Consolidated Financial Statements and Supplementary Information

Frederick Regional Health System, Inc. and Subsidiaries
Years Ended June 30, 2014 and 2013
With Report of Independent Auditors

Ernst & Young LLP

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Frederick Regional Health System, Inc. and Subsidiaries

Consolidated Financial Statements
and Supplementary Information

Years Ended June 30, 2014 and 2013

Contents

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Report of Independent Auditors

The Board of Directors
Frederick Regional Health System, Inc. and Subsidiaries

We have audited the accompanying consolidated financial statements of Frederick Regional Health System, Inc. and Subsidiaries, which comprise the consolidated balance sheets as of June 30, 2014 and 2013, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Frederick Regional Health System, Inc. and Subsidiaries at June 30, 2014 and 2013, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating details appearing in conjunction with the consolidated financial statements are presented for purposes of additional analysis and are not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audits of the 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. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Ernst & Young LLP

October 21, 2014

Frederick Regional Health System, Inc. and Subsidiaries

Consolidated Balance Sheets

(In Thousands)

	June 30 2014	June 30 2013
Assets		
Current assets:		
Cash and cash equivalents	**$ 33,668**	$ 33,193
Patient receivables, net	**47,109**	46,925
Other receivables	**1,843**	1,557
Inventory	**4,405**	4,482
Prepaid expenses	**3,692**	2,578
Assets limited as to use	**4,033**	3,263
Promises to give, net	**711**	571
Total current assets	**95,461**	92,569
Net property and equipment	**199,089**	203,925
Other assets:		
Assets limited as to use	**19,546**	23,478
Investments – donor restricted	**3,705**	3,247
Promises to give, net	**3,447**	2,525
Long-term investments	**132,552**	114,110
Other investments	**3,489**	3,257
Debt issuance costs, net	**1,510**	1,533
Other assets	**5,739**	4,232
Total other assets	**169,988**	152,382
Total assets	**$ 464,538**	$ 448,876

	June 30	
	2014	**2013**
Liabilities and net assets		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	**$ 5,697**	$ 4,310
Accounts payable	**20,767**	18,814
Accrued expenses	**20,561**	19,350
Advances from third-party payors	**8,546**	8,762
Other current liabilities	**4,693**	3,277
Total current liabilities	**60,264**	54,513
Long-term liabilities, net of current portion:		
Long-term debt and capital lease obligations	**166,275**	172,128
Interest rate swap contract	**11,238**	11,627
Accrued pension expense	**16,602**	12,161
Other long-term liabilities	**19,972**	16,838
Total long-term liabilities, net of current portion	**214,087**	212,754
Total liabilities	**274,351**	267,267
Net assets:		
Unrestricted	**182,314**	175,266
Temporarily restricted	**6,897**	5,367
Permanently restricted	**976**	976
Total net assets	**190,187**	181,609
Total liabilities and net assets	**$ 464,538**	$ 448,876

See accompanying notes.

Frederick Regional Health System, Inc. and Subsidiaries

Consolidated Statements of Operations
(In Thousands)

	June 30	
	2014	**2013**
Unrestricted revenue and other support:		
Net patient service revenue	**$ 345,364**	$ 347,423
Provision for bad debts	**(11,402)**	(12,402)
Net patient service revenue less provision for bad debts	**333,962**	335,021
Other operating revenues	**10,757**	12,890
Gifts, bequests, and contributions	**2,241**	1,783
Net assets released from restriction used for operations	**132**	273
Total unrestricted revenue and other support	**347,092**	349,967
Operating expenses:		
Salaries and wages	**147,591**	148,560
Employee benefits	**38,027**	40,120
Professional fees	**12,978**	12,629
Cost of goods sold	**56,343**	54,485
Supplies	**9,357**	10,519
Contract services	**36,927**	35,298
Other	**11,985**	11,802
Utilities	**4,272**	4,067
Insurance	**3,821**	3,536
Depreciation and amortization	**25,852**	21,229
Interest	**4,874**	4,557
Total operating expenses	**352,027**	346,802
Operating (loss) income	**(4,935)**	3,165
Other income gain (loss), net:		
(Loss) gain on sale of assets	**(116)**	251
Loss on extinguishment of debt	**–**	(3,063)
Investment gain, net	**6,161**	4,834
Change in unrealized gains on trading securities, net	**10,744**	4,379
Realized and unrealized (losses) gains on interest rate swap contract, net	**(2,156)**	2,321
Other nonoperating income, net	**944**	294
Total other income, net	**15,577**	9,016
Excess of unrestricted revenue and other support over expenses	**10,642**	12,181
Other changes in unrestricted net assets:		
Pension adjustment	**(3,738)**	13,534
Released from restriction used to purchase capital	**144**	119
Increase (decrease) in unrestricted net assets	**$ 7,048**	$ 25,834

See accompanying notes.

Frederick Regional Health System, Inc. and Subsidiaries

Consolidated Statements of Changes in Net Assets
(In Thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets, June 30, 2012	$ 149,432	$ 5,141	$ 976	$ 155,549
Excess of unrestricted revenue and other support over expenses	12,181	–	–	12,181
Pension adjustment	13,534	–	–	13,534
Released from restriction used to purchase capital	119	(119)	–	–
Assets released from restrictions	–	(273)	–	(273)
Restricted gifts, bequests, and contributions	–	618	–	618
Changes in net assets	25,834	226	–	26,060
Net assets, June 30, 2013	175,266	5,367	976	181,609
Excess of unrestricted revenue and other support over expenses	**10,642**	**–**	**–**	**10,642**
Pension adjustment	**(3,738)**	**–**	**–**	**(3,738)**
Released from restriction used to purchase capital	**144**	**(144)**	**–**	**–**
Assets released from restrictions	**–**	**(132)**	**–**	**(132)**
Restricted gifts, bequests, and contributions	**–**	**1,806**	**–**	**1,806**
Changes in net assets	**7,048**	**1,530**	**–**	**8,578**
Net assets, June 30, 2014	**$ 182,314**	**$ 6,897**	**$ 976**	**$ 190,187**

See accompanying notes.

Frederick Regional Health System, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
(In Thousands)

	Year Ended June 30	
	2014	**2013**
Operating activities		
Change in net assets	**$ 8,578**	$ 26,060
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Loss on advance refunding of debt	**–**	3,063
Depreciation of property and equipment	**25,852**	21,229
Amortization of original issue discount, premium, and bond issue costs	**(68)**	28
Equity in earnings of joint ventures	**(232)**	(165)
Loss (gain) loss on sale of property and equipment	**116**	(251)
Change in unrealized gains on trading securities, net	**(10,744)**	(4,379)
Proceeds from realized (gains) on investments – trading	**(3,436)**	(1,640)
Increase in investments – trading	**(4,720)**	(7,534)
Decrease in assets limited as to use – trading, net	**–**	–
Proceeds from restricted contributions	**(276)**	(392)
Change in pledges receivable	**(1,062)**	41
Realized and unrealized losses (gains) in interest rate swap, net	**2,156**	(2,321)
Change in operating assets and liabilities:		
Receivables, patient, and other	**(470)**	3,251
Other assets	**(1,507)**	(807)
Inventories and prepaids	**(1,037)**	86
Accounts payable	**1,953**	(2,788)
Accrued expenses	**1,207**	(1,279)
Accrued pension expense	**4,441**	(14,207)
Advances from third-party payors	**(216)**	(1,303)
Other short-term liabilities	**1,420**	294
Other long-term liabilities	**3,134**	3,205
Net cash provided by operating activities	**25,089**	20,191
Investing activities		
Decrease (increase) in assets limited as to use, non-trading, net	**3,162**	(15,562)
Realized losses on interest rate swap contract	**(2,545)**	(2,564)
Purchases of property and equipment	**(21,132)**	(29,626)
Net proceeds from sale of assets	**–**	577
Net cash used in investing activities	**(20,515)**	(47,175)
Fundraising and financing activities		
Proceeds from restricted contributions	**276**	392
Repayments of long-term debt	**(9,305)**	(4,357)
Extinguishment of debt	**–**	(136,755)
Deferred financing costs paid	**(70)**	(1,569)
Proceeds from borrowings	**5,000**	170,250
Net cash provided by (used in) fundraising and financing activities	**(4,099)**	27,961
Net increase in cash and cash equivalents	**475**	977
Cash and cash equivalents at the beginning of the year	**33,193**	32,216
Cash and cash equivalents at the end of the year	**$ 33,668**	$ 33,193
Supplemental disclosures		
New capital lease obligation	**$ –**	$ 989
Cash paid for interest	**$ 5,421**	$ 4,478

See accompanying notes.

