



**GBMC HEALTHCARE, INC.  
AND SUBSIDIARIES**

Consolidated Financial Statements  
and Consolidating Information

June 30, 2011

(With Independent Auditors' Report Thereon)

**GBMC HEALTHCARE, INC.  
AND SUBSIDIARIES**

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

## Independent Auditors' Report

The Board of Directors  
GBMC HealthCare, Inc.:

We have audited the accompanying consolidated balance sheet of GBMC HealthCare, Inc. and subsidiaries (the Company) as of June 30, 2011, and the related consolidated statements of operations and changes in net assets, and cash flows for the year 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 audit.

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

In our opinion, the 2011 consolidated financial statements referred to above present fairly, in all material respects, the financial position of GBMC HealthCare, Inc. and subsidiaries as of June 30, 2011, and the results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in note 10 to the accompanying consolidated financial statements of GBMC Healthcare, Inc. and subsidiaries, unrestricted net assets as of June 30, 2010 have been restated to correct a misstatement in the Company's previously issued financial statements, which were audited by other auditors.

Our audit was made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information included in schedules 1 and 2 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, and results of operations of the individual companies. Accordingly, we do not express an opinion on the financial position or results of operations of the individual companies. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

**KPMG LLP**

October 5, 2011

**GBMC HEALTHCARE, INC.  
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Consolidated Balance Sheet

June 30, 2011

**Assets**

Current assets:	
Cash and cash equivalents	\$ 48,352,126
Short-term investments and limited use funds	29,846,138
Patient accounts receivable, net of reserves of \$16,830,657	54,716,991
Other receivables	6,651,653
Inventories	3,754,209
Prepaid expense and other current assets	4,156,153
Current pledge receivables, net	<u>3,261,671</u>
Total current assets	<u>150,738,941</u>
Noncurrent assets:	
Investments and limited use funds	212,085,117
Equity investments and advances to investees	853,147
Property, plant and equipment, net	265,176,529
Pledge receivables, net	1,433,167
Other assets	<u>2,454,126</u>
Total noncurrent assets	<u>482,002,086</u>
Total assets	<u>\$ 632,741,027</u>

**Liabilities and Net Assets**

Current liabilities:	
Accounts payable and accrued expenses	\$ 55,324,586
Insurance reserves – current	11,112,738
Accrued interest payable	1,664,206
Advances from third-party payors	14,030,556
Current portion of long-term debt and capital leases and financing obligations	1,742,485
Other current liabilities	<u>5,199,447</u>
Total current liabilities	89,074,018
Noncurrent liabilities:	
Long-term debt	113,809,751
Capital leases and financing obligations	30,936,850
Insurance reserves	19,775,051
Pension liability	22,323,167
Other long-term liabilities	<u>2,560,828</u>
Total liabilities	<u>278,479,665</u>
Net assets:	
Unrestricted-controlling interest	308,739,030
Unrestricted-noncontrolling interest	<u>478,754</u>
Total unrestricted	309,217,784
Temporarily restricted	27,071,903
Permanently restricted	<u>17,971,675</u>
Total net assets	<u>354,261,362</u>
Total liabilities and net assets	<u>\$ 632,741,027</u>

See accompanying notes to consolidated financial statements.

**GBMC HEALTHCARE, INC.  
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Consolidated Statement of Operations and Changes in Net Assets

Year ended June 30, 2011

Change in unrestricted net assets:	
Operating revenues:	
Net patient service revenue	\$ 428,082,272
Other healthcare revenue	<u>39,558,627</u>
Net healthcare revenues	467,640,899
Rental income	5,662,448
Other operating income	9,549,115
Net assets released from restrictions	<u>4,797,512</u>
Total operating revenues	<u>487,649,974</u>
Operating expenses:	
Salaries, wages and employee benefits	271,738,550
Expendable supplies	89,803,453
Purchased services	71,837,381
Depreciation and amortization	27,146,422
Interest	6,426,221
Provision for uncollectible accounts	<u>10,909,896</u>
Total operating expenses	477,861,923
Other operating income (expense):	
Equity loss of investee	<u>(188,343)</u>
Total operating income	9,599,708
Other income (expense):	
Contributions	3,047,421
Fundraising expense	(2,174,508)
Investment income, net	1,827,489
Net unrealized gain on investments	14,568,022
Net gain on sale of investments	8,182,257
Gain on sale of asset	130,111
Gain on interest rate swaps	80,640
Loss on extinguishment of debt	<u>(637,101)</u>
Excess of revenues over expenses	34,624,039
Other changes in unrestricted net assets:	
Pension related changes other than net periodic pension costs	9,301,615
Distributions to noncontrolling interest owners	(450,000)
Net assets released for purchase of fixed assets	1,525,045
Capital grant	<u>402,742</u>
Increase in unrestricted net assets	<u>45,403,441</u>
Changes in temporarily restricted net assets:	
Contributions	5,515,071
Investment income, net	431,046
Gain on sale of investments	1,494,588
Unrealized gain on investments	1,749,462
Net assets released for purchase of fixed assets	(1,525,045)
Net assets released for operations	<u>(4,797,512)</u>
Increase in temporarily restricted net assets	<u>2,867,610</u>
Changes in permanently restricted net assets:	
Contributions	1,361,405
Investment gains	<u>12,097</u>
Increase in permanently restricted net assets	<u>1,373,502</u>
Increase in net assets	49,644,553
Net assets, beginning of year	<u>304,616,809</u>
Net assets, end of year	<u>\$ 354,261,362</u>

See accompanying notes to consolidated financial statements.

**GBMC HEALTHCARE, INC.  
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Consolidated Statement of Cash Flows

Year ended June 30, 2011

Cash flows from operating activities:	
Change in net assets	\$ 49,644,553
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation and amortization	27,146,422
Loss on extinguishment of debt	637,101
Provision for uncollectible accounts	10,909,896
Equity in earnings of investee companies	188,343
Net gain on sale of assets	(130,111)
Realized and unrealized gain on investments and swap	(26,074,969)
Restricted investment income	(443,143)
Pension related changes other than net periodic pension costs	(9,301,615)
Restricted contributions	(6,876,476)
Capital grant	(402,742)
Changes in assets and liabilities:	
Increase in patient accounts receivable	(10,226,181)
Decrease in other receivables	1,880,948
Increase in inventories	(71,715)
Decrease in prepaid expenses and other assets	64,831
Increase in accounts payable and accrued expenses	2,722,885
Decrease in current and noncurrent other liabilities	(584,179)
Increase in advance from third parties	2,364,451
Increase in pension liability	602,514
Net cash provided by operating activities	<u>42,050,813</u>
Cash flows from investing activities:	
Increase in investments, and limited use funds	(5,395,107)
Additions to property and equipment	(24,044,093)
Distribution to noncontrolling interest	(450,000)
Swap termination payment	(2,720,000)
Net cash used in investing activities	<u>(32,609,200)</u>
Cash flows from financing activities:	
Payment on long-term debt and capital leases and financing obligations	(5,425,220)
Payment for financing costs	(697,301)
Defeasance of bonds	(61,855,235)
Proceeds from bond issuance	67,945,000
Proceeds from restricted contributions	5,519,899
Net cash provided by financing activities	<u>5,487,143</u>
Increase in cash and cash equivalents	14,928,756
Cash and cash equivalents, beginning of year	<u>33,423,370</u>
Cash and cash equivalents, end of year	<u>\$ 48,352,126</u>
Cash paid during the year for interest	\$ 5,434,235
Capital lease additions	1,456,814
Capital additions accrued but not paid	994,973
Limited use funds used to defease bonds	7,477,667

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

June 30, 2011

**(1) Organization and Consolidation**

GBMC HealthCare, Inc. (the Company), is a holding company for nonprofit companies which include: Greater Baltimore Medical Center, Inc. (Medical Center), GBMC Foundation, Inc., Gilchrist Hospice Care, Inc., GBMC Land, Inc., GBMC Investments, Inc., and a for-profit company, Ruxton Insurance Company, Ltd.

