investments and disclosure of the policy for determining when transfers among levels are recognized. ASU 2010-06 also clarified that disclosures should be provided for each class of assets and liabilities and clarified the requirement to disclose information about the valuation techniques and inputs used in estimating Level II and Level III measurements. Effective in fiscal year 2011, ASU 2010-06 also requires that information in the reconciliation of recurring Level III measurements about purchases, sales, issuances and settlements be provided on a gross basis. The adoption of ASU 2010-06 only required additional disclosures and did not have an impact on the consolidated financial statements. As the Health System does not have significant transfers between Levels, or any Level III measurements, no additional disclosures were necessary.

(Dollars in thousands)

(3) Accounts Receivable and Business Concentrations

The following table sets forth the detail of net accounts receivable as of June 30:

		2011	2010
Gross accounts receivable	$	56,597	47,717
Less:			
Allowance for uncollectible accounts		7,539	7,487
Allowance for contractual and charity adjustments		4,433	3,638
Net accounts receivable	$	44,625	36,592

During fiscal years 2011 and 2010 net patient service revenue was received from the following payors:

	2011	2010
Medicare	56%	55%
Medicaid	13	13
Blue Cross	13	13
Self-pay	3	3
Other	15	16
	100%	100%

Gross accounts receivable at June 30, 2011 and 2010 consisted of the following payors:

	2011	2010
Medicare	40%	43%
Medicaid	13	13
Blue Cross	11	9
Self-pay	18	18
Other	18	17
	100%	100%

(Dollars in thousands)

(4) Investments

Investments, which include Funds on deposit with trustees, Board designated investments and Investments restricted by donor or grantor, consist of the following as of June 30:

		2011	2010
U.S. government obligations	$	1,158	969
Corporate bonds/notes		9,069	11,696
Money market funds		3,429	3,472
Corporate stocks and other		11,884	7,433
Fixed income securities		39,309	37,315
	$	64,849	60,885

Investments have been classified in the accompanying consolidated balance sheets as follows as of June 30:

		2011	2010
Short-term investments	$	21,158	19,413
Funds on deposit with trustee		39,309	37,315
Board designated investments		840	1,012
Other long-term investments		677	721
Investments restricted by donor or grantor		2,865	2,424
	$	64,849	60,885

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:

		2011	2010
Income:			
Investment income	$	1,301	1,143
Realized gains on trading investment portfolio		1,352	1,174
Unrealized gains on trading investment portfolio		1,277	527
	$	3,930	2,844

(Continued)

(Dollars in thousands)

(5) Property and Equipment

Property and equipment and estimated useful lives (in years) are summarized as follows as of June 30:

		2011	2010
Land and land improvements (2 – 25 years)	$	16,191	16,169
Buildings and improvements (5 – 40 years)		401,509	401,660
Equipment (3 – 20 years)		162,404	155,780
Construction in progress		1,917	2,686
		582,021	576,295
Less accumulated depreciation		208,880	181,563
Property and equipment, net	$	373,141	394,732

In connection with the new medical center (see note 1), the Health System adjusted the remaining estimated useful lives of its two acute care hospitals and related improvements to coincide with their closing and the opening of the new hospital replacement facility.

Depreciation expense for the year ended June 30, 2011 was $29,238 including a one-time impairment of long-lived assets for $4,000. Depreciation expense was $17,517 for the year ended June 30, 2010.

A summary of interest cost and investment income on borrowed funds held by the trustee under the 2006 revenue bond indentures for the years ended June 30 is as follows:

		2011	2010
Interest cost:			
Capitalized	$	—	6,313
Charged to operations		16,114	9,824
Total	$	16,114	16,137
Interest income capitalized	$	—	1,253

(Continued)

(Dollars in thousands)

(6) Investments in Affiliates

Investments in affiliates and equity in income (loss) of affiliates are as follows as of and for the years ended June 30:

			Investment		Equity in income (loss)	
Name	**Interest**	**Business**	**2011**	**2010**	**2011**	**2010**
Maryland Physicians Care, Inc.	25.00%	State of Maryland Medicaid managed care	$ 15,865	13,188	4,677	3,580
Other affiliates	0.21 to 33.33	Supply purchasing and medical equipment	498	484	14	(4)
			$ 16,363	13,672	4,691	3,576