1. Organization and Mission

On June 28, 2011, the Frederick Memorial Hospital, Inc. (FMH) Board of Directors approved a corporate restructuring which included the creation of a non-profit 501(c)(3) parent corporation known as Frederick Regional Health System, Inc. (the System). Additionally two other non-profit entities were organized, Monocacy Insurance, LTD (MIL) and Monocacy Health Partners, LLC (MHP), both of which are 100% owned by the System. The reorganization was effective as of July 1, 2011, and had no impact on the comparability of the overall consolidated operating results. FMH is a wholly owned subsidiary of the System. MIL is a Cayman Islands domiciled single parent captive to provide a flexible risk financing structure to meet the needs of the System. MHP serves as a physician enterprise, providing governance, management and support functions for employed physicians which were previously part of FMH. MIL became operational October 1, 2013, as reflected in the accompanying consolidated financial statements. The System is a not-for-profit parent corporation formed on June 23, 2011, to be exempt from income tax under Section 501(a) of the Internal Revenue Code (the Code) as an organization described in Section 501(c)(3) whereby only unrelated business income as defined by Section 512(a)(1) of the Code, is subject to federal income tax. The System has received a determination letter from the Internal Revenue Service (IRS) stating that it is exempt from federal income taxes under Section 501(c) of the Code.

FMH is a not-for-profit hospital, exempt from federal income tax under Section 501(a) of the Code as an organization described in Section 501(c)(3) whereby only unrelated business income as defined by Section 512(a)(1) of the Code, is subject to federal income tax. The System is located in Frederick, Maryland, and provides health care services primarily to residents of Frederick County. FMH has received a determination letter from the IRS stating that they are exempt from federal income taxes under Section 501(c) of the Code.

MIL is a Cayman Islands domiciled single parent captive incorporated on May 24, 2011, and holds an Unrestricted Class B insurance license issued under Section 7(2) of the Cayman Island Insurance Law. MIL directly provides primary medical professional liability and primary general liability coverage to the System.

1. Organization and Mission (continued)

MHP serves as a physician enterprise, providing governance, management, and support functions for employed physicians. MHP is a not-for-profit corporation, formed on June 23, 2011, and operational as of October 1, 2013, exempt from income tax under Section 501(a) of the Code as an organization described in Section 501(c)(3) whereby only unrelated business income as defined by Section 512(a)(1) of the Code, is subject to federal income tax. MHP has received a determination letter from the IRS stating that they are exempt from federal income taxes under Section 501(c) of the Code.

Frederick Health Services Corporation (FHSC) is a Maryland for-profit corporation, all of the stock of which is owned by the System. FHSC is subject to federal and state income taxes. No provision for income taxes has been recorded for 2014 or 2013 due to the availability of net operating loss carryforwards. During the year ended June 30, 2014, FHSC recorded a net deferred tax asset of $807, which is presented in other assets on the balance sheet and as other nonoperating income, net, in the statement of operations.

2. Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts and transactions of the System and its wholly owned subsidiaries: FMH, MIL, FHSC, and MHP.

FMH has two wholly owned subsidiaries: Hospice of Frederick County, Inc. (HFC) and Emmitsburg Properties, LLC, both of which have been consolidated with FMH into the System in the accompanying consolidated financial statements. HFC, an independent 501(c)(3) organization controlled by FMH, operates as a fundraising organization for the benefit of hospice services and operates the Kline Hospice House. Emmitsburg Properties, LLC contains funds held as collateral on the outstanding Emmitsburg loans.

FHSC has three wholly owned subsidiaries: Rosehill of Frederick, LLC and Corporate Occupational Health Solutions, LLC, which are for-profit limited liability companies, and Frederick Surgical Services Corporation, all of which have been consolidated with FHSC into the System in the accompanying consolidated financial statements.

The accompanying consolidated financial statements include the accounts of the System and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

2. Significant Accounting Policies (continued)

Donor-Restricted Gifts

Unconditional promises to give cash and other assets 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. 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. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets if restricted for capital or reported in the statements of operations as net assets released from restrictions if restricted for operating purposes. Donations received with no restrictions and donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated statements of operations as other operating revenues.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less. Those cash and money market funds which are classified as long-term investments are excluded from cash and cash equivalents.

Patient Receivables and Allowances

The System’s policy is to write off all patient accounts that have been identified as uncollectible. An allowance for doubtful accounts is recorded for accounts not yet written off that are anticipated to become uncollectible. Insurance coverage and credit information are obtained from patients when available. No collateral is obtained for accounts receivable.

When determining the allowance, the System considers the collectability of accounts based on past experience, taking into account contractually due amounts from third-party payors and current collection trends on third-party and self-pay receivables. Self-pay receivables include both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill. Credit risks are assessed based on historical write-offs, net of recoveries, as well as an analysis of the aged accounts receivable balances with allowances generally increasing as the receivable ages. The analysis of receivables is performed monthly, and the allowances are adjusted accordingly.

2. Significant Accounting Policies (continued)

Inventory

Inventory is stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Cost of Goods Sold

Cost of goods sold consists primarily of drugs, medical supplies, and surgical implants used in the care and treatment of patients.

Investments and Assets Limited as to Use

The fair values of individual investments are based on quoted market prices of individual securities or investments or estimated amounts using quoted market prices of similar investments. Private equity investments are carried at cost and hedge funds are accounted for using the equity method. Realized and unrealized investment return from all unrestricted investments and assets limited as to use are included in the consolidated statements of operations as part of nonoperating gains and losses. Investment income (loss) on investments of temporarily and permanently restricted assets is added to or deducted from the appropriate restricted fund balance if the income is restricted. The cost of securities sold is based on the specific-identification method. Investments are classified as either current or noncurrent based on maturity dates and availability for current operations.

Substantially all of the System's investment portfolio (excluding certain assets limited as to use) is classified as trading, with unrealized gains and losses included in excess of unrestricted revenue and other support over expenses. Certain trusteed assets that are included in assets limited as to use are classified as other than trading. These assets primarily consist of funds held under trust arrangements related to unreleased bond proceeds.

2. Significant Accounting Policies (continued)

Investment Risk and Uncertainties

The System invests in professionally managed portfolios that contain corporate bonds, United States government obligations, municipal obligations, asset-backed securities, marketable equity securities, hedge funds, and money market funds. Such investments are exposed to various risks, such as interest rate, market, and credit. Due to the level of risk associated with such investments and the level of uncertainty related to changes in the value of such investments, it is at least reasonably possible that changes in risks in the near term would materially affect investment balances and the amounts reported in the financial statements.

Property and Equipment

Property and equipment are carried at historical cost. Items acquired by gift are recorded at fair value at the time of acquisition. Depreciation is recorded on the straight-line method over the estimated useful lives of the depreciable assets. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term, or the estimated useful lives of the assets.

Valuation of Long-Lived Assets

The System accounts for the valuation of long-lived assets under Accounting Standards Codification 360-10-45, *Accounting for the Impairment or Disposal of Long-Lived Assets.* This guidance requires that long-lived assets and certain identifiable intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Recoverability of the long-lived asset is measured by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reportable at the lower of the carrying amount or fair value, less costs to sell.

2. Significant Accounting Policies (continued)

Debt Issuance Costs

Debt issuance costs related to the Series 2002 and Series 2008 Maryland Health and Higher Educational Facilities Authority (MHHEFA) Bonds were written off as a component of loss on extinguishment of debt during the year ended June 30, 2013, as the result of retirement due to the refinancing of debt. Debt issuance costs related to the Series 2012 MHHEFA Bonds are being amortized over the life of the debt using the effective interest method.

Patient Service Revenue and Allowances

The System has agreements with third-party payors that provide for payments to the System for patient services at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated adjustments under reimbursement agreements with third-party payors. Estimated adjustments are accrued in the period the related services are rendered and adjusted in future periods as final settlements are determined.

The System's revenues may be subject to adjustment as a result of examination by government agencies or contractors, and as a result of differing interpretation of government regulations, medical diagnosis, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until subsequent to the period during which the services were rendered.

Other Operating Revenue

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments for eligible hospitals and professionals that implement and achieve meaningful use of certified electronic health record (EHR) technology. For Medicare and Medicaid EHR incentive payments, the System uses a grant accounting method to recognize the revenues. Under this accounting policy, EHR incentive payments are recognized as other operating revenue when attestation that the EHR meaningful use criteria for the required period of time was demonstrated. Accordingly, the System recognized $1,541 of EHR revenues for the year ended June 30, 2014, composed of $129 of Medicaid revenues and $1,412 of Medicare revenues. EHR revenues for the year ended June 30, 2013, were $3,067, of which $454 was Medicaid and $2,613 was Medicare.