The Medical Center is a not-for-profit hospital and a wholly owned subsidiary of the Company, which provides in-patient, outpatient and emergency care services primarily for residents of the Baltimore metropolitan area. In addition, the Medical Center has ownership of Finney Trimble, Surgical Associates, LLC, and GBMC/Hopkins Pediatric Surgery, LLC., healthcare providers. The Medical Center was formed by agreement dated September 1, 1965, by the Hospital for Women of Maryland of Baltimore City (Women's Hospital) and Presbyterian Eye, Ear and Throat Charity Hospital (Presbyterian Hospital).

GBMC Foundation, Inc. (Foundation) is a not-for-profit organization and wholly owned subsidiary of the Company, which coordinates fundraising efforts to benefit the Company and its subsidiaries.

Gilchrist Hospice Care, Inc. (Gilchrist) is a not-for-profit organization and wholly owned subsidiary of the Company, which provides inpatient and home hospice care in the greater Baltimore area.

GBMC Land, Inc. (Land) is a not-for-profit organization and wholly owned subsidiary of the Company, which operates Physicians Pavilion North, a medical building on the campus of the Medical Center.

Ruxton Insurance Company, Ltd. (Ruxton) is a wholly owned insurance captive of the Company domiciled in Bermuda. Ruxton assumes the risks for the Company's malpractice and general liability claims.

GBMC Investments, Inc., is a not-for-profit wholly owned subsidiary of the Company, which holds investments of the Company and is the parent of the following for-profit subsidiaries:

GBMC Agency, Inc. (Agency) has ownership of GBMC Physicians, LLC, a healthcare provider. In addition, GBMC Agency owns and operates the Physicians Pavilion at Owings Mills, and owns a general and limited partnership interest in GBMC Pavilion West Medical Arts Limited Partnership (PPW). PPW is a Maryland limited partnership formed to construct, own, and operate the five upper floors and an interest in certain common areas of Physicians Pavilion West.

GBMC Management, Inc. (PPE) owns and operates Physicians Pavilion East, a medical office building on the campus of the Medical Center.

The Company's consolidated financial statements include the subsidiaries which the Company has 50% or more ownership.

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Accounting**

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles. Significant intercompany accounts and transactions have been eliminated in consolidation.

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**(b) *Cash and Cash Equivalents***

Cash and cash equivalents, carried at cost which approximates fair value, include amounts invested in accounts which are readily convertible to known amounts of cash with original maturities of three months or less. Cash balances may exceed amounts insured by federal agencies and therefore bear a risk of loss. The Company has not experienced such losses on these funds.

**(c) *Limited Use Funds Held***

Limited use funds primarily include assets held by trustees under agreement. Such funds include assets set aside for bond repayment malpractice costs, plant replacement and amounts restricted by donors. Independent third parties designate the assets held by trustees under agreement. The limited use funds are classified as current or noncurrent based upon the timing and nature of their intended use.

**(d) *Inventories***

Inventories, consisting of medical supplies and drugs, are stated at the lower of cost or market, with cost being determined primarily under the first-in, first-out method.

**(e) *Investments and Investment Income***

Investments include amounts designated by management for specific purposes, insurance reserves, plant replacement and other purposes. The Company's investment portfolio is considered a trading portfolio and is classified as current or noncurrent assets based on management's intention as to use. Limited use funds that are required for obligations classified as current liabilities are reported as current assets. Investments in marketable securities are measured at fair market value on the consolidated balance sheet. The fair value of the investments is based on quoted market prices or dealer quotations. See note 4 for discussion of the measurement of fair value for investments.

The Company accounts for its equity investments using the equity method, and income/loss is included in income (loss) in earnings of investee under other operating income (expense) in the consolidated statement of operations and changes in net assets.

Investment income or loss (including realized gains and losses on investments, interest and dividends) on proceeds of borrowings that are held by a trustee, to the extent not capitalized, and investment income on assets deposited in the insurance captive investment is reported as other operating income. Investment income or loss (including unrealized and realized gains and losses on investments, interest and dividends) from all other unrestricted fund investments is included in excess of revenues over expenses unless restricted by donor or law. Investment income on investments of temporarily restricted net assets is recorded as an increase in temporarily restricted net assets to the extent restricted by the donor or law.

Investment income is recorded on the accrual basis. Purchases and sales of investments are reflected on a trade-date basis. Realized gains and losses on sales of investments are based on historical cost.



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**(f) Interest Rate Swaps**

The value of the interest rate swap agreement entered into by the Company was accounted for by marking to fair value at the close of business. The fair value was adjusted for accrued interest associated with the swap agreement. The fair value of the swap has been recorded at its gross value as assets and liabilities in the Company's consolidated balance sheet, and the changes in the fair value of the swap was recorded in the Company's consolidated statements of operations and changes in net assets as part of excess of revenues over expenses. The interest rate swap was terminated on February 9, 2011; the termination fees totaled \$2,720,000.

**(g) Property, Plant and Equipment**

Property, plant and equipment are recorded at cost or, if donated, at fair market value at date of gift. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from 3 to 40 years. The cost and accumulated depreciation relating to property, plant and equipment sold or retired are removed from the respective accounts at the time of disposition and the resulting gain or loss is reflected in the consolidated statement of operations and changes in net assets as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law.

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.

**(h) Donor-Restricted Gifts**

Unconditional promises to give cash and other assets to the Company are reported at their 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 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 of the restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statement of operations and changes in net assets as net assets released from restrictions. Donor restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

**(i) Other Assets**

Other assets include deferred financing costs related to long-term borrowings which are amortized on a straight-line basis, which approximates the effective interest rate method, over the life of the borrowings. Also included in other assets are deferred leasing costs and prepaid land lease payments

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for Gilchrist which are amortized over the lease terms and expensed on a straight-line basis over the life of the related leases.

The Medical Center has incurred deferred financing costs related to the issuance of Maryland Health and Higher Educational Facilities Authority (MHHEFA) Series 2011, Series 2001, Series 1995 and Series 1993 Revenue Bonds that have been capitalized. All of the deferred financing costs are being amortized over the anticipated life of the transactions on a straight-line basis, which approximates the effective interest rate method, which range from 3 to 32.5 years. Amortization expense for the year ended June 30, 2011 was \$372,769. Accumulated amortization at June 30, 2011 amounted to \$165,409.

**(j) *Compensated Absences***

The Company records a liability for amounts due to employees for future absences, which are attributable to services performed in the current and prior periods.

**(k) *Temporarily and Permanently Restricted Net Assets***

Temporarily restricted net assets are those whose use by the Company has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Company in perpetuity.

**(l) *Estimated Malpractice Costs***

The provision for estimated malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported and are recorded in Insurance reserves within the consolidated balance sheet.

**(m) *Net Patient Service Revenue***

Net patient service revenue is reported at the estimated net realizable amounts from patients and third-party payors for services rendered. Rates for the Medical Center's charges related to patient services are set and approved in accordance with the established regulations and rate methodologies of Maryland's rate-setting authority – the Health Services Cost Review Commission (HSCRC) – an independent agency created by the State of Maryland through legislative actions. All payors are required to pay the Medical Center's rates as approved by the HSCRC. The HSCRC allows a contractual allowance discount of up to 6.00% on charges to Medicare and Medicaid patients. Other third party payors may receive a prompt payment discount of up to 2.25% through an advanced funding agreement with the Medical Center.

