COHEN
RUTHERFORD
+ KNIGHT PC
Certified Public Accountants

Audited Consolidated Financial Statements and Other Financial Information

Doctors Community Hospital and Subsidiaries

June 30, 2012 and 2011

Audited Consolidated Financial Statements
Doctors Community Hospital and Subsidiaries
June 30, 2012 and 2011

– Contents –

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Report of Independent Auditors

Board of Directors
Doctors Community Hospital and Subsidiaries
Lanham, Maryland

We have audited the accompanying consolidated balance sheets of Doctors Community Hospital and Subsidiaries (the Hospital) as of June 30, 2012 and 2011, 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 Hospital'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. We were not engaged to perform an audit of the Hospital's internal control over financial reporting. Our audits included 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 Hospital'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, and 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 consolidated financial position of Doctors Community Hospital and Subsidiaries as of June 30, 2012 and 2011, and the results of their operations, the changes in their net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As further described in *Note A*, during 2012 the Hospital changed its method of reporting and disclosing charity care provided, and as further described in *Note G*, during 2012 the Hospital changed its method of accounting for malpractice liabilities and related insurance recoveries.

Cohen, Rutherford + Knight, P.C.

September 27, 2012

Consolidated Balance Sheets

Doctors Community Hospital and Subsidiaries

	June 30 2012	June 30 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 24,920,739	$ 27,349,011
Assets whose use is limited - current portion of trustee-held funds -- *Note B*	6,559,838	6,522,989
Patient accounts receivable, less uncollectible accounts of $6,716,030 and $6,595,076 for 2012 and 2011, respectively	28,997,879	23,287,650
Other amounts receivable	3,707,513	2,546,221
Inventories	3,698,273	3,498,390
Prepaid expenses	1,958,212	1,393,566
TOTAL CURRENT ASSETS	69,842,454	64,597,827
INVESTMENTS		
Marketable securities -- *Note B*	13,545,271	13,432,374
Joint ventures and equity investments -- *Note C*	2,888,078	2,359,764
	16,433,349	15,792,138
ASSETS WHOSE USE IS LIMITED -- *Note B*		
Investments held by Trustee or Authority, less current portion	24,873,121	28,101,884
LAND, BUILDINGS, AND EQUIPMENT -- *Note E*	124,502,258	126,965,135
DEFERRED FINANCING COSTS	2,317,213	2,477,547
GOODWILL -- *Note L*	2,494,734	2,475,791
OTHER ASSETS -- *Notes G and I*	20,990,372	16,029,401
TOTAL ASSETS	$ 261,453,501	$ 256,439,723

See the accompanying notes to the consolidated financial statements.

Consolidated Balance Sheets – Continued

Doctors Community Hospital and Subsidiaries

	June 30	
	2012	**2011**
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 15,803,956	$ 11,880,534
Salaries, wages, and related items	10,252,150	10,936,073
Advances from third party payers	7,948,715	7,620,548
Interest payable to bondholders	4,152,632	4,200,882
Current portion of long-term obligations -- *Note F*	3,796,609	3,621,623
TOTAL CURRENT LIABILITIES	41,954,062	38,259,660
NONCURRENT LIABILITIES		
Other noncurrent liabilities -- *Note G*	12,023,967	5,535,418
Pension obligation -- *Note I*	7,575,656	5,013,496
Long-term obligations, less current portion -- *Note F*	152,694,081	156,583,346
TOTAL LIABILITIES	214,247,766	205,391,920
NET ASSETS		
Unrestricted	43,919,040	49,313,787
Noncontrolling interest	2,233,135	1,551,726
Total unrestricted net assets	46,152,175	50,865,513
Temporarily restricted -- *Note M*	1,053,560	182,290
TOTAL NET ASSETS	47,205,735	51,047,803
COMMITMENTS AND CONTINGENCIES -- *Notes F, G, H, I, J and K*		
	$ 261,453,501	$ 256,439,723

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Operations and Other Changes in Unrestricted Net Assets

Doctors Community Hospital and Subsidiaries

	Year Ended June 30	
	2012	**2011**
REVENUE		
Net patient service revenue	$ 205,126,015	$ 206,706,874
Other operating revenue -- *Note B*	3,953,752	5,202,493
Pledges and contributions	634,838	616,392
Net assets released from restrictions used for operations -- *Note D*	344	91,425
TOTAL REVENUE	209,714,949	212,617,184
EXPENSES		
Salaries and wages	78,141,068	77,954,090
Employee benefits	13,850,498	16,172,705
Purchased services	31,348,858	30,426,496
Supplies	33,802,605	34,353,154
Other expenses	19,041,288	13,806,265
Provision for bad debts	14,155,773	14,467,766
Depreciation -- *Note E*	9,909,553	9,691,089
Amortization	160,965	1,064,740
Fundraising	247,437	280,997
Interest -- *Note F*	8,300,741	10,348,832
TOTAL OPERATING EXPENSES	208,958,786	208,566,135
INCOME FROM OPERATIONS	756,163	4,051,049
NONOPERATING GAINS (LOSSES)		
Gain on sale of property	100,161	8,390,497
Loss in joint ventures -- *Note C*	(597,184)	(664,740)
Unrealized gain on trading securities -- *Note B*	46,615	(575,127)
Interest rate swap termination -- *Note F*	0	(18,137,789)
Change in fair value of interest rate swap -- *Note F*	0	24,135,957
EXCESS OF REVENUE OVER EXPENSES	305,755	17,199,847
Subsidiary distributions to noncontrolling interest-holders	(1,025,288)	(1,909,800)
Pension - related changes other than net periodic pension cost -- *Note I*	(3,993,787)	1,718,275
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	$ (4,713,320)	$ 17,008,322

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Changes in Net Assets

Doctors Community Hospital and Subsidiaries

	Year Ended June 30, 2012			Year Ended June 30, 2011		
	Total	Controlling Interests	Noncontrolling Interests	Total	Controlling Interests	Noncontrolling Interests
UNRESTRICTED NET ASSETS						
Excess of expenses over revenue	$ 305,737	$ (1,400,960)	$ 1,706,697	$ 17,199,847	$ 15,760,093	$ 1,439,754
Dividends paid to noncontrolling interest-holders	(1,025,288)	0	(1,025,288)	(1,909,802)	0	(1,909,802)
Pension - related changes other than net periodic pension cost -- *Note I*	(3,993,787)	(3,993,787)	0	1,718,286	1,718,286	0
DECREASE IN UNRESTRICTED NET ASSETS AND NONCONTROLLING INTERESTS	(4,713,338)	(5,394,747)	681,409	17,008,331	17,478,379	(470,048)
TEMPORARILY RESTRICTED NET ASSETS						
Restricted contributions	1,001,614	1,001,614	0	150,000	150,000	0
Net assets released from restrictions for operations	(344)	(344)	0	(91,425)	(91,425)	0
Write off of pledge receivable	(130,000)	(130,000)	0	0	0	0
INCREASE IN TEMPORARILY RESTRICTED NET ASSETS	871,270	871,270	0	58,575	58,575	0
INCREASE (DECREASE) IN NET ASSETS	(3,842,068)	(4,523,477)	681,409	17,066,906	17,536,954	(470,048)
NET ASSETS, BEGINNING OF YEAR	51,047,803	49,496,077	1,551,726	33,980,897	31,959,123	2,021,774
NET ASSETS, END OF YEAR	$ 47,205,735	$ 44,972,600	$ 2,233,135	$ 51,047,803	$ 49,496,077	$ 1,551,726