2. Significant Accounting Policies (continued)

These amounts are included in other operating revenues in the accompanying consolidated statements of operations. The System's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. The recognition of revenues is based on management's best estimate. Any subsequent changes in the recognition of the revenue will impact the results of operations in the period in which they occur.

Performance Indicator

The performance indicator is the excess of unrestricted revenue and other support over expenses. Changes in unrestricted net assets, consistent with industry practice, includes pension adjustments and net assets released from restriction for capital purposes.

Fair Value of Financial Instruments

The carrying amounts reported on the accompanying consolidated balance sheets for cash and cash equivalents, other receivables, accounts payable, accrued expenses, and advances from third-party payors approximate their fair values. The fair value of the System's notes receivable, revenue bond notes, and other long-term debt approximate the carrying amounts, based on loans with similar terms and average maturities.

Use of Estimates

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

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This guidance is intended to improve and converge with international standards the financial reporting requirements for revenue from contracts with customers. It will be effective for fiscal year 2019 and early adoption is permitted beginning in fiscal year 2018. We have not yet determined the impact from adoption of this new accounting pronouncement on our financial statements.

(Dollars in Thousands)

3. Patient Receivables and Patient Service Revenue

Patient receivables consist of the following at June 30:

	2014	2013
Gross patient receivables	**$ 68,811**	$ 63,736
Less estimated uncollectible accounts and contractual allowances	**(21,702)**	(16,811)
Net patient receivables	**$ 47,109**	$ 46,925

Patient service revenue consists of the following for the years ended June 30:

	2014	2013
Inpatient charges	**$ 183,608**	$ 193,849
Outpatient charges	**264,405**	246,668
Gross charges	**448,013**	440,517
Less contractual and other allowances	**(88,127)**	(83,063)
Less charity care	**(14,522)**	(10,031)
Net patient service revenue	**345,364**	347,423
Less provision for bad debts	**(11,402)**	(12,402)
Net patient service revenue less provision for bad debts	**$ 333,962**	$ 335,021

The System provides care to patients who meet certain criteria under its charity care policy. The System charges at its established rates but waives all or a portion of reimbursement. Because the System does not pursue collection of amounts determined to qualify as charity care, these revenues are not reported as net patient service revenue. Using the cost to charge ratio to approximate cost, charity care provided for the years ended June 30, 2014 and 2013 was $10,973 and $7,605, respectively. The state of Maryland rate system includes components within the rates to partially compensate hospitals for uncompensated care.

(Dollars in Thousands)

4. Assets Limited as to Use

A summary of assets which are limited as to use substantially for debt service and self-insurance at June 30 is as follows:

	2014	2013
Current:		
Principal, interest and other – bonds	**$ 3,083**	$ 3,181
Loss escrow account	**950**	82
	$ 4,033	$ 3,263
Noncurrent:		
Construction funds	**$ 18,305**	$ 22,750
Deferred compensation trusts	**1,241**	728
	$ 19,546	$ 23,478

The assets which are limited as to use consists of the following at June 30:

	2014	2013
Current:		
Cash and money market accounts	**$ 3,083**	$ 3,181
Mutual funds	**950**	82
	$ 4,033	$ 3,263
Noncurrent:		
Cash and money market accounts	**$ 2,886**	$ 10,904
Agency securities	**15,440**	11,860
Equity securities	**985**	578
Mutual funds	**235**	136
	$ 19,546	$ 23,478

The noncurrent assets limited as to use mutual funds are primarily invested in cash and short-duration debt securities.

(Dollars in Thousands)

5. Promises to Give

Promises to give are discounted and are due as follows at June 30:

	2014	2013
Less than one year	**$ 837**	$ 672
One to five years	**2,558**	1,906
More than five years	**2,217**	1,517
	5,612	4,095
Less discounting and allowance for uncollectible promises	**1,454**	999
Total promises to give, net	**4,158**	3,096
Less current portion of promises to give, net	**711**	571
	$ 3,447	$ 2,525

Promises to give include $1,080 related to charitable remainder trusts. This net amount represents the excess of the fair value of the related trust accounts over the net present value of the annuities to be paid out of the trust to the named beneficiaries over their estimated life expectancy.

6. Investments

Long-term investments represent unrestricted investments and unrestricted income earned on unrestricted, temporarily restricted, and permanently restricted investments.

Donor-restricted investments are designated by the donors for expenses relating to capital projects, replacement or improvement of existing assets, or to cover the cost of services rendered as charity care and other programs.

(Dollars in Thousands)

6. Investments (continued)

Long-term and donor-restricted investments consist of the following at June 30:

	2014		2013	
	Cost	**Fair Value**	**Cost**	**Fair Value**
Cash and cash equivalents	**$ 6,187**	**$ 6,187**	$ 5,423	$ 5,423
U.S. government obligations	**5,101**	**5,111**	5,182	5,129
Corporate obligations	**3,400**	**3,543**	3,707	3,742
Mortgage-backed securities	**3,237**	**3,284**	2,765	2,795
Equity securities	**31,582**	**42,932**	28,087	33,033
Mutual funds	**55,143**	**58,350**	51,224	51,129
	$ 104,650	**$ 119,407**	$ 96,388	$ 101,251

Fair value of investments carried at cost at June 30:

	2014		2013	
	Cost	**Fair Value**	**Cost**	**Fair Value**
Private equity and alternative investments	**$ 2,220**	**$ 3,304**	$ 2,317	$ 3,073
	$ 2,220	**$ 3,304**	$ 2,317	$ 3,073

The System is invested in a hedge fund that is accounted for under the equity method of accounting, which approximates fair value. The carrying value of the fund was $14,630 and $13,789 as of June 30, 2014 and 2013, respectively. Valuation of this equity investment is primarily based on financial data supplied by the underlying investee fund. The System has the ability to liquidate this investment on a quarterly basis. The System must provide notice of intent to redeem its shares 65 days prior to the redemption date. Within 45 days of the redemption date, 90% of the redemption value will be returned to the System with the balance payable 30 days after the receipt of the fund's annual audited financial statements. Value may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment. The historic cost of these investments was $11,500 and $11,500 as of June 30, 2014 and 2013, respectively.

The private equity investments are shown at cost on the accompanying consolidated financial statements.

(Dollars in Thousands)

6. Investments (continued)

Investments are allocated as follows at June 30:

	2014	2013
Investment allocation:		
Unrestricted long-term investments	**$ 132,552**	$ 114,110
Donor-restricted investments	**3,705**	3,247
	$ 136,257	$ 117,357

Investment income, including income from short-term investments, for the years ended June 30, are as follows:

	2014	2013
Unrestricted:		
Net realized gains	**$ 3,442**	$ 1,752
Interest and dividends, net of investment expense	**2,258**	2,460
Income from joint ventures	**461**	622
	$ 6,161	$ 4,834

Investment expense was $416 and $467 for the fiscal years ended June 30, 2014 and 2013, respectively.

Other investments consist of the following at June 30:

	Carrying Value		Income	
	2014	2013	2014	2013
Premier Class B	**$ 662**	$ –	**$ –**	$ –
Joint ventures	**2,827**	3,257	**461**	622
	$ 3,489	$ 3,257	**$ 461**	$ 622

(Dollars in Thousands)

6. Investments (continued)

Investments in joint ventures are accounted for using the equity method, unless otherwise noted, at June 30, and are as follows:

	Entity	Interest %	2014	2013
Colonial Regional Alliance	FMH	14.3%	**$ 30**	$ 30
Carroll Occupational Health, LLC	FHSC	25.0	**66**	40
Comp Claim Management, LLC	FHSC	50.0	**32**	3
Open MRI of Frederick, LLC	FHSC	50.0	**117**	105
Glade Valley Nursing and Rehabilitation Center, Inc.	FMH	–	**–**	423
Premier Purchasing Partners (cost method)	FMH	–	**392**	490
Mt. Airy Health Services, LLC	FMH	50.0	**47**	262
Mt. Airy Med-Services, LLC	FHSC	50.0	**200**	–
Mt. Airy Plaza, LLC	FHSC	50.0	**(103)**	(212)
Frederick Surgical Center, LLC	FHSC	34.7	**2,046**	2,116
			$ 2,827	$ 3,257

Group Purchasing Organization Initial Public Offering

The System has participated and owned equity in the Premier Limited Partnership (Premier) which has served as a group purchasing organization for many years. This participation provides purchasing contract rates and rebates the System would not be able to obtain on its own. The System accounts for its investment in Premier on the cost method of accounting.