(7) Long-Term Debt

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

	2011	2010
Maryland Health and Higher Educational Facilities Authority (MHHEFA) Series 2006A and B Revenue (FHA Insured) Bonds, interest rate 5.50% through November 30, 2009, 4.0 to 5.3% thereafter	$ 332,480	339,470
Capital leases	1,371	1,743
Net unamortized bond premium	10,873	11,567
Long-term debt	344,724	352,780
Less current portion of long-term debt	7,514	7,361
Long-term debt less current portion	$ 337,210	345,419

Scheduled principal repayments on long-term debt for the years ending June 30 are as follows:

2012	$ 7,514
2013	7,863
2014	8,229
2015	8,300
2016	8,565

Cash paid for interest during the years ended June 30, 2011 and 2010 was approximately $16,362 and $16,487, respectively.

In November 2006, proceeds from issuance of $348,650 and $2,180 Maryland Health and Higher Education Facilities Authority Series 2006, Series A, and Series B bonds were obtained for the purpose of

(1) financing the costs of acquisition, construction and equipping a New Medical Center, (the Property) (see note 1), and (2) to refund prior debt issuances. The Health System redeemed $11,360 of the Series 2006A bonds in conjunctions with their final endorsement in 2010.

Principal payments on the Series 2006A revenue bonds commence on July 1, 2010, and are due semi-annually through January 1, 2035. Interest payments are due semi-annually commencing July 1, 2007. The total outstanding balance on the Series 2006B revenue bonds is due July 1, 2010. Interest payments are due semi-annually commencing July 1, 2007. Interest on the 2006 Series A and B revenue bonds accrue at a rate of 5.50% per annum through November 30, 2009, and 4.0% to 5.3% thereafter.

The Federal Housing Authority (FHA) has issued a commitment for mortgage insurance with respect to the project. The financing document contains quantitative and qualitative covenants (measured quarterly). The quantitative covenants include a debt service coverage ratio, a day's cash on hand requirement, current ratio requirement, a net days in accounts receivable requirement, and restrictions on operating losses and revenue over expenses.

In 2011, the Health System entered into a line of credit agreement with a bank that permits the Health System to borrow up to $1,000, the interest rate as of June 30, 2011 was 4.50%. The line of credit primarily supports a letter of credit agreement in the amount of $300. There was no outstanding balance as of June 30, 2011.

(8) Charity Care

The amount of charges foregone for services and supplies furnished under the Health System's Charity Care policy aggregated approximately $12,444 and $5,796 for the years ended June 30, 2011 and 2010, respectively. These charges closely represent the cost of providing those services and supplies mentioned above.

(9) Retirement Plans

The WMHS Retirement Plan (the Plan) is a noncontributory defined benefit plan, which covers substantially all full-time employees who meet certain age and service requirements. The Plan's funding policy is to contribute, annually, the pension costs as determined by the Plan's actuary, subject to adjustment for full funding limitations as defined by the Internal Revenue Code.

The Health System's investment policy, established by the Investment Committee of the Finance Committee and approved by the Health System's Board of Directors, is to ensure current and future benefit obligations are adequately funded in a cost effective manner. The investment guidelines are based on a time horizon of greater than five years. In establishing the risk tolerances, the ability to withstand short and intermediate term variability with some interim fluctuations in market value and rates of return may be tolerated in order to achieve the longer-term objectives.

The measurement date of the Plan is June 30.

(Dollars in thousands)

The component of the Plan's funded status, net periodic benefit costs and actuarial assumptions used in accounting for defined benefit plans for the years ended June 30, 2011 and 2010 are as follows:

		2011	2010
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	$	161,122	131,021
Service cost		5,337	4,758
Interest cost		8,646	8,459
Amendments		—	3,258
Assumptions		(4,749)	11,883
Actuarial loss		—	6,429
Benefits paid		(7,220)	(4,686)
Projected benefit obligation at end of year		163,136	161,122
Change in plan assets:			
Plan assets at fair value at beginning of year		127,247	113,101
Actual return		14,608	12,832
Employer contributions		7,000	6,000
Benefits paid		(7,220)	(4,686)
Fair value of plan assets at end of year		141,635	127,247
Funded status at end of year	$	(21,501)	(33,875)