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows – Continued
Doctors Community Hospital and Subsidiaries

	Year Ended June 30 2012	Year Ended June 30 2011
OPERATING ACTIVITIES AND OTHER GAINS		
Increase (decrease) in net assets	$ (3,842,068)	$ 17,066,906
Adjustment to reconcile (increase) decrease in net assets to net cash and cash equivalents provided by operating activities:		
Restricted contributions received	(1,001,614)	(150,000)
Depreciation	9,909,553	9,691,089
Provision for bad debts	14,155,773	14,467,766
Unrealized (gain) loss on investments	(46,615)	575,127
Gain on sale of property	(100,161)	(8,390,497)
Realized gain on sale of investments	(48,416)	(687,498)
Amortization of bond discount	(153,799)	(158,433)
Change in fair value of interest rate swap	0	(24,135,957)
Increase (decrease) in:		
Accounts payable and accrued expenses, exclusive of accrual for equipment cost	3,923,422	(5,182,208)
Accrued salaries, wages and related items	(683,923)	724,972
Advances from third party payers	328,167	1,622,387
Pension obligation	2,562,160	(2,153,406)
Interest payable	(48,250)	(93,883)
Other liabilities	6,488,549	756,264
(Increase) decrease in:		
Net patient accounts receivable	(19,866,002)	(17,004,089)
Other amounts receivable	(1,161,292)	(364,633)
Goodwill	(18,943)	0
Inventories	(199,883)	(726,108)
Deferred financing costs	160,334	1,064,740
Increase in joint ventures and equity investments	(528,314)	(176,907)
Prepaid expenses and other assets	(5,525,617)	(411,381)
NET CASH AND CASH EQUIVALENTS PROVIDED BY (USED IN) OPERATING ACTIVITIES AND OTHER GAINS	4,303,061	(13,665,749)
INVESTING ACTIVITIES		
Net sales of trading investments, including assets whose use is limited	3,174,048	16,267,375
Proceeds from sale of property	0	21,999,194
Purchase of property, plant and equipment	(7,346,485)	(8,144,060)
NET CASH AND CASH EQUIVALENTS PROVIDED BY (USED IN) INVESTING ACTIVITIES	(4,172,437)	30,122,509

(Continued)

Consolidated Statements of Cash Flows – Continued
Doctors Community Hospital and Subsidiaries

	Year Ended June 30 2012	Year Ended June 30 2011
FINANCING ACTIVITIES		
Principal payments on debt	$ (3,560,511)	$ (3,779,429)
Restricted contributions received	1,001,614	150,000
NET CASH AND CASH EQUIVALENTS USED IN FINANCING ACTIVITIES	(2,558,897)	(3,629,429)
NET INCREASE (DECREASE) IN CASH AND CASH AND CASH EQUIVALENTS	(2,428,273)	12,827,331
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	27,349,011	14,521,680
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 24,920,739	$ 27,349,011
SUPPLEMENTAL DISCLOSURE ON NON CASH TRANSACTIONS		
Acquisition of equipment under capital lease	$ 0	$ 3,565,475

See the accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements
Doctors Community Hospital and Subsidiaries

Note A – Organization and Summary of Significant Accounting Principles

Organization

Doctors Community Hospital (the Hospital) is a not-for-profit, non-stock corporation that operates an acute care general hospital facility licensed for 219 beds. The Hospital serves the health care needs of the residents of Prince George's County, the District of Columbia, and the greater Washington, D.C. metropolitan area. The Hospital has three wholly owned/controlled subsidiaries: Doctors Community Health Ventures, Inc. (Health Ventures), Doctors Community Hospital Foundation, Inc. (the Foundation), and Spine Team Maryland, LLC (STM).

Health Ventures is a for-profit corporation that invests in corporations and other businesses consistent with the Hospital's mission and strategic plan.

The Foundation is a not-for-profit, non-stock corporation established to raise and invest funds to support or benefit the operations of the Hospital. The Foundation's bylaws provide that all funds raised, except those required for the operation of the Foundation, be distributed to or be held for the benefit of the Hospital. The Foundation's bylaws also provide the Hospital with the authority to direct its activities, management, and policies.

STM is a limited liability company formed in Maryland for the purpose of providing medical and surgical services for the residents of Prince Georges County and surrounding areas.

The Hospital owns a 60% interest in Doctors Regional Cancer Center, LLC (DRCC) and Doctors Community Hospital Sleep Center, LLC (the Sleep Center). DRCC is a limited liability company formed in Maryland for the purpose of providing outpatient cancer treatment services to the residents of central Maryland. The Sleep Center is a limited liability company formed in Maryland for the purpose of providing diagnostic sleep services for residents of Prince Georges County and surrounding areas.

Principles of Consolidation

The consolidated financial statements include the accounts of the Hospital, Health Ventures, the Foundation, DRCC, the Sleep Center, and STM (collectively, the Company). All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Note A – Organization and Summary of Significant Accounting Principles – Continued

Cash and Cash Equivalents

The Company has cash holdings in commercial banks routinely exceeding the Federal Deposit Insurance Corporation maximum insurance limit of $250,000. Cash and cash equivalents are reported at cost which approximates market value.

Investments

Marketable securities, including assets whose use is limited, are carried at fair value. All such investments are classified as trading. Assets whose use is limited that are required to meet current liabilities of the Hospital have been classified as current assets.

Unrestricted investment income, including realized gains and losses on the sale of trading securities, is reported as other operating revenue. The cost of securities sold is based on the specific-identification method. Unrealized gains and losses on trading securities are included in non-operating gains (losses) in the accompanying consolidated statements of operations and other changes in unrestricted net assets.

Patient Revenue and Accounts Receivable

Net patient service revenue and net patient accounts receivable are reported at estimated net realizable amounts from patients, third party payers, and others for services rendered. Discounts ranging from 2.25% to 6% of Hospital charges are given to Medicare, Medicaid, and certain approved commercial health insurance providers and health maintenance organizations. In addition, these payers routinely review patient billings and deny payments for certain charges that they deem medically unnecessary or performed without appropriate pre-authorization. Discounts and denials are recorded as reductions of net patient service revenue. Accounts receivable from these third-party payers have been adjusted to reflect the difference between charges and the estimated reimbursable amounts.

Note A – Organization and Summary of Significant Accounting Principles – Continued

Patient Revenue and Accounts Receivable - Continued

Gross patient revenue was comprised of the following for the years ended June 30:

	2012	2011
Medicare	43%	43%
Medicaid	13%	13%
Blue Cross Blue Shield	20%	20%
Other third-party payers	20%	19%
Self-pay patients	4%	5%
	100%	100%

The Company bills third party payers directly for services provided. Insurance coverage and credit information are obtained from patients upon admission when available. No collateral is obtained for patient accounts receivable. Patient accounts receivable deemed to be uncollectible by management have been written off. An allowance for doubtful accounts is recorded based on historical trends for patient accounts receivable that are anticipated to become uncollectible in future periods.

Gross patient accounts receivable were comprised of the following for the years ended June 30:

	2012	2011
Medicare	32%	29%
Medicaid	23%	22%
Blue Cross Blue Shield	8%	15%
Other third-party payers	17%	20%
Self-pay patients	20%	14%
	100%	100%

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on the consolidated financial statements. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Note A – Organization and Summary of Significant Accounting Principles – Continued

Inventories

Inventories consist of supplies and drugs and are carried at the lower of cost or market using the average-cost method.