During the year ended June 30, 2014, Premier restructured from a privately held company to a public company in an initial public offering (IPO) and several financial transactions have occurred with those holding equity in Premier before the IPO, including the System. As a result, the System received a cash payment of approximately $1.1 million in exchange for 16% of its previous ownership in Premier. In addition, in exchange for the extension of the group purchasing contract, the System received partial ownership of the new public company (the Class B units).

6. Investments (continued)

The System recognized a gain of approximately $1.0 million on the sale of its 16% interest which is presented in other operating income in the accompanying consolidated financial statements. The System received 233,669 Class B units that are earned in seven separate tranches over an 85 month period ending October 31, 2020. The opportunity will exist in the future for these Class B units to be converted to the Premier public company stock. Prior to vesting, the Class B units may be transferred or sold with the approval of Premier. During the year ended June 30, 2014, the System recognized approximately $0.7 million related to Tranche 1 of the Class B units. This amount is recorded as an investment on the accompanying consolidated balance sheets and was recognized as a reduction of supplies expense in the accompanying consolidated statements of operations as the value of the Class B shares is tied to the group purchasing contract and is considered a vendor incentive.

7. Fair Value Measurements

Assets and liabilities recorded at fair value in the accompanying consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value.

FASB guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date, emphasizing that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, the FASB establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity’s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

7. Fair Value Measurements (continued)

The Level inputs, as defined by FASB guidance for fair value measurements and disclosures, are as follows:

- Level 1 – Inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities that the System has the ability to access at the measurement date.
- Level 2 – Inputs are inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the assets or liabilities (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.
- Level 3 – Inputs are unobservable inputs for the assets or liabilities, which are typically based on an entity’s own assumptions, as there is little, if any, related market activity.

(Dollars in Thousands)

7. Fair Value Measurements (continued)

The determination of the fair value level within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The System's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the assets or liabilities. The following tables present the System's assets and liabilities measured at fair value on a recurring basis, aggregated by the level in the fair value hierarchy within which those measurements fall, as of June 30:

		Fair Value Measurements at Reporting Date Using		
	Fair Value at June 30, 2014	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Assets				
Cash and cash equivalents	**$ 45,857**	**$ 45,857**	**$ –**	**$ –**
Equity securities	**43,928**	**43,928**	**–**	**–**
U.S. government obligations	**5,112**	**–**	**5,112**	**–**
Agency securities	**15,439**	**–**	**15,439**	**–**
Corporate and other bonds	**3,543**	**–**	**3,543**	**–**
Mutual funds	**59,526**	**59,526**	**–**	**–**
Mortgage-backed securities	**3,284**	**–**	**3,284**	**–**
Private equity and alternative investments	**3,304**	**–**	**–**	**3,304**
Contributions receivable	**4,158**	**–**	**–**	**4,158**
Total assets	**$ 184,151**	**$ 149,311**	**$ 27,378**	**$ 7,462**
Liabilities				
Interest rate swap liability	**$ (11,238)**	**$ –**	**$ (11,238)**	**$ –**
Total liabilities	**$ (11,238)**	**$ –**	**$ (11,238)**	**$ –**

(Dollars in Thousands)

7. Fair Value Measurements (continued)

	Fair Value at June 30, 2013	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	$ 52,698	$ 52,698	$ –	$ –
Equity securities	33,611	33,611	–	–
U.S. government obligations	5,129	–	5,129	–
Agency securities	11,860	–	11,860	–
Corporate and other bonds	3,742	–	3,742	–
Mutual funds	51,347	51,347	–	–
Mortgage-backed securities	2,795	–	2,795	–
Private equity and alternative investments	3,073	–	–	3,073
Contributions receivable	3,096	–	–	3,096
Total assets	$ 167,351	$ 137,656	$ 23,526	$ 6,169
Liabilities				
Interest rate swap liability	$ (11,627)	$ –	$ (11,627)	$ –
Total liabilities	$ (11,627)	$ –	$ (11,627)	$ –

The fair value of the System's trading securities is determined by third-party service providers utilizing various methods dependent upon the specific type of investment. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Where significant inputs, including benchmark yields, broker-dealer quotes, issuer spreads, bids, offers, the LIBOR curve, and measures of volatility, are used by these third-party dealers or independent pricing services to determine fair values the securities are classified within Level 2. Private equity and alternative investments are carried at cost. Hedge fund investments are carried under the equity method of accounting.

7. Fair Value Measurements (continued)

Assets utilizing Level 1 inputs include exchange-traded equity securities and equity and fixed income mutual funds. Assets and liabilities utilizing Level 2 inputs include U.S. government securities, corporate bonds, mortgage-backed securities, and interest rate swaps. Assets utilizing Level 3 inputs are contributions receivable and private equity and alternative investments.

Interest Rate Swap

The System entered into an interest rate swap agreement in conjunction with the issuance of variable rate bonds. The swap contract is valued using models based on readily observable market parameters for all substantial terms of the contract. The fair market value of the swap agreement is included as interest rate swap contract in the accompanying consolidated balance sheets. The fair market value calculation includes a credit valuation adjustment as required of $700 and $763 reducing the interest rate swap agreement liability position on June 30, 2014 and 2013, respectively. The change in the fair market value of the swap agreement is included in excess of unrestricted revenue and other support over expenses, as the swap is not designated as an effective hedge.

Credit exposure associated with non-performance by the counterparty to the derivative instrument is generally limited to the uncollateralized fair value of the asset related to instruments recognized in the balance sheets.

Other

Assets utilizing Level 3 inputs are contributions receivable and private equity investments. Contributions receivable are recorded net of allowance for uncollectible pledges and discounted to net present value. The present value of estimated future cash flows using a discount rate commensurate with the risks involved is an appropriate measure of fair value for unconditional promises to give cash and is considered Level 3. The private equity and alternative investments are carried at cost of $1,837 and $2,317 on the accompanying consolidated financial statements on June 30, 2014 and 2013, respectively.

(Dollars in Thousands)

7. Fair Value Measurements (continued)

The following table provides a reconciliation of the beginning and ending balances of items measured at fair value on a recurring basis in the previous table that used significant unobservable inputs (Level 3):

	Contributions Receivable	Private Equity and Alternative Investments	Total
Balance at June 30, 2012	$ 3,137	$ 1,554	$ 4,691
Purchases, issuances, and settlements	(41)	1,519	1,478
Balance at June 30, 2013	3,096	3,073	6,169
Purchases, issuances, and settlements	**1,062**	**231**	**1,293**
Balance at June 30, 2014	**$ 4,158**	**$ 3,304**	**$ 7,462**

8. Property and Equipment

Property and equipment consist of the following at June 30:

	Estimated Useful Lives	2014	2013
Land	–	**$ 3,734**	$ 3,734
Land improvements	08 – 20 years	**1,225**	1,225
Buildings	20 – 40 years	**210,514**	190,273
Fixed equipment	10 – 20 years	**16,594**	16,449
Movable equipment	03 – 20 years	**193,486**	186,277
Leasehold improvements	05 – 20 years	**24,806**	21,907
		450,359	419,865
Less accumulated depreciation	–	**254,370**	229,331
		195,989	190,534
Construction in process, renovations, and deposits	–	**3100**	13,391
		$ 199,089	$ 203,925

(Dollars in Thousands)

8. Property and Equipment (continued)

Construction in progress consists of the System's building renovations. As these projects are completed, the related assets are transferred out of construction in progress and into the appropriate asset category and are depreciated over the applicable useful lives.

Capitalized computer software, net of accumulated amortization, as of June 30, 2014 and 2013 was $9,278 and $10,333, respectively. Amortization of computer software was $2,267 for fiscal year 2014. There was no amortization of computer software in fiscal year 2013.

The net book value of assets under capital lease arrangements totaled $3,854 and $5,907 as of June 30, 2014 and 2013, respectively. Depreciation expense related to assets under capital lease arrangements was $1,807 and $2,092 for the fiscal years ended June 30, 2014 and 2013, respectively.

9. Long-Term Debt

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

	2014	2013
MHHEFA Series 2012A Bonds	**$ 99,099**	$ 100,139
MHHEFA Series 2012B Bonds	**68,930**	70,020
Note payable – Emmitsburg	**62**	175
Capital lease obligations	**3,881**	6,104
	171,972	176,438
Less current maturities	**5,697**	4,310
	$ 166,275	$ 172,128

Series 2012A MHHEFA Revenue Bonds

In December 2012, the System obtained a loan of $96,240 in MHHEFA Revenue Bonds, Frederick Memorial Hospital Issue, Series 2012A. The MHHEFA Series 2012A Bonds were issued to refund all of the MHHEFA Series 2002 Bonds and to finance a portion of certain construction and equipment costs of the System. The Series 2012A Bonds were issued with a premium of $3,990, which is being amortized over the life of the bonds. The accumulated amortization was $251 at June 30, 2014. The annual interest rate on the bond loan ranges between 3% and 5% over the term of the bond. Interest is payable semiannually on each January 1 and July 1, through July 1, 2038.

