COHEN
RUTHERFORD
+ KNIGHT PC
Certified Public Accountants

Garrett County Memorial Hospital and Subsidiary

Consolidated Audited Financial Statements

June 30, 2012 and 2011

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- Contents -

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Independent Auditor's Report

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

We have audited the accompanying consolidated balance sheets of Garrett County Memorial Hospital and subsidiary (collectively, the Company) 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 Company'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform our audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial 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 financial position of Garrett County Memorial Hospital and subsidiary as of June 30, 2012 and 2011, and the results of their operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in *Note J* to the consolidated financial statements, during 2012 the Company changed its method of accounting for professional liability claims and related insurance recoveries.

CR+K

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2012 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of testing of internal control over financial reporting and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Cohen, Rutherford + Knight, P.C.

October 18, 2012
Bethesda, Maryland

Garrett County Memorial Hospital and Subsidiary
Consolidated Balance Sheets

	June 30	
	2012	**2011**
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 6,619,034	$ 3,820,927
Short-term investments -- *Note B*	13,930,564	17,417,996
Patient accounts receivable, net of allowance for doubtful accounts of $3,023,320 and $2,088,948 at June 30, 2012 and 2011, respectively -- *Note K*	6,004,236	4,276,424
Other amounts receivable	623,163	248,526
Insurance recoverable -- *Note J*	559,139	0
Assets whose use is limited by donors -- *Note B*	130,377	230,577
Inventories	970,037	1,004,522
Prepaid expenses	485,157	458,881
TOTAL CURRENT ASSETS	29,321,707	27,457,853
NONCURRENT ASSETS		
Property and equipment -- *Note D*	21,112,464	20,343,924
Long-term investments -- *Note B*	3,719,062	3,663,231
Investment in affiliates -- *Note C*	127,303	303,453
Assets whose use is limited by donors, less current portion -- *Note B*	355,886	349,323
Assets whose use is limited by board of governors -- *Note B*	698,073	698,073
Deferred financing costs	25,340	26,693
TOTAL NONCURRENT ASSETS	26,038,128	25,384,697
TOTAL ASSETS	$ 55,359,835	$ 52,842,550

Garrett County Memorial Hospital and Subsidiary
Consolidated Balance Sheets – Continued

	June 30 2012	June 30 2011
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accounts payable	$ 895,058	$ 965,141
Accrued salaries and wages	2,135,430	2,456,674
Advances from third parties	468,083	433,983
Current portion of long-term debt -- *Note E*	146,887	210,452
Other current liabilities -- *Note J*	2,490,099	1,157,860
TOTAL CURRENT LIABILITIES	6,135,557	5,224,110
Long-term debt, less current portion -- *Note E*	3,594,369	3,742,217
Pension obligation -- *Note G*	10,571,840	6,247,471
TOTAL LIABILITIES	20,301,766	15,213,798
NET ASSETS		
Unrestricted	34,580,773	37,073,302
Temporarily restricted -- *Note F*	442,210	520,364
Permanently restricted -- *Note M*	35,086	35,086
TOTAL NET ASSETS	35,058,069	37,628,752
TOTAL LIABILITIES AND NET ASSETS	$ 55,359,835	$ 52,842,550

See the accompanying notes to the consolidated financial statements.

Garrett County Memorial Hospital and Subsidiary
Consolidated Statements of Operations and Other Changes in Unrestricted Net Assets

	Year Ended June 30	
	2012	**2011**
REVENUE		
Net patient service revenue -- *Note K*	$ 41,222,346	$ 38,967,085
Other revenue	620,436	592,406
Net assets released from restriction for use in operations -- *Note F*	16,118	35,970
TOTAL REVENUE	41,858,900	39,595,461
EXPENSES -- *Note L*		
Salaries and wages	16,572,988	16,157,560
Employee benefits -- *Note G*	6,056,951	5,319,123
Supplies	6,464,646	6,327,715
Utilities	606,239	614,447
Purchased services	4,248,881	3,736,766
Depreciation and amortization -- *Note D*	2,666,697	2,786,678
Interest -- *Note E*	159,161	172,662
Provision for uncollectible accounts	2,941,477	1,760,509
Other expenses	945,177	789,425
TOTAL OPERATING EXPENSES	40,662,217	37,664,885
GAIN FROM OPERATIONS	1,196,683	1,930,576
OTHER INCOME (LOSS)		
Investment income -- *Note B*	187,676	846,560
Equity in loss of affiliates -- *Note C*	(176,148)	(1,673)
Other	413,715	39,546
TOTAL OTHER INCOME (LOSS)	425,243	884,433
EXCESS OF REVENUE OVER EXPENSES	1,621,926	2,815,009
Net assets released from restriction for the purchase of property and equipment -- *Note F*	32,084	75,180
Pension-related changes other than net periodic pension cost -- *Note G*	(4,146,539)	2,026,834
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	$ (2,492,529)	$ 4,917,023

See the accompanying notes to the consolidated financial statements.

