

# Holy Cross Hospital

(A Member of Trinity Health)

Consolidated Financial Statements as of and  
for the Years Ended June 30, 2011 and 2010,  
Supplemental Information as of and for the  
Year Ended June 30, 2011, and  
Independent Auditors' Report

**HOLY CROSS HOSPITAL**  
**(A Member of Trinity Health)**

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## INDEPENDENT AUDITORS' REPORT

To Trinity Health and the Board of Trustees of  
Holy Cross Hospital:

We have audited the accompanying consolidated balance sheets of Holy Cross Hospital (the "Hospital"), a wholly-controlled member organization of Trinity Health, as of June 30, 2011 and 2010, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Hospital as of June 30, 2011 and 2010, and the results of its operations and changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplemental information for 2011 listed in the table of contents is presented for the purpose of additional analysis of the basic consolidated financial statements, rather than to present the financial position, results of operations and changes in net assets of the individual entities, and is not a required part of the basic consolidated financial statements. This supplemental information is the responsibility of the Hospital's management. Such information has been subjected to the auditing procedures applied in our audit of the basic 2011 consolidated financial statements and, in our opinion, is fairly stated, in all material respects, when considered in relation to the basic 2011 consolidated financial statements taken as a whole.

September 29, 2011

**HOLY CROSS HOSPITAL**  
**(A Member of Trinity Health)**

**CONSOLIDATED BALANCE SHEETS**  
**AS OF JUNE 30, 2011 AND 2010**  
**(In thousands)**

	2011	2010
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 18,044	\$ 18,747
Investment in Trinity Health corporate pooled investment program	176,394	133,327
Patient accounts receivable — net of allowance for doubtful accounts of \$11.6 million and \$8.3 million in 2011 and 2010, respectively	52,155	50,103
Inventories	6,346	5,663
Prepaid expenses and other current assets	<u>5,530</u>	<u>3,964</u>
Total current assets	<u>258,469</u>	<u>211,804</u>
ASSETS LIMITED OR RESTRICTED AS TO USE — By:		
Deferred compensation	48	46
Donors	<u>2,848</u>	<u>2,438</u>
Total assets limited or restricted as to use	<u>2,896</u>	<u>2,484</u>
PROPERTY AND EQUIPMENT — Net	130,081	132,701
INVESTMENTS IN UNCONSOLIDATED AFFILIATES	1,837	1,393
PREPAID CHARGES FOR SHARED INFORMATION SERVICES	17,890	18,899
OTHER ASSETS	<u>85</u>	<u>530</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 411,258</u></b>	<b><u>\$ 367,811</u></b>
<b>LIABILITIES AND NET ASSETS</b>		
CURRENT LIABILITIES:		
Current portion of long-term debt	\$ 517	\$ 485
Current portion of notes payable to Trinity Health	1,991	1,927
Accounts payable	20,622	12,868
Accrued expenses	265	334
Salaries, wages, and related liabilities	23,451	19,604
Estimated payables to third-party payors	<u>16,893</u>	<u>16,113</u>
Total current liabilities	63,739	51,331
LONG-TERM DEBT — Net of current portion	154	671
NOTES PAYABLE TO TRINITY HEALTH, NET OF CURRENT PORTION	97,402	99,350
OTHER LONG-TERM LIABILITIES	<u>792</u>	<u>994</u>
Total liabilities	<u>162,087</u>	<u>152,346</u>
NET ASSETS:		
Unrestricted	246,323	213,027
Temporarily restricted	2,815	2,412
Permanently restricted	<u>33</u>	<u>26</u>
Total net assets	<u>249,171</u>	<u>215,465</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b><u>\$ 411,258</u></b>	<b><u>\$ 367,811</u></b>

See notes to consolidated financial statements.

**HOLY CROSS HOSPITAL**  
**(A Member of Trinity Health)**

**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**  
**FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**  
**(In thousands)**

	2011	2010
UNRESTRICTED REVENUE:		
Net patient service revenue	\$ 401,837	\$ 381,735
Net assets released from restrictions	1,266	833
Other revenue	<u>13,218</u>	<u>11,629</u>
Total unrestricted revenue	<u>416,321</u>	<u>394,197</u>
EXPENSES:		
Salaries and wages	162,163	151,858
Employee benefits	35,989	34,086
Contract labor	<u>5,284</u>	<u>6,347</u>
Total labor expenses	203,436	192,291
Supplies	65,705	65,124
Purchased services	53,384	50,762
Depreciation and amortization	23,019	21,862
Provision for bad debts	20,041	18,127
Occupancy	14,287	13,636
Interest	3,570	3,836
Other	<u>6,545</u>	<u>6,282</u>
Total expenses	<u>389,987</u>	<u>371,920</u>
OPERATING INCOME	<u>26,334</u>	<u>22,277</u>
NONOPERATING ITEMS:		
Net gains on investments in Trinity Health corporate pooled investment program:		
Investments held at fair value	13,254	7,817
Equity method investments	4,756	2,375
Other	<u>(652)</u>	<u>(717)</u>
Total nonoperating items	<u>17,358</u>	<u>9,475</u>
EXCESS OF REVENUE OVER EXPENSES	<u>\$ 43,692</u>	<u>\$ 31,752</u>

(Continued)

**HOLY CROSS HOSPITAL**  
**(A Member of Trinity Health)**

**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**  
**FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**  
**(In thousands)**