9. Long-Term Debt (continued)

Series 2012A Bonds maturing on or after July 1, 2023, are subject to redemption prior to maturity beginning on July 1, 2022, at the option of the authority at the principal amount of the Series 2012A Bonds to be redeemed plus accrued interest thereon to the date set for redemption.

Under the provisions of the bond agreement, the System has granted to the authority a security interest in all receipts now owned and hereafter acquired. The Series 2012A Bonds are secured ratably with the Series 2012B Bonds. The fair value of the Series 2012A MHHEFA Revenue Bonds is estimated based on the quoted market prices for the same or similar issues. The fair value of the 2012A Bonds as of June 30, 2014, is estimated at $93,555.

There is no debt service reserve requirement associated with the Series 2012A Bonds.

The bond agreement contains certain financial covenants.

Series 2012B MHHEFA Revenue Bonds

In December 2012, the System obtained a loan of $70,020 in MHHEFA Revenue Bonds, Frederick Memorial Hospital Issue, Series 2012B. The MHHEFA Series 2012B Bonds were issued to refund all of the MHHEFA Series 2008 Bonds. Upon settlement of the bonds, MHHEFA and the obligated group entered into a financing agreement with Branch Banking and Trust (BB&T) whereby BB&T became the initial purchaser of the 2012B Bonds. The interest rate on the bonds is based on an index floating rate determined by BB&T equal to the applicable percentage multiplied by LIBOR plus the applicable spread plus the TEFRA adjustment, if any. Interest on the bonds is paid monthly and averaged 1.33% through June 30, 2014.

Series 2012B Bonds are subject to redemption at the option of the authority at the principal amount of the Series 2012B Bonds to be redeemed plus accrued interest to the date set for redemption. The Series 2012B Bonds, which mature on July 1, 2035, are secured ratably with the Series 2012A Bonds. The System is required to make annual payments to BB&T sufficient to meet the annual debt service requirements of the refunding bond issue for the succeeding year. Annual sinking fund installments for the 2012B bonds range from $1,090 on July 1, 2013, to $4,855 on July 1, 2028.

There is no debt service reserve requirement associated with the Series 2012B Bonds.

The bond agreement contains certain financial covenants.

(Dollars in Thousands)

9. Long-Term Debt (continued)

Note Payable – Emmitsburg

In December 1994, the System acquired a 100% interest in Emmitsburg Properties. In accordance with the terms of the purchase agreement, the System executed two notes payable to the former owners aggregating $1,219. The notes are payable in monthly installments of principal and interest of $10, bear interest at 8%, and are due December 31, 2015.

Capital Lease Obligations

As of June 30, 2014, the System has entered into certain capital lease obligations to secure major medical diagnostic equipment. Future payments under these obligations are as follows:

Years ending June 30:		
2015	$	2,095
2016		1,371
2017		530
2018		23
2019		–
Total payments		4,019
Less interest payments		138
Total lease obligations, principal		3,881
Less current portion		1,997
Long-term obligations under capital leases	$	1,884

(Dollars in Thousands)

9. Long-Term Debt (continued)

Debt service requirements on long-term debt and capital lease obligations, excluding original issue premium on bonds at June 30, 2014, of $3,739 is as follows:

	Principal
Years ending June 30:	
2015	$ 5,697
2016	5,103
2017	4,429
2018	4,087
2019	4,405
Thereafter	144,510
	$ 168,231

On September 9, 2013, the System entered into a $20,000 revolving line of credit with a lending institution for the purpose of funding short-term working capital needs. The line of credit bears a variable interest rate of one-month LIBOR plus 1.5% per annum, adjusted monthly. All outstanding principal and interest must be repaid within two years of closing. There must not be any outstanding principal balance for at least 30 consecutive days during each year the line of credit is available. The System took a $5,000 draw upon closing. There is no outstanding balance on this line of credit on June 30, 2014.

10. Interest Rate Swap Contract

The System records its derivatives as assets or liabilities at fair value. A derivative is typically defined as an instrument, whose value is derived from an underlying instrument, index or rate, has a notional amount, requires little or no initial investment, and can be net settled. The System participates in an interest rate swap contract that is considered a derivative financial instrument.

In conjunction with the issuance of the Series 2008 Bonds, the System modified its interest rate swap contract with a third party to a notional amount of $72,160 which reduces annually by an amount equal to the sinking fund installment due on the 2008 Bonds until maturity of July 1, 2035. The notional amount is $68,930 on June 30, 2014. The swap agreement remains in effect after the issuance of the 2012 Series Bonds. The System is exposed to credit loss in the event of

10. Interest Rate Swap Contract (continued)

nonperformance by the counterparty to the interest rate swap contract. However, the System does not anticipate nonperformance by the counterparty. Under the swap contract, the System pays interest at a fixed rate of 3.0804% per annum and receives interest at a variable rate equal to 0.0067% of the one-month London Interbank Offered Rate (LIBOR) (0.1524% as of June 30, 2014). The swap contract requires payments to be made or received monthly. The fair value of the swap contract was a liability of $11,238 and $11,627 at June 30, 2014 and 2013, respectively.

The System accrued net payments under its interest rate swap program of $2,545 and $2,564 during fiscal years 2014 and 2013, respectively. These amounts are included within realized and unrealized (losses) gains on interest rate swap contract, net in the accompanying consolidated statements of operations and investing activities in the accompanying consolidated statement of cash flows.

The interest rate swap contract is not designated as an effective cash flow hedge. The System's objectives of entering into the interest rate swap contract include limiting or hedging variable interest rate payments, to achieve lower overall borrowing costs than a comparable unhedged fixed rate borrowing, to alter the pattern of debt service payments, and to improve asset/liability matching. Changes in the fair value of the derivative financial instrument are recognized in the consolidated statements of operations as a component of other loss. The carrying value of the System's derivative financial instrument approximates fair value. The interest rate swap contract is valued using models based on readily observable market parameters for all substantial terms of the contract.

Credit exposure associated with non-performance by the counterparties to derivative instruments is generally limited to the uncollateralized fair value of the asset related to instruments recognized in the consolidated balance sheets. The System attempts to mitigate the risk of non-performance by selecting counterparties with high credit ratings and monitoring their creditworthiness.

(Dollars in Thousands)

10. Interest Rate Swap Contract (continued)

The System's derivative agreements do not contain any credit support provisions that require it to post collateral if there are declines in the derivative value or its credit rating.

Balance Sheet Location	Fair Value 2014	Fair Value 2013
Asset derivatives		
Derivatives not designated as hedging instruments:		
Interest rate contracts	**$ –**	$ –
Liability derivatives		
Long-term liabilities	**$ 11,238**	$ 11,627
Total derivatives not designated as hedging instruments	**$ 11,238**	$ 11,627

A summary of the effect of the non-hedging derivatives on the System's income statement for the year ended June 30, 2014, is as follows:

Type of Non-Hedging Derivatives	Income Statement Location of (Loss) Gain Recognized	Derivative (Loss) Gain Recognized
Interest rate swap contract – realized losses	Other loss	**$ (2,545)**
Interest rate swap contract – unrealized gains	Other gain	**389**
Total		**$ (2,156)**

(Dollars in Thousands)

10. Interest Rate Swap Contract (continued)

A summary of the effect of the non-hedging derivatives on the System's income statement for the year ended June 30, 2013, is as follows:

Type of Non-Hedging Derivatives	Income Statement Location of Loss Recognized	Derivative Loss Recognized
Interest rate swap contract – realized losses	Other loss	$ (2,564)
Interest rate swap contract – unrealized losses	Other loss	4,885
Total		$ 2,321

11. Employee Benefit Plans

The System has a, defined benefit pension plan that covers substantially all employees. The System's funding policy is to make a minimum annual contribution equal to net periodic pension cost for the plan year as determined by its actuary. The System uses a measurement date of June 30 to determine plan assets and benefit obligations. Effective June 30, 2007, the System approved a curtailment of the plan. The curtailment is such that participants will no longer accrue benefits under the plan and no new participants will be accepted. Current participant accounts will not receive any service credits or increases in benefits for post curtailment compensation increases beyond June 30, 2007; however, the System will make annual contributions to the plan in accordance with actuarially determined amounts to meet future accumulated benefit obligations under the frozen plan. Effective July 1, 2007, a modified defined contribution plan (403b) was implemented as described below.