Land, Buildings, and Equipment

Land, buildings, and equipment are recorded at cost. Depreciation is recorded over the estimated useful lives of the assets using the straight-line method. Maintenance and repairs are charged to expense as incurred. The straight-line method is used to amortize the cost of equipment under capital leases over the estimated useful lives of the equipment or the term of the lease, whichever is appropriate.

Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital and the Foundation has been limited by donors to a specific time period or purpose. As of June 30, 2012 and 2011, the Company had no permanently restricted net assets. Temporarily restricted net assets are available to fund various health care services and other community benefits provided by the Hospital. The Company's policy is to treat restricted contributions recorded and released in the same fiscal year as unrestricted contributions.

Excess of Revenue over Expenses

The consolidated statements of operations and other changes in unrestricted net assets include the excess of revenue over expenses (the "performance indicator"). Changes in unrestricted net assets, which are excluded from the excess of revenue over expenses, consistent with industry practice, include contributions received and used for additions of long-lived assets, distributions to non-controlling interest-holders, and changes in the pension obligation other than net periodic pension cost.

Charity Care

A patient is classified as a charity patient by reference to certain established policies of the Hospital. These policies define charity services as those services for which no payment is anticipated. In assessing a patient's ability to pay, the Hospital utilizes the generally recognized poverty income levels in the local community, but also includes certain cases where incurred charges are significant when compared to income.

Under current accounting standards, the Company is required to report the cost of providing charity care. The cost of charity care provided by the Hospital totaled $2,949,975 and $2,128,738 for the years ended June 30, 2012 and 2011, respectively. Rates charged by the Hospital for regulated

Note A – Organization and Summary of Significant Accounting Principles – Continued

Charity Care – Continued

services are determined based on an assessment of direct and indirect cost calculated pursuant to the methodology established by the Maryland Health Services Cost Review Commission ("HSCRC" - see *Note J*), and therefore the cost of charity services noted above for the Hospital are equivalent to its established rates for those services. For any charity services rendered by the Company other than from the Hospital, the cost of charity care is calculated by applying the estimated total cost-to-charge ratio for the non-Hospital services to the total amount of charges for services provided to patients benefitting from the charity care policies of the Company's non-Hospital affiliates.

The Hospital receives a payment from the HSCRC with respect to an Uncompensated Care Fund ("UCC") established for rate-regulated hospitals in Maryland. The UCC is intended to provide Maryland hospitals with funds to support the provision of uncompensated care at those hospitals. The Hospital received $3,116,258 for 2012 and $4,212,316 for 2011 in UCC payments.

Contributions and Pledges

Unconditional promises to give cash and other assets to the Hospital and the Foundation are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received or when the conditions for receiving the donation have been satisfied. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. Contributions restricted by donors for additions to the Hospital's operating property are transferred from temporarily restricted net assets to unrestricted net assets when the expenditure is made. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of changes in net assets as net assets released from restriction.

The Hospital and Foundation write off any grants and pledges receivable that are considered uncollectible; accordingly, there is no allowance for doubtful accounts recorded for these grants and pledges. Grants and pledges receivable have not been discounted because management considers the effect to be immaterial. The balance of pledges receivable was $141,605 and $274,805 at June 30, 2012 and 2011, respectively, and is included in other amounts receivable in the accompanying consolidated balance sheets.

Advertising Costs

The Hospital expenses advertising costs as they are incurred. Advertising expense was $1,510,464 and $1,348,387 for the fiscal years June 30, 2012 and 2011, respectively, and is reported as other expense in the accompanying consolidated statements of operations and other changes in unrestricted net assets.

Note A – Organization and Summary of Significant Accounting Principles – Continued

Functional Expenses

The Company's consolidated operating expenses by functional classification are as follows:

	Year Ended June 30	
	2012	**2011**
Health care services	$ 150,106,879	$ 149,886,585
Management and general	58,374,889	58,289,229
Fundraising	477,018	390,321
	$ 208,958,786	$ 208,566,135

Deferred Financing Costs

Financing costs incurred in issuing the Maryland Health and Higher Educational Facilities Authority (the Authority or MHHEFA) Revenue Bonds have been capitalized by the Hospital. These costs are being amortized over the life of the related bond issue using the bonds-outstanding method, which approximates the interest method. Deferred financing costs and accumulated amortization, which are included in other assets in the accompanying consolidated balance sheets, are as follows:

	June 30	
	2012	**2011**
Deferred financing costs	$ 3,008,043	$ 3,008,043
Accumulated amortization	(690,830)	(530,496)
	$ 2,317,213	$ 2,477,547

The estimated aggregate amortization expense anticipated for the next five years is as follows:

2013	$ 156,899
2014	153,096
2015	149,132
2016	144,973
2017	140,603
	$ 744,703

Note A – Organization and Summary of Significant Accounting Principles – Continued

Fair Value of Financial Instruments

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

- **Cash and cash equivalents, patient accounts receivable, other amounts receivable, notes receivable, accounts payable and accrued expenses, employee compensation and related payroll taxes, and advances from third-party payers***:* The carrying amount reported in the balance sheets for each of these assets and liabilities approximates their fair value.

- **Marketable securities and assets limited as to use***:* Fair values are based on quoted market prices of individual securities or investments if available, or are estimated using quoted market prices for similar securities.

- **Long-term debt***:* Fair values of the Hospital's fixed-rate debt are based on current traded values (see *Note F*).

- **Interest rate swap:** The fair value of the Hospital's interest rate swap was based on the proprietary model of a third party valuation specialist (see *Note F*).

Income Taxes

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

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

Note A – Organization and Summary of Significant Accounting Principles – Continued

Income Taxes – Continued

The Hospital and the Foundation 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 informational returns were filed for the Hospital and the Foundation, no tax returns were filed during 2012 and 2011.

Health Ventures is subject to corporate income tax, and incurred an income tax liability of $0 and $70,000 for the years ended June 30, 2012 and 2011, respectively.

DRCC and Sleep Center are Maryland limited liability companies that have not elected to be taxed as a corporation under current Treasury regulations. DRCC and Sleep Center are owned by more than one member. As such, DRCC and Sleep Center are subject to the partnership tax rules under Subchapter K of the Internal Revenue Code of 1986 (IRC), as amended. Under these rules DRCC and Sleep Center are not subject to federal or state income tax, but must file annual information returns indicating their gross and taxable income to determine the tax results to their members.

STM is a Maryland limited liability company that has not elected to be taxed as a corporation under current treasury regulations. STM is wholly owned by the Hospital. As such, STM is a "disregarded entity" under current IRC regulations.

Goodwill

Goodwill represents the excess of cost over the fair value of assets acquired. Management evaluates goodwill for impairment on an annual basis. Management reviewed the carrying value reported for goodwill in the accompanying consolidated balance sheets for impairment and believes there is none as of June 30, 2012.

Recent Changes in Accounting Standards

In July 2011, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) No. 2011-7, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. ASU 2011-7 affects entities within the scope of Topic 954, Health Care Entities that recognize significant amounts of patient service revenue at the time services are rendered even though the entities do not assess a patient's ability to pay. ASU 2011-7 requires certain health care entities to change the presentation of their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from

Note A – Organization and Summary of Significant Accounting Principles – Continued

Recent Changes in Accounting Standards – Continued

an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, those health care entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. ASU 2011-7 also requires disclosure of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowances for doubtful accounts. This is effective for fiscal years beginning after December 15, 2011 for public entities and for the first annual period ending after December 15, 2012 for non-public entities (early adoption permitted). Application for periods presented in the statement of operations would be retrospective; however, the disclosures required by the amendments would be prospective. Management is currently evaluating the impact on the Company's future financial statements of adoption of this change in accounting.