The Medical Center's HSCRC approved rates are adjusted annually to account for compliance with approved rates, annual inflation and changes in cost and volume. The Medical Center has a charge per case (CPC) agreement with the HSCRC. The CPC agreement establishes a prospectively approved average charge per inpatient case based upon an estimated case mix index. The agreement allows the Medical Center to adjust approved unit rates, within certain limits, to achieve the average CPC target. The HSCRC allows for certain corridors related to the approved rates such that variances within those corridors do not adversely impact the Medical Center. In 2011, the HSCRC

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implemented a charge per visit (CPV) methodology for hospital based outpatient services, which is similar in nature to the CPC inpatient methodology discussed above. The CPV methodology establishes prospectively approved average charges per outpatient visit for a significant portion of outpatient services provided. The remaining outpatient services are charged using the established HSCRC unit rates. The Medical Center's policy is to defer revenue above the approved amounts and beyond the approved corridors. No amounts were deferred as of June 30, 2011.

Gilchrist Hospice Care's net revenue is reported at the estimated net realizable amounts from third-party payors who pay on a per-diem basis.

Physician charges are not regulated by the HSCRC, and are primarily reimbursed by third party payors. The overall average of adjustments for physician charges during fiscal year 2011 was approximately 52%. Adjustment to patient service revenue for contractual allowances, discounts and financial assistance were \$100,623,740 for the year ended June 30, 2011.

**(n) Excess of Revenue over Expenses**

The consolidated statement of operations and changes in net assets include a performance indicator, excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice include pension changes other than net periodic pension costs, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purpose acquiring such assets).

**(o) Financial Assistance and Community Benefits**

As part of the Company's mission, it provides medical care without discrimination of any kind, including the ability of a patient to pay for services. Under the Company's Financial Assistance Policy, patients who meet certain financial-based criteria can qualify for free care on all or a portion of the total patient bill. The Company recorded \$5,202,464 of financial assistance in fiscal year 2011.

In addition to its Financial Assistance Policy, the Company has a long-standing commitment of supporting the community through the provision of outreach services designed to address identified health and social issues. Specifically, the Company provides a variety of screening and early detection tests, wellness activities, social support services and educational seminars. A majority of these services are provided at either nominal or no cost to community members.

**(p) Rental Income**

Base rental income is recognized as revenue on a straight-line basis over the life of the lease. Expense reimbursements are recognized when the related expense is incurred.

**(q) Income Taxes**

Income taxes are provided for earnings (loss) of those subsidiaries which are subject to federal and state income tax based on the Company's share of the subsidiaries' taxable income, whether or not distributed. The Company's share of these subsidiaries' net losses is deductible to the extent of the Company's tax basis in the subsidiaries.

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The Financial Accounting Standards Board's (FASB) guidance on accounting for uncertainty in income taxes clarifies the accounting for uncertainty of income tax positions. This guidance defines the threshold for recognizing tax return positions in the consolidated financial statements as "more likely than not" that the position is sustainable, based on its technical merits. This guidance also provides guidance on the measurement, classification and disclosure of tax return positions in the consolidated financial statements. The Company has adopted this guidance, and there were no amounts recorded in the consolidated financial statements during the year ended June 30, 2011 for uncertain tax positions.

**(r) Use of Estimates**

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

**(s) New Accounting Pronouncements**

In July 2011, the FASB issued Accounting Standards Update (ASU) 2011-07, *Health Care Entities (Topic 954), Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities (ASU 2011-07)*, which requires a health care entity 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, enhanced disclosures about an entity's policies for recognizing revenue, assessing bad debts, as well as qualitative and quantitative information about changes in the allowance for doubtful accounts are required. The adoption of ASU 2011-07 is effective beginning July 1, 2012.

In August 2010, the FASB issued ASU No. 2010-24, *Health Care Entities (Topic 954), Presentation of Insurance Claims and Related Insurance Recoveries (ASU 2010-24)*, which clarified that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. The adoption of ASU 2010-24 is effective beginning July 1, 2011 and is not expected to have an impact on the Company's consolidated financial statements.

In August 2010, the FASB issued ASU No. 2010-23, *Health Care Entities (Topic 954), Measuring Charity Care for Disclosure*, ASU 2010-23 is intended to reduce the diversity in practice regarding the measurement basis used in the disclosure of charity care: ASU 2010-23 requires that cost be used as the measurement basis for charity care disclosure purposes and that cost be identified as the direct and indirect cost of providing the charity care, and requires disclosure of the method used to identify or determine such costs. The adoption of ASU 2010-23 is effective for the Company beginning July 1, 2011.

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**(3) Concentrations of Credit Risk**

The Company 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 parties as of June 30, 2011 was as follows:

Medicare	28%
Medicaid	5
Blue Cross	19
Other third party payors	39
Self pay	9
	<hr/>
	100%
	<hr/> <hr/>

A summary of net patient service revenue by major category of payor for the year ended June 30, 2011 is as follows:

Medicare	38%
Medicaid	3
Blue Cross	20
Other third party payors	37
Self-pay	2
	<hr/>
	100%
	<hr/> <hr/>

The Company provides general acute healthcare services in the State of Maryland. The Company and other healthcare providers are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the federal Medicare and state Medicaid programs;
- Regulation of hospital rates by the State of Maryland Health Services Cost Review Commission;
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes, and;
- Lawsuits alleging malpractice or other claims.

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.

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

The federal government and many states have aggressively increased enforcement under Medicare and Medicaid anti-fraud and abuse laws and physician self referral laws (STARK law and regulation). Recent federal initiatives have prompted a national review of federally funded healthcare programs. In addition, the federal government and many states have implemented programs to audit and recover potential overpayments to providers from the Medicare and Medicaid programs. In September 2009, the Company was notified that the recovery audit contractors (RAC) would begin auditing company operations in 2011 and the Company received its first request for records in the fourth quarter of fiscal year 2011. The Company has implemented a response program as well as a compliance program to monitor conformance with applicable laws and regulations, but the possibility of future government review and enforcement action exists.

As a result of recently enacted and pending federal healthcare reform legislation, substantial changes are anticipated in the United States healthcare system. Such legislation includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursement to healthcare providers and the legal obligations of health insurers, providers and employers. These provisions are currently slated to take effect at specified times over the next decade. This federal healthcare reform legislation did not affect the 2011 consolidated financial statements.

**(4) Investments and Limited Use Funds**

Investments and limited use funds as of June 30, 2011 consisted of the following:

Investments:

Commercial paper, certificates of deposit and cash	\$ 43,671,442
U.S. obligations	11,761,195
Corporate bonds	81,505,914
Equities	89,083,695
Mutual funds	7,696,206
International funds	8,212,803
Total	241,931,255
Less current portion	29,846,138
Total noncurrent investments and limited use funds	\$ 212,085,117

The limited use funds are comprised of the following at June 30, 2011:

Limited use funds for debt service	\$ 8,964,801
Insurance settlements	41,041,909
Donor restricted	41,362,334
Total	\$ 91,369,044

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Investment income and gains for cash and cash equivalents and investments and limited use funds are comprised of the following for the year ending June 30, 2011:

Income:		
Investment income	\$	2,270,632
Realized gains on sales of investments		9,676,845
Unrealized gains on investments		<u>16,317,484</u>
	\$	<u><u>28,264,961</u></u>

Current guidance for fair value measurements establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entities own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value under current guidance must maximize the use of observable inputs and minimize the use of unobservable inputs. The guidance describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the Company for financial instruments measured at fair value on a recurring basis. The three levels of inputs are as follows:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.
- Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, 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 same 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.