11. Employee Benefit Plans (continued)

The following provides a reconciliation of the changes in fair value of the plan's assets and projected benefit obligations, and the plan's funded status based on a June 30, 2014 and 2013, measurement date:

	2014	2013
	(In Thousands)	
Accumulated benefit obligation	**$ 84,128**	$ 74,887
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	**$ 74,887**	$ 84,407
Service cost	**495**	495
Interest cost	**3,763**	3,503
Actuarial loss (gain)	**7,485**	(11,618)
Benefits paid	**(2,502)**	(1,900)
Projected benefit obligation at end of year	**84,128**	74,887
Change in plan assets:		
Fair value of plan assets at beginning of year	**62,726**	58,039
Actual return on plan assets	**6,133**	2,921
Employer contribution	**1,169**	3,666
Benefits paid	**(2,502)**	(1,900)
Fair value of plan assets at end of year	**67,526**	62,726
Funded status	**(16,602)**	(12,161)
Net amount recognized	**$ (16,602)**	$ (12,161)

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

The discount rate actuarial assumption was changed from 5.10% to 4.47% resulting in an $7,800 increase in the projected benefit obligation as of June 30, 2014.

Net amounts recognized in unrestricted net assets that have not been recognized in net periodic benefit cost are as follows:

	June 30	
	2014	**2013**
Net actuarial loss	**$ 20,104**	$ 16,314
Prior service cost	**288**	340
Total recognized in unrestricted net assets	**$ 20,392**	$ 16,654

The following table sets forth the weighted-average assumptions used to determine benefit obligations:

	June 30	
	2014	**2013**
Discount rate	**4.47%**	5.10%
Rate of compensation increase	**N/A**	N/A

The following table sets forth the weighted-average assumptions used to determine net periodic benefit cost:

	Year Ended June 30	
	2014	**2013**
Discount rate	**5.10%**	4.20%
Expected return on plan assets	**5.75%**	6.50%
Rate of compensation increase	**N/A**	N/A

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

Net periodic pension cost included the following components:

	2014	2013
Service cost	**$ 495**	$ 495
Interest cost	**3,763**	3,503
Expected return on plan assets	**(3,603)**	(3,860)
Amortization of prior service cost	**52**	51
Unrecognized net actuarial loss	**1,166**	2,803
Net periodic pension cost	**$ 1,873**	$ 2,992

The estimated net loss that is expected to be amortized from other changes in unrestricted net assets into net periodic benefit cost for the year ending June 30, 2015, is $52.

The System determines the expected long-term rate of return on plan assets by taking into consideration the historical returns of various asset classes and the types of investments the plan is expected to hold.

The defined benefit pension plan asset allocation as of the measurement date presented as a percentage of total plan assets were as follows:

	2014	2013
Equity securities	**30.0%**	25.9%
Debt securities	**–**	54.5
Cash	**54.0**	3.8
Hedge funds	**16.0**	15.8
Total	**100.0%**	100.0%

The plan assets are recorded at fair value and are categorized based upon the level of judgment associated with the inputs used to measure their fair value.

11. Employee Benefit Plans (continued)

FASB guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date, emphasizing that fair value is market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, the FASB establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy). The Level inputs, as defined by FASB guidance for fair value measurements and disclosures, are as follows:

- Level 1 – Inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities that the System has the ability to access at the measurement date.

- Level 2 – Inputs are inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the assets or liabilities (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.

- Level 3 – Inputs are unobservable inputs for the assets or liabilities, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

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

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

The System's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the assets or liabilities. The following tables present the plan's assets and liabilities measured at fair value on a recurring basis, aggregated by the level in the fair value hierarchy within which those measurements fall, as of June 30:

		Fair Value Measurements at Reporting Date Using		
	Fair Value at June 30, 2014	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Assets				
Cash and cash equivalents	**$ 36,676**	**$ 36,676**	**$ –**	**$ –**
Equity securities	**20,197**	**20,197**	**–**	**–**
Fixed income mutual funds	**–**	**–**	**–**	**–**
Hedge funds and other alternative	**10,653**	**–**	**–**	**10,653**
Total assets	**$ 67,526**	**$ 56,873**	**$ –**	**$ 10,653**

		Fair Value Measurements at Reporting Date Using		
	Fair Value at June 30, 2013	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Assets				
Cash and cash equivalents	$ 2,351	$ 2,351	$ –	$ –
Equity securities	16,235	16,235	–	–
Fixed income mutual funds	34,206	34,206	–	–
Hedge funds and other alternative	9,934	–	–	9,934
Total assets	$ 62,726	$ 52,792	$ –	$ 9,934

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

The following table provides a reconciliation of the beginning and ending balances of items measured at fair value on a recurring basis in the previous table that used significant unobservable inputs (Level 3):

	Hedge Funds	Total
Balance at June 30, 2012	$ 9,603	$ 9,603
Purchases, issuances, and settlements	331	331
Balance at June 30, 2013	9,934	9,934
Purchases, issuances, and settlements	**719**	**719**
Balance at June 30, 2014	**$ 10,653**	**$ 10,653**

The fair value of the plan's trading securities is determined by third-party service providers utilizing various methods dependent upon the specific type of investment. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Assets utilizing Level 1 inputs include exchange-traded equity securities and equity and fixed income mutual funds. Assets utilizing Level 3 inputs are hedge funds.

The hedge fund is accounted for at fair value which has been estimated using the net asset value per share of the fund as of June 30, 2014. The plan has the ability to liquidate this investment on a quarterly basis. The Plan must provide notice of intent to redeem its shares 65 days prior to the redemption date. Within 45 days of the redemption date, 90% of the redemption value will be returned to the plan with the balance payable 30 days after the receipt of the fund's annual audited financial statements.

Assets of the plan are invested in a manner consistent with fiduciary standards of the Employee Retirement Income Security Act of 1974; namely, (a) the safeguards and diversity to which a prudent investor would adhere must be present, and (b) all transactions undertaken on behalf of the plan must be for the sole interest of plan participants and beneficiaries, to provide benefits in a prudent manner. Investment objectives of the plan also include:

- Achieve an annualized total return that equals or exceeds the actuarial target
- Preserve the value of the plan's assets

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

- Diversify assets sufficiently, and, in accordance with modern portfolio theory, avoid large specific risks (losses) and minimize the volatility of the portfolio

- Provide sufficient liquidity to plan benefit payment outflows and meet the plan's requirements

The strategic target asset allocation for the plan is 23% in equities, 62% in fixed income securities, 10% in hedge funds, and 5% real estate.

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

2015	$ 2,481
2016	2,581
2017	2,821
2018	3,069
2019	3,345
2020–2024	20,507

The System also has a tax-deferred annuity savings (403b) plan available to substantially all employees. In conjunction with the curtailment of the defined benefit pension plan, the System modified the (403b) plan effective July 1, 2007. Under the terms of the modified plan, every eligible employee receives a base contribution of 2.5% of earnings. The System will match 50.0% to 70.0% on employee contributions up to 5.0% of employee earnings depending on years of service. In addition, certain employees are eligible for transition credits based on age and years of service to the System. The System's contribution for base matching and transition credits totaled $5,499 and $6,120 for fiscal years 2014 and 2013, respectively.

The System is partially self-insured against employee medical claims. Plan expenses include claims paid and a provision for claims incurred but not reported. As of June 30, 2014 and 2013 the System has recorded a liability for claims incurred but not reported of $1,669 and $2,008, respectively. The program has an annual aggregate stop-loss provision of $500 per employee.

(Dollars in Thousands)

11. Employee Benefit Plans (continued)

In December 2005, the System adopted two non-qualified deferred compensation plans with an effective date of December 15, 2004, for certain members of executive management. Under the plans, participating employees may contribute amounts from their compensation to the plan and may receive a discretionary employer contribution. Employees are fully vested in all employee contributions to the plans. Vesting in employer contributions occurs in accordance with the underlying plan documents. All assets of the plans are held in separate trusts. Total contributions by the System to the plans were $313 and $349 for the years ended June 30, 2014 and 2013, respectively.