		2011	2010
Components of net periodic benefit costs:			
Service cost	$	5,337	4,758
Interest cost		8,646	8,459
Expected return on plan assets		(8,673)	(7,781)
Recognized prior service cost		(593)	(593)
Recognized net loss		3,928	3,576
Effect of plan amendment		—	3,258
Net periodic pension cost	$	8,645	11,677

Deferred pension costs, which have not yet been recognized in periodic pension expense but are accrued in unrestricted net assets, are $35,096 and $49,114 at June 30, 2011 and 2010, respectively. Deferred pension costs represents unrecognized actuarial losses or unexpected changes in the projected benefit obligation and plan assets over time primarily due to changes in assumed discount rates and investment experience, unrecognized prior service costs which is the impact of changes in plan benefits applied retrospectively to employee service previously rendered. The amount of deferred pension costs expected to be recognized as a component of net period pension costs during the year ending June 30, 2012 is $2,232.

(Dollars in thousands)

	2011	2010
Weighted average assumptions – benefit obligations:		
Discount rate	5.69%	5.48%
Salary scale	2.00	2.00
Return on assets	7.00	7.00
Weighted average assumptions – net periodic expense:		
Discount rate	5.48%	6.25%
Salary scale	2.00	2.00
Return on assets	7.00	7.00

The accumulated benefit obligation for the definite benefit pension plan was $160,552 and $158,008 at June 30, 2011 and 2010, respectively.

The Health System's pension plan weighted average asset allocations at the measurement dates of June 30, 2011 and 2010, by asset category are as follows:

	Percentage of plan assets		
	Target allocation	2011	2010
Asset class:			
Equities	40%	37%	33%
Fixed	60	63	67

The Health System expects to contribute $6 million to the Plan for the fiscal year ending June 30, 2012.

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

2012	$	6,026
2013		6,563
2014		6,982
2015		7,608
2016		8,340
2017 – 2021		55,036

The expected benefits to be paid are based on the same assumptions used to measure the Health System's benefit obligation as of June 30, 2011.

The Health System also sponsors a defined contribution retirement plan in accordance with Section 403(b) of the Internal Revenue Code. The Health System's expense related to this plan for the years ending June 30, 2011 and 2010 was $1,565 and $1,501, respectively, and is included in employee benefits in the accompanying consolidated statements of operations.

(10) Self-Insurance Programs

(a) General and Professional Liability (GLPL)

On December 14, 2004, the Health System formed a new wholly owned insurance subsidiary, Western Maryland Insurance Company, Ltd. (WMIC), an exempted company under the Companies Law of the Cayman Islands, to provide GLPL insurance to the Health System and certain affiliates. Effective January 1, 2005, this subsidiary insures the Health System for its GLPL risks under a claims-made policy with a limit of $1,000 per claim and $6,664 in the aggregate. Claims in excess of $1,000 per claim and $6,664 in the aggregate, up to a limit of $20,000, have been reinsured with Zurich American Insurance Company, an independent third-party insurance company. The Health System's retained self-insurance risk under these policies is $1,000 per occurrence.

Management's estimate of the liability for GLPL claims, including incurred but not reported claims, is principally based on actuarial estimates performed by an independent third-party actuary. The Company's estimated liability for GLPL claims, including incurred but not reported claims, totaled $7,681 and $6,562 as of June 30, 2011 and 2010, respectively. These amounts are included in other noncurrent liabilities in the accompanying financial statements. While management believes that this liability is adequate as of June 30, 2011, the ultimate liability may exceed the amount recorded.

(b) Workers' Compensation Insurance

In 2011 and 2010, the Health System participated in a self-insured plan for workers' compensation claims. Stop-loss coverage has been purchased through a commercial carrier for claims in excess of $400.

The Health System has accrued a liability of $2,173 and $1,900 as of June 30, 2011 and 2010, respectively, for known and incurred but not reported claims. Management believes this accrual is adequate to provide for all workers' compensation claims that have been incurred through June 30, 2011.

(c) Health Insurance

The Health System is self-insured for employee health claims. Under these self-insurance plans, the Health System has accrued a liability of $1,784 and $1,665 as of June 30, 2011 and 2010, respectively, for known claims and incurred but not reported claims. Management believes this accrual is adequate to provide for all employee health claims that may have been incurred through June 30, 2011.