Reclassification

Certain prior year amounts have been reclassified to conform to the current year's presentation.

Subsequent Events

Subsequent events have been evaluated by management through September 27, 2012, which is the date the consolidated financial statements were available to be issued.

Note B – Investments

The following is a summary of investment securities:

	June 30	
	2012	**2011**
Marketable securities:		
Cash and cash equivalents		
Cash	$ 4,007	$ 1,542
Money market funds	6,352,485	257,792
Fixed maturity		
U.S. Government Agency Bonds/Notes	3,999,880	0
Equity securities		
Mutual funds	3,188,899	13,173,040
	$ 13,545,271	$ 13,432,374
Assets whose use is limited:		
Cash and cash equivalents		
Money market funds	$ 13,920,292	$ 6,148,427
Fixed maturity		
U.S. Government Agency Bonds/Notes	17,512,667	28,476,446
	$ 31,432,959	$ 34,624,873

All current funds classified as assets whose use is limited are debt service reserve funds.

Note B – Investments – Continued

Investment return is summarized as follows:

	Other Operating Revenue	Non Operating Gains (Losses)	Total
2012			
Interest and dividend income	$ 275,449	$ 0	$ 275,449
Net realized gain	48,416	0	48,416
Net unrealized loss	0	46,615	46,615
Investment fees	(33,545)	0	(33,545)
	$ 290,320	$ 46,615	$ 336,935
2011			
Interest and dividend income	$ 582,467	$ 0	$ 582,467
Net realized gain	687,498	0	687,498
Net unrealized loss	0	(575,127)	(575,127)
Investment fees	(48,363)	0	(48,363)
	$ 1,221,602	$ (575,127)	$ 646,475

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

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Note B – Investments – Continued

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

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset or liability, 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 or liability. 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 or liability. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

Fair values of the Company's investments in mutual funds classified at Level 1 are based on quoted market prices. Fair values for the Company's fixed maturity securities (corporate debt and federal government obligations) are based on prices provided by its investment managers and its custodian bank. Both the investment managers and the custodian bank use a variety of pricing sources to determine market valuations. Each designate specific pricing services or indexes for each sector of the market based upon the provider's experience. The Company's federal government obligations and government backed securities portfolio is highly liquid, which allows for a high percentage of the portfolio to be priced through pricing services.

The fair value of the Company's interest rate swap (level 3) was based on the proprietary model of a third party valuation specialist. The fair value considered the prevailing interest rate environment and the specific terms and conditions of the swap, and considered the credit risk of the Company and the counterparty. The method used to determine the fair value calculated the estimated future payments required by the swap and discounts these payments using an appropriate discount rate. The value represents the estimated exit price that the Company would pay to terminate the agreement.

Note B – Investments – Continued

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2012.

	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Cash	$ 4,007	$ 0	$ 0	$ 4,007
Money market funds	0	20,272,777	0	20,272,777
Fixed maturity				
U.S. Government Agency Bonds/Notes	0	21,512,547	0	21,512,547
Equity securities				
Mutual funds				
Short government	783,636	0	0	783,636
Ultrashort bond	797,746	0	0	797,746
Short-term bond	2,128,013	0	0	2,128,013
Intermediate government	816,418	0	0	816,418
World bond	322,736	0	0	322,736
High-yield bond	228,372	0	0	228,372
Intermediate-term bond	228,433	0	0	228,433
Moderate allocation	102,123	0	0	102,123
Mid-cap growth	332,803	0	0	332,803
Real estate	162,815	0	0	162,815
Foreign large blend	838,395	0	0	838,395
Large blend	199,995	0	0	199,995
Diversified emerging markets	219,808	0	0	219,808
Large growth	124,803	0	0	124,803
Small blend	286,521	0	0	286,521
Total assets	$ 7,576,624	$ 41,785,324	$ 0	$ 49,361,948

Note B – Investments – Continued

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2011:

	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Cash	$ 1,542	$ 0	$ 0	$ 1,542
Money market funds	0	6,406,219	0	6,406,219
Fixed maturity				
U.S. Government Agency Bonds/Notes	0	28,476,446	0	28,476,446
Equity securities				
Mutual funds				
Short government	3,288,099	0	0	3,288,099
Ultrashort bond	3,300,001	0	0	3,300,001
Short-term bond	5,070,836	0	0	5,070,836
Intermediate government	3,292,247	0	0	3,292,247
World bond	281,775	0	0	281,775
High-yield bond	205,362	0	0	205,362
Intermediate-term bond	208,389	0	0	208,389
Moderate allocation	99,381	0	0	99,381
Mid-cap growth	334,754	0	0	334,754
Real estate	145,370	0	0	145,370
Foreign large blend	954,239	0	0	954,239
Large blend	193,154	0	0	193,154
Diversified emerging markets	235,754	0	0	235,754
Large growth	107,519	0	0	107,519
Small blend	338,742	0	0	338,742
Total assets	$ 18,057,164	$ 34,882,665	$ 0	$ 52,939,829

There were no significant transfers between fair value hierarchy levels for the years ended June 30, 2012 and 2011.

Note C – Joint Ventures and Equity Investments

Health Ventures invests in corporations and other forms of business consistent with the mission and strategic plan of the Company. Health Ventures' unconsolidated investments are carried at cost or at equity depending on the percentage of ownership and control. Health Venture's investments in Magnolia Gardens L.L.C. and Diagnostic Imaging Associates, LLC are not consolidated with the financial statements of the Company because Health Ventures does not control the investees. The investment income of these joint ventures and equity investments is reported in non operating revenue in the accompanying consolidated statements of operations and other changes in unrestricted net assets. These investments are summarized as follows as of June 30:

Name	Percent Ownership	Accounting Method	2012	2011
Magnolia Gardens LLC	51.0%	Equity	$ 2,864,253	$ 2,325,301
Neighborcare Home Medical Equipment of Maryland LLC	5.0%	Cost	0	250,000
Metropolitan Ambulatory Urological Institute, LLC	31.7%	Equity	143,667	90,458
Diagnostic Imaging Associates, LLC	52.8%	Equity	(119,842)	(305,995)
			$ 2,888,078	$ 2,359,764

Note D – Related Party Transactions

The Hospital has income guarantee agreements with certain physicians. These advances are held as promissory notes and are often forgiven based on the established terms of these notes, such as maintaining an active practice in the Hospital's community.

The Hospital advanced funds to Health Ventures in its establishment of Metropolitan Medical Group, LLC and Diagnostic Imaging, LLC (DI). The Medical Director of Radiology for the Hospital is an investor in DI. The Medical Director of Radiology for the Hospital is an investor in DI. Since MMS is wholly owned by Health Ventures, the amounts loaned have been eliminated in consolidation. Amounts loaned to DI were $818,107 and $812,072 as of June 30, 2012 and 201. Each amount loaned for years ending June 30, 2012 and 2011 is net of a reserve of $1,000,000. At June 30, 2012, the loaned amount outstanding was converted into an equity contribution to DI on Health Ventures' behalf.

A member of the board of directors maintains a business that had transactions with the Hospital that amounted to $505,575 and $606,915 for the years ended June 30, 2012 and 2011, respectively.

The Foundation transferred $128,506 and $106,746 for the years ended June 30, 2012 and 2011, respectively, of restricted net assets to the Hospital, which were then released from restriction by the Hospital for use in operations.

