

COHEN
RUTHERFORD
+ KNIGHT^{PC}
Certified Public Accountants



**Garrett County Memorial
Hospital and Subsidiary**

**Consolidated Audited Financial
Statements**

June 30, 2010 and 2009

Garrett County Memorial Hospital and Subsidiary
Consolidated Audited Financial Statements
June 30, 2010 and 2009

- Contents -

Independent Auditor's Report.....	1-2
Consolidated Balance Sheets.....	3-4
Consolidated Statements of Operations and Other Changes in Unrestricted Net Assets.....	5
Consolidated Statements of Changes in Net Assets.....	6
Consolidated Statements of Cash Flows.....	7-8
Notes to the Consolidated Financial Statements.....	9-31
Report of Independent Auditor on Other Financial Information and Schedule of Expenditures of Federal Awards.....	32
Consolidating Balance Sheet Information.....	33-34
Consolidating Statement of Operations Information.....	35
Schedule of Expenditures of Federal Awards.....	36
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed In Accordance with Government Auditing Standards.....	37-38
Independent Auditor's Report on Compliance with Requirements Applicable to Each Major Federal Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133	39-40
Schedule of Findings and Questioned Costs.....	41

Independent Auditor's Report

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

We have audited the accompanying consolidated balance sheets of Garrett County Memorial Hospital and subsidiary (collectively, the Company) as of June 30, 2010 and 2009, and the related consolidated statements of operations and other changes in unrestricted net assets, changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform our audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Garrett County Memorial Hospital and subsidiary as of June 30, 2010 and 2009, and the results of their operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



In accordance with *Government Auditing Standards*, we have also issued our reports dated September 22, 2010 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of these reports is to describe the scope of testing of internal control over financial reporting and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Cohen, Rutherford + Knight, P.C.

September 22, 2010

**Garrett County Memorial Hospital and Subsidiary
Consolidated Balance Sheets**

	June 30	
	<u>2010</u>	<u>2009</u>
<i>ASSETS</i>		
CURRENT ASSETS		
Cash and cash equivalents	\$ 4,042,810	\$ 2,972,430
Short-term investments -- <i>Note B</i>	12,372,837	7,870,394
Patient accounts receivable, net of allowance for doubtful accounts of \$2,249,597 and \$2,321,019 at June 30, 2010 and 2009, respectively -- <i>Note K</i>	4,940,616	4,996,651
Other amounts receivable	247,291	280,549
Assets whose use is limited by donors -- <i>Note B</i>	268,872	296,275
Inventories	989,075	975,859
Prepaid expenses	<u>480,852</u>	<u>400,543</u>
TOTAL CURRENT ASSETS	23,342,353	17,792,701
NONCURRENT ASSETS		
Property and equipment -- <i>Note D</i>	21,640,184	22,565,231
Long-term investments -- <i>Note B</i>	3,033,546	2,695,789
Investment in affiliates -- <i>Note C</i>	305,125	310,039
Assets whose use is limited by donors, less current portion -- <i>Note B</i>	326,869	360,611
Assets whose use is limited by board of governors -- <i>Note B</i>	698,073	698,073
Deferred financing costs	<u>28,046</u>	<u>35,430</u>
TOTAL NONCURRENT ASSETS	<u>26,031,843</u>	<u>26,665,173</u>
TOTAL ASSETS	<u>\$ 49,374,196</u>	<u>\$ 44,457,874</u>

(Continued)

See the accompanying notes to the consolidated financial statements.

**Garrett County Memorial Hospital and Subsidiary
Consolidated Balance Sheets – Continued**

	June 30	
	<u>2010</u>	<u>2009</u>
<i>LIABILITIES AND NET ASSETS</i>		
CURRENT LIABILITIES		
Accounts payable	\$ 634,022	\$ 953,525
Accrued salaries and wages	2,265,077	2,222,098
Advances from third parties	414,183	280,341
Current portion of long-term debt -- <i>Note E</i>	230,273	668,100
Other current liabilities	<u>1,193,321</u>	<u>1,126,678</u>
TOTAL CURRENT LIABILITIES	4,736,876	5,250,742
Long-term debt, less current portion -- <i>Note E</i>	3,952,669	4,182,942
Pension obligation -- <i>Note G</i>	<u>7,943,468</u>	<u>7,324,428</u>
TOTAL LIABILITIES	<u>16,633,013</u>	<u>16,758,112</u>
NET ASSETS		
Unrestricted	32,156,279	27,103,536
Temporarily restricted -- <i>Note F</i>	549,818	561,140
Permanently restricted -- <i>Note M</i>	<u>35,086</u>	<u>35,086</u>
TOTAL NET ASSETS	<u>32,741,183</u>	<u>27,699,762</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 49,374,196</u>	<u>\$ 44,457,874</u>

See the accompanying notes to the consolidated financial statements.