Garrett County Memorial Hospital and Subsidiary
Consolidated Statements of Changes in Net Assets

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Assets
BALANCE AT JUNE 30, 2010	$ 32,156,279	$ 549,818	$ 35,086	$ 32,741,183
Excess revenue over expenses	2,815,009	0	0	2,815,009
Net assets released from restriction for the purchase of property and equipment -- *Note F*	75,180	(75,180)	0	0
Pension-related changes other than net periodic pension cost -- *Note G*	2,026,834	0	0	2,026,834
Contributions	0	81,696	0	81,696
Net assets released from restriction for use in operations -- *Note F*	0	(35,970)	0	(35,970)
INCREASE (DECREASE) IN NET ASSETS	4,917,023	(29,454)	0	4,887,569
BALANCE AT JUNE 30, 2011	37,073,302	520,364	35,086	37,628,752
Excess revenue over expenses	1,621,926	0	0	1,621,926
Net assets released from restriction for the purchase of property and equipment -- *Note F*	32,084	(32,084)	0	0
Pension-related changes other than net periodic pension cost -- *Note G*	(4,146,539)	0	0	(4,146,539)
Contributions	0	23,496	0	23,496
Net assets released from restriction for use in operations -- *Note F*	0	(16,118)	0	(16,118)
Other	0	(53,448)	0	(53,448)
DECREASE IN NET ASSETS	(2,492,529)	(78,154)	0	(2,570,683)
BALANCE AT JUNE 30, 2012	$ 34,580,773	$ 442,210	$ 35,086	$ 35,058,069

See the accompanying notes to the consolidated financial statements.

Garrett County Memorial Hospital and Subsidiary
Consolidated Statements of Cash Flows

	Year Ended June 30	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase (decrease) in net assets	$ (2,570,683)	$ 4,887,569
Adjustments to reconcile increase (decrease) in net assets to net cash and cash equivalents provided by operating activities:		
Investment income	76,117	(422,506)
Restricted contributions	(23,496)	(81,696)
Depreciation	2,665,344	2,785,325
Amortization of deferred financing costs	1,353	1,353
Provision for uncollectible accounts	2,941,477	1,760,509
Equity in loss of affiliates	176,148	1,673
Loss (gain) on disposal of equipment	(44,816)	38,577
Decrease (increase) in:		
Patient accounts receivable	(4,669,289)	(1,096,317)
Supplies	34,485	(15,447)
Prepaid expenses	(26,276)	21,971
Insurance recoverable	(559,139)	0
Other amounts receivable	(374,637)	(1,235)
Increase (decrease) in:		
Accounts payable	(70,083)	331,119
Accrued salaries and wages	(321,244)	191,597
Advances from third parties	34,100	19,800
Pension obligation	4,324,369	(1,695,997)
Other current liabilities	1,332,239	(35,461)
NET CASH AND CASH EQUIVALENTS PROVIDED BY OPERATING ACTIVITIES	2,925,969	6,690,834

(Continued)

Garrett County Memorial Hospital and Subsidiary
Consolidated Statements of Cash Flows – Continued

	Year Ended June 30 2011	Year Ended June 30 2010
CASH AND CASH EQUIVALENTS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	$ (3,389,068)	$ (1,527,643)
Net sale (purchase) of trading securities	3,449,121	(5,236,497)
NET CASH AND CASH EQUIVALENTS PROVIDED (USED) IN INVESTING ACTIVITIES	60,053	(6,764,140)
CASH AND CASH EQUIVALENTS FROM FINANCING ACTIVITIES		
Repayments of long-term debt	(211,411)	(230,273)
Proceeds from restricted contributions	23,496	81,696
NET CASH AND CASH EQUIVALENTS USED IN FINANCING ACTIVITIES	(187,915)	(148,577)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,798,107	(221,883)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	3,820,927	4,042,810
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 6,619,034	$ 3,820,927
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	$ 158,878	$ 172,390

See the accompanying notes to the consolidated financial statements.

Note A – Organization and Summary of Significant Accounting Principles

Organization

Garrett County Memorial Hospital (the Hospital) is an instrumentality of Garrett County, Maryland. The Hospital was organized for charitable purposes and is exempt from income taxes as an instrumentality of Garrett County. In 2003, the Hospital formed and became the sole member of Professional Emergency Physician Services, LLC, (PEPS) which is a for-profit limited liability company. The purpose of PEPS is to provide professional emergency services solely to the Hospital. In addition, the Hospital owns 100% of the outstanding shares of Garrett Community Health Services (GCHS), which is a for-profit corporation. GCHS has had no activity for the years ended June 30, 2012 and 2011.

Principles of Consolidation

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

Basis of Presentation

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

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

- Increases (decreases) in permanently restricted net assets if the terms of the gift or the Hospital's interpretation of relevant state law require that they be added to the principal of a permanent net asset;

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

- Increases (decreases) in unrestricted net assets in all other cases.

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

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, after contractual adjustments. Patient accounts receivable include charges for amounts due from Medicare, Maryland Medical Assistance (Medicaid), Blue Cross, commercial insurers, and self-pay patients (*see Note K*). Contractual adjustments represent the differences between amounts billed as patient service revenue and amounts contracted with third party payers, and are accrued on an estimated basis in the period in which the related services are rendered and adjusted in future periods as final settlements are determined. Contractual adjustments are included in the determination of net patient service revenue as reported in the accompanying consolidated statements of operations, whereas the provision for uncollectible self-pay amounts is reported as an operating expense. Rates charged are based primarily on rates established by the State of Maryland Health Services Cost Review Commission (HSCRC); accordingly, revenue reflects actual charges to patients based on rates in effect during the period in which the services are rendered (*see Note I*).

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

Charity Care

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

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. Under current accounting standards, the Hospital is required to report the cost of providing charity care. The cost of charity care provided by the Hospital totaled $2,348,193 and $2,211,133 for the years ended June 30, 2012 and 2011, respectively. Rates charged by the Hospital for regulated services are determined based on an assessment of direct and indirect cost calculated pursuant to the methodology established by the Maryland Health Services Cost Review Commission ("HSCRC" - *see Note I*), and therefore the cost of charity services noted above for the Hospital are equivalent to its established rates for those services.