12. Concentration of Credit Risk

The System has funds on deposit with financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation. The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors (in percentages) at June 30, was as follows:

	2014	**2013**
Medicare	**24%**	29%
Medicaid	**20**	14
Blue Cross	**16**	14
HMOs and PPOs	**20**	18
Commercial insurance and other third-party payors	**7**	7
Patients	**13**	18
	100%	100%

(Dollars in Thousands)

13. Functional Expenses

The System and its subsidiaries provide general health care services to residents within its geographic location. Expenses related to providing these services are as follows:

		2014		2013
Health care services	**$**	**305,764**	$	303,663
General and administrative		**46,263**		43,139
	$	**352,027**	$	346,802

14. Temporarily and Permanently Restricted Net Assets

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

		2014		2013
Health care services:				
Buildings and equipment	**$**	**2,440**	$	2,163
Restricted by time only		**3,627**		2,493
Education programs		**407**		398
Indigent care and research		**423**		313
	$	**6,897**	$	5,367

Permanently restricted net assets consist of investments to be held in perpetuity, the income from which is expendable for:

		2014		2013
General health care services (reported as operating income)	**$**	**971**	$	971
Specific health care services (reported as temporarily restricted income)		**5**		5
	$	**976**	$	976

During 2014 and 2013, net assets were released from donor restrictions by incurring expenses or capital expenditures satisfying the restricted purposes in the amounts of $276 and $392, respectively.

15. Contingencies

The System has been named as a defendant in various legal proceedings arising from the performance of their normal activities. In the opinion of management, after consultation with legal counsel and after consideration of applicable insurance, the amount of the System's ultimate liability under all current legal proceedings will not have a material adverse effect on their consolidated financial position or results of operations.

FMH was insured for professional liability under an occurrence-based policy through June 30, 2005. Effective July 1, 2005, FMH established an irrevocable self-insurance trust to set aside funds to cover future professional liability claims. The initial funding to the trust was $1,500. Total disbursements from the fund for a covered loss by one or more persons as a result of any one occurrence were not to exceed $1,000 and $3,000 in the aggregate in any one fiscal year. The funded balance of the trust was $6,984 at June 30, 2011. Concurrently, FMH purchased excess umbrella coverage through a commercial carrier with a per-occurrence and aggregate limit of $10,000 per policy period.

As of July 1, 2011, MIL, a single parent captive, was created to provide a flexible risk financing structure to meet the needs of the System's organization. MIL coverage limits are $1,000 per incident and $5,000 in the aggregate in any one fiscal year on a mature claims-made basis retroactive to July 1, 2005. Commercial general liability is covered under the captive program for $1,000 per incident on a claims-made basis retroactive to July 1, 2005, as well.

As of June 30, 2012, MIL assumed the FMH Professional Liability and Comprehensive General Liability coverage previously included under the self-insurance trust for incidents occurring between July 1, 2005 and June 30, 2011, that were reported to FMH prior to June 30, 2011. The policy for this period provides limits of $1,000 per medical incident with a $3,000 annual aggregate limit. The FMH self-insurance trust was fully liquidated as of June 30, 2012.

There are known claims and incidents that could result in the assertion of additional claims, as well as claims from unknown incidents that could be asserted arising from services provided to patients. Effective July 1, 2011, the System adopted ASU 2010-23, *Measuring Charity for Disclosure*, which clarified that a health care entity should not net insurance recoveries against a related claim liability. The System maintains reserves including excess coverage, in the amount of $13,652, at June 30, 2014, and $11,743 at June 30, 2013, and a related reinsurance receivable of $4,698 at June 30, 2014, and $3,903 at June 30, 2013. The System employs an independent actuary to estimate the ultimate settlement of such claims.

(Dollars in Thousands)

15. Contingencies (continued)

These reserves are recorded on an undiscounted basis at June 30, 2014 and 2013. In management's opinion, the amounts recorded provide an adequate reserve for loss contingencies. However, changes in circumstances affecting professional liability claims could cause these estimates to change by material amounts in the short term.

16. Commitments

Operating Leases

The System and its subsidiaries lease facilities under various operating leases, the last of which expires in 2030. The System has various options to renew the leases. The System also leases equipment under various operating leases. Rent expense under all operating leases was $4,355 and $3,822 for 2014 and 2013, respectively. Future minimum payments under non-cancelable operating leases are as follows:

Years ending June 30:	
2015	$ 3,407
2016	3,275
2017	2,842
2018	2,772
2019	2,766
Thereafter	23,276
	$ 38,338

Workers' Compensation

The System is self-insured against workers' compensation claims, up to $500 per occurrence, and has excess insurance coverage of $1,000 per occurrence. Expenses include claims paid and a provision for claims incurred but not reported.

16. Commitments (continued)

Supply Chain Management Agreement

The System has a master service agreement with a vendor to provide supply chain management functions. This agreement contains certain purchase volume commitments.

Letter of Credit

The System has a letter of credit issued by a lending institution in the amount of $1,377. This letter of credit is renewed on an annual basis and is required by the state of Maryland as collateral for unemployment benefits.

17. Regulatory Environment

Medicare and Medicaid

The Medicare and Medicaid reimbursement programs represent a substantial portion of the System's revenues. The System's operations are subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse.

Over the past several years, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of fines and penalties, as well as repayments for patient services previously billed. Compliance with fraud and abuse standards and other government regulations can be subject to future government review and interpretation.

Also, future changes in federal and state reimbursement funding mechanisms and related government budgeting constraints could have an adverse effect on the System.

17. Regulatory Environment (continued)

In 1983, Congress approved a Medicare prospective payment plan for most inpatient services as part of the Social Security Amendment Act of 1983. Hospitals in Maryland are currently exempt from these federal reimbursement regulations under a special waiver. The waiver currently in effect is subject to renewal based upon criteria defined in the federal law. Under these payment arrangements with Medicare, a retroactive adjustment could occur if certain performance standards are not attained by all hospitals on a statewide basis. The impact, if any, of any retroactive adjustment of the Medicare prospective payment system, should hospitals in Maryland become subject to such system, on future operations of the System, has not been determined.

State of Maryland Health Services Cost Review Commission

Certain hospital charges are subject to review and approval by the Maryland Health Services Cost Review Commission (HSCRC or the Commission). Hospital management has filed the required forms with the Commission and believes the hospital to be in compliance with Commission requirements.

Through June 2014, 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 prospective payment system reimbursement principles granted to the state of Maryland under Section 1814(b) of the Social Security Act and will continue as long as the rate of increase for costs per hospital inpatient admission in Maryland is below the national average.

Beginning in fiscal year 2014, the System entered into an agreement with the HSCRC to participate in the Global Budgeted Revenue (GBR) program. GBR methodology encourages hospitals to focus on population health strategies by establishing a fixed annual revenue cap for each GBR hospital. The agreement is evergreen in nature and covers both regulated inpatient and outpatient revenues.

Under GBR, hospital revenue is known at the beginning of each fiscal year. Annual revenue is calculated from a base year and is adjusted annually for inflation, infrastructure requirements, population changes, performance in quality-based programs and changes in levels of uncompensated care. Revenue may also be adjusted annually for market levels and shifts of services to unregulated services.

17. Regulatory Environment (continued)

As of January 2014, the Centers for Medicare and Medicaid Services approved a modernized waiver that will be in place as long as Maryland hospitals commit to achieving significant quality improvements, limits on all-payor per capita hospital growth and limits on annual Medicare per capita hospital cost growth to a rate lower than the national annual per capita growth rate.

The Commission's rate-setting methodology for hospital service centers 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 month and annually. Overcharges and undercharges due to either patient volume or price variances, adjusted for 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 System overcharged by $1,575, as of June 30, 2014, which is within the allowable corridor as specified in the GBR Agreement. For the year ended June 30, 2013, the System exceeded the allowable target by $2,471.

The timing of the HSCRC's rate adjustments for the System 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, and there is at least a possibility that the amounts may be material. The System's policy is to record revenue based on actual charges for services to patients in the year in which the services are performed. The hospital recognizes unbilled revenue for in-house patients.

Previously, under the HSCRC rate-setting system, the System's inpatient charges were subject to an inpatient charge per case target (the Charge Per Case Target). Under the charge per case target methodology, the hospital monitored its average charge per case compared to HSCRC case mix adjusted targets on a monthly basis. The Charge Per Case Target was adjusted annually for inflation, case mix changes, and other factors.

Beginning in fiscal year 2012, the System entered into a three-year agreement with the HSCRC to participate in the Admission Readmission Revenue (ARR) program. The ARR arrangement was a voluntary revenue constraint program to incentivize hospitals to coordinate care and reduce unnecessary readmissions. The ARR agreement imposes a case mix adjusted Charge per Episode (CPE) target to inpatient admissions and any subsequent readmission within 30 days of the discharge of the initial admission of the same patient. The CPE target was adjusted annually for inflation, case mix charges, and other factors.