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

	Year Ended June 30	
	2010	2009
REVENUE		
Net patient service revenue -- <i>Note K</i>	\$ 40,445,878	\$ 39,305,705
Other revenue	579,964	507,211
Net assets released from restriction for use in operations -- <i>Note F</i>	<u>57,944</u>	<u>57,101</u>
TOTAL REVENUE	41,083,786	39,870,017
EXPENSES -- <i>Note M</i>		
Salaries and wages	15,455,503	15,539,845
Employee benefits	5,060,449	4,264,607
Supplies	5,971,363	6,232,213
Utilities	604,746	807,844
Purchased services	3,730,379	4,785,622
Depreciation and amortization -- <i>Note D</i>	2,790,495	2,741,558
Interest -- <i>Note E</i>	210,812	238,850
Provision for uncollectible accounts	1,954,207	2,259,437
Other expenses	<u>786,369</u>	<u>865,476</u>
TOTAL OPERATING EXPENSES	36,564,323	37,735,452
GAIN FROM OPERATIONS	4,519,463	2,134,565
OTHER INCOME (LOSS)		
Investment income (loss) -- <i>Note B</i>	535,918	(332,899)
Equity in earnings of affiliates -- <i>Note C</i>	77,586	140,662
Other	<u>(159,987)</u>	<u>(299,695)</u>
TOTAL OTHER INCOME (LOSS)	453,517	(491,932)
EXCESS OF REVENUE OVER EXPENSES	4,972,980	1,642,633
Net assets released from restriction for the purchase of property and equipment -- <i>Note F</i>	330,366	1,112,320
Pension-related changes other than net periodic pension cost -- <i>Note G</i>	<u>(250,603)</u>	<u>(3,836,926)</u>
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	<u>\$ 5,052,743</u>	<u>\$ (1,081,973)</u>

See the accompanying notes to the consolidated financial statements.

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

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Assets</u>
BALANCE AT JUNE 30, 2008	\$ 28,185,509	\$ 1,613,733	\$ 35,086	\$ 29,834,328
Excess revenue over expenses	1,642,633	0	0	1,642,633
Net assets released from restriction for the purchase of property and equipment -- <i>Note F</i>	1,112,320	(1,112,320)	0	0
Pension-related changes other than net periodic pension cost -- <i>Note G</i>	(3,836,926)	0	0	(3,836,926)
Contributions	0	116,828	0	116,828
Net assets released from restriction for use in operations -- <i>Note F</i>	0	(57,101)	0	(57,101)
INCREASE (DECREASE) IN NET ASSETS	<u>(1,081,973)</u>	<u>(1,052,593)</u>	<u>0</u>	<u>(2,134,566)</u>
BALANCE AT JUNE 30, 2009	27,103,536	561,140	35,086	27,699,762
Excess revenue over expenses	4,972,980	0	0	4,972,980
Net assets released from restriction for the purchase of property and equipment -- <i>Note F</i>	330,366	(330,366)	0	0
Pension-related changes other than net periodic pension cost -- <i>Note G</i>	(250,603)	0	0	(250,603)
Contributions	0	376,988	0	376,988
Net assets released from restriction for use in operations -- <i>Note F</i>	0	(57,944)	0	(57,944)
INCREASE (DECREASE) IN NET ASSETS	<u>5,052,743</u>	<u>(11,322)</u>	<u>0</u>	<u>5,041,421</u>
BALANCE AT JUNE 30, 2010	<u>\$ 32,156,279</u>	<u>\$ 549,818</u>	<u>\$ 35,086</u>	<u>\$ 32,741,183</u>

See the accompanying notes to the consolidated financial statements.

**Garrett County Memorial Hospital and Subsidiary
Consolidated Statements of Cash Flows**

	Year Ended June 30	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase (decrease) in net assets	\$ 5,041,421	\$ (2,134,566)
Adjustments to reconcile increase (decrease) in net assets to net cash and cash equivalents provided by operating activities:		
Investment (income) loss	(386,650)	332,899
Restricted contributions	(376,988)	(116,828)
Depreciation	2,783,111	2,728,145
Amortization of deferred financing costs	7,384	13,413
Provision for uncollectible accounts	1,954,207	2,259,437
Equity in earnings of affiliates	(77,586)	(140,662)
Loss on disposal of equipment	44,887	222,966
Decrease (increase) in:		
Patient accounts receivable	(1,898,172)	(3,049,206)
Supplies	(13,216)	5,432
Prepaid expenses	(80,309)	24,742
Increase (decrease) in:		
Accounts payable	(319,503)	228,355
Accrued salaries and wages	42,979	195,030
Advances from third parties	133,842	(128,000)
Pension obligation	619,040	3,949,174
Other current liabilities	66,643	480,213
NET CASH AND CASH EQUIVALENTS PROVIDED BY OPERATING ACTIVITIES	7,541,090	4,870,544
<i>(Continued)</i>		

See the accompanying notes to the consolidated financial statements.

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

	<u>2010</u>	<u>2009</u>
CASH AND CASH EQUIVALENTS FROM INVESTING ACTIVITIES		
Purchases of property and equipment	\$ (1,902,951)	\$ (3,094,155)
Net investment in affiliate	82,500	(66,405)
Other amounts receivable	33,258	31,604
Net purchase of trading securities	<u>(4,392,405)</u>	<u>(320,779)</u>
NET CASH AND CASH EQUIVALENTS USED IN INVESTING ACTIVITIES	<u>(6,179,598)</u>	<u>(3,449,735)</u>
CASH AND CASH EQUIVALENTS FROM FINANCING ACTIVITIES		
Repayments of long-term debt	(668,100)	(631,625)
Proceeds from restricted contributions	<u>376,988</u>	<u>116,828</u>
NET CASH AND CASH EQUIVALENTS USED IN FINANCING ACTIVITIES	<u>(291,112)</u>	<u>(514,797)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,070,380	906,012
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>2,972,430</u>	<u>2,066,418</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 4,042,810</u>	<u>\$ 2,972,430</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	<u>\$ 213,166</u>	<u>\$ 235,984</u>

See the accompanying notes to the consolidated financial statements.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements

Note A – Organization and Summary of Significant Accounting Principles

Organization

Garrett County Memorial Hospital (the Hospital) is an instrumentality of Garrett County, Maryland. The Hospital was organized for charitable purposes and is exempt from income taxes as an instrumentality of Garrett County. In 2003, the Hospital formed and became the sole member of Professional Emergency Physician Services, LLC, (PEPS) which is a for-profit limited liability company. The purpose of PEPS is to provide professional emergency services solely to the Hospital. In addition, the Hospital owns 100% of the outstanding shares of Garrett Community Health Services (GCHS), which is a for-profit corporation. GCHS has had no activity for the years ended June 30, 2010 and 2009.