	2011	2010
UNRESTRICTED NET ASSETS:		
Excess of revenue over expenses	\$ 43,692	\$ 31,752
Net assets released from restrictions for capital acquisitions		636
Cumulative effect of change in accounting principal	(372)	
Unrestricted contributions of long lived assets	20	530
Transfers to affiliates	<u>(10,044)</u>	<u>(3,601)</u>
Increase in unrestricted net assets	<u>33,296</u>	<u>29,317</u>
TEMPORARILY RESTRICTED NET ASSETS:		
Contributions	1,669	1,275
Net assets released from restrictions	<u>(1,266)</u>	<u>(1,469)</u>
Increase (decrease) in temporarily restricted net assets	<u>403</u>	<u>(194)</u>
PERMANENTLY RESTRICTED NET ASSETS:		
Net investment income	8	4
Other	<u>(1)</u>	<u>(1)</u>
Increase in permanently restricted net assets	<u>7</u>	<u>3</u>
INCREASE IN NET ASSETS	33,706	29,126
NET ASSETS — Beginning of year	<u>215,465</u>	<u>186,339</u>
NET ASSETS — End of year	<u>\$ 249,171</u>	<u>\$ 215,465</u>

(Concluded)

See notes to consolidated financial statements.

**HOLY CROSS HOSPITAL**  
**(A Member of Trinity Health)**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED JUNE 30, 2011 AND 2010**  
**(In thousands)**

	<b>2011</b>	<b>2010</b>
<b>OPERATING ACTIVITIES:</b>		
Increase in net assets	<u>\$ 33,706</u>	<u>\$ 29,126</u>
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Transfers to affiliates	10,044	3,601
Cumulative effect of change in accounting principles	372	
Net realized gains on investment in Trinity Health corporate pooled investment program	(5,459)	(1,533)
Change in net unrealized gains on investments in Trinity Health corporate pooled investment program	(10,131)	(6,088)
Restricted contributions and investment income received	(8)	(3)
Depreciation and amortization	23,019	21,862
Provision for bad debts	20,041	18,127
Undistributed equity earnings in unconsolidated affiliates	(299)	(358)
Unrestricted contributions of long-lived assets	(20)	
Loss on sale of property and equipment	37	43
Changes in:		
Patient accounts receivable	(22,094)	(13,714)
Pledges receivable included in assets limited as to use	3	173
Other assets	(3,923)	(2,883)
Accounts payable and other liabilities	12,489	(559)
Estimated payables to third-party payors	(1,020)	(297)
Total adjustments	<u>23,051</u>	<u>18,371</u>
Net cash provided by operating activities	<u>56,757</u>	<u>47,497</u>
<b>INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(17,019)	(10,415)
Purchases of locally held investments	(1,911)	(9)
Proceeds from sales of locally held investments	1,498	28
Change in investments in Trinity Health corporate pooled investment program	<u>(27,622)</u>	<u>(41,835)</u>
Net cash used in investing activities	<u>(45,054)</u>	<u>(52,231)</u>
<b>FINANCING ACTIVITIES:</b>		
Transfers to affiliates	(10,044)	(3,601)
Proceeds from restricted contributions and restricted investment income	8	2
Repayments of long-term debt and notes payable to Trinity Health	<u>(2,370)</u>	<u>(2,651)</u>
Net cash used in financing activities	<u>(12,406)</u>	<u>(6,250)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(703)	(10,984)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>18,747</u>	<u>29,731</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 18,044</u>	<u>\$ 18,747</u>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Cash paid during the year for interest	<u>\$ 3,570</u>	<u>\$ 3,801</u>
Accrued property, plant and equipment	<u>\$ 617</u>	<u>\$ 1,775</u>

See notes to consolidated financial statements.

# HOLY CROSS HOSPITAL

(A Member of Trinity Health)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

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### 1. ORGANIZATION AND COMMUNITY BENEFIT MINISTRY

Holy Cross Hospital (the “Hospital”), a Maryland not-for-profit corporation, owns and operates a 450-bed acute care hospital and is the parent corporation for Holy Cross Hospital Foundation, a not-for-profit corporation established in 2007 supporting the charitable mission of the Hospital, and Maryland Care Group, Inc., a taxable corporation that owns an outpatient surgery center and private home service agency. The Hospital provides services to patients who reside primarily in the local geographic region. The Hospital is a member of Trinity Health, an Indiana not-for-profit corporation, sponsored by Catholic Health Ministries (CHM), a Public Juridic Person of the Holy Roman Catholic Church. There are significant related-party transactions with Trinity Health and its ministry organizations.

The mission and role statement for the Hospital is as follows:

*We serve together in Trinity Health  
In the spirit of the Gospel  
To heal body, mind and spirit  
To improve the health of our communities  
And to steward the resources entrusted to us*

The Hospital exists to support the health ministry of Trinity Health and to be the most trusted provider of health care services in our area. Our health care team will achieve this trust through:

- High quality, efficient and safe health care services for all, in partnership with our physicians and others
- Accessibility of services to our most vulnerable and underserved populations
- Community outreach that improves health status
- Ongoing learning and sharing of new knowledge and
- Our friendly, caring spirit

**Community Benefit Ministry** — Consistent with its mission, the Hospital provides medical care to all patients regardless of their ability to pay. In addition, the Hospital provides services intended to benefit the poor and underserved, including those persons who cannot afford health insurance because of inadequate resources and/or are uninsured or underinsured, and to enhance the health status of the communities in which it operates.