Note E – Land, Buildings, and Equipment

Land, buildings, and equipment are summarized as follows:

		June 30	
Name	**Useful Life**	**2012**	**2011**
Land improvements	10-40 Years	$ 7,135,958	$ 7,135,958
Buildings	4-40 Years	123,641,789	123,641,789
Furniture and equipment	2-20 Years	75,306,543	70,956,441
Equipment under capital lease obligations	2-20 Years	9,987,859	9,987,859
		216,072,149	211,722,047
Less accumulated depreciation		98,821,201	91,636,409
		117,250,948	120,085,638
Construction in progress		1,112,808	740,995
Land		6,138,502	6,138,502
		$ 124,502,258	$ 126,965,135

Accumulated depreciation includes accumulated amortization of capital leased equipment in the amount of $2,467,106 and $1,509,807 as of June 30, 2012 and 2011, respectively. Depreciation expense of capital leased equipment was $560,291 and $560,291 for fiscal year 2012 and 2011, respectively.

Note F – Long-Term Debt

Long-term indebtedness consisted of the following:

	June 30 2012	June 30 2011
Maryland Health and Higher Education Facilities Authority Revenue Bonds, Series 2007A:		
4.00% term bonds due July 1, 2013	$ 5,065,000	$ 7,450,000
5.00% term bonds due July 1, 2020	21,890,000	21,890,000
5.00% term bonds due July 1, 2027	30,795,000	30,795,000
5.00% term bonds due July 1, 2029	10,915,000	10,915,000
Maryland Health and Higher Education Facilities Authority Revenue Bonds, Series 2010:		
5.30% term bonds due July 1, 2025	5,330,000	5,330,000
5.625% term bonds due July 1, 2030	9,095,000	9,095,000
5.75% term bonds due July 1, 2038	68,245,000	68,245,000
Capital leases	5,117,816	6,273,608
Notes payable	0	19,688
	156,452,816	160,013,296
Current portion of long-term debt	(3,796,609)	(3,621,623)
Original issue premium, net of accumulated amortization	1,839,562	2,027,513
Original issue discount, net of accumulated amortization	(1,801,688)	(1,835,840)
	$ 152,694,081	$156,583,346

The fair value of the Company's long-term debt, based on quoted market prices, was $153,252,644 and $140,854,447 at June 30, 2012 and 2011, respectively.

Note F – Long-Term Debt – Continued

The aggregate maturities of long-term debt, including sinking fund principal requirements during the next five fiscal years, are as follows:

2013	$ 3,796,609
2014	4,273,218
2015	4,479,966
2016	4,083,023
2017	3,310,000
2018 and after	136,510,000
	$156,452,816

Total interest paid for the years ended June 30, 2012 and 2011 was $8,312,043 and $10,348,832, respectively.

Revenue Bonds

On May 15, 2010, the Hospital issued $82,670,000 principal amount of Revenue Bonds, Series 2010 (Series 2010 Bonds). The proceeds of this issue were used to retire the Revenue Bonds, Series 2008 and to finance the costs of renovation and equipment purchases.

On January 4, 2007, the Hospital issued $77,685,000 principal amount of Revenue Bonds, Series 2007A (Series 2007 Bonds). The proceeds of this issue were used to retire certain existing bonds, pooled loans, and to finance the costs of renovation and equipment purchases.

The Series 2010 Bonds and the Series 2007 Bonds are secured by the revenue and accounts receivable of the Hospital. The Hospital is required to maintain certain debt ratios as defined by the Agreement. In the opinion of management, the Hospital has complied with the required covenants for 2012 and 2011.

Note F – Long-Term Debt – Continued

Other Debt

During 2008, DRCC obtained a $4,000,000 revolving line of credit from a commercial lender to finance the acquisition of certain medical equipment. The line of credit was converted to a capital lease during 2009. The outstanding principal balance was $2,630,450 and $3,184,329 on June 30, 2012 and 2011, respectively. Beginning in October 2009, monthly payments of principal and interest at 6.8% per annum become due. Aggregate future principal payments as of June 30, 2012 are as follows:

2013	$	592,585
2014		633,995
2015		678,298
2016		725,698
	$	2,630,576

In July 2012, the DRCC refinanced the capital lease. The refinanced balance was $2,711,191 at an interest rate of 3.6%. Other debt includes the Hospital's obligations under various other capital leases (see *Note H*).

Derivative Instrument

Generally accepted accounting principles require that all derivative instruments be recognized in the financial statements at their fair value. The Hospital entered into an interest rate swap agreement that was considered to be a derivative financial instrument. The interest rate swap contract was not designated as an effective cash flow hedge under current accounting principles. Consequently, changes in the fair value of the interest rate swap agreement were recognized in the consolidated statement of operations as a component of excess of revenue over expenses.

Note F – Long-Term Debt – Continued

Derivative Instruments – Continued

The Hospital's interest rate swap had an initial notional amount of $75,000,000 subject to scheduled amortization, an effective date of January 1, 2009, and a termination date of July 1, 2040. It provided for the Hospital to pay a fixed rate of approximately 4.6% and receive a variable rate based on 79% of one month London Interbank Offered Rate. Subject to the terms of the agreement, either party had the option to terminate the agreement prior to the termination date provided that no event of default or termination had occurred. Specifically, the interest rate swap provider had the optional right to terminate this transaction (provided that no event of default or termination event had occurred) on May 1, 2011 and annually thereafter until scheduled termination. Upon election to optionally terminate this transaction, a termination amount in respect of such termination would be due from one counterparty to this transaction to the other counterparty.

The Hospital entered into an agreement with the counterparty to terminate the interest rate swap agreement on April 14, 2011. The Hospital made payments to the counterparty that totaled $18,137,789 to terminate the interest rate swap, and such payments are reported as a non-operating loss in the associated consolidated statements of operations and changes in unrestricted net assets.

Note G – Medical Malpractice and Workers' Compensation Insurance

From October 18, 2001 to October 31, 2004, the Hospital maintained occurrence-based professional liability insurance with a per-claim limit of $8,000,000 and aggregate annual limit of $10,000,000 with a commercial carrier. The Hospital was liable for a deductible up to $250,000 for each occurrence up to a maximum of $750,000. Prior to October 18, 2001, the Hospital's policy had no deductible. Effective November 1, 2004, due to the commercial carrier discontinuing services in Maryland and rising insurance costs, the Hospital purchased coverage on a claims-made basis from Freestate Healthcare Insurance Company, Ltd., a group captive formed by several Maryland hospitals. The Hospital owns a partial interest in the captive that is accounted for using the cost method. The cost of $15,000 is recorded in other assets in the accompanying consolidated balance sheets as of June 30, 2012 and 2011. Premiums are expensed as incurred and are established based on the Hospital's historical experience supplemented as necessary with industry experience. The total premium is allocated to each of the shareholders based on their experience. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insured under the policy. Each named insured's assessment of 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, 2012. 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.

Note G – Medical Malpractice and Workers' Compensation Insurance – Continued

The captive is responsible for claims up to $1,000,000 for each and every loss event. Additional coverage has been purchased for all claims in excess of $1,000,000 to a limit of $6,000,000 effective March 1, 2006. The estimated unpaid loss liability reserved by the captive for the Hospital was $6,356,004 and $5,111,182 at June 30, 2012 and 2011, respectively. In accordance with current accounting standards, the June 30, 2012 unpaid loss liability is recorded as a non current liability and the related insurance recovery was reported as a non current receivable, in the accompanying consolidated balance sheets. The liability for all claims incurred but not reported for the Hospital were $1,200,643 and $1,176,824 at June 30, 2012 and 2011, respectively. The Hospital engages a consulting actuary to assist in the determination of all professional liability claims incurred but not reported.