Principles of Consolidation

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

Basis of Presentation

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

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

- Increases (decreases) in permanently restricted net assets if the terms of the gift or the Hospital's interpretation of relevant state law require that they be added to the principal of a permanent net asset;
- Increases (decreases) in temporarily restricted net assets if the terms of the gift impose restrictions on the use of the income;
- Increases (decreases) in unrestricted net assets in all other cases.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

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

Net Patient Service Revenue

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

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

Charity Care

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

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. The estimated amount of charges forgone under the Hospital's charity care policy was \$2,259,122 and \$1,897,637 in 2010 and 2009, respectively.

Advertising expense

The Company expenses advertising costs as they are incurred.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

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

Cash and Cash Equivalents

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

Supplies

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

Donor-Restricted Funds

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

Assets Whose Use is Limited

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

Property and Equipment

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

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

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

Property and Equipment - Continued

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

Deferred Financing Costs

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

Investments

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

Investments in Affiliates

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

Excess of Revenues over Expenses

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

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

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

Estimated Malpractice Costs

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

Use of Estimates

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

Income Taxes

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

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

The Hospital had no unrecognized tax benefits or such amounts were immaterial during the periods presented. For tax periods with respect to which no unrelated business income was recognized, no tax return was required. Tax periods for which no return is filed remain open for examination indefinitely. No tax returns were filed during 2010 and 2009.

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

Subsequent Events

Subsequent events have been evaluated by management through September 22, 2010 which is the date the financial statements were available to be issued.

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

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

Reclassification

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

Recent Changes in Accounting Standards

In August 2010, the Financial Accounting Standards Board (FASB) amended the Accounting Standards Codification (ASC) for Health Care Entities to require that cost be used as the measurement basis for charity care disclosures and that cost be identified as the direct and indirect costs of providing the charity care. This amendment is effective for fiscal years beginning after December 15, 2010. Also, in August 2010, the FASB amended the ASC for Health Care Entities to clarify 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 considerations of insurance recoveries. This amendment is effective for fiscal years and interim periods within those years, beginning after December 15, 2010. Management is currently evaluating the impact on the Company’s future financial statements of adoption of these changes in accounting.

Note B – Investments and Assets Whose Use is Limited

Investments and assets limited as to use consist of the following at June 30:

	<u>Investments</u>	<u>Assets whose use is limited by donors</u>	<u>Assets whose use is limited by the Board of Governors</u>	<u>Total</u>
At June 30, 2010:				
Cash and cash equivalents	\$ 137,609	\$ 102,488	\$ 0	\$ 240,097
Certificates of deposit	12,452,837	5,095	698,073	13,156,005
Government securities	275,762	18,757	0	294,519
Corporate bonds	239,621	16,299	0	255,920
Preferred stock	77,478	5,270	0	82,748
Marketable equity securities				
Mutual funds	1,369,496	93,154	0	1,462,650
Common stocks	448,654	30,178	0	478,832
Equities	404,926	27,543	0	432,469
Pledges receivable, net	0	296,957	0	296,957
	<u>15,406,383</u>	<u>595,741</u>	<u>698,073</u>	<u>16,700,197</u>
Less short-term portion	<u>12,372,837</u>	<u>268,872</u>	<u>0</u>	<u>12,641,709</u>
	<u>\$ 3,033,546</u>	<u>\$ 326,869</u>	<u>\$ 698,073</u>	<u>\$ 4,058,488</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

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

	Investments	Assets whose use is limited by donors	Assets whose use is limited by the Board of Governors	Total
At June 30, 2009:				
Cash and cash equivalents	\$ 318,997	\$ 100,393	\$ 0	\$ 419,390
Certificates of deposit	7,618,573	138,495	698,073	8,455,141
Government securities	277,199	5,036	0	282,235
Corporate bonds	598,262	10,869	0	609,131
Preferred stock	70,169	1,275	0	71,444
Marketable equity securities				
Mutual funds	1,093,792	19,871	0	1,113,663
Common stocks	325,970	5,922	0	331,892
Equities	263,221	4,782	0	268,003
Pledges receivable, net	0	370,243	0	370,243
	<u>10,566,183</u>	<u>656,886</u>	<u>698,073</u>	<u>11,921,142</u>
Less short-term portion	<u>7,870,394</u>	<u>296,275</u>	<u>0</u>	<u>8,166,669</u>
	<u>\$ 2,695,789</u>	<u>\$ 360,611</u>	<u>\$ 698,073</u>	<u>\$ 3,754,473</u>

Assets whose use is limited include investments and pledges receivable. Board designated funds consist of certificates of deposit at June 30, 2010 and 2009.