The State of Maryland requires all not-for-profit hospitals to compile and make public an annual report of community benefit activities according to Community Benefit Reporting Requirements and Standard Definitions established by the Maryland Health Services Cost Review Commission. For the years ended June 30, 2011 and 2010, the following summary has been prepared in accordance with the requirements and reflects the amount of the Hospital's community benefit ministry (in thousands):

	2011	2010
Charity care	\$ 19,236	\$ 16,430
Unreimbursed Medicaid - Medicaid assessment	1,045	
Community health services	5,113	6,097
Health professions education	4,286	2,954
Mission driven health services	7,470	9,426
Research	291	338
Financial contributions	205	284
Community building activities	63	57
Community benefit operations	<u>1,825</u>	<u>1,481</u>
 Community benefit ministry	 <u>\$ 39,534</u>	 <u>\$ 37,067</u>

The Hospital provides a significant amount of care to patients not paid for by or on behalf of those receiving it, that is reported as bad debt at cost and not included in the amounts reported above. During the years ended June 30, 2011 and 2010, the Hospital reported bad debt at cost (determined using a cost to charge ratio applied to the provision for bad debts) of \$14.3 million and \$13.0 million, respectively. Bad debt at cost is included in the bad debt expense in the consolidated statements of operations.

**Charity Care** — Services provided to patients who cannot afford health care services due to inadequate resources and/or are uninsured or underinsured. A patient is classified as a charity patient in accordance with the Hospital's established policies and when no payment for such services is anticipated. Services provided to these patients are not reported as revenue in the consolidated statements of operations and changes in net assets.

**Unreimbursed Medicaid - Medicaid assessment** - Medicaid is a joint federal and state program that pays the medical bills of people who have low-income and cannot afford medical care. Maryland's regulatory system creates a unique process for hospital payment that differs from the rest of the nation. Community benefit expenses are equal to Medicaid revenue in Maryland, as such, the net effect is zero. The exception to this is the impact on the hospital of its share of the Medicaid assessment. In recent years, the state of Maryland has closed fiscal gaps in the state Medicaid budget by assessing hospitals through the rate-setting system.

**Community Health Services** — Community health services are activities and services for which no patient bill exists. These services are not expected to be financially self-supporting, although some may be supported by outside grants or funding. Amounts reported are net of any outside funding. Some examples include health screenings, senior exercise classes, and support groups. The Hospital actively collaborates with community groups and agencies to assist those in need in providing such services.

**Health Professions Education** — Health professions education includes the unreimbursed cost of training health professionals, such as medical residents, nursing students, technicians, and students in allied health professions.

**Mission Driven Health Services** — Mission driven health services are net costs for billed services that are subsidized by the Hospital. These include services offered despite a financial loss because they are needed in the community and either other providers are unwilling to provide the services or the services would otherwise not be available in sufficient amount. Examples of services include adult day care, palliative care, and pharmacy programs.

**Research** — Research includes unreimbursed clinical and community health research and studies on health care delivery.

**Financial Contributions** — Financial contributions are made by the Hospital on behalf of the poor and underserved to community agencies. These amounts include special system wide funds used for charitable activities as well as resources contributed directly to programs, organizations, and foundations for efforts on behalf of the poor and the underserved. Amounts included here also represent certain in-kind donations.

**Community Building Activities** — Community building activities include the costs of programs that improve the physical environment, promote economic development, enhance other community support systems, develop leadership skills training, and build community coalitions.

**Community Benefit Operations** — Community benefit operations include costs associated with dedicated staff, community health needs, and/or asset assessments, and other costs associated with community benefit strategy and operations.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Principles of Consolidation** — The consolidated financial statements include the accounts of the Hospital, and all wholly owned, majority-owned, and controlled organizations. Investments where the Hospital holds less than 20% of the ownership interest are accounted for using the cost method. All other investments, which are not controlled by the Hospital, are accounted for using the equity method of accounting. For equity method investments, the Hospital has included its equity share of income or losses from investments in unconsolidated affiliates in other revenue in the consolidated statements of operations and changes in net assets. All material intercompany transactions and account balances have been eliminated in consolidation.

The accompanying consolidated financial statements present the financial position, results of operations, and changes in net assets and cash flows for the Hospital and are not necessarily indicative of what the financial position, results of operations, and changes in net assets and cash flows would have been if the Hospital had been operated as an unaffiliated corporation during the periods presented.

**Use of Estimates** — The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management of the Hospital to make assumptions, estimates, and judgments that affect the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. The Hospital considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its consolidated financial statements, including the following: recognition of net patient service revenue, which includes contractual allowances; recorded value of investments; provisions for bad debts; estimated third party payor settlements; and reserves for losses and expenses related to health care professional and general liability. Management relies on historical experience and other assumptions believed to be reasonable in making its judgment and estimates. Actual results could differ materially from those estimates.

**Cash and Cash Equivalents** — For purposes of the consolidated statements of cash flows, cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less.

**Investments and Investment Earnings** – Investments, inclusive of assets limited or restricted as to use, include marketable debt and equity securities. Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value and are classified as trading securities. Investments also include investments in commingled funds and absolute return strategy funds structured as limited liability corporations or partnerships. Commingled funds that hold securities directly are stated at the fair value of the underlying securities, as determined by the administrator, based on readily determined market values. The absolute return strategy investments are accounted for under the equity method. Redemptions may be made with written notice ranging from one month to one year.

Investment earnings (including equity earnings, realized gains and losses on investments, holding gains and losses on trading securities, interest and dividends) are included in excess of revenue over expenses as non-operating items, unless the income or loss is restricted by donor or law.

**Investment in Trinity Health Corporate Pooled Investment Program** - The Hospital invests certain of its funds in Trinity Health corporate pooled investment program. The corporate pooled investment program primarily invests in the following types of financial instruments: cash and cash equivalents, marketable equity securities (domestic and international), government bonds and notes, corporate bonds and notes (domestic and international), mutual funds, asset-backed securities, investments in commingled funds and other investments structured as limited liability corporations or partnerships. Limited liability corporations and partnerships that do not directly hold securities are accounted for under the equity method. Earnings, including interest and dividends, equity earnings and realized and unrealized gains and losses on investment in the corporate pooled investment program, are allocated to the participants based upon each participant's weighted average percentage of the corporate pooled investment fund in which they are participating.