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A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

<u>Assets</u>	<u>Quoted prices in active markets Level 1</u>	<u>Significant other observable inputs Level 2</u>	<u>Significant unobservable inputs Level 3</u>	<u>Total fair value</u>
Investments:				
Managed cash funds	\$ 41,070,324	2,601,118	—	43,671,442
Corporate debt securities	—	53,492,574	—	53,492,574
Bonds – treasury	5,977,079	—	—	5,977,079
Bonds – federal agency backed	—	5,784,116	—	5,784,116
Bonds – mortgage-backed	—	13,129,615	—	13,129,615
Mutual funds – fixed income	—	14,721,783	—	14,721,783
Municipal bonds	—	161,942	—	161,942
Total fixed income	<u>5,977,079</u>	<u>87,290,030</u>	<u>—</u>	<u>93,267,109</u>
Common stock	76,934,042	—	—	76,934,042
Foreign stock	12,149,653	—	—	12,149,653
Mutual funds	7,696,206	—	—	7,696,206
Mutual funds international	8,212,803	—	—	8,212,803
Total equity	<u>104,992,704</u>	<u>—</u>	<u>—</u>	<u>104,992,704</u>
Total investments and limited use funds	152,040,107	89,891,148	—	241,931,255
Less current portion	<u>25,354,860</u>	<u>4,491,278</u>	<u>—</u>	<u>29,846,138</u>
Total noncurrent investments and limited use funds	<u>\$ 126,685,247</u>	<u>85,399,870</u>	<u>—</u>	<u>212,085,117</u>

The Company values Level 1 marketable securities using the closing market prices as of the valuation date. Fair values determined by Level 1 inputs utilize quoted trades at least weekly in an active market. The Company values Level 2 investments using the current prices published. Fair values determined by Level 2 inputs utilize data points that are observable, such as quoted prices, interest rates and yield curves. There were no significant transfers between levels during the year ended June 30, 2011.

**(5) Equity Investments**

Agency, Inc. holds a 25% equity interest in MIB Partnership (MIB). MIB operates a freestanding magnetic resonance imaging center on the campus of the Medical Center.



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**(6) Property, Plant and Equipment**

The following is a summary of the cost of property, plant and equipment as of June 30, 2011:

Land and land improvements	\$ 22,437,430
Buildings and building service equipment	319,712,537
Movable equipment	193,412,633
Capital leases	39,413,685
Construction in progress	1,871,207
	<u>576,847,492</u>
Less accumulated depreciation and amortization	<u>(311,670,963)</u>
Total property, plant and equipment, net	<u>\$ 265,176,529</u>
Depreciation expense	\$ 26,628,304
Amortization expense	518,118
Total depreciation and amortization expense	<u>\$ 27,146,422</u>

**(7) Long-Term Debt**

Long-term debt as of June 30, 2011 consisted of the following:

MHHEFA project and refunding revenue bonds:	
Series 2011 Bonds:	
2.50% – 5.75% term bonds	\$ 67,945,000
Series 2001 Bonds:	
5.00% term bonds	40,265,000
Series 1995 Bonds:	
Variable rate serial bonds	6,745,000
Unamortized bond discount	<u>(815,249)</u>
	114,139,751
Less current portion of long-term debt	<u>(330,000)</u>
	<u>\$ 113,809,751</u>

On April 20, 2011, MHHEFA issued \$67,945,000 of tax exempt Revenue Bonds, Series 2011 on behalf of the Medical Center. Bond proceeds were loaned to the Medical Center pursuant to the Master Trust Indenture. The Series 2011 bonds bear interest at 2.50% – 5.75%. The bond proceeds and limited use funds were used to finance construction and renovation to the hospital and to refund, a) the Series 2009 Revenue Bonds (\$45,000,000); b) a portion of Series 2001 Revenue Bonds (\$12,565,000); and c) the Series 1993 Revenue Bonds (\$11,975,000). The Series 2011 bonds are due on July 1 in annual installments ranging from \$2,180,000 in 2012 to \$11,095,000 in 2034.

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On November 1, 2001, MHHEFA issued \$52,830,000 of tax exempt Revenue Bonds, Series 2001 on behalf of the Medical Center. Bond proceeds were loaned to the Medical Center pursuant to the Master Trust Indenture. A portion of the proceeds was used to refund the 6% Series 1991 bonds that mature on July 1, 2021. The bonds are collateralized by a first lien on all gross receipts of the Medical Center. The Series 2001 5% term bonds are due July 1, 2025 and 2034 in the amount of \$8,180,000 and \$32,085,000, respectively. On July 1, 2011, with proceeds from the Series 2011 Revenue Bonds, the Medical Center refunded \$12,565,000 of the Series 2001 bonds.

On October 4, 1995, MHHEFA issued \$10,000,000 of tax exempt Revenue Bonds, Series 1995 on behalf of the Medical Center. The Series 1995 bonds are due on July 1 in annual installments ranging from \$330,000 in 2011 to \$590,000 in 2025. The bonds bear interest at a variable rate, which is determined on a weekly basis by the remarketing agent of the issue. The rate as of June 30, 2011 was 0.15%. The bonds are collateralized by a first lien on all gross receipts of the Medical Center. The Series 1995 Bonds are supported by a Standby Bond Purchase Agreement issued by M&T Bank, covering the remaining portion of the obligation, effective through October 1, 2013.

The unexpended bond proceeds and approximately one year's debt service of the Series 2001 and 1993 Serial Bonds were deposited with a trustee and are classified as limited use funds. The net interest impact was interest income of \$121,040 for 2011 was included in other operating revenue in the consolidated statement of operations and changes in net assets.

The aggregate future maturities of long-term debt as of June 30, 2011 are as follows:

	<b>Long-term debt</b>
2012	\$ 330,000
2013	2,525,000
2014	2,655,000
2015	2,750,000
2016	3,295,000
Thereafter	103,400,000
	114,955,000
Less unamortized bond discount	(815,249)
	\$ 114,139,751

The fair value of the Medical Center's long-term debt, which is estimated, based on quotes from underwriters, was approximately \$112,096,638 as of June 30, 2011. Additionally, the Medical Center complied with all covenants as of June 30, 2011.

Under the Master Trust Indenture, the Company is required to maintain, among other covenants, a maximum annual debt service coverage ratio of not less than 1.1 to 1.0.

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In 2010, the Medical Center renewed a \$10,000,000 line of credit, which expires on November 30, 2011 bearing interest at the LIBOR Daily Floating Rate. No amounts were drawn on this line during fiscal year 2011.

**(8) Temporarily and Permanently Restricted Net Assets**

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

Education	\$	2,446,381
Departmental needs		15,249,059
Uncompensated care		4,361,996
Purchase of equipment/construction		<u>5,014,467</u>
	\$	<u><u>27,071,903</u></u>

Permanently restricted net assets at June 30, 2011 are restricted to investment in perpetuity, the income from which is expendable to support:

Endowment, income from which is restricted to offset expenses supporting Genetics Center, Urology Research, Nursing Education and specific departmental needs	\$	7,586,035
Uncompensated care		<u>10,385,640</u>
	\$	<u><u>17,971,675</u></u>

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purposes as follows:

Education	\$	677,334
Departmental needs		3,192,279
Uncompensated care		<u>927,899</u>
Net asset released for operations	\$	<u><u>4,797,512</u></u>
Purchase of equipment/construction	\$	1,525,045

The Company's endowment fund consists of a \$10 million endowment for Gilchrist as well, as other donations from individual donors. The Company has no internal board designated endowment funds recorded in unrestricted net assets. The net assets associated with the endowment are classified and reported based on the existence or absence of donor imposed restrictions.