Pledges receivable are recorded net of an allowance for uncollectible pledges of \$99,069 and \$105,942 at June 30, 2010 and 2009, respectively. Pledges are recorded at their net present value and are due as follows at June 30, 2010:

2011	\$ 185,358
2012	74,172
2013	32,882
2014	27,342
2015	24,837
After 2015	<u>59,397</u>
	403,988
Present value discount at 1.76%	(7,962)
Allowance for doubtful accounts	<u>(99,069)</u>
	<u>\$ 296,957</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

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

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

	<u>2010</u>	<u>2009</u>
Interest and dividends	\$ 244,680	\$ 321,012
Net realized gains (losses)	(95,412)	(68,885)
Net unrealized losses	<u>386,650</u>	<u>(585,026)</u>
	<u>\$ 535,918</u>	<u>\$ (332,899)</u>

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

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

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

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

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

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

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

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

Fair values of the Company’s fixed maturity securities (government securities and corporate bonds) are based on prices provided by its investment managers, who use a variety of pricing sources to determine market valuations. Each designate specific pricing services or indexes for each sector of the market based upon the provider’s experience. The Company’s fixed maturity securities portfolio is highly liquid, which allows for a high percentage of the portfolio to be priced through pricing services.

Fair values of the Company’s certificate of deposits are based on cost plus accrued interest, which in the opinion of management approximates fair value. Fair values of marketable equity securities (mutual funds and stock) have been determined by the Company from observable market quotations, when available. Private placement securities and other equity securities where a public quotation is not available are valued by using broker quotes.

The following table presents the Company’s fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2010:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and cash equivalents	\$ 80,876	\$ 0	\$ 80,876
Certificates of deposit	13,315,223	0	13,315,223
Government securities	77,116	217,404	294,520
Corporate bonds	45,545	210,375	255,920
Mutual funds	1,462,651	0	1,462,651
Corporate stock	994,050	0	994,050
	<u>\$ 15,975,461</u>	<u>\$ 427,779</u>	<u>\$ 16,403,240</u>

The following table presents the Company’s fair value hierarchy for assets measured at fair value on a recurring basis as of June 30, 2009:

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash and cash equivalents	\$ 419,390	\$ 0	\$ 419,390
Certificates of deposit	0	8,455,141	8,455,141
Government securities	0	282,235	282,235
Corporate bonds	0	609,131	609,131
Mutual funds	1,113,663	0	1,113,663
Corporate stock	671,339	0	671,339
	<u>\$ 2,204,392</u>	<u>\$ 9,346,507</u>	<u>\$ 11,550,899</u>

**Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued**

Note C – Investments in Affiliates

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

<u>Joint Venture</u>	<u>Method of Accounting</u>	<u>Type of organization</u>	<u>Business purpose</u>	<u>Percentage ownership</u>	
				<u>2010</u>	<u>2009</u>
Garrett Rehabilitation Services (GRS)	Equity	For-profit	Medical, rehabilitative and therapy services	50%	50%
Oakland MRI Center, LLC (OMRI)	Equity	For-profit	MRI and Dexa scan services	50%	50%
Freestate Healthcare Insurance Company, Ltd. (Freestate)	Equity	For-profit	Malpractice and professional liability insurance	16.7%	12.5%
Western Maryland Medical Supply, LLC (WMMS)	Cost	For-profit	Durable medical equipment services	33.3%	33.3%

GRS is a joint venture in which the Hospital and Select Medical of Maryland, Inc. have invested equally. GRS provides physical therapy, speech pathology, occupational therapy and general rehabilitation services in an outpatient clinical setting. GRS also provides inpatient rehabilitation services for the Hospital. Such services to the Hospital approximated \$362,556 in 2010 and \$373,400 in 2009. The investment is recorded under the equity method in the accompanying consolidated financial statements.

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

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

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

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note C – Investments in Affiliates – Continued

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

	<u>Investment balance</u>		<u>Equity (loss) in earnings</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
GRS	\$ 118,300	\$ 157,522	\$ 48,278	\$ 92,857
OMRI	(27,694)	(48,426)	20,732	35,936
Freestate	20,493	15,339	154	27,668
WMMS	194,026	185,604	8,422	(15,799)
	<u>\$ 305,125</u>	<u>\$ 310,039</u>	<u>\$ 77,586</u>	<u>\$ 140,662</u>

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

	<u>2010</u>	<u>2009</u>
Current assets	\$ 9,099,463	\$ 19,539,881
Noncurrent assets	27,975,006	12,547,505
TOTAL ASSETS	<u>37,074,469</u>	<u>32,087,386</u>
Current liabilities	933,130	841,816
Noncurrent liabilities	34,743,720	29,847,522
Net worth	1,397,619	1,398,048
TOTAL LIABILITIES AND NET WORTH	<u>\$ 37,074,469</u>	<u>\$ 32,087,386</u>
Total operating revenue	\$ 10,517,948	\$ 4,917,462
Total operating expense	10,283,430	4,704,845
NET INCOME	<u>\$ 234,518</u>	<u>\$ 212,617</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note D – Property, Plant and Equipment

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

	Estimated useful life	2010	2009
Land improvements	10 - 40 years	\$ 646,773	\$ 646,773
Buildings and improvements	15 - 40 years	27,379,746	26,658,336
Fixed equipment	5 - 20 years	3,410,260	2,577,059
Movable equipment	3 - 20 years	13,672,514	12,567,870
Equipment under capital lease	lease term	<u>559,572</u>	<u>559,572</u>
		45,668,865	43,009,610
Less accumulated depreciation		<u>25,308,753</u>	<u>23,208,854</u>
		20,360,112	19,800,756
Land		1,162,039	1,236,539
Construction in progress		<u>118,033</u>	<u>1,527,936</u>
		<u>\$ 21,640,184</u>	<u>\$ 22,565,231</u>

Depreciation expense for the years ended June 30, 2010 and 2009 was \$2,783,111 and \$2,728,145, respectively. Depreciation expense includes amortization expense of \$97,401 and \$81,167 related to leased equipment for the years ended June 30, 2010 and 2009. Accumulated amortization of capital leases was \$370,333 and \$272,932 in June 30, 2010 and 2009, respectively.