The Hospital is self-insured against workers' compensation claims up to a per-accident limit of $400,000 with an annual limitation of approximately $1,200,000. A liability has been recorded for all known claims and an estimate for claims incurred but not reported in the amount of $646,076 and $888,587 at June 30, 2012 and 2011, respectively. These amounts are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

Note H – Leases

The Company has operating leases covering various medical and other equipment and facilities. Generally, the leases carry renewal provisions and require the Hospital to pay maintenance costs.

The Hospital and DRCC have entered into capital leases for certain equipment. The cost of assets under capital leases is included in land, building, and equipment (see *Note E*), and related capital lease obligations are included in long-term debt (see *Note F*) in the accompanying consolidated balance sheets. Depreciation expense on these assets is included with depreciation expense in the consolidated statements of operations and other changes in unrestricted net assets.

Note H – Leases - Continued

Future minimum lease payments as of June 30, 2012 are as follows:

	Capital Leases	Operating Leases
2013	$ 1,311,609	$ 1,987,806
2014	1,393,218	1,550,853
2015	1,479,966	1,340,224
2016	933,023	1,278,187
2017 and thereafter	0	7,094,421
Total minimum lease payments	5,117,816	$ 13,251,491
Current portion of long-term debt	(1,311,609)	
Capital lease obligations, less current portion	$ 3,806,207	

Total rental expense reported in the accompanying consolidated statements of operations and other changes in unrestricted net assets for the years ended June 30, 2012 and 2011 was $3,806,038 and $3,076,681, respectively.

Note I – Retirement Plans

The Hospital froze the defined benefit pension plan (the Plan) in 2011, which covered substantially all employees. The Plan curtailment was recognized in 2011. The decision to terminate in the Plan has not been made by the board of directors. The benefits are based on years of service and the employee's compensation during years of employment. The Hospital's funding policy is to make sufficient contributions to the Plan to comply with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 (ERISA). The Hospital expects to contribute $1,000,000 to the Plan during 2013 to keep the funding levels at the IRS requirements. The measurement date of the Plan is June 30.

The following table provides a reconciliation of the benefit obligation, Plan assets, and funded status of the Plan in the Company's consolidated financial statements based on actuarial valuations:

Note I – Retirement Plans – Continued

	2012	2011
Accumulated Benefit Obligation	$ 22,012,920	$ 18,093,874
Change in Benefit Obligation		
Benefit obligation at beginning of year	$ 18,093,874	$ 17,122,151
Service cost	0	879,214
Interest cost	904,053	905,352
Curtailment gain	0	(262,388)
Actuarial loss	3,410,330	989
Benefits paid	(386,337)	(551,444)
Benefit Obligation at End of Year	22,021,920	18,093,874
Change in Plan Assets		
Fair value of plan assets at beginning of year	$ 13,080,378	$ 9,955,249
Actual return on plan assets	(203,019)	1,545,345
Employer contributions	1,955,241	2,131,228
Benefits paid	(386,336)	(551,444)
Fair Value of Plan Assets at End of Year	14,446,264	13,080,378
Funded Status (Pension Obligation)	$ (7,575,656)	$ (5,013,496)
Components of Net Periodic Benefit Cost		
Service cost	$ 0	$ 879,214
Interest cost	904,053	905,352
Expected return on plan assets	(833,540)	(724,028)
Amortization of prior service cost	0	8,033
Curtailment loss	0	92,333
Recognigiton of loss from change in measurement date	453,101	534,262
Net Periodic Pension Cost	$ 523,614	$ 1,695,166

Note I – Retirement Plans – Continued

The total amount recognized in unrestricted net assets for 2012 and 2011 is as follows:

	2012	2011
Net loss	$ 10,035,138	$ 6,041,351
Prior service cost	0	0
	$ 10,035,138	$ 6,041,351

The total amount of prior service cost and net gain (loss) expected to be recognized in net periodic benefit cost during 2013 is $854,193.

The Plan's assets are invested primarily in cash and cash equivalents and mutual funds as follows as of June 30:

	2012	2011
Equity securities	34%	52%
Fixed maturity	66%	36%
Other	0%	12%
	100%	100%

Plan assets are invested to ensure that the 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 was 50% equities and 50% fixed maturity securities and cash as of June 30, 2012.

The Plan's estimated future benefit payments are as follows:

2013	$ 2,404,434
2014	835,500
2015	640,254
2016	783,914
2017	948,671
2018 - 2022	6,520,850
Total	$ 12,133,623

Note I – Retirement Plans – Continued

The weighted-average assumptions used to determine net periodic benefit cost and the projected benefit obligation for the years ended June 30 were as follows:

	2012	2011
Discount rate	3.70%	5.25%
Expected return on Plan assets	6.50%	6.50%
Rate of compensation increase	N/A	2.00%

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2012:

	Level 1	Level 2	Level 3	Total Fair Value
Equity securities				
Mutual funds				
Diversified emerging markets	$ 276,721	$ 0	$ 0	$ 276,721
Foreign large growth	274,963	0	0	274,963
Foreign small/mid growth	140,472	0	0	140,472
Inflation-protected bond	1,495,079	0	0	1,495,079
Intermediate government	2,090,077	0	0	2,090,077
Intermediate-term bond	3,705,588	0	0	3,705,588
Large growth	1,134,024	0	0	1,134,024
Large value	1,014,110	0	0	1,014,110
Mid-cap blend	1,388,545	0	0	1,388,545
Multisector bond	2,202,025	0	0	2,202,025
Small growth	292,759	0	0	292,759
Small value	431,901	0	0	431,901
Total assets	$ 14,446,264	$ 0	$ 0	$ 14,446,264

Note I – Retirement Plans – Continued

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2011:

	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Money market funds	$ 226,769	$ 0	$ 0	$ 226,769
Equity securities				
Mutual funds				
Diversified emerging markets	671,943	0	0	671,943
Foreign large growth	682,662	0	0	682,662
Foreign small/mid growth	1,370,670	0	0	1,370,670
Inflation-protected bond	603,099	0	0	603,099
Intermediate government	524,033	0	0	524,033
Intermediate-term bond	2,950,422	0	0	2,950,422
Large growth	669,312	0	0	669,312
Large value	1,322,320	0	0	1,322,320
Mid-cap blend	666,513	0	0	666,513
Multisector bond	609,237	0	0	609,237
Small growth	792,324	0	0	792,324
Small value	690,635	0	0	690,635
World allocation	1,300,439	0	0	1,300,439
Total assets	$ 13,080,378	$ 0	$ 0	$ 13,080,378

There were no significant transfers between fair value hierarchy levels for the years ended June 30, 2012 and 2011.

The Hospital has a deferred compensation plan that permits certain executives to defer receiving a portion of their compensation. The deferred amounts are included in other assets in the accompanying consolidated balance sheets. The associated liability of an equal amount is included in other liabilities in the accompanying consolidated balance sheets. The liability recorded regarding the deferred compensation was $4,467,320 and $4,358,593 as of June 30, 2012 and 2011, respectively. During 2012 and 2011, distributions of $622,271 and $136,142 were made to participants in the deferred compensation plan, respectively.

The Hospital is the beneficiary of life insurance policies in place for certain executives. Approximately $9,400,000 is included in other assets at June 30, 2012 and 2011, which is the amount that could be realized by the Hospital under the insurance contracts.