The Company has interpreted the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) as requiring the preservation of the original gift as of the gift date of the donor-restricted endowment funds

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absent explicit donor stipulations to the contrary. As a result of this interpretation the Company classifies as permanently restricted net assets the original value of the gifts donated to the permanent endowment. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Company in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance, with UPMIFA, the Company considers the following factors in making a determination to appropriate or accumulate endowment funds:

- The duration and preservation of the fund,
- The purposes of the Company and the donor restricted endowment fund,
- General economic conditions,
- The possible effect of inflation and deflation,
- The expected total return from income and the appreciation of investments,
- Other resources of the organization, and
- The investment policies of the organization.

The Company had the following activities to its endowment fund during the year ended June 30, 2011 delineated by net asset class:

	<u>Unrestricted</u>	<u>Temporary restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Endowment net assets, June 30, 2010	\$ —	3,927,159	16,598,173	20,525,332
Investment return:				
Investment income, net	—	255,187	2,159	257,346
Net appreciation (realized and unrealized)	—	1,229,718	9,938	1,239,656
Total investment return	—	1,484,905	12,097	1,497,002
Contributions	—	—	1,361,405	1,361,405
Appropriation of endowment assets for expenditure	—	(600,000)	—	(600,000)
Endowment net assets, June 30, 2011	\$ <u>—</u>	<u>4,812,064</u>	<u>17,971,675</u>	<u>22,783,739</u>

**(a) Endowment Funds with Deficits**

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist, they are classified as a reduction of unrestricted net assets. There were no such deficits as of June 30, 2011.

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**(b) Return Objectives and Risk Parameters**

The Company has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, the return objective for the endowment assets, measured over a full market cycle, shall be to maximize the return against a blended index, based on the endowment's target allocation applied to the appropriate individual benchmarks. The Company expects its endowment funds over time, to provide an average rate of return of approximately 7.5% annually. Actual returns in any given year may vary from this amount.

**(c) Strategies Employed for Achieving Investment Objectives**

To achieve 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 gains) and current yield (interest and dividends). The Company targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term objectives within prudent risk constraints.

**(d) Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives**

The Board of Directors of the Company approves the method to be used to appropriate endowment funds for expenditure. The Company amended its endowment spending allocation policy to conform to UPMIFA which was passed by Maryland on April 14, 2009 and limits annual endowment spending to 7% of the annual market value per year.

**(9) Functional Expenses**

The Company provides general healthcare services to residents within its geographic location. Expenses related to providing these services for the year ended June 30, 2011 were as follows:

Health care services	\$ 409,313,620
General and administrative	<u>68,548,303</u>
Total operating expenses	<u><u>\$ 477,861,923</u></u>

**(10) Leases**

***Capital Leases***

During 2011, management determined that a prior year lease transaction accounted for as an operating lease met the criteria for capitalization. Accordingly, management recorded the value of the related property of \$24,549,358, the related financing of \$29,904,893 and an unrestricted net asset adjustment of \$5,355,534 as an adjustment to amounts reported as of June 30, 2010. The 2011 financial statements reflect this adjustment to the amount previously reported as beginning net assets.

The Company is obligated under a long term lease expiring in 2030 for the use of a medical office building. Payments increase at varying rates from \$2,257,368 to \$3,004,560 per year over the remaining life. Interest rates approximated 5.76% as of June 30, 2011.

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The Company leases medical equipment with annual payments ranging from \$54,000 to \$1,113,000 and the last lease expires in fiscal year 2016.

Scheduled principal repayments on capital lease and financing obligations are as follows:

Year ending December 31,		
2012	\$	3,210,561
2013		3,158,227
2014		3,140,901
2015		2,731,941
2016		2,537,289
Thereafter		37,991,550
		52,770,469
Less amount representing interest		20,421,134
	\$	32,349,335

***Operating Leases***

The Company leases office space in the Owings Mills Physicians Pavilion and its Physicians Pavilions East, West and North as lessor under leases ranging from two to ten years. Options to renew these leases range from one to ten years. The leases include provisions for pass-through of operating expenses and real estate taxes.

Minimum future rental income exclusive of pass-throughs for all pavilions for the years subsequent to June 30, 2011 is as follows:

2012	\$	5,696,471
2013		4,005,385
2014		4,077,658
2015		2,286,547
2016		1,824,112
Thereafter		1,574,444

Most of the Company's leases contain renewal options. Renewal options are not included in the minimum future rental income unless exercised. Rental income, including pass-throughs, associated with these leases amounted to approximately \$5,662,448 for the year ended June 30, 2011.

**(11) Pension Plans**

Effective July 1, 2007, the Company established a 401(a) Defined Contribution Plan (the Plan) covering all employees except those covered by the collective bargaining agreement, or employees in a zero hour or registry position. The Company contributes up to 6% of all eligible employee wages (basic contribution) to the Plan and the Company matches up to 3% of employee wages of those who contribute to the Greater

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Baltimore Medical Center, Inc. Voluntary 403(b) Plan. At the discretion of the Board of Directors the Company may contribute additional funds to the Plan. The Company plans to make a basic contribution of \$4,124,607 in fiscal year 2012 and has made a \$2,513,929 contribution for the match for fiscal year 2011.

Effective July 1, 2009 the Company established a 401(a) Defined Contribution Plan (Plan I) for the members covered by a collective bargaining agreement. The Company matches up to 3% of eligible employee wages of those who contribute to the Greater Baltimore Medical Center, Inc. Voluntary 403(b) Plan. The Company contributed \$78,540 for fiscal year 2011.

In addition, the Company has two noncontributory defined benefit pension plans, NonUnion (Plan II) and Union (Plan III), covering all full-time employees with at least one year of service. Benefits under the plans are determined based on increasing percentages (depending on years of service) of final average compensation. Annual contributions are made to these plans in accordance with Employment Retirement Income Security Act (ERISA) regulations.

Effective June 30, 2007, Plan II was frozen. As a result, no future benefits may be earned; however, employees are eligible to vest under the terms of the Plan.

Effective July 1, 2008, Plan II was amended to change the interest rate credit for the matched contribution from 7.5% to the six-month treasury rate.

Effective June 30, 2009, Plan III was amended to freeze the matching contribution. The matching contribution was made for the Union in the 401(a) Defined Contribution plan (Plan I).

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The following tables set forth the plans' funded status and amounts recognized in the Company's consolidated financial statements as of June 30. The change in benefit obligation, plan assets, and funded status of the pension plans are shown below:

Change in benefit obligation:	
Benefit obligation at beginning of year	\$ 137,169,408
Service cost	689,462
Interest cost	8,361,640
Actuarial loss	4,701,003
Benefits paid	<u>(4,687,546)</u>
Benefit obligation at end of year	<u>\$ 146,233,967</u>
Change in plan assets:	
Fair value of plan assets at beginning of year	\$ 106,147,140
Actual return on plan assets	18,363,838
Employer contribution	4,087,368
Benefits paid	<u>(4,687,546)</u>
Fair value of plan assets at end of year	<u>\$ 123,910,800</u>
Funded status:	
Funded status at end of year	\$ (22,323,167)
Amounts recognized in the balance sheets:	
Non current liabilities	\$ (22,323,167)
Amounts recognized in unrestricted net assets:	
Net prior service cost	\$ (2,901,883)
Net actuarial loss	<u>37,401,537</u>
	<u>\$ 34,499,654</u>
Net periodic benefit cost	
Components of net periodic benefit cost:	
Service cost	\$ 689,462
Interest cost	8,361,640
Expected return on plan assets	(7,867,738)
Amortization of prior service cost	(331,933)
Amortization of loss deferral	<u>3,838,451</u>
Net periodic pension benefit cost	<u>\$ 4,689,882</u>



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Net actuarial gain	\$ (5,795,097)
Less:	
Amortization of net loss	(3,838,451)
Amortization of prior service costs	331,933
Total	<u>\$ (9,301,615)</u>
Total recognized in net periodic benefit cost in unrestricted net assets	<u>\$ (4,611,733)</u>

The accumulated benefit obligation for the pension plans, which differs from the estimated actuarial present value of the projected benefit obligation because it is based on current rather than future compensation levels, was \$144,427,243 as of June 30, 2011.