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

Charity Care - Continued

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

The 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 $167,629 for 2012 and $0 for 2011 in UCC payments, and contributed $159,953 for 2012 and $622,068 for 2011 to the UCC as required by the HSCRC.

Advertising expense

The Company expenses advertising costs as they are incurred.

Cash and Cash Equivalents

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

Supplies

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

Donor-Restricted Funds

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

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

Assets Whose Use is Limited

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

Property and Equipment

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

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

Deferred Financing Costs

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

Investments

Investments and assets whose use is limited, which are invested in marketable securities, are reported at their fair value, based on quoted market prices provided by the asset managers. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities (*see Note B*).

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

Investments in Affiliates

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

Excess of Revenues over Expenses

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

Estimated Malpractice Costs

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

Use of Estimates

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

Income Taxes

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

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

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

Income Taxes - Continued

The Hospital had no unrecognized tax benefits or such amounts were immaterial during the periods presented. For tax periods with respect to which no unrelated business income was recognized, no tax return was required. Tax periods for which no return is filed remain open for examination indefinitely. No tax returns were filed for the Hospital during 2012 and 2011.

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

Subsequent Events

Subsequent events have been evaluated by management through October 18, 2012 which is the date the consolidated financial statements were available to be issued.

Recent Changes in Accounting Standards

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. Some of the amendments clarify the Board's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. Some of the disclosures required by the amendments in this update are not required for nonpublic entities. Those disclosures include information about transfers between Level 1 and Level 2, Level 3 fair value measurement sensitivity and categorization by level for items not measured at fair value in the statement of financial position. For nonpublic entities, the amendments are effective for annual periods beginning after December 15, 2011. In July 2011, the FASB issued ASU 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. This standard 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 an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Additionally, these entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. This amendment is effective for fiscal years beginning after December 15, 2012. Management is evaluating the impact, if any, that adoption of these update may have on the financial statements of the Company.

Note B – Investments and Assets Whose Use is Limited

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

	Investments	Assets whose use is limited by donors	Assets whose use is limited by the Board of Governors	Total
At June 30, 2012:				
Cash and cash equivalents	$ 221,498	$ 100,904	$ 0	$ 322,402
Certificates of deposit	13,930,564		698,073	14,628,637
Government securities	161,439	5,570	0	167,009
Corporate bonds	299,911	10,563	0	310,474
Preferred stock	74,373	3,468	0	77,841
Mutual funds	2,445,971	137,671	0	2,583,642
Common stock	515,870	39,210	0	555,080
Pledges receivable, net	0	188,877	0	188,877
	17,649,626	486,263	698,073	18,833,962
Less short-term portion	13,930,564	130,377	0	14,060,941
	$ 3,719,062	$ 355,886	$ 698,073	$ 4,773,021

	Investments	Assets whose use is limited by donors	Assets whose use is limited by the Board of Governors	Total
At June 30, 2011:				
Cash and cash equivalents	$ 290,039	$ 109,411	$ 0	$ 399,450
Certificates of deposit	17,416,193	1,803	698,073	18,116,069
Government securities	93,210	5,961	0	99,171
Corporate bonds	253,292	16,198	0	269,490
Preferred stock	105,626	6,755	0	112,381
Mutual funds	2,395,998	153,223	0	2,549,221
Common stock	526,869	33,373	0	560,242
Pledges receivable, net	0	253,176	0	253,176
	21,081,227	579,900	698,073	22,359,200
Less short-term portion	17,417,996	230,577	0	17,648,573
	$ 3,663,231	$ 349,323	$ 698,073	$ 4,710,627

Assets whose use is limited include investments and pledges receivable. Board designated funds consist of certificates of deposit at June 30, 2012 and 2011.

Note B – Investments and Assets Whose Use is Limited – Continued

Pledges receivable are recorded net of an allowance for uncollectible pledges of $18,085 and $105,258 at June 30, 2012 and 2011, respectively. Pledges are recorded at their net present value and are due as follows at June 30, 2012:

2013	$	44,141
2014		33,972
2015		30,065
2016		29,065
2017		25,219
After 2017		46,789
		209,251
Present value discount		(2,289)
Allowance for doubtful accounts		(18,085)
	$	188,877

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

		2012		2011
Interest and dividends	$	228,573	$	252,011
Net realized gains		35,220		171,999
Net unrealized gains (losses)		(76,117)		422,550
	$	187,676	$	846,560

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

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

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

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

Note B – Investments and Assets Whose Use is Limited – Continued

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

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset, including estimates of the timing, amount of expected future cash flows, and the credit standing of the issuer. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial asset. Furthermore, the disclosed fair values do not reflect any premium or discount that could result from offering for sale at one time an entire holding of a particular financial asset. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