**Derivative Financial Instruments** - Trinity Health periodically utilizes various financial instruments (e.g., options, and swaps) to hedge interest rate, equity downside risk and other exposures. Trinity Health's policies prohibit trading in derivative financial instruments on a speculative basis.

**Inventories** — The Hospital inventories are stated at the lower of cost or market. The cost of inventories is determined principally by the weighted average cost method.

**Assets Limited or Restricted as to Use** — Assets set aside over which the Board retains control and may at its discretion subsequently use for other purposes, and donor restricted assets are included in assets limited as to use.

**Donor-Restricted Gifts** — Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements 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 consolidated statements of operations and changes in net assets.

**Property and Equipment** — Property and equipment including internally used software, are recorded at cost, if purchased, or at fair value at the date of donation, if donated. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. The useful lives of these assets range from 3 to 40 years. Interest costs incurred during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted support and are excluded from the excess of revenue 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.

**Prepaid Charges for Shared Information Services** — The Hospital invests in information systems that are shared by all ministry organizations of Trinity Health. Prepaid charges represent the prorated portion of the net book value of shared information systems and include hardware, software, and other capital expenses, net of accumulated depreciation on these assets. Shared information systems are recorded at cost and depreciated over the estimated useful life of the assets using the straight-line method. Useful lives range from 4 to 10 years.

**Asset Impairment** — The Hospital evaluates the carrying value of its long-lived assets for impairment when a triggering event occurs as required by FASB Accounting Standards Codification (“ASC”) 360, “*Property, Plant, and Equipment*”. These evaluations are primarily based on the estimated recoverability of the assets’ carrying value. No adjustments were required for the years ended June 30, 2011 and 2010.

**Intercompany Loan Program** — The Hospital has the ability to borrow funds through the Trinity Health intercompany loan program. Loans under this program accrue interest at a variable rate determined quarterly. Interest and principal are paid monthly to Trinity Health under provisions of the loan agreement.

**Temporarily and Permanently Restricted Net Assets** — Temporarily restricted net assets are those whose use by the Hospital 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 Hospital in perpetuity.

**Patient Accounts Receivable, Estimated Payables to Third-Party Payors, and Net Patient Service Revenue** — The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from established rates. Patient accounts receivable and net patient service revenue are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Estimated retroactive adjustments under reimbursement agreements with third-party payors are included in net patient service revenue and estimated receivables from and payables to third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

**Allowance for Doubtful Accounts** — Substantially all of the Hospital’s receivables are related to providing health care services to patients. Accounts receivable are reduced by an allowance for amounts that could become uncollectible in the future. The Hospital’s estimate for its allowance for doubtful accounts is based upon management’s assessment of historical and expected net collections by payor.

**Income Taxes** — The Hospital and Holy Cross Hospital Foundation have been recognized as tax-exempt pursuant to Section 501(a) of the Internal Revenue Code. The Hospital also has a taxable subsidiary, Maryland Care Group, Inc., which is included in the consolidated financial statements. Maryland Care Group, Inc. has entered into a tax sharing agreement and files consolidated federal income tax returns with other corporate taxable subsidiaries. The Hospital and its subsidiaries includes penalties and interest, if any, with its provision for income taxes. The Hospital has no uncertain tax positions.

**Excess of Revenue Over Expenses** – The consolidated statements of operations and changes in net assets include excess of revenue over expenses. Changes in unrestricted net assets which are excluded from excess of revenue over expenses, consistent with industry practice, include the permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets received or gifted (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), and cumulative effect of changes in accounting principles.

**Adopted Accounting Pronouncements** – On July 1, 2010, the Hospital adopted Financial Accounting Standards Board’s (“FASB”) Accounting Standards Codification (“ASC”) guidance on accounting for transfers of financial assets. This guidance clarifies that the objective is to determine whether a transferor and all of the entities included in the transferor’s financial statements being presented have surrendered control over transferred financial assets. That determination must consider the transferor’s continuing involvements in the transferred financial asset, including all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer, even if they were not entered into at the time of the transfer. The adoption of this guidance had no impact on the consolidated financial statements.

On July 1, 2010, the Hospital adopted guidance for not-for-profit entities regarding mergers and acquisitions. This guidance defines a combination of one or more other not-for-profit entities, business or nonprofit activities as either a merger or acquisition. It also establishes principles and requirements in determining whether a not-for-profit entity combination is a merger or acquisition, applies the carryover method in accounting for mergers, applies the acquisition method in accounting for acquisitions, including which of the combining entities is the acquirer, and requires enhanced disclosures about the merger or acquisition. In addition, it amends existing FASB ASC guidance on goodwill and other intangible assets and noncontrolling interests in consolidated financial statements to make previous guidance that was only applicable to for-profit entities fully applicable to not-for-profit entities. The adoption of this guidance did not have a material impact to the consolidated financial statements except the Hospital ceased amortizing goodwill beginning July 1, 2010 and performed a transitional impairment test on all capitalized goodwill. As a result of the impairment test, a \$372,000 charge was recorded as the effect of a cumulative change in accounting principle in the consolidated statement of operations and changes in net assets for the year ended June 30, 2011

**Forthcoming Accounting Pronouncements** In August 2010, the FASB issued new ASC guidance, which requires a company in the healthcare industry to use its direct and indirect costs of providing charity care as the measurement basis for charity care disclosures. This guidance also requires additional disclosures of the method used to identify such costs. This guidance is effective for the Hospital beginning July 1, 2011. The adoption of this guidance will have no impact on the Hospital’s consolidated statement of financial position and results of operations, but will result in additional disclosures to be presented in Note 2.