Amounts in unrestricted net assets expected to be recognized as a component of net periodic pension benefit cost in fiscal year 2012:

Prior service cost	\$ (331,933)
Loss	2,549,888

**(a) Assumptions**

The weighted averages used in developing the projected pension benefit obligations for the plans as of June 30, 2011 were as follows:

Discount rate	6.03%
Expected return on plan assets	7.50
Rate of compensation increase	4.00

**(b) Expected Long-Term Rate of Return**

The expected long-term rate of return assumption used was based on a total plan return estimation by looking at the current yields available from fixed-income and reasonable equity return assumption based on long-term market trends and applying this to the Plan's asset mix. In addition, the actual long-term historical returns realized by the pension plans were taken into consideration.

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(c) ***Estimated Future Benefit Payments***

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

	<u>Nonunion</u>	<u>Union</u>	<u>Total</u>
2012	\$ 5,390,122	939,600	6,329,722
2013	5,711,785	1,014,830	6,726,615
2014	6,219,220	1,063,975	7,283,195
2015	6,728,471	1,078,543	7,807,014
2016	6,963,885	1,123,196	8,087,081
2017 – 2020	40,974,610	6,384,694	47,359,304
Total	\$ <u>71,988,093</u>	<u>11,604,838</u>	<u>83,592,931</u>

The Company's pension plan weighted average asset allocations as of June 30 by asset category were as follows:

Equity securities	53.81%
Debt securities	45.46
Cash and cash equivalents	<u>0.73</u>
	<u>100.00%</u>

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The following table sets forth by level, within the fair value hierarchy, the Plan's assets at fair value as of June 30, 2011:

	<b>Quoted prices in active markets Level 1</b>	<b>Significant other observable inputs Level 2</b>	<b>Significant unobservable inputs Level 3</b>	<b>Total fair value</b>
Investments:				
Managed cash funds	\$ 908,058	—	—	908,058
Mutual funds – fixed income	—	56,328,067	—	56,328,067
Total fixed income	908,058	56,328,067	—	57,236,125
Common stock	30,384,780	—	—	30,384,780
Foreign stock	1,540,360	—	—	1,540,360
Mutual funds	26,491,860	—	—	26,491,860
Mutual funds international	8,257,675	—	—	8,257,675
Total equity	66,674,675	—	—	66,674,675
Total investment	\$ 67,582,733	56,328,067	—	123,910,800

The following is a description of the valuation methodologies used for assets measured at fair value:

Corporate bonds: Valued at unadjusted quoted market share prices within active markets or based on external price data of comparable securities.

Equity securities: Valued at unadjusted quoted market share prices within active markets.

Mutual funds: Valued at the net asset value (NAV) of shares held by the Plans at year-end. Shares traded in an active market.

Common/collective trust funds: Valued at fair value based on the unit value of the fund. Unit values are determined by the bank sponsoring such funds dividing the fund's net assets at fair value by its units outstanding at the valuation date.

**(d) Pension Investment Policies**

The primary objective of the Company's pension investment program is the long-term growth of capital consistent with the protection of principal during major market declines. The program utilizes several balanced managers and provides for asset allocation guidelines consistent with the Company's risk exposure. The equity portion of the portfolio may range from 45% to 65% of total portfolio assets with a target of 55% measured at market value. The fixed income and cash equivalents portion of the portfolio may range from 35% to 65% of total portfolio assets with a target of 45% measured at market value.

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The equity segment of the portfolio may include common and preferred stock, convertible securities, warrants, and cash equivalent securities. Equity holdings in any one industry should not exceed 20% of the equity portfolio, holdings in any one economic sector should not exceed 50% of the equity portfolio and holdings in any one company should not exceed 15% of the equity portfolio. Cash equivalent positions should not exceed 10% of the equity managers' portfolio and no more than 15% of the total portfolio measured at market value shall be invested in small companies, defined as companies of less than \$500 million in market capitalization.

The fixed income segment of the portfolio may include marketable bonds, preferred stocks, up to 20% in Securities and Exchange Commission (SEC) registered 144A and securities and cash equivalent securities. With the exception of securities issued by or guaranteed by the U.S. Treasury or U.S. government agencies and instrumentalities, the maximum position in a single issuer's securities should not exceed 5% of the portfolio at market value. The manager is expected to maintain a weighted average bond portfolio quality rating of at least "A." Exposure to below investment grade securities, that is less than "BBB," is limited to a maximum of 20% of the portfolio at market value.

**(e) Contributions**

The Company expects to contribute \$2,325,000 to its bargaining unit pension plan and \$7,025,000 to its nonbargaining unit pension plan in the fiscal year ending June 30, 2012.

The Company has a noncontributory, nonqualified deferred compensation plan for certain key employees. Benefits under the Plan are determined based on increasing percentages (depending on years of service) of base pay and incentive pay. The Company recorded expense related to this plan of \$507,240 in 2011.

**(12) Asserted and Unasserted Malpractice Claims and Contingencies**

In conjunction with the offshore captive, the Company recorded reserve activity for claims and claims expense as follows:

Malpractice reserves at beginning of year	\$ 24,087,314
Net claims and claims expense incurred for the period	8,087,749
Net claims and claims expense paid	<u>(7,281,712)</u>
Malpractice reserves at end of year	<u>\$ 24,893,351</u>

Reserves balances have been discounted at the rate of 3% for the year ended June 30, 2011. Retention or limits in which Ruxton assumes the risk of loss is based on an annual occurrence basis of \$3 million per occurrence and \$14 million in aggregate.

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As of June 30, 2011, the Company was partially self-insured for workers compensation claims on a claims-made basis. The aggregate reserves for workers compensation, which have been determined and discounted at the rate of 2.2% are presented as follows:

Gross workers compensation reserves <sup>(a)</sup>	\$ 3,612,845
Less recoverable from reinsurance <sup>(b)</sup>	<u>(557,871)</u>
Net workers compensation reserves	<u><u>\$ 3,054,974</u></u>

(a) Recorded within accrued salaries and employee benefits on the consolidated balance sheet

(b) To adjust total liability for amounts covered by reinsurance related to claims in excess of the per occurrence retention

The receivable for the expected reinsurance recoverable is recorded within other current assets on the consolidated balance sheet. The Company's excess workers' compensation policy is based on a per claim basis in excess of \$350,000.

The Company is subject to legal proceedings and claims, which arise from the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to the actions will not materially affect the consolidated financial position of the Company.

**(13) Insurance Captive**

On August 1, 2003, Ruxton, a wholly owned subsidiary of the Company, was incorporated as a captive insurance company in Bermuda. Ruxton assumed all the liabilities of the GBMC Self Insurance Trust. The capitalization of \$120,000 and additional funding of \$7,052,000 were contributed to Ruxton as the initial funding for the transferred liabilities and investments. Additional funding of \$7,500,000 was contributed to Ruxton during fiscal year 2008. The Company recorded \$9,727,000 in malpractice premium expense in fiscal year 2011. Ruxton covers all members of the Medical Center and the Company. Retention or limits in which Ruxton Insurance Company, Ltd. assumes the risk of loss is based on \$3 million per occurrence and \$14 million in aggregate.

**(14) Taxes**

The Company and most of its subsidiaries are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. The subsidiaries of GBMC Investments Inc. are taxable entities. An operating loss carryforward of approximately \$47,362,825 is available to offset future taxable income of GBMC Investments' subsidiaries through the year 2025.

As of June 30, 2011 deferred tax assets of \$23.0 million, consisting primarily of operating loss carryforwards, were offset by a related valuation allowance.