17. Regulatory Environment (continued)

The HSCRC established an uncompensated care fund whereby certain hospitals are required to contribute to the fund to help cover the costs associated with uncompensated care for all Maryland hospitals equitably. The System's contribution to the fund was $4,193 and $5,260 for the years ended June 30, 2014 and 2013, respectively.

18. Subsequent Events

The System has evaluated subsequent events for the year ended June 30, 2014 through October 21, 2014, the date these financial statements were issued.

On July 7, 2014, Frederick Memorial Hospital, Meritus Health, and Western Maryland Health System established Trivergent Health Alliance (THA), the parent company to Trivergent Health Alliance MSO (MSO). The MSO is a managed services organization that provides regional healthcare services. The purpose of the MSO is to increase operational efficiencies, reduce costs, and enhance the quality of care by focusing efforts in the following areas: human resources, information technology, laboratory services, materials management, pharmacy services, and revenue cycle. Frederick Memorial Hospital contributed working capital of $100 to THA and $900 to the MSO for a 33% ownership interest.

No other significant subsequent events were noted that would require recognition or disclosure at this time.

Supplementary Information

Frederick Regional Health System, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet

(Dollars in Thousands)

June 30, 2014

	Frederick Regional Health System, Inc.	Frederick Memorial Hospital, Inc. Consolidated	Monocacy Insurance LTD	Monocacy Health Partners LLC	Frederick Health Services Corporation	Elimination	Frederick Regional Health System, Inc. Consolidated
Assets							
Current assets:							
Cash and cash equivalents	$ 43	$ 22,793	$ 453	$ 6,071	$ 4,308	$ –	$ 33,668
Patient receivables, net	–	44,540	–	1,871	698	–	47,109
Other receivables	–	1,843	–	–	–	–	1,843
Inventory	–	4,405	–	–	–	–	4,405
Prepaid expenses	–	3,587	17	–	88	–	3,692
Assets limited as to use	–	3,083	950	–	–	–	4,033
Promises to give, net	–	711	–	–	–	–	711
Total current assets	43	80,962	1,420	7,942	5,094	–	95,461
Net property and equipment	–	194,729	–	1,157	3,203	–	199,089
Other assets:							
Assets limited as to use	–	19,546	–	–	–	–	19,546
Investments – donor restricted	–	3,705	–	–	–	–	3,705
Promises to give, net	–	3,447	–	–	–	–	3,447
Long-term investments	–	125,001	7,551	–	–	–	132,552
Other investments	206,816	17,461	–	–	2,358	(223,146)	3,489
Debt issuance costs, net	–	1,510	–	–	–	–	1,510
Other assets	–	4,969	3,430	–	807	(3,467)	5,739
Intercompany receivables	–	13,101	–	–	–	(13,101)	–
Total other assets	206,816	188,740	10,981	–	3,165	(239,714)	169,988
Total assets	$ 206,859	$ 464,431	$ 12,401	$ 9,099	$ 11,462	$ (239,714)	$ 464,538

Frederick Regional Health System, Inc. and Subsidiaries

Supplementary Consolidating Balance Sheet (continued)

(Dollars in Thousands)

	Frederick Regional Health System, Inc.	Frederick Memorial Hospital, Inc. Consolidated	Monocacy Insurance LTD	Monocacy Health Partners LLC	Frederick Health Services Corporation	Elimination	Frederick Regional Health System, Inc. Consolidated
Liabilities and net assets							
Current liabilities:							
Current maturities of long-term debt and capital lease obligations	$ –	$ 5,697	$ –	$ –	$ –	$ –	$ 5,697
Accounts payable	4	20,472	–	227	301	(237)	20,767
Accrued expenses	–	17,506	58	2,297	700	–	20,561
Advances from third-party payors	–	8,546	–	–	–	–	8,546
Loans payable, affiliates	–	–	–	–	3,245	(3,245)	–
Other current liabilities	–	2,778	1,915	–	–	–	4,693
Total current liabilities	4	54,999	1,973	2,524	4,246	(3,482)	60,264
Long-term liabilities, net of current portion:							
Long-term debt and capital lease obligations	–	166,275	–	–	–	–	166,275
Interest rate swap contract	–	11,238	–	–	–	–	11,238
Accrued pension expense	–	16,602	–	–	–	–	16,602
Other long-term liabilities	–	9,664	10,308	–	–	–	19,972
Intercompany liabilities	353	–	–	12,748	–	(13,101)	–
Total long-term liabilities, net of current portion	353	203,779	10,308	12,748	–	(13,101)	214,087
Total liabilities	357	258,778	12,281	15,272	4,246	(16,583)	274,351
Net assets:							
Unrestricted	206,502	197,780	120	(6,173)	7,216	(223,131)	182,314
Temporarily restricted	–	6,897	–		–	–	6,897
Permanently restricted	–	976	–		–	–	976
Total net assets	206,502	205,653	120	(6,173)	7,216	(223,131)	190,187
Total liabilities and net assets	$ 206,859	$ 464,431	$ 12,401	$ 9,099	$ 11,462	$ (239,714)	$ 464,538

Frederick Regional Health System, Inc. and Subsidiaries

Supplementary Consolidating Statement of Operations
(Dollars in Thousands)

Year Ended June 30, 2014

	Frederick Regional Health System, Inc.	Frederick Memorial Hospital, Inc.	Monocacy Insurance LTD	Monocacy Health Partners LLC	Frederick Health Services Corporation	Elimination	Frederick Regional Health System, Inc. Consolidated
Net patient service revenue	$ –	$ 324,099	$ –	$ 16,602	$ 4,786	$ (123)	$ 345,364
Provision for bad debts	–	(10,665)	–	(744)	7	–	(11,402)
Net patient service revenue less provision for bad debts	–	313,434	–	15,858	4,793	(123)	333,962
Other operating revenue	–	7,856	2,100	1,186	3,990	(4,375)	10,757
Gifts, bequests and contributions	–	2,241	–	–	–	–	2,241
Net assets released from restrictions	–	132	–	–	–	–	132
Total unrestricted revenue and other support	–	323,663	2,100	17,044	8,783	(4,498)	347,092
Operating expenses:							
Salaries and contract labor	–	128,378	–	15,177	4,258	(222)	147,591
Employee benefits	–	33,828	–	3,238	997	(36)	38,027
Professional fees	56	12,631	134	104	65	(12)	12,978
Cost of goods sold	–	54,835	–	758	750	–	56,343
Supplies	4	9,318	–	108	–	(73)	9,357
Contract services	253	35,590	–	1,697	631	(1,244)	36,927
Other	1	10,396	54	1,275	1,034	(775)	11,985
Utilities	–	4,063	–	112	133	(36)	4,272
Insurance	–	3,038	2,323	482	78	(2,100)	3,821
Depreciation and amortization	–	23,584	–	266	2,002	–	25,852
Interest	–	4,872	–	–	107	(105)	4,874
Total operating expenses	314	320,533	2,511	23,217	10,055	(4,603)	352,027
Operating income	(314)	3,130	(411)	(6,173)	(1,272)	105	(4,935)

Frederick Regional Health System, Inc. and Subsidiaries

Supplementary Consolidating Statement of Operations (continued)

(Dollars in Thousands)

	Frederick Regional Health System, Inc.	Frederick Memorial Hospital, Inc.	Monocacy Insurance LTD	Monocacy Health Partners LLC	Frederick Health Services Corporation	Elimination	Frederick Regional Health System, Inc. Consolidated
Other income (loss):							
Gain (loss) on sale of assets	$ –	$ (115)	$ –	$ –	$ (1)	$ –	$ (116)
Loss on extinguishment of debt	–	–	–	–	–	–	–
Investment income (loss)	–	5,544	46	–	676	(105)	6,161
Change in unrealized gains (losses) on	–		–	–	–	–	
trading securities, net	–	10,379	365	–	–	–	10,744
Realized and unrealized gains (losses)	–		–	–	–	–	–
on interest rate swap contract, net	–	(2,156)	–	–	–	–	(2,156)
Other nonoperating	–	211	–	–	733	–	944
Total other income (loss)	–	13,863	411	–	1,408	(105)	15,577
Excess of unrestricted revenue and other support over expenses	(314)	16,993	–	(6,173)	136	–	10,642
Other changes in unrestricted net assets:							
Additional minimum pension adjustment	–	(3,738)	–	–	–	–	(3,738)
Released from restriction used to purchase capital	–	144	–	–	–	–	144
Other changes in unrestricted net assets	–	–	–	–	–	–	–
Total other changes in unrestricted net assets	–	(3,594)	–	–	–	–	(3,594)
Increase in unrestricted net assets	$ (314)	$ 13,399	$ –	$ (6,173)	$ 136	$ –	$ 7,048

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