### 3. INVESTMENTS IN UNCONSOLIDATED AFFILIATES, BUSINESS ACQUISITIONS, AND DIVESTITURES

**Investments in Unconsolidated Affiliates** — The Hospital investments in entities that are recorded under the cost or equity method of accounting. At June 30, 2011 and 2010, they maintained investments in unconsolidated affiliates with ownership interests ranging up to 25%. The Hospital's share of equity earnings from entities accounted for under the equity method was \$298,583 and \$358,000 for the years ended June 30, 2011 and 2010, respectively, which is included in other revenue in the consolidated statements of operations and changes in net assets. The Hospital also recorded \$80,626 and \$113,000 for the years ended June 30, 2011 and 2010, respectively, in dividends from entities accounted for under the cost method, which is included in other revenue in the consolidated statements of operations and changes in net assets.

Unconsolidated affiliates include -two radiation therapy centers, an ambulatory surgery center, and a clinical imaging center. Two of these unconsolidated affiliates maintain their own indebtedness, some of which is partially guaranteed by the Hospital as more fully described in Note 9, Commitments and Contingencies.

Investments in unconsolidated affiliates as of June 30, 2011 and 2010 include the following:

**Chesapeake Potomac Regional Cancer Center (CPRCC)** — Effective July 1, 2007, Maryland Regional Cancer Center (MRCC) divested 100% of the Chesapeake Potomac Regional Cancer Center. The Hospital acquired a 20% ownership in CPRCC. The Hospital accounts for the investment using the equity method of accounting.

**Doctor's Regional Cancer Center (DRCC)** — Effective July 1, 2007, MRCC divested 100% of the Doctor's Regional Cancer Center. The Hospital received a direct distribution from the gain on sale and acquired a 20% ownership in DRCC. The Hospital accounts for the investment using the equity method of accounting.

**Surgery Center of Maryland (SCM)** — Effective March 1, 2008, the Hospital reduced its ownership in Surgery Center of Maryland from 35% to 12.5%, The Hospital now accounts for the reduced ownership with the cost method of accounting.

**Clinical Imaging** — In May 2008, the Hospital acquired a 25% ownership in a Radiology Center in Silver Spring, Maryland for \$125,000. The Hospital accounts for the investment using the equity method of accounting.

The unaudited summarized financial position and results of operations of these entities accounted for under the equity method as of and for the years ended June 30, 2011 and 2010 are as follows (in thousands):

	2011 (in thousands)		
	<u>Clinical Imaging</u>	<u>CPRCC</u>	<u>DRCC</u>
Total assets	\$ 445	\$ 7,955	\$ 7,742
Total liabilities	610	4,014	3,679
Net assets	(165)	3,942	4,063
Revenue — net	349	3,580	6,786
Excess (deficiency) of revenue over expenses	(188)	662	508

  

	2010 (in thousands)		
	<u>Clinical Imaging</u>	<u>CPRCC</u>	<u>DRCC</u>
Total assets	\$ 517	\$ 8,005	\$ 8,483
Total liabilities	834	5,027	4,957
Net assets	(317)	2,978	3,526
Revenue — net	830	7,134	5,745
Excess (deficiency) of revenue over expenses	(264)	618	(403)

#### 4. NET PATIENT SERVICE REVENUE

A summary of the payment arrangements with major third-party payors is as follows:

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

The current rate of reimbursement for services to patients under the Medicare and Medicaid programs is based on an agreement between the Center for Medicare and Medicaid Services (CMS) and the Commission. The agreement provides that the program reimburse the Hospital at set discounts from approved rates for services provided to program beneficiaries. This agreement is based upon a waiver from Medicare reimbursement principles under Section 1814(b) of the Social Security Act and will continue as long as all hospitals elect to be reimbursed under this program and the cumulative rate of increase for costs per hospital inpatient admission in Maryland is below the national cumulative rate. Management believes that this program will remain in effect at least through June 30, 2012.

Under the Commission's reimbursement methodology, a target average charge per case was established for the Hospital based on past actual charges and case mix indices and is adjusted each year for inflation. The actual average charge per case is compared with the target average charge per case, and to the extent that the actual average exceeds or is less than the target, the overcharge or undercharge plus applicable

penalties will reduce (in the case of overcharges) or increase (in the case of undercharges) the approved target for future rate years. At June 30, 2011 and 2010, the Hospital was in compliance with its average charge per case target.

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

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

*Kaiser Permanente* — In accordance with the rate review system established by the Commission, the Hospital and Kaiser Permanente have agreed that those charges subject to the rate review system and covered by Kaiser Permanente are generally paid at 95% of billed charges.

*Medicare and Medicaid* — Hospitals regulated by the Commission have been granted a waiver from the prospective payment system reimbursement provisions of the Medicare and Medicaid programs. The Hospital generally is paid 94% of allowable charges for covered services under these programs. The Hospital is paid for outpatient dialysis, home health, and hospice services at prospectively determined rates. These rates vary according to clinical, diagnostic, and other factors.