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

Note B – Investments and Assets Whose Use is Limited – Continued

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

	Level 1	Level 2	Total
Cash and cash equivalents	$ 322,402	$ 0	$ 322,402
Certificates of deposit	14,628,637	0	14,628,637
Government securities			
Maturity 1 - 10 years	0	138,761	138,761
Maturity > 10 years	0	28,248	28,248
Corporate bonds			
Maturity 1 - 10 years	0	137,291	137,291
Maturity > 10 years	0	173,183	173,183
Mutual funds			
Short Government	51,256	0	51,256
Bank Loan	70,917	0	70,917
Diversified Emerging Markets	68,829	0	68,829
Foreign Large Blend	393,687	0	393,687
High Yield Bond	129,503	0	129,503
Intermediate-Term Bond	332,263	0	332,263
Large Blend	408,704	0	408,704
Large Growth	187,514	0	187,514
Large Value	212,555	0	212,555
Mid-Cap Blend	80,254	0	80,254
Mid-Cap Growth	90,978	0	90,978
Short-Term Bond	85,514	0	85,514
Small Growth	63,399		63,399
Technology	66,452	0	66,452
World Bond	63,231	0	63,231
Other	278,586	0	278,586
Stocks			
Basic Materials	92,939	0	92,939
Conglomerates	34,475	0	34,475
Consumer Goods	47,443	0	47,443
Financial	33,835	0	33,835
Healthcare	91,218	0	91,218
Industrial goods	20,351	0	20,351
Preferred Stock	77,841	0	77,841
Services	124,462	0	124,462
Technology	77,471	0	77,471
Utilities	32,886	0	32,886
	$ 18,167,602	$ 477,483	$ 18,645,085

Note B – Investments and Assets Whose Use is Limited – Continued

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

	Level 1	Level 2	Total
Cash and cash equivalents	$ 399,450	$ 0	$ 399,450
Certificates of deposit	18,116,069	0	18,116,069
Government securities			
Maturity 1 - 10 years	0	25,848	25,848
Maturity > 10 years	0	73,323	73,323
Corporate bonds			
Maturity 1 - 10 years	0	78,553	78,553
Maturity > 10 years	0	190,937	190,937
Mutual funds			
Short Government	53,164	0	53,164
Bank Loan	72,222	0	72,222
Diversified Emerging Markets	52,454	0	52,454
Foreign Large Blend	401,939	0	401,939
High Yield Bond	131,109	0	131,109
Intermediate-Term Bond	347,922	0	347,922
Large Blend	301,945	0	301,945
Large Growth	134,520	0	134,520
Large Value	196,403	0	196,403
Mid-Cap Blend	98,957	0	98,957
Mid-Cap Growth	122,539	0	122,539
Short-Term Bond	88,817	0	88,817
Technology	64,646	0	64,646
World Bond	67,958	0	67,958
Other	414,626	0	414,626
Stocks			
Basic Materials	100,818	0	100,818
Conglomerates	31,794	0	31,794
Consumer Goods	44,609	0	44,609
Financial	39,589	0	39,589
Healthcare	84,464	0	84,464
Industrial goods	15,699	0	15,699
Preferred Stock	106,339	0	106,339
Services	108,364	0	108,364
Technology	108,787	0	108,787
Utilities	32,160	0	32,160
	$ 21,737,363	$ 368,661	$ 22,106,024

There were no transfers between levels during 2012 and 2011.

Note C – Investments in Affiliates

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

Joint Venture	Method of Accounting	Type of organization	Business purpose	Percentage ownership 2012	2011
Garrett Rehabilitation Services (GRS)	Equity	For-profit	Medical, rehabilitative and therapy services	50%	50%
Oakland MRI Center, LLC (OMRI)	Equity	For-profit	MRI and Dexa scan services	50%	50%
Freestate Healthcare Insurance Company, Ltd. (Freestate)	Equity	For-profit	Malpractice and professional liability insurance	16.7%	16.7%
Western Maryland Medical Supply, LLC (WMMS)	Cost	For-profit	Durable medical equipment services	33.3%	33.3%

GRS is a joint venture in which the Hospital and Select Medical of Maryland, Inc. have invested equally. GRS provides physical therapy, speech pathology, occupational therapy and general rehabilitation services in an outpatient clinical setting. GRS also provides inpatient rehabilitation services for the Hospital. Such services to the Hospital approximated $$393,015 in 2012 and $398,161 in 2011. The investment is recorded under the equity method in the accompanying consolidated financial statements.

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

Note C – Investments in Affiliates – Continued

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

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

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

	Investment balance		Equity (loss) in earnings	
	2012	2011	2012	2011
GRS	$ 121,040	$ 149,679	$ (28,638)	$ 31,379
OMRI	43,471	(46,125)	89,596	(18,431)
Freestate	20,493	20,493	0	0
WMMS	(57,701)	179,406	(237,106)	(14,621)
	$ 127,303	$ 303,453	$ (176,148)	$ (1,673)

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

	2012	2011
Current assets	$ 23,376,608	$ 17,053,663
Noncurrent assets	14,867,550	19,579,293
TOTAL ASSETS	38,244,158	36,632,956
Current liabilities	1,766,760	961,281
Noncurrent liabilities	35,698,038	34,285,239
Net worth	779,360	1,386,436
TOTAL LIABILITIES AND NET WORTH	$ 38,244,158	$ 36,632,956
Total operating revenue	$ 9,436,769	$ 8,592,129
Total operating expense	10,375,850	9,700,468
NET LOSS	$ (939,081)	$ (1,108,339)

Note D – Property, Plant and Equipment

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

	Estimated useful life	2012	2011
Land improvements	10 - 40 years	$ 704,465	$ 672,151
Buildings and improvements	15 - 40 years	27,644,931	27,402,021
Fixed equipment	5 - 20 years	4,741,835	3,561,551
Movable equipment	3 - 20 years	15,392,364	13,940,561
Equipment under capital lease	lease term	559,572	559,572
		49,043,167	46,135,856
Less accumulated depreciation		29,498,338	27,511,661
		19,544,829	18,624,195
Land		1,162,039	1,162,039
Construction in progress		405,596	557,690
		$ 21,112,464	$ 20,343,924

Depreciation expense for the years ended June 30, 2012 and 2011 was $2,665,344 and $2,785,325, respectively. Depreciation expense includes amortization expense of $73,212 and $97,401 related to leased equipment for the years ended June 30, 2012 and 2011. Accumulated amortization of capital leases was $540,946 and $467,734 in June 30, 2012 and 2011, respectively.