Note J – Maryland Health Services Cost Review Commission

Certain of the Hospital's charges are subject to review and approval by the Maryland Health Services Cost Review Commission (the Commission). Hospital management has filed the required forms with the Commission and believes the Hospital is in compliance with Commission requirements.

The current rate of reimbursement for principally all inpatient services and certain other services to patients under the Medicare and Medicaid programs is based on an agreement between the Centers for Medicare and Medicaid Services and the Commission. This agreement is based upon a waiver from Medicare reimbursement principles under Section 1814(b) of the Social Security Act and will continue as long as all third-party payers elect to be reimbursed under this program and the rate of increase for costs per hospital inpatient admission is below the national average. Management believes that this program will remain in effect at least through June 2013.

The Commission and the Hospital entered into an agreement that is based on a rate methodology for those Hospital service centers that provide only inpatient services. Under this methodology, a target average charge per case is established for the Hospital, based on past actual charges and case mix indices. The actual average charge per case is compared with the target average charge-per-case and to the extent that the actual average exceeds the target, the overcharge plus applicable penalties will reduce the approved target for future years. At June 30, 2012, the Hospital was in compliance with its average charge per case target.

The Commission's rate-setting methodology for Hospital service centers that provide both inpatient and outpatient services or only outpatient services consists of establishing an acceptable unit rate for defined inpatient and outpatient service centers within the Hospital. The actual average unit charge for each service center is compared to the approved rate monthly. Overcharges and undercharges due to either patient volume or price variances, plus penalties where applicable, are applied to decrease (in the case of overcharges) or increase (in the case of undercharges) future approved rates on an annual basis.

The Commission changed the charge-per-case reimbursement methodology for all Maryland hospitals effective July 1, 2005. The Commission chose a severity-adjusted method of grouping hospital discharges to measure differences in patient acuity and to align payments appropriately to that acuity. This policy decision reflects the Commission's desire to continuously improve the rate-setting system and to remain a leader in the development of policies that ensure cost containment, access to care, equity in payment, and financial stability of the hospital industry.

The timing of the Commission's rate adjustments for the Hospital could result in an increase or reduction in rates due to the variances and penalties described above in a year subsequent to the year in which such items occur. The Hospital's policy is to accrue revenue based on actual charges for services to patients in the year in which the services to patients are performed and billed.

Note K – Commitments and Contingencies

Litigation

There are several lawsuits pending in which the Hospital has been named as defendant. In the opinion of Hospital management, after consultation with legal counsel, the potential liability, in the event of adverse settlement, will not have a material impact on the Hospital's consolidated financial position.

Risk Factors

The Company's ability to maintain and/or increase future revenues could be adversely affected by:

- the growth of managed care organizations promoting alternative methods for health care delivery and payment of services such as discounted fee for service networks and capitated fee arrangements (the rate setting process in the State of Maryland prohibits hospitals from entering into discounted fee arrangements; however, managed care contracts may provide for exclusive service arrangements);

- 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;

- 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;

- the future of Maryland's certificate of need program, where future deregulation could result in the entrance of new competitors, or future additional regulation may eliminate the Company's ability to expand new services; and

- 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, 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,

Note K – Commitments and Contingencies – Continued

operating results and cash flows of the Hospital. In April 2010 the Hospital was surveyed by Joint Commission and received a full three-year Joint Commission accreditation through July 2013. In July 2012 the Hospital was notified that it will be surveyed in the spring of 2013.

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 Company's invested funds and the resulting impact on the future financial position, results of operations and cash flows of the Company could be material.

The Company invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in values of investment securities will occur in the near term, and such changes could materially affect the amounts reported as investments on the consolidated balance sheets.

Note L – Goodwill

During June 2007, the Hospital purchased a 60% interest in DRCC. Goodwill in the amount of $1,062,531 resulted from the transaction and has been included in the accompanying consolidated balance sheets as of June 30, 2012 and 2011.

Upon inception of DRCC in 2007, and as part of its initial capital contribution, Maryland Regional Cancer Care, LLC, the founding member of DRCC, transferred a portion of its goodwill to DRCC. The amount of goodwill transferred to DRCC was $646,975 and has been included in the accompanying consolidated balance sheets at June 30, 2012 and 2011.

Health Ventures has a 51% ownership interest in Magnolia Gardens, LLC. Goodwill in the amount of $766,285 resulted from the purchase of ownership and has been included in the accompanying consolidated balance sheets as of June 30, 2012 and 2011.

Note M – Temporarily Restricted Net Assets

Temporarily restricted net assets are available as of June 30 for the following programs and projects:

	2012	2011
Nancy Heilman Scholarship Fund	$ 1,479	$ 1,479
Brian Erfan Memorial Fund	5,850	5,850
Jane Schafer Scholarship Fund	10,785	10,785
Cardiac Rehab Scholarship	13,594	11,980
Borden Breast Center	20,000	150,000
Komen Grant	999,656	0
UASI 2008 grant	2,177	2,177
MHA HPP Disaster Grant	19	19
	$ 1,053,560	$ 182,290

COHEN
RUTHERFORD
+ KNIGHT PC
Certified Public Accountants

Report of Independent Auditors on Other Financial Information

Board of Directors
Doctors Community Hospital and Subsidiaries
Lanham, Maryland

The 2012 and 2011 audited consolidated financial statements of Doctors Community Hospital and Subsidiaries and our report thereon are presented in the preceding section of this report. Those audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary information presented hereinafter as of and for the year ended June 30, 2012 is presented for purposes of additional analysis of the basic consolidated financial statements, and is not a required part of the basic consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Cohen, Rutherford + Knight, P.C.

September 27, 2012

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

Consolidating Balance Sheet Information

Doctors Community Hospital and Subsidiaries

June 30, 2012

ASSETS	Doctors Community Hospital	Doctors Community Hospital Foundation, Inc.	Doctors Community Health Ventures, Inc	Doctors Regional Cancer Center, LLC	Doctors Community Hospital Sleep Center, LLC	Spine Team Maryland, LLC	Eliminations	Consolidated
CURRENT ASSETS								
Cash and cash equivalents	$ 21,595,161	$ 181,985	$ 677,600	$ 1,360,738	$ 440,687	$ 664,568	$ 0	$ 24,920,739
Assets limited to use for debt service	6,559,838	0	0	0	0	0	0	6,559,838
Patient accounts receivable, net of allowance	25,276,267	0	1,078,975	713,510	87,691	233,170	1,608,266	28,997,879
Other amounts receivable	3,143,867	278,846	16,196	202,272	63,350	2,982	0	3,707,513
Inventories	3,613,413	0	3,951	0	80,909	0	0	3,698,273
Prepaid expenses	1,839,563	4,739	0	61,482	0	52,428	0	1,958,212
TOTAL CURRENT ASSETS	62,028,109	465,570	1,776,722	2,338,002	672,637	953,148	1,608,266	69,842,454
INVESTMENTS								
Marketable securities	13,382,249	163,022	0	0	0	0	0	13,545,271
Investment in Doctors Regional Cancer Center	2,648,170	0	0	0	0	0	(2,648,170)	0
Investment in Sleep Services of America, Inc.	701,540	0	0	0	0	0	(701,540)	0
Joint ventures and equity investments	0	0	3,888,078	0	0	0	(1,000,000)	2,888,078
Due to DCH	11,793,835	0	0	0	410,466	0	(12,204,301)	0
	28,525,794	163,022	3,888,078	0	410,466	0	(16,554,011)	16,433,349
ASSETS WHOSE USE IS LIMITED								
Funds held by Trustee or Authority, less current portion	24,873,121	0	0	0	0	0	0	24,873,121
LAND, BUILDINGS, AND EQUIPMENT	118,910,814	0	481,951	4,687,972	292,918	128,603	0	124,502,258
DEFERRED FINANCING COSTS	2,317,213	0	0	0	0	0	0	2,317,213
GOODWILL	1,062,531	0	766,285	646,975	0	18,943	0	2,494,734
OTHER ASSETS	21,018,282	0	72,090	0	0	0	(100,000)	20,990,372
TOTAL ASSETS	$ 258,735,864	$ 628,592	$ 6,985,126	$ 7,672,949	$ 1,376,021	$ 1,100,694	$ (15,045,745)	$ 261,453,501

See the accompanying report of independent auditors on other financial information.