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note E – Long-Term Debt

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

	<u>2010</u>	<u>2009</u>
USDA bond	\$ 2,838,467	\$ 2,894,547
Series 2004 Bonds	1,120,751	1,176,290
Hospital Refunding Bonds of 1997	0	450,000
Capital lease obligation	<u>223,724</u>	<u>330,205</u>
	4,182,942	4,851,042
Less current portion	<u>230,273</u>	<u>668,100</u>
	<u>\$ 3,952,669</u>	<u>\$ 4,182,942</u>

United States Department of Agriculture (USDA) Bonds

In June 2007, Garrett County issued the Garrett County Memorial Hospital Refunding Bonds, Series 2007 (Series 2007 Bonds), for the purpose of providing funding for the Hospital’s Emergency Room/Same Day Surgery/Admissions construction and renovation project. The Series 2007 Bonds represent a supplemental loan agreement between the Hospital and Garrett County Maryland for amounts that are equal to the loan principal of the Garrett County Series 2007 Bonds. The funds were provided to Garrett County from the USDA. Funding from the bonds was also used to refinance the series 2002 and 2003 bonds.

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

Series 2004 Bonds

In November 2004, Garrett County issued County Commissioners of Garret County Hospital Refunding Bonds, Series 2004 (Series 2004 Bonds) refunding bonds for the purpose of refunding a portion of the Series 2002 Bonds. The Series 2004 Bonds represent a supplemental loan agreement between the Hospital and Garrett County for amounts that are equal to the loan principal of the County’s Series 2004 Bonds.

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

Garrett County Memorial Hospital and Subsidiary Notes to the Consolidated Financial Statements – Continued

Note E – Long-Term Debt – Continued

Hospital Refunding Bonds of 1997

In January 1997, Garrett County issued General Obligation Bonds (Hospital Refunding Bonds of 1997) for the purpose of refinancing the Hospital Refunding Bonds of 1986. The Hospital Refunding Bonds of 1997 represented a supplemental loan agreement between the Hospital and Garrett County for amounts that were equal to the loan principal of the County's Hospital Refunding Bonds of 1997.

The Hospital Refunding Bonds of 1997 bore interest at a rate of 5.20% and 5.10% in 2010 and 2009, respectively. Bond repayments were made in semi-annual installments to a trustee to meet the payment schedule stipulated in the loan agreement. As of June 30, 2010, the loan has been paid in full.

Capital Leases

The Hospital periodically enters into various leases for equipment that meet the criteria for capitalization under current accounting standards. Interest expense related to the leases for the years ended June 30, 2010 and 2009 was \$18,590 and \$24,528, respectively and is reported in the accompanying consolidated statements of operations and other changes in unrestricted net assets.

Aggregate maturities of all long-term debt as of June 30, 2010 are as follows:

2011	\$	230,273
2012		210,452
2013		146,681
2014		131,526
2015		137,023
After 2015		<u>3,326,987</u>
	\$	<u>4,182,942</u>

The Company is subject to certain restrictive covenants defined in various agreements with lenders. In the opinion of management, the Company was in compliance with all applicable restrictive covenants as of June 30, 2010 and 2009.

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note F – Temporarily Restricted Net Assets

Temporarily restricted net assets of \$549,818 and \$561,140 at June 30, 2010 and 2009, respectively, are restricted primarily for plant replacement, expansion, and health care clinical services.

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

	<u>2010</u>	<u>2009</u>
Health care clinical services	\$ 57,944	\$ 57,101
Plant replacement and expansion	330,366	1,112,320
	<u>\$ 388,310</u>	<u>\$ 1,169,421</u>

Note G – Pension Plan

The Hospital has a noncontributory defined benefit pension plan (the Plan) covering all employees of the Hospital who work at least twenty hours per week. Benefits are based on the participants' credited service and average monthly earnings. The Hospital's funding policy is to contribute an amount annually that is equal to the normal cost plus interest on the unfunded accrued liability. The Internal Revenue Service classifies the Plan as a government plan, and the Plan, as such, is exempt from the requirements of the Employee Retirement Income Security Act of 1974. The Hospital uses a June 30 measurement date for the Plan. The Hospital plans to contribute \$1,037,900 to the Plan in 2010. The assumption change in the table below represents change in the discount rate.