Note E – Long-Term Debt

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

	2012	2011
USDA bonds	$ 2,718,167	$ 2,780,027
Series 2004 bonds	1,002,640	1,062,900
Capital lease obligation	20,449	109,742
	3,741,256	3,952,669
Less current portion	146,887	210,452
	$ 3,594,369	$ 3,742,217

United States Department of Agriculture (USDA) Bonds

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

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

Series 2004 Bonds

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

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

Note E – Long-Term Debt – Continued

Capital Leases

The Hospital periodically enters into various leases for equipment that meet the criteria for capitalization under current accounting standards. Interest expense related to such leases for the years ended June 30, 2012 and 2011 was $3,349 and $11,090, respectively, and is reported in the accompanying consolidated statements of operations and other changes in unrestricted net assets.

Aggregate maturities of all long-term debt as of June 30, 2012 are as follows:

2013	$	146,887
2014		131,727
2015		137,238
2016		142,979
2017		148,960
After 2017		3,033,465
	$	3,741,256

The Company is subject to certain restrictive covenants defined in various agreements with lenders. In the opinion of management, the Company was in compliance with all applicable restrictive covenants as of June 30, 2012 and 2011.

Note F – Temporarily Restricted Net Assets

Temporarily restricted net assets of $442,210 and $520,364 at June 30, 2012 and 2011, respectively, are restricted primarily for plant replacement, expansion, and health care clinical services.

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

	2012		2011	
Health care clinical services	$	16,118	$	35,970
Plant replacement and expansion		32,084		75,180
	$	48,202	$	111,150

Note G – Pension Plan

The Hospital has a noncontributory defined benefit pension plan (the Plan) covering all employees of the Hospital who work at least twenty hours per week. Benefits are based on the participants' credited service and average monthly earnings. The Hospital's funding policy is to contribute an amount annually that is equal to the normal cost plus interest on the unfunded accrued liability. The Internal Revenue Service classifies the Plan as a government plan, and the Plan, as such, is exempt from the requirements of the Employee Retirement Income Security Act of 1974. The Hospital uses a June 30 measurement date for the Plan. The Hospital plans to contribute $1.1million to the Plan in 2012. The assumption change in the table below represents change in the discount rate for 2012 and changes in the discount rate and rate of compensation increase for 2011.

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

	2012	2011
Projected benefit obligation at beginning of year	$ 23,761,401	$ 22,204,178
Service cost	1,009,536	956,384
Interest	1,362,461	1,214,638
Assumption change	3,518,118	(1,145,533)
Actuarial loss	237,493	1,226,986
Benefits paid	(877,279)	(695,252)
Projected benefit obligation at end of year	$ 29,011,730	$ 23,761,401

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

	2012	2011
Fair value of Plan assets as beginning of year	$ 17,513,930	$ 14,260,711
Actual return on Plan assets	770,489	2,871,131
Employer contribution	1,032,750	1,077,340
Benefits paid	(877,279)	(695,252)
Fair value of Plan assets as end of year	$ 18,439,890	$ 17,513,930
Funded status	$ (10,571,840)	$ (6,247,471)
Net loss included in unrestricted net assets	$ 9,417,313	$ 5,270,774
Accumulated benefit obligation	$ 26,024,577	$ 20,524,665

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

	2012	2011
Service cost	$ 1,009,536	$ 956,384
Interest cost	1,362,461	1,214,638
Expected return on assets held in the plan	(1,414,542)	(1,158,888)
Amortization of net loss	253,125	396,043
	$ 1,210,580	$ 1,408,177

Note G – Pension Plan – Continued

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

	2012	2011
Discount rate	4.83%	5.83%
Rate of compensation increase	3.56%	3.56%

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

	2012	2011
Discount rate	4.83%	5.83%
Rate of compensation increase	3.56%	3.56%
Expected long-term return on plan assets	8.00%	8.00%

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

	2012	2011
Equity securities	53%	55%
Fixed maturity securities	42%	38%
Other	5	7%
Total plan assets	100%	100%

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

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

2013	$ 828,000
2014	943,000
2015	1,026,000
2016	1,123,000
2017	1,232,000
2018-2023	11,124,000
	$ 16,276,000

Note G – Pension Plan – Continued

The fair values of the Hospital's Plan assets as of June 30, 2012 by asset category are as follows:

	Level 1	Level 2	Total
Cash and Cash Equivalents			
Cash	$ 97,592	$ 0	$ 97,592
Money market funds	265,066	0	265,066
Fixed Income			
U.S. Government Agency Bonds/Notes (Maturity 1 to 10 years)	0	51,305	51,305
Corporate Bonds			
Maturity 1 to 10 years	0	2,672,308	2,672,308
Maturity > 10 years	0	1,286,749	1,286,749
Municipal Bonds			
Maturity 1 to 10 years	0	1,092,010	1,092,010
Maturity > 10 years	0	323,049	323,049
Mutual Funds			
Trust Originated Preferred Securities	49,860	0	49,860
Capital Trust	219,204	0	219,204
Bank Loan	149,647	0	149,647
World Bond	314,375	0	314,375
Inflation-Protected Bond	264,069	0	264,069
Intermediate Government	152,928	0	152,928
High Yield Bond	645,442	0	645,442
Intermediate-Term Bond	405,925	0	405,925
Equity Securities			
Mutual Funds			
Diversified Emerging Markets	78,878	0	78,878
Financial	73,936	0	73,936
Foreign Large Blend	199,225	0	199,225
Foreign Large Growth	90,219	0	90,219
Foreign Large Value	43,754	0	43,754
Foreign Small/Mid Growth	123,294	0	123,294
Large Blend	597,428	0	597,428
Large Growth	675,280	0	675,280
Large Value	909,985	0	909,985
Mid-Cap Blend	314,136	0	314,136
Mid-Cap Growth	619,795	0	619,795
Mid-Cap Value	190,204	0	190,204
Natural Resources	41,746	0	41,746
Small Blend	60,906	0	60,906
Small Growth	238,592	0	238,592
Small Value	235,550	0	235,550
Technology	226,128	0	226,128

Note G – Pension Plan – Continued

	Level 1	Level 2	Total
	(continued)		
Common Stocks			
Basic Materials	547,918	0	547,918
Conglomerates	156,240	0	156,240
Consumer Goods	331,765	0	331,765
Financial	269,343	0	269,343
Healthcare	350,960	0	350,960
Industrial Goods	186,810	0	186,810
Services	673,592	0	673,592
Technology	329,248	0	329,248
Utilities	186,516	0	186,516
Exchange Traded Funds			
Diversified Emerging Markets	39,135	0	39,135
Health	111,300	0	111,300
Industrials	93,330	0	93,330
Large Growth	284,535	0	284,535
Large Blend	374,289		374,289
Large Value	341,100	0	341,100
Mid-Cap Value	266,309	0	266,309
PowerShares	602,970	0	602,970
Real-estate	95,903	0	95,903
Small Blend	39,780	0	39,780
Small Growth	82,323	0	82,323
Small Value	77,429	0	77,429
SPDR	183,665	0	183,665
Technology	106,845	0	106,845
	$ 13,014,469	$ 5,425,421	$ 18,439,890

Note G – Pension Plan – Continued

The fair values of the Hospital's Plan assets as June 30, 2011 by asset category are as follows:

	Level 1	Level 2	Total
Cash and Cash Equivalents			
Cash	$ 89,228	$ 0	$ 89,228
Money market funds	1,192,951	0	1,192,951
Fixed Income			
U.S. Government Agency Bonds/Notes			
(Maturity 1 to 10 years)	0	704,717	704,717
Corporate Bonds			
Maturity 1 to 10 years	0	1,510,949	1,510,949
Maturity > 10 years	0	1,164,597	1,164,597
Municipal Bonds			
Maturity 1 to 10 years	0	246,392	246,392
Maturity > 10 years	0	1,064,079	1,064,079
Mutual Funds			
Trust Originated Preferred Securities	49,660	0	49,660
Capital Trust	396,064	0	396,064
Bank Loan	149,953	0	149,953
World Bond	340,308	0	340,308
Inflation-Protected Bond	149,597	0	149,597
Intermediate Government	151,863	0	151,863
High Yield Bond	422,119	0	422,119
Intermediate-Term Bond	201,258	0	201,258
Equity Securities			
Mutual Funds			
Diversified Emerging Markets	89,567	0	89,567
Financial	76,825	0	76,825
Foreign Large Blend	210,680	0	210,680
Foreign Large Growth	107,407	0	107,407
Foreign Large Value	54,170	0	54,170
Foreign Small/Mid Growth	137,152	0	137,152
Large Blend	487,778	0	487,778
Large Growth	635,077	0	635,077
Large Value	877,259	0	877,259
Mid-Cap Blend	340,823	0	340,823
Mid-Cap Growth	626,963	0	626,963
Mid-Cap Value	201,876	0	201,876
Natural Resources	56,789	0	56,789
Small Blend	92,538	0	92,538
Small Growth	316,283	0	316,283
Small Value	255,105	0	255,105
Technology	229,728	0	229,728

Note G – Pension Plan – Continued

	Level 1	Level 2	Total
	(continued)		
Common Stocks			
Basic Materials	511,436	0	511,436
Conglomerates	158,970	0	158,970
Consumer Goods	271,853	0	271,853
Financial	297,399	0	297,399
Healthcare	316,366	0	316,366
Industrial Goods	138,355	0	138,355
Services	654,071	0	654,071
Technology	413,650	0	413,650
Utilities	183,306	0	183,306
Exchange Traded Funds			
Diversified Emerging Markets	47,600	0	47,600
Health	103,292	0	103,292
Industrials	97,960	0	97,960
Large Growth	152,200	0	152,200
Large Value	204,840	0	204,840
Mid-Cap Value	109,825	0	109,825
PowerShares	511,750	0	511,750
Real-estate	90,450	0	90,450
Small Blend	41,400	0	41,400
Small Growth	85,365	0	85,365
Small Value	80,751	0	80,751
SPDR	315,807	0	315,807
Technology	97,530	0	97,530
	$ 12,823,197	$ 4,690,734	$ 17,513,931

Note H – Certain Significant Risks and Uncertainties

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

- Dependence on revenues derived from reimbursement by the Federal Medicare and state Medicaid programs *(see Note K)*;
- Regulation of hospital rates by the State of Maryland Health Services Cost Review Commission *(see Note I)*;
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes; and
- Lawsuits alleging malpractice and related claims (*see Note J)*.