(Dollars in thousands)

(11) Lease Commitments

Future minimum payments under noncancelable operating leases with terms in excess of one year or more for the years ending June 30 are as follows:

2012	$	3,024
2013		2,535
2014		1,859
2015		935
2016		102
Thereafter		44
Total	$	8,499

Rental expense under operating leases amounted to $3,839 and $2,157 for the years ended June 30, 2011 and 2010, respectively.

Effective May 14, 1982, Memorial entered into a lease for the Memorial property from the City of Cumberland (the City) for a period of 40 years for a nominal annual rent. On February 15, 2000, Memorial and the City signed an amendment and extension agreement that makes the Health System a new party to the lease and the term of the lease was changed to 50 years from the date of the amended agreement with two automatic renewal terms of 10 years each. This lease is classified as a capital lease for financial reporting purposes and the related capital lease obligation and asset (which are nominal amounts) are recorded in the Health System's consolidated financial statements (the net book value of the Memorial property consists of land improvements, building improvements and fixed equipment recorded at cost and depreciated over the lesser of useful life or the term of the lease). The lease terminated effective January 12, 2010 and the Health System returned the Memorial property to the City "as is."

(12) Temporarily and Permanently Restricted Net Assets

Temporarily and permanently restricted net assets as of June 30, 2011 and 2010 are available for the following purposes:

		2011	2010
Temporary restrictions:			
Specific support of healthcare services	$	4,327	5,702
Permanent restrictions:			
Trustee held assets to be held in perpetuity, the income from which primarily is expendable to support health care services	$	2,035	1,737

(13) Fair Value of Financial Instruments

(a) Fair Value of Financial Instruments

The following methods and assumptions were used by the Health System in estimating the fair value of their financial instruments:

Cash and cash equivalents, investments, funds on deposit with trustee, board designated investments, patient accounts receivable, other assets, accounts payable, and accrued liabilities, payable to third-party payors, and other long term liabilities – The carrying amounts reported in the consolidated balance sheets approximate the related fair values.

The fair value of a financial instrument is the amount 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. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Health System's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Health System based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, accounts receivable, due from affiliates, other assets, line of credit, accounts payable, advances from third-party payors, due to affiliates, and accrued expenses – The carrying amounts, at face value or cost plus accrued interest, approximate fair value because of the short maturity of these instruments.

Board designated and other investments – Equity and debt securities classified as trading are measured using quoted market prices at the reporting date multiplied by the quantity held.

(b) Long-Term Debt

The Series 2006 Bonds bear interest at fixed rates and, accordingly, had a carrying amount and fair value of $332,480 and $330,848.

The fair value of the Health System's long-term debt is measured using quoted offered-side prices when quoted market prices are available. If quoted market prices are not available, the fair value is determined by discounting the future cash flows of each instrument at rates that reflect, among other things, market interest rates and the Health System's credit standing. In determining an appropriate spread to reflect its credit standing, the Health System considers credit default swap spreads, bond yields of other long-term debt offered by the Health System, and interest rates currently offered to the Venture for similar debt instruments of comparable maturities by the Health System's bankers as well as other banks that regularly compete to provide financing to the Health System.

(Dollars in thousands)

(c) Fair Value Hierarchy

The Health System adopted Topic 820 on July 1, 2008 for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. Topic 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Health System has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The table below presents assets that are measured at fair value as of June 30, 2011 aggregated by the three level valuation hierarchy:

	2011			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
U.S. government obligations	$ 1,158	—	—	1,158
Corporate bonds/notes	9,069	—	—	9,069
Money market funds	3,429	—	—	3,429
Corporate stocks and other	11,884	—	—	11,884
Fixed income securities	39,309	—	—	39,309
Total assets	$ 64,849	—	—	64,849

For the year ended June 30, 2011, there were no significant transfers between levels 1, 2 or 3.

(Dollars in thousands)

The table below presents assets that are measured at fair values as of June 30, 2010 aggregated by the three level valuation hierarchy:

	2010			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
U.S. government obligations	$ 969	—	—	969
Corporate bonds/notes	11,696	—	—	11,696
Money market funds	3,472	—	—	3,472
Corporate stocks and other	7,433	—	—	7,433
Fixed income securities	37,315	—	—	37,315
Total assets	$ 60,885	—	—	60,885

The table below presents the pension plan's investable assets as of June 30, 2011 aggregated by the three level valuation hierarchy:

	2011			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Money market funds	$ 3,523	—	—	3,523
Mutual funds	127,482	—	—	127,482
Fixed income securities	2,508	—	—	2,508
Other funds	—	8,122	—	8,122
Total assets	$ 133,513	8,122	—	141,635

For the year ended June 30, 2011, there were no significant transfers between levels 1, 2 or 3.