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

Projected benefit obligation at beginning of year	\$ 19,680,938	\$ 17,614,983
Service cost	795,776	781,949
Interest	1,203,429	1,187,371
Assumption change	1,177,371	702,242
Benefits paid	<u>(653,336)</u>	<u>(605,607)</u>
Projected benefit obligation at end of year	<u>\$ 22,204,178</u>	<u>\$ 19,680,938</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note G – Pension Plan – Continued

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

	<u>2010</u>	<u>2009</u>
Fair value of plan assets as beginning of year	\$ 12,356,510	\$ 14,239,729
Actual return on plan assets	1,549,851	(2,090,970)
Employer contribution	1,007,686	813,358
Benefits paid	<u>(653,336)</u>	<u>(605,607)</u>
Fair value of plan assets as end of year	<u>\$ 14,260,711</u>	<u>\$ 12,356,510</u>
Funded status	<u>\$ (7,943,467)</u>	<u>\$ (7,324,428)</u>
Net loss included in unrestricted net assets	<u>\$ 7,297,608</u>	<u>\$ 7,047,006</u>
Accumulated benefit obligation	<u>\$ 17,215,862</u>	<u>\$ 16,736,914</u>

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

	<u>2010</u>	<u>2009</u>
Service cost	\$ 795,776	\$ 781,949
Interest cost	1,203,429	1,187,371
Expected return on assets held in the plan	(1,005,530)	(1,149,915)
Amortization of net loss	<u>382,448</u>	<u>106,201</u>
	<u>\$ 1,376,123</u>	<u>\$ 925,606</u>

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

	<u>2010</u>	<u>2009</u>
Discount rate	5.56%	6.22%
Rate of compensation increase	3.22%	3.22%

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

	<u>2010</u>	<u>2009</u>
Discount rate	5.56%	6.22%
Rate of compensation increase	3.22%	3.22%
Expected long-term return on plan assets	8.00%	8.00%

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note G – Pension Plan – Continued

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

	<u>2010</u>	<u>2009</u>
Equity securities	54%	52%
Debt securities	41%	39%
Other	5%	9%
Total plan assets	<u>100%</u>	<u>100%</u>

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

The fair value of the Hospital’s pension plan assets as June 30, 2010 by asset category are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash	\$ 713,846	\$ 0	\$ 0	\$ 713,846
Fixed income securities	2,497,473	3,256,829	0	5,754,302
Equities	<u>7,716,704</u>	<u>0</u>	<u>0</u>	<u>7,716,704</u>
	<u>\$ 10,928,023</u>	<u>\$ 3,256,829</u>	<u>\$ 0</u>	<u>\$ 14,184,852</u>

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

2011	\$ 690,000
2012	698,000
2013	750,000
2014	864,000
2015	962,000
2016 - 2021	<u>9,099,000</u>
	<u>\$ 13,063,000</u>

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note H – Certain Significant Risks and Uncertainties

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

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

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

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

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

During September 2008, certain large U.S. financial institutions failed, primarily as a result of holdings in troubled subprime loans or assets collateralized with such distressed loans. These institutional failures, and the negative economic conditions that contributed to these failures, generated substantial volatility in global financial markets and substantial uncertainty regarding access to capital and the continued viability of many other financial institutions. Despite the federal legislative initiatives to ameliorate these conditions, global credit markets remain volatile and the health of the global economy continues to be uncertain. These conditions create uncertainty regarding the future valuation of the Company's invested funds and the resulting impact on the future financial position, results of operations and cash flows of the Company could be material.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note I – Maryland Health Services Cost Review Commission

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

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

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

Note J – Insurance

Malpractice Insurance

The Company is involved in litigation arising in the normal course of business. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. Additional claims may be asserted against the Company arising from services provided through June 30, 2010. Management believes that no material loss will result from any pending or threatened litigation or from incidents incurred but not reported.

An estimated liability for incurred but not reported professional liability claims has been recorded in the amount of approximately \$694,000 for the years ended June 30, 2010 and 2009. This amount is included in accounts payable and accrued liabilities in the accompanying consolidated financial statements. Management believes this accrual is adequate to provide for all professional liability claims that have been incurred through June 30, 2010, but not reported to its insurance carrier.

Garrett County Memorial Hospital and Subsidiary

Notes to the Consolidated Financial Statements – Continued

Note J – Insurance – Continued

Malpractice Insurance -- Continued

Effective March 1, 2005, the Hospital became a shareholder of the newly formed Freestate Healthcare Insurance Company, Ltd. (Freestate), a captive insurance company formed in the Cayman Islands by eight Maryland hospitals. The Hospital became a shareholder of Freestate when the Hospital's insurance company decided not to continue to write insurance policies for hospitals within the State of Maryland effective March 1, 2005. The Hospital believes that becoming a shareholder of the captive insurance company provides the best long-term solution to providing insurance coverage that is cost effective and predictable. Freestate provides insurance coverage on a claims-made basis to its owners for professional liability claims and comprehensive general liability of \$1,000,000 for each and every claim. Freestate has entered into reinsurance and excess policy agreements with independent insurance companies to limit its losses for professional liability and comprehensive general liability claims. The Hospital has \$2,000,000 of additional insurance in the aggregate through such reinsurance arrangements. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insureds under the policy. Each named insured's assessment or credit is based on the percentage of their actual exposure to the actual exposure of all named insureds. In management's opinion, the assets of Freestate are sufficient to meet its obligations as of June 30, 2010. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the payment of such claims would be the responsibility of the member hospitals.

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

Health Insurance

In fiscal year 2003, the Company became self-insured for employee health claims. Under the self-insurance plan, the Company has accrued a liability of \$323,672 and \$227,116 for the years ended June 30, 2010 and 2009 for incurred but not reported claims. Management believes that the accruals are adequate to provide for all employee health claims that have been incurred for the years ended June 30, 2010 and 2009.