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

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

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

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.

Note I – Maryland Health Services Cost Review Commission

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

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

The current rate of reimbursement for services to patients under the Medicare program is based on an agreement between the Centers of Medicare and Medicaid Services (CMS) and the HSCRC. This agreement is based upon a waiver from Medicare prospective payment system reimbursement principles granted under Section 1814(b) of the Social Security Act.

Note J – Insurance

Malpractice Insurance

The Company is involved in litigation arising in the normal course of business. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. Additional claims may be asserted against the Company arising from services provided through June 30, 2012. Management believes that no material loss will result from any pending or threatened litigation or from incidents incurred but not reported.

During 2012, the Company adopted ASU 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries,* which requires a health care entity to report gross insurance recoveries separately from the related claims liability for professional liability claims already reported to its insurance carrier. As of June 30, 2012, the Hospital recorded insurance recoverable and professional claim liability of $559,139 as both a current asset and a current liability in the accompanying consolidated financial statements.

An estimated liability for incurred but not reported professional liability claims has been recorded in the amount of approximately $694,000 for the years ended June 30, 2012 and 2011. This amount is included in other current liabilities in the accompanying consolidated financial statements. Management believes this accrual is adequate to provide for all professional liability claims that have been incurred through June 30, 2012, but not reported to its insurance carrier.

Note J – Insurance – Continued

Malpractice Insurance -- Continued

Effective March 1, 2005, the Hospital became a shareholder of the newly formed Freestate Healthcare Insurance Company, Ltd. (Freestate), a captive insurance company formed in the Cayman Islands by eight Maryland hospitals. The Hospital became a shareholder of Freestate when the Hospital's insurance company decided not to continue to write insurance policies for hospitals within the State of Maryland effective March 1, 2005. The Hospital believes that becoming a shareholder of the captive insurance company provides the best long-term solution to providing insurance coverage that is cost effective and predictable. Freestate provides insurance coverage on a claims-made basis to its owners for professional liability claims and comprehensive general liability of $1,000,000 for each and every claim. Freestate has entered into reinsurance and excess policy agreements with independent insurance companies to limit its losses for professional liability and comprehensive general liability claims. The Hospital has $2,000,000 of additional insurance in the aggregate through such reinsurance arrangements. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insureds under the policy. Each named insured's assessment or credit is based on the percentage of their actual exposure to the actual exposure of all named insureds. In management's opinion, the assets of Freestate are sufficient to meet its obligations as of June 30, 2012. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the payment of such claims would be the responsibility of the member hospitals. The estimated cost of claims is actuarially determined based upon past experience and discounted using a discount rate of 4% in 2011. The reserve of $559,139 includes provisions for asserted claims as of June 30, 2012, and is reported as other current liabilities in the accompanying consolidated balance sheets.

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

Health Insurance

In fiscal year 2003, the Company became self-insured for employee health claims. Under the self-insurance plan, the Company has accrued a liability of $779,474 and $254,508 for the years ended June 30, 2012 and 2011 for incurred but not reported claims. Management believes that the accruals are adequate to provide for all employee health claims that have been incurred for the years ended June 30, 2012 and 2011.

Note K – Business and Credit Concentrations

The Company provides health care services through its inpatient and outpatient care facilities located in Oakland, Maryland. The Company grants credit to patients, substantially all of whom are local residents. The Company generally does not require collateral or other security in extending credit; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits receivable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, health maintenance organizations (HMOs) and commercial insurance policies).

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

	2012	2011
Self-pay and others	$ 2,055,920	$ 1,245,683
Medicare	3,130,215	1,788,247
Commercial insurance and HMOs	1,578,410	1,253,267
Medicaid	886,394	861,268
Blue Cross	1,376,617	1,216,907
	9,027,556	6,365,372
Allowance for doubtful accounts	(3,023,320)	(2,088,948)
	$ 6,004,236	$ 4,276,424

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

	2012	2011
Medicare	45%	45%
Commercial insurance and HMOs	16%	15%
Blue Cross	15%	16%
Medicaid	16%	16%
Self-pay and others	8%	8%
	100%	100%

Note L – Functional Expenses

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

	2012	2011
Health care services	$ 31,575,606	$ 30,087,798
General and administrative	9,086,611	7,577,087
	$ 40,662,217	$ 37,664,885

Note M – Endowment

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

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

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

Note N – Endowment - Continued

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

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

From time to time, the fair value of assets associated with the endowment fund may fall below the level that the donor or SPMIFA required the Company to retain as a fund of perpetual duration. There were no such deficiencies as of June 30, 2012 or 2011.

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

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

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

	2012			2011		
	Unrestricted	Permanently Restricted	Endowment Total	Unrestricted	Permanently Restricted	Endowment Total
Beginning balance	$ 11,484	$ 35,086	$ 46,570	9,721	$ 35,086	$ 44,807
Interest and dividends	801	0	801	1,763	0	1,763
Ending Balance	**$ 12,285**	**$ 35,086**	**$ 47,371**	**$ 11,484**	**$ 35,086**	**$ 46,570**

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Certified Public Accountants

Report of Independent Auditors on Other Financial Information

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

The 2012 and 2011 consolidated audited financial statements of Garrett County Memorial Hospital and Subsidiary and our report thereon are presented in the preceding section of this report. Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The schedule of consolidated balance sheet information and consolidated statement of operations information as of and for the year ended June 30, 2012 on pages 38 - 40 are presented for the purpose of additional analysis of the basic financial statements and are not a required part of the basic 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 basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards general accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements taken as a whole.