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**(15) Related Parties and Affiliates**

The Company participated in transfers between the Company's affiliates during the year ended June 30, 2011 as follows:

GBMC Physicians LLC	\$	16,580,834
GBMC Investments, Inc.		(15,355,751)
PPW		992,310
Land		3,789,594
Healthcare		542,837
Foundation		4,450,147
Medical Center		<u>(10,999,971)</u>
Net transfers	\$	<u>          —</u>

The Company leases office space in the physicians pavilions east, west, north and Owings Mills which are medical office buildings owned by subsidiaries of the Company, under operating leases ranging from two to ten years with various renewal terms. Minimum rental payments including pass-through due under these leases as of June 30, 2011 were:

2012	\$	2,856,152
2013		3,802,866
2014		2,641,681
2015		2,188,237
2016		1,902,242

Rent expense, including pass-through expenses, under the leases was approximately \$5,823,507 for the year ended June 30, 2011.

**(16) Promises to Contribute**

The Company has received unconditional and conditional promises to give. The pledge receivables are recorded on a discounted basis using a rate in effect at the time of the Pledge. Such rates approximate 4%. The Company is the beneficiary of three charitable remainder trusts whose present value as of June 30, 2011 is \$600,887. These trusts are recorded as long-term pledge receivables.

**GBMC HEALTHCARE, INC.  
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Notes to Consolidated Financial Statements

June 30, 2011

As of June 30, 2011, the value of pledge receivables consisted of the following:

Due within 1 year	\$	3,261,671
Due 1 – 5 years		1,119,777
Due over 5 years		<u>681,952</u>
Gross pledge receivables		5,063,400
Less discount and allowance		<u>(368,562)</u>
Net pledge receivables	\$	<u><u>4,694,838</u></u>

**(17) Controlling and Noncontrolling Interest**

Effective July 1, 2010, the Company adopted new accounting guidance that requires a not-for-profit reporting entity to account for and present noncontrolling interests in a consolidated subsidiary as a separate component of the appropriate class of consolidated net assets. The following tables presents a reconciliation of the changes in consolidated unrestricted net assets attributable to the Company's controlling interest and noncontrolling interest:

		<b>Unrestricted net assets- controlling interest</b>	<b>Unrestricted net assets- noncontrolling interest</b>	<b>Total unrestricted net assets</b>
Balance as of June 30, 2010	\$	262,488,816	1,325,527	263,814,343
Excess of revenues over expenses		35,020,812	(396,773)	34,624,039
Pension related changes other than net periodic pension costs		9,301,615	—	9,301,615
Distributions to noncontrolling interest owners		—	(450,000)	(450,000)
Net assets released for purchase of fixed assets		1,525,045	—	1,525,045
Capital grant		<u>402,742</u>	<u>—</u>	<u>402,742</u>
Increase in net assets		<u>46,250,214</u>	<u>(846,773)</u>	<u>45,403,441</u>
Balance as of June 30, 2011	\$	<u><u>308,739,030</u></u>	<u><u>478,754</u></u>	<u><u>309,217,784</u></u>

**GBMC HEALTHCARE, INC.  
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Notes to Consolidated Financial Statements

June 30, 2011

The noncontrolling interest comprises of:

- 50% interest in Greater Baltimore Imaging Partnership, which provides medical imaging services on the campus of the Medical Center.
- 50% interest in PPS-GBMC Joint Venture, LLC. doing business as Neighborcare which provides pharmaceutical services on the campus of the Medical Center.
- 50% interest in GBMC/HOPKINS Pediatric Surgery, LLC. which provides professional medical services.
- 4% interest in GBMC Pavilion West Medical Arts Limited Partnership which is a medical office building on the Medical Center campus.

**(18) Subsequent Events**

The Company has evaluated all events and transactions from the consolidated balance sheet date through October 5, 2011, the date the consolidated financial statements were issued, and determined there are no other items to be recognized or disclosed this period.



**ACCOMPANYING CONSOLIDATING INFORMATION**

**GBMC HEALTHCARE, INC.  
AND SUBSIDIARIES**

Consolidating Balance Sheet

June 30, 2011

Assets	Greater Baltimore Medical Center, Inc.	GBMC Investments Inc. and subsidiaries	Gilchrist Hospice Care Inc.	Ruxton Insurance	GBMC Foundation Inc.	GBMC Land Inc.	GBMC Healthcare Inc. (parent)	Eliminating entries	Total
Current assets:									
Cash and cash equivalents	\$ 38,962,240	1,897,892	6,597,127	818,014	—	60,796	16,057	—	48,352,126
Short-term investments and limited use funds	24,290,926	—	436,912	5,118,300	—	—	—	—	29,846,138
Patient accounts receivable, net	49,818,446	585,405	4,313,140	—	—	—	—	—	54,716,991
Other receivables	3,341,445	1,053,685	748,546	1,242,392	—	213,509	52,076	—	6,651,653
Advances to affiliates	2,001,688	(3,712)	—	—	—	—	3,573	(2,001,549)	—
Inventories	3,353,318	381,444	19,447	—	—	—	—	—	3,754,209
Prepaid expense and other current assets	3,667,666	35,577	217,470	235,440	—	—	—	—	4,156,153
Current pledges receivable	86,028	—	290,000	—	2,885,643	—	—	—	3,261,671
Total current assets	125,521,757	3,950,291	12,622,642	7,414,146	2,885,643	274,305	71,706	(2,001,549)	150,738,941
Investments and limited use funds	54,311,873	72,220,362	49,629,213	35,923,669	—	—	—	—	212,085,117
Equity investments and advances to investees	433,646	419,475	—	—	—	—	—	26	853,147
Interest in net assets of affiliates	22,695,318	—	—	—	—	—	354,289,386	(376,984,704)	—
Long-term receivables from affiliates	6,279,214	—	—	—	—	—	—	(6,279,214)	—
Other noncurrent assets	1,024,312	967,179	339,862	—	(1)	122,774	—	—	2,454,126
Pledges receivable, net	222,759	—	1,019,486	—	190,922	—	—	—	1,433,167
Property and equipment, net	229,826,535	22,571,084	11,533,166	—	—	1,245,744	—	—	265,176,529
Total assets	\$ 440,315,414	100,128,391	75,144,369	43,337,815	3,076,564	1,642,823	354,361,092	(385,265,441)	632,741,027
<b>Liabilities and Net Assets</b>									
Current liabilities:									
Accounts payable and accrued expenses	\$ 49,526,669	838,091	4,287,864	(165,914)	—	734,434	103,442	—	55,324,586
Insurance reserves current	5,616,438	—	378,000	5,118,300	—	—	—	—	11,112,738
Payable to affiliates	—	(308,336)	544,764	1,768,833	—	—	(3,712)	(2,001,549)	—
Accrued interest payable	1,664,206	—	—	—	—	—	—	—	1,664,206
Advances from third party payors	14,030,556	—	—	—	—	—	—	—	14,030,556
Current portion of long-term debt and capital lease liability	1,742,485	—	—	—	—	—	—	—	1,742,485
Other current liabilities	4,957,574	241,873	—	—	—	—	—	—	5,199,447
Total current liabilities	77,537,928	771,628	5,210,628	6,721,219	—	734,434	99,730	(2,001,549)	89,074,018
Long-term debt	113,809,751	—	—	—	—	—	—	—	113,809,751
Capital lease liabilities	30,936,850	—	—	—	—	—	—	—	30,936,850
Insurance reserves	—	—	—	19,775,051	—	—	—	—	19,775,051
Long-term payable to affiliate	—	6,279,214	—	—	—	—	—	(6,279,214)	—
Pension liability	22,323,167	—	—	—	—	—	—	—	22,323,167
Other long-term liabilities	684,473	1,876,355	—	—	—	—	—	—	2,560,828
Total liabilities	245,292,169	8,927,197	5,210,628	26,496,270	—	734,434	99,730	(8,280,763)	278,479,665
Net assets:									
Unrestricted-controlling	164,913,638	74,843,632	55,481,243	16,841,545	—	908,389	308,739,030	(312,988,447)	308,739,030
Unrestricted-noncontrolling	(783,141)	1,315,308	—	—	—	—	478,754	(532,167)	478,754
Total unrestricted	164,130,497	76,158,940	55,481,243	16,841,545	—	908,389	309,217,784	(313,520,614)	309,217,784
Temporarily restricted	23,306,714	8,464,467	4,066,858	—	2,053,830	—	27,071,903	(37,891,869)	27,071,903
Permanently restricted	7,586,034	6,577,787	10,385,640	—	1,022,734	—	17,971,675	(25,572,195)	17,971,675
Total liabilities and net assets	\$ 440,315,414	100,128,391	75,144,369	43,337,815	3,076,564	1,642,823	354,361,092	(385,265,441)	632,741,027

See accompanying independent auditors' report.