During 2011 and 2010, net patient service revenue was received as follows:

	2011	2010
Medicare and state Medicaid programs	51%	44%
Blue Cross	15%	14%
Other	34%	42%

A summary of net patient service revenue for the years ended June 30, 2011 and 2010, is as follows (in thousands):

	2011	2010
Gross charges:		
Acute inpatient	\$ 319,520	\$ 303,886
Outpatient, nonacute inpatient, and other	<u>151,443</u>	<u>143,855</u>
Gross patient revenue	470,963	447,741
Less:		
Contractual and other allowances	(49,890)	(49,576)
Charity care charges	<u>(19,236)</u>	<u>(16,430)</u>
Net patient service revenue	<u>\$ 401,837</u>	<u>\$ 381,735</u>

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

## 5. PROPERTY AND EQUIPMENT

A summary of property and equipment at June 30, 2011 and 2010, is as follows (in thousands):

	2011	2010
Land	\$ 493	\$ 493
Buildings and improvements	183,614	179,236
Equipment	<u>145,517</u>	<u>144,935</u>
Total	329,624	324,664
Less accumulated depreciation and amortization	(208,391)	(198,386)
Construction in progress	<u>8,848</u>	<u>6,423</u>
Property and equipment — net	<u>\$ 130,081</u>	<u>\$ 132,701</u>

Equipment includes assets recorded under capital leases of \$2.8 million with accumulated amortization for such assets of \$1.4 million as of June 30, 2011 and \$1.0 million as of June 30, 2010. The associated charges to income are recorded in depreciation and amortization expense. In June 2011 and 2010, the Hospital completed an inventory of all fixed and movable equipment capitalized in the fixed asset system. The inventory resulted in the removal of \$8.6 million and \$51.0 million for the years ended June 30, 2011 and 2010, respectively, of retired assets with the majority being fully depreciated.

On January 20, 2011 Maryland Health Care Commission granted two certificates of need for the Hospital. These two certificates of need relate to the construction of a 93-bed hospital in Germantown, Maryland and the construction of a Silver Spring Tower to augment the patient care at the existing 455 licensed bed facility in Silver Spring, Maryland. The total budgets for the projects are \$206.9 million and \$207.9 million, respectively. Construction will be contracted with a third party. Funding will be provided from cash, investments from Trinity Health corporate pooled investment program, philanthropy, and bond issue through Trinity Health. The anticipated borrowings related to these projects from Trinity Health for fiscal year 2012 is estimated to be \$30.5 million.

## 6. LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS

A summary of long-term debt and capital lease obligations, including amounts owed to Trinity Health, at June 30, 2011 and 2010, is as follows (in thousands):

	2011	2010
Notes payable to Trinity Health, 3.6% to 4.95% payable in varying monthly installments — due through 2040	\$ 99,393	\$ 101,277
Capital lease obligations, at varying rates of imputed interest, 6.9% to 6.4%	<u>671</u>	<u>1,156</u>
	100,064	102,433
Less current portion of long-term debt	<u>(2,508)</u>	<u>(2,412)</u>
Long-term debt	<u>\$ 97,556</u>	<u>\$ 100,021</u>

Scheduled principal repayments on long-term debt are as follows (in thousands):

### Years Ending June 30:

2012	\$ 2,508
2013	2,233
2014	2,163
2015	2,253
2016	2,346
Thereafter	<u>88,561</u>
Total	<u>\$ 100,064</u>

**Obligated Group and Other Requirements** - Trinity Health has debt outstanding under a Master Trust Indenture dated July 1, 1998, as amended and supplemented thereto, the Amended and Restated Master Indenture (“ARMI”). The ARMI permits Trinity Health to issue obligations to finance certain activities. Obligations issued under the ARMI are general, direct obligations of Trinity Health and any future members of the Trinity Health Obligated Group. Proceeds from the tax-exempt bonds and refunding bonds are to be used to finance the construction, acquisition and equipping of capital improvements. Since the implementation of the ARMI, Trinity Health is the sole member of the Trinity Health Obligated Group. Certain ministry organizations of Trinity Health constitute Designated Affiliates and Trinity Health covenants to cause each Designated Affiliate to pay, loan or otherwise transfer to Trinity Health such amounts necessary to pay the amounts due on all obligations issued under the ARMI. The Hospital is a designated affiliate under the ARMI. Trinity Health, the Designated Affiliates and all other controlled affiliates are referred to as the Credit Group. Trinity Health has granted a security interest in certain pledged property and has caused not less than 85% of the Designated Affiliates representing, when combined with Trinity Health and any future members, not less than 85% of the consolidated net revenue of the Credit Group to grant to Trinity Health security interests in certain pledged property in order to secure all obligations issued under the ARMI. The aggregate amount of obligations outstanding

using the ARMI (other than obligations that have been advance refunded) are \$2,630 million and \$2,546 million at June 30, 2011 and June 30, 2010, respectively.

The interest paid to Trinity Health is based on Trinity's Health borrowings under the Master Trust Indenture. The borrowings by Trinity Health are both at fixed and variable rates. See Note 11 regarding the amount of outstanding debt by Trinity Health that is fixed and variable.

There are several conditions and covenants required by the ARMI with which Trinity Health must comply, including covenants that require Trinity Health to maintain a minimum debt service coverage and limitations on liens or security interests in property, except for certain permitted encumbrances, affecting the property of Trinity Health or any Material Designated Affiliate (a Designated Affiliate whose total revenues for the most recent fiscal year exceed 5% of the total revenues of the Credit Group for the most recent fiscal year). Trinity Health is in compliance with these conditions and covenants as of June 30, 2011. Long-term debt outstanding as of June 30, 2011 and June 30, 2010, excluding amounts issued under the ARMI, is generally collateralized by certain property and equipment.

## **7. PROFESSIONAL AND GENERAL LIABILITY PROGRAMS**

The Hospital is a participant in a self-insured, pooled-risk professional and general liability program established for the ministry organizations of Trinity Health. As a result, the Hospital is self-insured for certain levels of general and professional liability, workers' compensation, and certain other claims.

For 2011 and 2010, Trinity Health's self-insured limit for the first layers of professional liability was \$20 million per occurrence, as well as \$250,000 for each occurrence within a \$1 million insured auto liability program. Additional layers of professional liability insurance are available with coverage provided through other insurance carriers and various reinsurance arrangements. The total amount available for these subsequent layers is \$100 million in aggregate. Trinity Health also insures \$500,000 in property damage liability with commercial insurance providing coverage up to \$1 billion.