Cohen, Rutherford + Knight, P.C.

October 18, 2012
Bethesda, Maryland

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

Garrett County Memorial Hospital
Consolidating Balance Sheet Information
As of June 30, 2012

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Elimination Entries	Consolidated
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	$ 6,585,892	$ 33,142	$ 0	$ 6,619,034
Short-term investments	13,930,564	0	0	13,930,564
Patient accounts receivable, net	5,896,250	107,986	0	6,004,236
Other amounts receivable	623,138	25	0	623,163
Insurance recoverable	559,139	0	0	559,139
Assets whose use is limited by donors	130,377	0	0	130,377
Inventories	969,604	433	0	970,037
Prepaid expenses	408,377	76,780	0	485,157
Due from affiliates	194,856	0	(194,856)	0
TOTAL CURRENT ASSETS	29,298,197	218,366	(194,856)	29,321,707
NONCURRENT ASSETS				
Property and equipment	21,112,464	0	0	21,112,464
Long-term investments	3,719,062	0	0	3,719,062
Investment in affiliates	127,303	0	0	127,303
Assets whose use is limited by donors, less current portion	355,886	0	0	355,886
Assets whose use is limited by board of governors	698,073	0	0	698,073
Deferred financing costs, net	25,340	0	0	25,340
TOTAL NONCURRENT ASSETS	26,038,128	0	0	26,038,128
TOTAL ASSETS	$ 55,336,325	$ 218,366	$ (194,856)	$ 55,359,835

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

Garrett County Memorial Hospital
Consolidating Balance Sheet Information – Continued
As of June 30, 2012

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Elimination Entries	Consolidated
LIABILITIES AND NET ASSETS				
CURRENT LIABILITIES				
Accounts payable	$ 891,018	4,040	$ 0	$ 895,058
Accrued salaries and wages	2,029,115	106,315	0	2,135,430
Due to affiliates	0	194,856	(194,856)	0
Advances from third parties	468,083	0	0	468,083
Current portion of long-term debt	146,887	0	0	146,887
Other current liabilities	2,329,091	161,008	0	2,490,099
TOTAL CURRENT LIABILITIES	5,864,194	466,219	(194,856)	6,135,557
Long-term debt, less current portion	3,594,369	0	0	3,594,369
Pension obligation	10,571,840	0	0	10,571,840
TOTAL LIABILITIES	20,030,403	466,219	(194,856)	20,301,766
NET ASSETS				
Unrestricted	34,828,626	(247,853)	0	34,580,773
Temporarily restricted	442,210	0	0	442,210
Permanently restricted	35,086	0	0	35,086
TOTAL NET ASSETS	35,305,922	(247,853)	0	35,058,069
TOTAL LIABILITIES AND NET ASSETS	$ 55,336,325	$ 218,366	$ (194,856)	$ 55,359,835

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

Garrett County Memorial Hospital
Consolidating Statement of Operations Information
For the Year Ended June 30, 2012

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Elimination Entries	Consolidated
REVENUE				
Net patient service revenue	$ 38,879,002	$ 2,343,344	$ 0	$ 41,222,346
Other revenue	762,603	587	(142,754)	620,436
Net assets released from restriction for use in operations	16,118	0	0	16,118
TOTAL REVENUE	39,657,723	2,343,931	(142,754)	41,858,900
EXPENSES				
Salaries and wages	15,511,713	1,061,275	0	16,572,988
Employee benefits	5,902,942	154,009	0	6,056,951
Supplies	6,461,714	2,932	0	6,464,646
Utilities	604,217	2,022	0	606,239
Purchased services	3,926,933	321,948	0	4,248,881
Depreciation and amortization	2,666,697	0	0	2,666,697
Interest	159,161	0	0	159,161
Provision for uncollectible accounts	2,265,192	676,285	0	2,941,477
Management fees	0	142,754	(142,754)	0
Other expenses	895,735	49,442	0	945,177
TOTAL EXPENSES	38,394,304	2,410,667	(142,754)	40,662,217
GAIN (LOSS) FROM OPERATIONS	1,263,419	(66,736)	0	1,196,683
OTHER INCOME (LOSS)				
Investment income (loss)	187,622	54	0	187,676
Equity in earnings of affiliates	(176,148)	0	0	(176,148)
Other	413,713	2	0	413,715
TOTAL OTHER INCOME	425,187	56	0	425,243
EXCESS REVENUE OVER EXPENSES (EXPENSES OVER REVENUE)	$ 1,688,606	$ (66,680)	$ 0	$ 1,621,926

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

COHEN RUTHERFORD + KNIGHT PC
Certified Public Accountants

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

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

We have audited the consolidated financial statements of Garrett County Memorial Hospital and subsidiary (collectively, the Company) as of and for the year ended June 30, 2012, and have issued our report thereon dated October 18, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Company's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statement will not be prevented or detected and corrected on a timely basis.

CR+K

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined previously.

Compliance and Other Matters

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

This report is intended solely for the information and use of management, the Board of Governors, management, others within the Company, and the United States Department of Agriculture, and is not intended to be and should not be used by anyone other than these specified parties.

Cohen, Rutherford + Knight, P.C.

October 18, 2012
Bethesda, Maryland