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note K – Business and Credit Concentrations

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

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

	<u>2010</u>	<u>2009</u>
Self-pay and others	\$ 1,471,940	\$ 1,507,386
Medicare	2,522,169	2,765,440
Commercial insurance and HMOs	1,175,725	1,238,020
Medicaid	631,221	757,847
Blue Cross	<u>1,389,158</u>	<u>1,048,977</u>
	7,190,213	7,317,670
Allowance for doubtful accounts	<u>(2,249,597)</u>	<u>(2,321,019)</u>
	<u>\$ 4,940,616</u>	<u>\$ 4,996,651</u>

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

	<u>2010</u>	<u>2009</u>
Medicare	47%	45%
Commercial insurance and HMOs	16%	20%
Blue Cross	15%	15%
Medicaid	16%	12%
Self-pay and others	<u>6%</u>	<u>8%</u>
	<u>100%</u>	<u>100%</u>

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note L – Functional Expenses

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

	<u>2010</u>	<u>2009</u>
Health care services	\$ 28,956,231	\$ 28,972,202
General and administrative	7,608,092	8,763,250
	<u>\$ 36,564,323</u>	<u>\$ 37,735,452</u>

Note M – Endowment

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

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

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

Garrett County Memorial Hospital and Subsidiary
Notes to the Consolidated Financial Statements – Continued

Note N – Endowment - Continued

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

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

From time to time, the fair value of assets associated with the endowment fund may fall below the level that the donor or SPMIFA required the Company to retain as a fund of perpetual duration. There were no such deficiencies as of June 30, 2010 or 2009.

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

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

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

	2010			2009		
	Unrestricted	Permanently Restricted	Endowment Total	Unrestricted	Permanently Restricted	Endowment Total
Beginning balance	\$ 9,721	\$ 35,086	\$ 44,807	7,340	\$ 35,086	\$ 42,426
Interest and dividends	2,209	0	2,209	2,381	0	2,381
Ending Balance	\$ 11,930	\$ 35,086	\$ 47,016	\$ 9,721	\$ 35,086	\$ 44,807



Report of Independent Auditors on Other Financial Information and the Schedule of Expenditures of Federal Awards

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

The 2010 and 2009 consolidated audited financial statements of Garrett County Memorial Hospital and Subsidiary and our report thereon are presented in the preceding section of this report. Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The schedule of consolidated balance sheet information and consolidated statement of operations information as of and for the year ended June 30, 2010 on pages 33 - 35 are presented for the purpose of additional analysis of the basic financial statements rather than to present the balance sheet and statement of operations for the individual entities, and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is also presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Cohen, Rutherford + Knight, P.C.

September 22, 2010



**Garrett County Memorial Hospital
Consolidating Balance Sheet Information
As of June 30, 2010**

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Elimination Entries	Consolidated
<i>ASSETS</i>				
CURRENT ASSETS				
Cash and cash equivalents	\$ 3,969,369	\$ 73,441	\$ 0	\$ 4,042,810
Short-term investments	12,372,837	0	0	12,372,837
Patient accounts receivable, net	4,847,134	93,482	0	4,940,616
Other amounts receivable	245,644	1,647	0	247,291
Assets whose use is limited by donors	268,872	0	0	268,872
Inventories	988,494	581	0	989,075
Prepaid expenses	402,460	78,392	0	480,852
Due from affiliates	86,211	0	(86,211)	0
TOTAL CURRENT ASSETS	23,181,021	247,543	(86,211)	23,342,353
NONCURRENT ASSETS				
Property and equipment	21,640,184	0	0	21,640,184
Long-term investments	3,033,546	0	0	3,033,546
Investment in affiliates	305,125	0	0	305,125
Assets whose use is limited by donors, less current portion	326,869	0	0	326,869
Assets whose use is limited by board of governors	698,073	0	0	698,073
Deferred financing costs, net	28,046	0	0	28,046
TOTAL NONCURRENT ASSETS	26,031,843	0	0	26,031,843
TOTAL ASSETS	\$ 49,212,864	\$ 247,543	\$ (86,211)	\$ 49,374,196

See the accompanying report of independent auditors on other financial information and the schedule of expenditures of federal awards.

Garrett County Memorial Hospital
Consolidating Balance Sheet Information – Continued
As of June 30, 2010

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Elimination Entries	Consolidated
<i>LIABILITIES AND NET ASSETS</i>				
CURRENT LIABILITIES				
Accounts payable	\$ 632,424	\$ 1,598	\$ 0	\$ 634,022
Accrued salaries and wages	2,130,062	135,015	0	2,265,077
Due to affiliates	0	86,211	(86,211)	0
Advances from third parties	414,183	0	0	414,183
Current portion of long-term debt	230,273	0	0	230,273
Other current liabilities	1,031,793	161,528	0	1,193,321
TOTAL CURRENT LIABILITIES	4,438,735	384,352	(86,211)	4,736,876
Long-term debt, less current portion	3,952,669	0	0	3,952,669
Pension obligation	7,943,468	0	0	7,943,468
TOTAL LIABILITIES	16,334,872	384,352	(86,211)	16,633,013
NET ASSETS				
Unrestricted	32,293,088	(136,809)	0	32,156,279
Temporarily restricted	549,818	0	0	549,818
Permanently restricted	35,086	0	0	35,086
TOTAL NET ASSETS	32,877,992	(136,809)	0	32,741,183
TOTAL LIABILITIES AND NET ASSETS	\$ 49,212,864	\$ 247,543	\$ (86,211)	\$ 49,374,196

See the accompanying report of independent auditors on other financial information and the schedule of expenditures of federal awards.