The table below presents the pension plan's investable assets as of June 30, 2010 aggregated by the three level valuation hierarchy:

	2010			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Mutual funds	$ 118,661	—	—	118,661
Other funds	—	8,586	—	8,586
Total assets	$ 118,661	8,586	—	127,247

(Continued)

(14) Medical Office Building

As discussed in note 2(g), the Health System was required to be treated as the "owner" of the MOB, in accordance with EITF No. 97-10 for the year ended June 30, 2011. As of June 30, 2010, the total cost of the asset was $21.4 million, and was included in buildings with the offsetting obligation in other long-term liabilities. The asset and financing obligation were reflected on the Health System's consolidated balance sheets. The System purchased the MOB for $21,025 on February 17, 2011 and is included in the balance of property, plant and equipment as of June 30, 2011.

(15) Commitments and Contingencies

(a) Litigation

From time to time, the Health System and its subsidiaries are involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Health System's future financial position or results from operations.

(b) Other Matters

The Health System has contracts with various physician groups to provide certain emergency, obstetric, and surgical services. Those contracts include certain income guarantee levels which eliminate as volumes related to services provided increase. The Health System paid $1,822 and $1,480 related to the guarantee provisions of the contracts in 2011 and 2010, respectively.

(16) Regulation and Reimbursement

The Health System provides health care services primarily through one general acute care hospital. The Health System and other healthcare 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;
- Regulation of hospital rates by the HSCRC;
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes; and
- Lawsuits alleging malpractice and related claims.

Such inherent risks require the use of certain management estimates in the preparation of the Health System'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 Health System's revenues and the Health System'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 Health System.

Change in federal and state reimbursement funding mechanisms and related government budgetary constraints could have a significant adverse effect on the Health System.

The current rate of reimbursement for services to patients under the Medicare and Medicaid programs is based on an agreement between the Center for Medicaid and Medicare Services (CMS) and the HSCRC. This agreement is based upon a waiver from Medicare prospective pay system reimbursement principles granted to the State of Maryland under Section 1814(b) of the Social Security Act and will continue as long as all third-party payors elect to be reimbursed in Maryland under this program and the rate of increase for costs per hospital inpatient admission in Maryland is below the national average.

On November 16, 2010, The System and the HSCRC agreed to a three-year contract for the System to implement the Total Patient Revenue (TPR) methodology, effective July 1, 2010. The TPR agreement establishes a prospective, fixed revenue base, the “TPR cap”, for the upcoming year. This includes both inpatient and outpatient regulated services. Under TPR, the System’s revenue for all HSCRC regulated services is predetermined for the upcoming year, regardless of changes in volume, service mix intensity, or mix of inpatient or outpatient services that occurred during the year. The TPR agreement allows the System to adjust unit rates, within certain limits, to achieve the overall revenue base for the System at year end. Any overcharge or undercharge versus the TPR cap is prospectively added to the subsequent year’s TPR cap. Although the TPR cap does not adjust for changes in volume or service mix, the TPR cap is adjusted annually for inflation, and for changes in payor mix and uncompensated care. Beginning in year three of the three-year contract, the System will receive an annual adjustment to its cap for the change in population in the System’s service area. TPR is designed to encourage hospitals to operate efficiently by reducing utilization and managing patients in the appropriate care delivery setting.

(Dollars in thousands)

(17) Noncontrolling Interest

Effective June 30, 2011, the Health System adopted new accounting guidance (applied retroactively to June 30, 2009) that requires a not-for-profit reporting entity to account for and present noncontrolling interests in a consolidated subsidiary as separate component of the appropriate class of consolidated net assets (equity). The reconciliation of noncontrolling interest reported in unrestricted net assets is as follows:

		WMHS Corporation	Noncontrolling interest	Unrestricted net assets
Balance at June 30, 2009	$	126,806	2,117	128,923
Western Maryland Health System Foundation beginning net assets		4,707	—	4,707
Operating income		(5,714)	3,449	(2,265)
Nonoperating income		7,342	—	7,342
Excess of revenues over expenses		1,628	3,449	5,077
Change in funded status of pension plan		(10,277)	—	(10,277)
Net assets released for purchase of property and equipment		1,785	—	1,785
Distributions to noncontrolling interest in consolidated subsidiaries		—	(3,650)	(3,650)
Change in net assets		(2,157)	(201)	(2,358)
Balance at June 30, 2010		124,649	1,916	126,565
Operating income		2,470	4,241	6,711
Nonoperating income		8,716	—	8,716
Excess of revenues over expenses		11,186	4,241	15,427
Change in funded status of pension plan		14,018	—	14,018
Net assets released for purchase of property and equipment		2,798	—	2,798
Distributions to noncontrolling interest in consolidated subsidiaries		—	(4,126)	(4,126)
Change in net assets		28,002	115	28,117
Balance at June 30, 2011	$	152,651	2,031	154,682

(Dollars in thousands)

(18) Functional Expenses

The Health System considers healthcare services and general and administrative to be its primary functional categories for purposes of expense classification. The Health System's operating expenses by functional classification are as follows for the years ended June 30:

		2011	2010
Healthcare services	$	259,045	257,622
General and administrative		30,715	21,795
	$	289,760	279,417

(19) Subsequent Events

Management evaluated all events and transactions that occurred after June 30, 2011 and through October 24, 2011. The Health System did not have any material recognizable subsequent events during this period.

SUPPLEMENTARY INFORMATION

Schedule 1

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

Consolidating Balance Sheet Information

June 30, 2011

(Dollars in thousands)

Assets		Western Maryland Health System Corporation	Frostburg Nursing & Rehabilitation Center	Haystack Consolidated Services, Inc.	Western Maryland Health System Foundation Inc.	Eliminations	Consolidated
Current assets:							
Cash and cash equivalents	$	34,815	5,568	1,383	3,253	—	45,019
Short-term investments		17,627	—	673	2,858	—	21,158
Funds on deposit with trustee		15,138	—	—	—	—	15,138
Accounts receivable, net		43,242	1,383	—	—	—	44,625
Pledge receivable, net		—	—	—	1,708	—	1,708
Other receivables, net		6,211	17	58	6	(1,324)	4,968
Inventories and other current assets		13,602	297	—	1	(1,367)	12,533
Total current assets		130,635	7,265	2,114	7,826	(2,691)	145,149
Funds on deposit with trustee		24,171	—	—	—	—	24,171
Board designated investments		840	—	—	—	—	840
Other long-term investments		75	—	—	602	—	677
Investments restricted by donor or grantor		1,579	—	—	1,286	—	2,865
Beneficial interest in trustee held and Foundation's assets		—	—	—	1,789	—	1,789
Property and equipment, net		372,807	334	—	—	—	373,141
Unamortized financing fees		4,568	—	—	—	—	4,568
Investments in affiliates		16,006	—	357	—	—	16,363
Other assets		392	—	—	—	—	392
Total assets	$	551,073	7,599	2,471	11,503	(2,691)	569,955

(Continued)

Schedule 1

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

Consolidating Balance Sheet Information

June 30, 2011

(Dollars in thousands)

Liabilities and Net Assets		**Western Maryland Health System Corporation**	**Frostburg Nursing & Rehabilitation Center**	**Haystack Consolidated Services, Inc.**	**Western Maryland Health System Foundation Inc.**	**Eliminations**	**Consolidated**
Current liabilities:							
Current portion of long-term debt	$	7,514	—	—	—	—	7,514
Accounts payable and accrued liabilities		6,926	335	1,073	1,325	(2,691)	6,968
Accrued bond interest payable		8,018	—	—	—	—	8,018
Accrued salaries and benefits		12,845	222	—	—	—	13,067
Payable to third-party payors		6,051	—	—	—	—	6,051
Total current liabilities		41,354	557	1,073	1,325	(2,691)	41,618
Long-term debt, net of current portion		337,210	—	—	—	—	337,210
Pension benefits in excess of pension assets		21,501	—	—	—	—	21,501
Other liabilities		8,582	—	—	—	—	8,582
Total liabilities		408,647	557	1,073	1,325	(2,691)	408,911
Net assets:							
Unrestricted:							
Unrestricted net assets		138,816	7,042	1,398	5,395	—	152,651
Noncontrolling interest in consolidated subsidiaries		2,031	—	—	—	—	2,031
Total unrestricted net assets		140,847	7,042	1,398	5,395	—	154,682
Temporarily restricted		1,333	—	—	2,994	—	4,327
Permanently restricted		246	—	—	1,789	—	2,035
Total net assets		142,426	7,042	1,398	10,178	—	161,044
Total liabilities and net assets	$	551,073	7,599	2,471	11,503	(2,691)	569,955

See accompanying independent auditors’ report.