The Hospital has contributed an amount to Trinity Health, representing its share of the expected losses under the aforementioned programs, and charged its contributions to expense. The liability for self-insurance reserves represents estimates of the ultimate net cost of all losses and loss adjustment expenses which are incurred but unpaid. The reserves are based on the loss and loss adjustment expense factors inherent in Trinity Health's premium structure. Independent consulting actuaries determined these factors from estimates of Trinity Health's expenses and available industry-wide data. The reserves include estimates of future trends in claim severity and frequency. Although considerable variability is inherent in such estimates, management believes that the liability for unpaid claims and related adjustment expenses is adequate based on the loss experience of Trinity Health. The estimates are continually reviewed and adjusted as necessary. The amount of the changes to the estimated self-insurance reserves were determined based upon the annual, independent actuarial analyses.

Claims in excess of certain insurance coverage and the recorded self-insurance liability have been asserted against the Hospital by various claimants. The claims are in various stages of processing, and some may ultimately be brought to trial. There are known incidents occurring through June 30, 2011, that may result in the assertion of additional claims, and other claims may be asserted arising from services provided in the past. While it is possible that settlement of asserted claims and claims which may be asserted in the future could result in liabilities in excess of amounts for which the Hospital has provided, management, based upon the advice of counsel, believes that the excess liability, if any, should not materially affect the consolidated financial position, operations, or cash flows of the Hospital.

## 8. PENSION AND OTHER BENEFIT PLANS

**Self-Insured Employee Health Benefits** — Trinity Health administers a self-insured employee health benefits plans for its employees. The majority of the Hospital's employees participate in the programs. The provisions of the plans permit employees and their dependents to elect to receive medical care at either the Hospital's member organizations or other health care providers. The Hospital provides for reported claims and claims incurred but not reported from other health care providers.

**Defined Compensation Benefits** — The Hospital sponsors defined contribution pension plans covering substantially all of its employees. The plans include discretionary employer matching contributions of up to 3% of compensation. Employer and employee contributions are self-directed by plan participants in defined contribution plans. The Hospital suspended employer matching contributions during the fiscal year ended June 30, 2010. Contribution expense under the plans totaled approximately \$3.4 million in 2011.

**Deferred Compensation** — The Hospital has a nonqualified deferred compensation plan, which permits eligible employees to defer a portion of their compensation. The plan is funded and is distributable in cash after retirement or termination of employment. The plan allows participants to defer up to a maximum of \$15,000 of salary with investment income accruing based on investment selections of the participant. At June 30, 2011 and 2010, the assets and liabilities under the plan totaled \$47,567 and \$46,183, respectively.

**Noncontributory Defined Benefit Pension Plans ("Pension Plans")** — Substantially all of the Hospital's employees participate in noncontributory defined benefit pension plans of Trinity Health. The plans' assets are invested in equity securities, debt securities, mutual funds, hedge funds, commingled funds directly holding securities, long/short equity, private equity funds and real estate. The plan is accounted for as a multi-employer plan. As a multi-employer plan, the Hospital contributes an amount equal to its proportionate share of the annual expense of Trinity Health. For the years ended June 30, 2011 and 2010, net pension cost was \$9 million and \$10 million, respectively.

In September 2009, Trinity Health amended substantially all of its defined benefit pension plans to modify the benefit formula from a final average pay formula to a cash balance formula effective July 1, 2010, and the plans' liabilities and assets were remeasured as of September 30, 2009. Through June 30, 2010, benefits were based on years of service and employees' highest five years of compensation. Benefits accrued through June 30, 2010 under the final average pay formula were frozen. Beginning July 1, 2010, participants accrue benefits based on the cash balance formula, which credits participants annually with percentage of eligible compensation based on age and years of service, as well as an interest credit based on a benchmark interest rate. A transition adjustment is provided to participants who were vested as of June 30, 2010, whose age and service met certain requirements at that date. The transition adjustment applies to the pension benefit earned through June 30, 2010 and increases compensation under the final average pay formula over a 5-year period.

**Postretirement Health Care and Life Insurance Benefits ("Postretirement Plans")** — The Hospital participates in a contributory plan established to provide uniform, defined postretirement health benefits, and life insurance ("retiree medical plan") to certain retirees of organizations affiliated with Trinity Health. Medical benefits for these retirees are subject to deductibles and co-payment provisions. All of the Postretirement Plans are closed to new participants. The plan's assets are invested in equity securities, fixed income funds, and money market investments. The plan is accounted for as a multi-employer plan. As a multi-employer plan, the Hospital contributes an amount equal to its proportionate share of the annual expense of Trinity Health. In June 2010, Trinity Health approved an amendment to restructure the funded plans as Health Reimbursement Account arrangements for Medicare eligible participants

effective January 1, 2011. For the years ended June 30, 2011 and 2010, retiree medical plan income (expense) was (\$1.2) million and \$1.1 million, respectively.

## 9. COMMITMENTS AND CONTINGENCIES

**Operating Leases** — The Hospital leases various land, equipment, and facilities under operating leases. Total rental expense, which includes provisions for maintenance in some cases, in 2011 and 2010, was \$2.3 million and \$2.2 million, respectively.