**Garrett County Memorial Hospital
Consolidating Statement of Operations Information
For the Year Ended June 30, 2010**

	Garrett County Memorial Hospital	Professional Emergency Physician Services, LLC	Elimination Entries	Consolidated
REVENUE				
Net patient service revenue	\$ 38,315,299	\$ 2,130,579	\$ 0	\$ 40,445,878
Other revenue	723,787	804	(144,627)	579,964
Net assets released from restriction for use in operations	<u>57,944</u>	<u>0</u>	<u>0</u>	<u>57,944</u>
TOTAL REVENUE	39,097,030	2,131,383	(144,627)	41,083,786
EXPENSES				
Salaries and wages	14,460,237	995,266	0	15,455,503
Employee benefits	4,906,945	153,504	0	5,060,449
Supplies	5,967,329	4,034	0	5,971,363
Utilities	602,133	2,613	0	604,746
Purchased services	3,409,136	321,243	0	3,730,379
Depreciation and amortization	2,790,495	0	0	2,790,495
Interest	210,812	0	0	210,812
Provision for uncollectible accounts	1,467,789	486,418	0	1,954,207
Management fees	0	144,627	(144,627)	0
Other expenses	<u>766,544</u>	<u>19,825</u>	<u>0</u>	<u>786,369</u>
TOTAL EXPENSES	34,581,420	2,127,530	(144,627)	36,564,323
GAIN (LOSS) FROM OPERATIONS	4,515,610	3,853	0	4,519,463
OTHER INCOME (LOSS)				
Investment income (loss)	535,801	117	0	535,918
Equity in earnings of affiliates	77,586	0	0	77,586
Other	<u>(160,406)</u>	<u>419</u>	<u>0</u>	<u>(159,987)</u>
TOTAL OTHER INCOME	452,981	536	0	453,517
EXCESS REVENUE OVER EXPENSES	<u>\$ 4,968,591</u>	<u>\$ 4,389</u>	<u>\$ 0</u>	<u>\$ 4,972,980</u>

See the accompanying report of independent auditors on other financial information and the schedule of expenditures of federal awards.

Garrett County Memorial Hospital
Schedule of Expenditures of Federal Awards
 For the Year Ended June 30, 2010

Federal Grantor / Program Title	Federal CFDA Number	Identification Number	Federal Expenditures
MAJOR PROGRAM			
U.S. Department of Agriculture Rural Development Rural Housing Service Community Facilities Direct Loan Program	10.766	Loan 97-08	\$ 2,838,467
TOTAL MAJOR PROGRAM			2,838,467
TOTAL EXPENDITURES			\$ 2,838,467

The schedule of expenditures of federal awards includes the federal grant activity of Garrett County Memorial Hospital and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirement of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic consolidated financial statements.

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

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

We have audited the consolidated financial statements of Garrett County Memorial Hospital and subsidiary (collectively, the Company) as of and for the year ended June 30, 2010, and have issued our report thereon dated September 22, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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



Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore there can be no assurance that all significant deficiencies or material weaknesses have been identified. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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

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

Cohen, Rutherford + Knight, P.C.

September 22, 2010



**Independent Auditor's Report on Compliance with
Requirements Applicable to Each Major Federal Program
and on Internal Control Over Compliance in Accordance
With OMB Circular A-133**

The Board of Governors
Garrett County Memorial Hospital
Oakland, Maryland

Compliance

We have audited the compliance of Garrett County Memorial Hospital and Subsidiary (the Company) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to the major federal program for the year ended June 30, 2010. The Company's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Company's compliance with those requirements. In our opinion, the Company complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2010.





Internal Control Over Compliance

The management of the Company is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Company's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over compliance.

A control deficiency in an internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in a remote likelihood that a material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

This report is intended solely for the information and use of management, the Board of Governors, management, others within the Company, the Department of Agriculture, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Cohen, Rutherford + Knight, P.C.

September 22, 2010

Garrett County Memorial Hospital
Schedule of Findings and Questioned Costs
 For the Year Ended June 30, 2010

SECTION I - SUMMARY OF AUDITOR'S RESULTS

FINANCIAL STATEMENTS

Type of Auditor's Report Issued:	Unqualified
Internal Control Over Financial Reporting?	
Material Weakness(es) Identified?	None reported
Significant Deficiency(ies) Identified Not Considered To Be Material Weaknesses?	None reported
Noncompliance Material to the Financial Statements Noted?	None reported

FEDERAL AWARDS

Internal Control Over Major Program:	
Material Weakness(es) Identified?	None reported
Significant Deficiency(ies) Identified Not Considered To Be Material Weaknesses?	None reported
Type of Auditors' Report Issued on Compliance for Major Programs?	Unqualified
Any Audit Findings Disclosed That Are Required To Be Reported in Accordance with Section 510(a) of Circular A-133?	None reported

Identification of Major Program:

CFDA Number/Identification Number	Name of Federal Program
10.766 Loan 97-08	USDA Loan
Dollar Threshold to Distinguish between Type A and Type B Programs?	\$300,000
Auditee Qualified as Low-Risk Auditee?	Yes

SECTION II - FINANCIAL STATEMENT FINDINGS

No matters were reported

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

No matters were reported