Consolidating Balance Sheet Information

Doctors Community Hospital and Subsidiaries

June 30, 2012

	Doctors Community Hospital	Doctors Community Hospital Foundation, Inc.	Doctors Community Health Ventures, Inc	Doctors Regional Cancer Center, LLC	Doctors Community Hospital Sleep Center, LLC	Spine Team Maryland, LLC	Eliminations	Consolidated
LIABILITIES AND NET ASSETS								
CURRENT LIABILITIES								
Accounts payable and accrued expenses	$ 15,231,092	$ 57,272	$ 311,131	$ 424,637	$ 179,157	$ 11,133	$ (410,466)	$ 15,803,956
Due to DCH	0	519,612	0	122,328	27,630	3,287,414	(3,956,984)	0
Salaries, wages, and related items	9,661,972	0	590,178	0	0	0	0	10,252,150
Advances from third party payers	7,948,715	0	0	0	0	0	0	7,948,715
Interest payable to bondholders	4,152,632	0	0	0	0	0	0	4,152,632
Current portion of long-term obligation	3,204,024	0	0	592,585	0	0	0	3,796,609
TOTAL CURRENT LIABILITIES	40,198,435	576,884	901,309	1,139,550	206,787	3,298,547	(4,367,450)	41,954,062
NONCURRENT LIABILITIES								
Other noncurrent liabilities	12,023,967	0	0	81,803	0	0	(81,803)	12,023,967
Pension obligation, net of current portion	7,575,656	0	0	0	0	0	0	7,575,656
Long-term obligations, net of current portion	150,656,089	0	7,782,677	2,037,992	0	0	(7,782,677)	152,694,081
TOTAL LIABILITIES	210,454,147	576,884	8,683,986	3,259,345	206,787	3,298,547	(12,231,930)	214,247,766
NET ASSETS AND MEMBERS' EQUITY								
Unrestricted	47,279,865	0	0	0	0	0	(3,360,825)	43,919,040
Members' equity	0	0	(1,698,860)	4,413,604	1,169,234	(2,197,853)	(1,686,125)	0
Noncontrolling interest	0	0	0	0	0	0	2,233,135	2,233,135
Total unrestricted net assets	47,279,865	0	(1,698,860)	4,413,604	1,169,234	(2,197,853)	(2,813,815)	46,152,175
Temporarily restricted	1,001,852	51,708	0	0	0	0	0	1,053,560
TOTAL NET ASSETS	48,281,717	51,708	(1,698,860)	4,413,604	1,169,234	(2,197,853)	(2,813,815)	47,205,735
	$ 258,735,864	$ 628,592	$ 6,985,126	$ 7,672,949	$ 1,376,021	$ 1,100,694	$ (15,045,745)	$ 261,453,501

See the accompanying report of independent auditors on other financial information.

Consolidating Statement of Operations Information
Doctors Community Hospital and Subsidiaries
For the Year Ended June 30, 2012

	Doctors Community Hospital	Doctors Community Hospital Foundation, Inc.	Doctors Community Health Ventures, Inc	Doctors Regional Cancer Center, LLC	Doctors Community Hospital Sleep Center, LLC	Spine Team Maryland, LLC	Eliminations	Consolidated
UNRESTRICTED NET ASSETS								
OPERATING REVENUE								
Net patient service revenue	$ 186,290,140	$ 0	$ 3,537,213	$ 9,026,877	$ 5,177,008	$ 1,094,777	$ 0	$ 205,126,015
Other operating revenue	4,458,536	686	1,821,368	554	0	39,319	(2,366,711)	3,953,752
Pledges and contributions	30,000	604,838	0	0	0	0	0	634,838
Net assets released from restrictions used for operations	344	0	0	0	0	0	0	344
TOTAL OPERATING REVENUE	190,779,020	605,524	5,358,581	9,027,431	5,177,008	1,134,096	(2,366,711)	209,714,949
EXPENSES								
Salaries and wages	76,856,456	133,572	0	0	840,117	310,923	0	78,141,068
Employee benefits	13,609,184	0	0	0	183,531	57,783	0	13,850,498
Purchased services	25,139,388	31,344	425,313	5,786,510	300,513	1,362,305	(1,696,515)	31,348,858
Supplies	33,253,233	6,082	0	136,006	344,484	62,800	0	33,802,605
Other expenses	11,161,745	54,322	6,836,773	636,036	348,004	674,612	(670,204)	19,041,288
Provision for bad debts	14,128,046	4,261	0	23,466	0	0	0	14,155,773
Depreciation	8,597,548	0	144,180	991,939	147,969	27,917	0	9,909,553
Amortization	160,334	0	0	0	0	631	0	160,965
Fundraising	0	247,437	0	0	0	0	0	247,437
Interest	8,101,613	0	0	199,128	0	0	0	8,300,741
TOTAL EXPENSES	191,007,547	477,018	7,406,266	7,773,085	2,164,618	2,496,971	(2,366,719)	208,958,786
NONOPERATING INCOME								
Gain on sale of property	100,161	0	0	0	0	0	0	100,161
Unrealized loss on trading securities	46,615	0	0	0	0	0	0	46,615
Equity (loss) in joint ventures	2,560,039	0	(597,184)	0	0	0	(2,560,039)	(597,184)
EXCESS OF REVENUE OVER EXPENSE (EXPENSE OVER REVENUE)	2,478,288	128,506	(2,644,869)	1,254,346	3,012,390	(1,362,875)	(2,560,031)	305,755
Net asset transfer	128,506	(128,506)	0	0	0	0	0	0
Write off of pledge receivable	0	(130,000)	0	0	0	0	0	(130,000)
Dividends paid	0	0	0	(1,043,219)	(1,520,000)	0	1,537,931	(1,025,288)
Contributions	1,000,000	1,614	0	0	0	0	0	1,001,614
Net assets released from restrictions for use in operations	(344)	0	0	0	0	0	0	(344)
Pension - related changes other than net periodic pension cost	(3,993,787)	0	0	0	0	0	0	(3,993,787)
Increase (decrease) in net assets	(387,337)	(128,386)	(2,644,869)	211,127	1,492,390	(1,362,875)	(1,022,100)	(3,842,050)
Net assets, beginning of year	48,669,054	180,094	946,009	4,202,477	(323,156)	(834,978)	(1,791,715)	51,047,785
Net assets, end of year	$ 48,281,717	$ 51,708	$ (1,698,860)	$ 4,413,604	$ 1,169,234	$ (2,197,853)	$ (2,813,815)	$ 47,205,735

See the accompanying report of independent auditors on other financial information.