Schedule 2

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

Consolidating Statement of Operations Information

Year ended June 30, 2011

(Dollars in thousands)

	Western Maryland Health System Corporation (see note 1)	Frostburg Nursing & Rehabilitation Center	Haystack Consolidated Services, Inc.	Western Maryland Health System Foundation Inc.	Eliminations	Consolidated
Unrestricted revenues, gains and other support:						
Net patient service revenue	$ 284,209	7,048	—	—	—	291,257
Other revenue	5,432	47	—	—	(265)	5,214
Total revenues, gains and other support	289,641	7,095	—	—	(265)	296,471
Expenses:						
Salaries and wages	97,309	3,075	—	—	—	100,384
Employee benefits	33,607	1,331	—	—	—	34,938
Professional fees	8,340	50	—	—	—	8,390
Purchased services	17,455	410	—	240	(240)	17,865
Supplies	56,841	879	—	7	(7)	57,720
Utilities	5,131	213	—	—	—	5,344
Insurance	4,829	4	—	2	(2)	4,833
Bad debts	5,358	474	—	—	—	5,832
Interest	16,114	—	—	—	—	16,114
Depreciation and amortization	29,492	59	—	—	—	29,551
Other	8,258	437	9	101	(16)	8,789
Total expenses	282,734	6,932	9	350	(265)	289,760
Operating income	6,907	163	(9)	(350)	—	6,711

(Continued)

Schedule 2

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

Consolidating Statement of Operations Information

Year ended June 30, 2011

(Dollars in thousands)

	Western Maryland Health System Corporation	Frostburg Nursing & Rehabilitation Center	Haystack Consolidated Services, Inc.	Western Maryland Health System Foundation Inc.	Eliminations	Consolidated
Nonoperating income:						
Equity in income of affiliates	$ 4,697	—	(6)	—	—	4,691
Investment income	2,492	9	31	121	—	2,653
Unrealized gains on trading portfolio	905	—	(1)	373	—	1,277
Other	58	—	—	37	—	95
Total nonoperating income	8,152	9	24	531	—	8,716
Excess of revenue over expenses	$ 15,059	172	15	181	—	15,427

See accompanying independent auditors' report.

Schedule 3

WESTERN MARYLAND HEALTH SYSTEM CORPORATION

Consolidating Statement of Changes in Net Assets Information

Year ended June 30, 2011

(Dollars in thousands)

		Western Maryland Health System Corporation	Frostburg Nursing & Rehabilitation Center	Haystack Consolidated Services, Inc.	Western Maryland Health System Foundation Inc.	Consolidated
Unrestricted net assets:						
Balance at June 30, 2010	$	113,113	6,855	1,383	5,214	126,565
Excess of revenues over expenses		15,059	172	15	181	15,427
Change in funded status of pension plan		14,018	—	—	—	14,018
Grants		—	15	—	—	15
Net assets released for purchase of property and equipment		2,783	—	—	—	2,783
Distributions to noncontrolling interest in consolidated interest		(4,126)	—	—	—	(4,126)
Balance at June 30, 2011		140,847	7,042	1,398	5,395	154,682
Temporarily restricted net assets:						
Balance at June 30, 2010		2,046	—	—	3,656	5,702
Investment income		—	—	—	11	11
Donations		—	—	—	373	373
Grants		1,024	—	—	—	1,024
Net assets released from restrictions used for operations		1,046	—	—	(1,046)	—
Net assets released for purchase of property and equipment		(2,783)	—	—	—	(2,783)
Balance at June 30, 2011		1,333	—	—	2,994	4,327
Permanently restricted net assets:						
Balance at June 30, 2010		246	—	—	1,491	1,737
Change in beneficial interest of trustee-held assets		—	—	—	298	298
Balance at June 30, 2011		246	—	—	1,789	2,035
Net assets at June 30, 2011	$	142,426	7,042	1,398	10,178	161,044

See accompanying independent auditors' report.