**GBMC HEALTHCARE, INC.  
AND SUBSIDIARIES**

Consolidating Statement of Operations and Changes in Net Assets

June 30, 2011

	Greater Baltimore Medical Center, Inc.	GBMC Investments Inc. and subsidiaries	Gilchrist Hospice Care Inc.	Ruxton Insurance	GBMC Foundation Inc.	GBMC Land Inc.	GBMC Healthcare Inc. (parent)	Eliminating entries	Total
Change in unrestricted net assets:									
Operating revenues:									
Net patient service revenue	\$ 382,711,980	9,852,081	35,518,211	—	—	—	—	—	428,082,272
Other healthcare revenue	15,092,362	24,466,265	—	—	—	—	—	—	39,558,627
Net healthcare revenue	397,804,342	34,318,346	35,518,211	—	—	—	—	—	467,640,899
Rental income	2,738,374	6,027,975	—	—	—	2,719,606	—	(5,823,507)	5,662,448
Other operating income	7,692,173	1,237,625	18,709	11,100,102	—	179,483	156,276	(10,835,253)	9,549,115
Net assets released from restrictions	3,874,864	33,200	889,448	—	—	—	—	—	4,797,512
Total operating revenues	412,109,753	41,617,146	36,426,368	11,100,102	—	2,899,089	156,276	(16,658,760)	487,649,974
Operating expenses:									
Salaries, wages and employee benefits	219,272,906	28,147,879	23,894,680	—	—	276,433	146,652	—	271,738,550
Expendable supplies	81,482,063	5,753,668	2,495,434	—	—	71,868	420	—	89,803,453
Purchased services	55,267,104	13,059,110	6,205,305	10,729,882	982,656	3,226,305	13,636	(17,646,617)	71,837,381
Depreciation and amortization	23,693,984	2,243,228	1,054,068	—	—	155,142	—	—	27,146,422
Interest	6,426,123	232,532	—	—	—	—	—	(232,434)	6,426,221
Provision for uncollectible accounts	9,501,983	1,191,491	216,422	—	—	—	—	—	10,909,896
Overhead	(2,976,764)	1,766,763	399,996	249,997	—	50,004	260,004	250,000	—
Total operating expenses	392,667,399	52,394,671	34,265,905	10,979,879	982,656	3,779,752	420,712	(17,629,051)	477,861,923
Other operating income (expense):									
Equity in gain (loss) of investee companies	40,419	(220,422)	—	—	—	—	—	(8,340)	(188,343)
Operating income (loss)	19,482,773	(10,997,947)	2,160,463	120,223	(982,656)	(880,663)	(264,436)	961,951	9,599,708
Other income:									
Contributions	891,291	—	2,110,132	—	982,656	—	50,000	(986,658)	3,047,421
Fundraising expense	(1,224)	—	(793,757)	—	(1,629,527)	—	—	250,000	(2,174,508)
Investment income, net	628,821	760,938	670,164	—	—	—	—	(232,434)	1,827,489
Net unrealized gain investments	2,360,886	6,290,741	4,353,332	1,563,063	—	—	—	—	14,568,022
Net gain on sale of investments	1,999,568	5,262,672	920,017	—	—	—	—	—	8,182,257
Net gain on sale of assets	130,111	—	—	—	—	—	—	—	130,111
Gain on swaps	80,640	—	—	—	—	—	—	—	80,640
Loss on extinguishment of debt	(637,101)	—	—	—	—	—	—	—	(637,101)
Excess of revenues over expenses	24,935,765	1,316,404	9,420,351	1,683,286	(1,629,527)	(880,663)	(214,436)	(7,141)	34,624,039
Other unrestricted net assets:									
Pension related changes other than net periodic pension costs	9,301,615	—	—	—	—	—	—	—	9,301,615
Net assets released for purchase of fixed assets	1,525,045	—	—	—	—	—	—	—	1,525,045
Equity in unrestricted income of affiliate	1,791,733	—	—	—	—	—	49,316,152	(51,107,885)	—
Distributions to noncontrolling interest owners	—	(450,000)	—	—	—	—	—	—	(450,000)
Transfers	(7,937,496)	1,975,538	—	—	1,629,527	3,789,594	542,837	—	—
Capital grant	402,742	—	—	—	—	—	—	—	402,742
Increase (decrease) in unrestricted net assets	30,019,404	2,841,942	9,420,351	1,683,286	—	2,908,931	49,644,553	(51,115,026)	45,403,441
Changes in temporarily restricted net assets:									
Contributions	4,677,460	—	838,808	—	5,102,846	—	—	(5,104,043)	5,515,071
Investment income, net	(43,012)	255,187	218,871	—	—	—	—	—	431,046
Gain on sale of investment	26	564,581	929,981	—	—	—	—	—	1,494,588
Net unrealized gain investments	—	665,137	1,084,325	—	—	—	—	—	1,749,462
Equity in temporarily restricted income of affiliate	3,714,969	—	—	—	—	—	—	(3,714,969)	—
Transfer of temp. restricted assets	(2,007,769)	209,883	—	—	(3,304,960)	—	—	5,102,846	—
Net assets released for purchase of fixed assets	(1,525,045)	—	—	—	—	—	—	—	(1,525,045)
Net assets released for operations	(3,874,864)	(33,200)	(889,448)	—	—	—	—	—	(4,797,512)
Increase (decrease) in temporarily restricted net assets	941,765	1,661,588	2,182,537	—	1,797,886	—	—	(3,716,166)	2,867,610
Changes in permanently restricted net assets:									
Contributions	1,025,384	—	336,020	—	1,024,184	—	—	(1,024,183)	1,361,405
Investment gains	—	—	12,097	—	—	—	—	—	12,097
Equity in permanently restricted income of affiliate	1,054,707	—	—	—	—	—	—	(1,054,707)	—
Transfer of permanently restricted assets	(1,054,707)	31,973	—	—	(1,450)	—	—	—	—
Increase (decrease) in permanently restricted net assets	1,025,384	31,973	348,117	—	1,022,734	—	—	(1,054,706)	1,373,502
Increase (decrease) in net assets	31,986,553	4,535,503	11,951,005	1,683,286	2,820,620	2,908,931	49,644,553	(55,885,898)	49,644,553
Net assets, beginning of year	163,036,692	86,665,691	57,982,736	15,158,259	255,944	(2,000,542)	304,616,809	(321,098,780)	304,616,809
Net assets, end of year	\$ 195,023,245	\$ 91,201,194	\$ 69,933,741	\$ 16,841,545	\$ 3,076,564	\$ 908,389	\$ 354,261,362	\$ (376,984,678)	\$ 354,261,362

See accompanying independent auditors' report.