The following is a schedule of future minimum lease payments under operating leases as of June 30, 2011, that have initial or remaining lease terms in excess of one year (in thousands):

### Years Ending June 30:

2012	1,373
2013	1,410
2014	1,352
2015	1,175
2016	1,127
Thereafter	<u>1,372</u>
Total	<u>\$ 7,809</u>

**Guarantees** — The Hospital entered into debt guarantees of Surgery Center of Maryland, an unconsolidated affiliate, that are excluded from the consolidated balance sheets. The Hospital has guaranteed 18.75% of the debt of Surgery Center. The maximum guarantee is for \$435,000 and relates to Surgery Center's \$2,120,000 of term loan and \$200,000 of revolving credit. The guaranteed debt was used to finance equipment purchases and working capital. The Hospital has also entered into debt guarantees of Clinical Imaging, another of its unconsolidated affiliates. The Hospital has guaranteed 25.0% of Clinical Imaging's note payable to Sun Trust. The maximum guarantee for Clinical Imaging as of June 30, 2011 is for \$375,000.

**Asset Retirement Obligations** — The Hospital has conditional asset retirement obligations for certain fixed assets mainly related to the removal of asbestos, lead paint, and a lead-lined room. A reconciliation of the discounted asset retirement obligation at June 30, 2011 and 2010, is as follows (in thousands):

	2011	2010
Asset retirement obligation — beginning of year	\$ 683	\$ 648
Accretion of discount	38	35
Change in estimate	<u>(7)</u>	<u>      </u>
Asset retirement obligation — end of year	<u>\$ 714</u>	<u>\$ 683</u>

**Litigation** — The Hospital is involved in litigation and regulatory investigations arising in the course of doing business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on Hospital's consolidated financial position or results of operations.

## 10. RELATED-PARTY TRANSACTIONS

The Hospital is allocated the cost of central-administered services from the corporate office of Trinity Health. The Hospital also shares certain services with affiliates and other ministry organizations of Trinity Health. These services include treasury management, information systems, benefits administration, clinical engineering, accounts payable, patient financial services and professional liability insurance. The composition of the related-party transactions with Trinity Health and other ministry organizations at June 30, 2011 and 2010, was as follows (in thousands):

	2011	2010
Amounts recorded in the consolidated balance sheets:		
Investments in corporate pooled investment funds:		
Investments in Trinity Health corporate pooled investment program	\$ 176,394	\$ 133,327
Assets restricted as to use	<u>1,325</u>	<u>1,323</u>
Investments in corporate pooled investment funds	177,719	134,650
Prepaid expenses and other current assets	764	92
Prepaid charges for shared information systems	17,890	18,899
Property and equipment		118
Accounts and other payables	6,323	1,613
Deferred compensation liability	48	46
Note payable to Trinity Health, including current portion	99,393	101,277
Amounts recorded in the consolidated statements of operations and changes in net assets:		
Operating expenses:		
Other revenue	51	106
Employee benefits	7,883	11,550
Contract labor	3,199	3,443
Purchased Services:		
Information services	17,926	16,499
Management services	4,509	7,017
Revenue management services	1,225	3
Supply chain & accounts payable services	681	
Repairs and maintenance - included in occupancy	2,952	2,087
Amortization	4,556	4,320
Interest expense	3,830	3,955
Insurance — included in other expenses	3,380	3,650
Gain (losses) on investments in corporate pooled investment program and fees	18,010	10,192
Other - Included in nonoperating items	(652)	(717)
Transfers to affiliates	(10,044)	(3,601)

Trinity Health has purchased or constructed fixed assets, mainly computer hardware and software that are utilized by the ministry organizations of Trinity Health. The Hospital pays a prepaid service charge to Trinity Health to share in the use of these assets as allocated by Trinity Health and has recorded the

prepayment as prepaid charges for shared information services. As the assets are used, the Hospital records amortization expense as allocated by Trinity Health.

## 11. FAIR VALUE MEASUREMENTS

The Hospital's consolidated financial statements reflect certain assets and liabilities recorded at fair value. Assets and liabilities measured at fair value on a recurring basis on the Hospital's consolidated balance sheets include cash, cash equivalents, marketable securities, equity securities and mutual funds. Liabilities measured at fair value on a recurring basis for disclosure only include debt.

Fair value is 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. The fair value should be based on assumptions that market participants would use, including a consideration of non-performance risk.

To determine fair value, the Hospital uses various valuation methodologies based on market inputs. For many instruments, pricing inputs are readily observable in the market; the valuation methodology is widely accepted by market participants and involves little to no judgment. For other instruments, pricing inputs are less observable in the marketplace. These inputs can be subjective in nature and involve uncertainties and matters of considerable judgment. The use of different assumptions, judgments and/or estimation methodologies may have a material effect on the estimated fair value amounts.

***Additional Fair Value Disclosures under ASC 820*** - On July 1, 2008 the Hospital adopted ASC 820, "Fair Value Measurements and Disclosures". This standard defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The fair value hierarchy is as follows:

Level 1 – Quoted (unadjusted) prices for identical instruments in active markets.

Level 2 – Other observable inputs, either directly or indirectly, including:

- Quoted prices for similar instruments in active markets;
- Quoted prices for identical or similar instruments in non-active markets (few transactions, limited information, non-current prices, high variability over time, etc.);
- Inputs other than quoted prices that are observable for the instrument (interest rates, yield curves, volatilities, default rates, etc.); and
- Inputs that are derived principally from or corroborated by other observable market data.

Level 3 – Unobservable inputs that cannot be corroborated by observable market data.

### **Valuation Methodologies**

Exchange-traded securities whose fair value is derived using quoted prices in active markets are classified as Level 1. In instances where quoted market prices are not readily available, fair value is estimated using quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices, discounted cash flow models and other pricing models. These models are primarily industry-standard models that consider various assumptions, including time value and yield curve as well as other relevant economic measures. The Hospital classifies these securities as Level 2 within the fair value hierarchy.

In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Hospital's assessment of the significance

of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset.

Following is a description of the valuation methodologies the Hospital used for instruments recorded at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy:

***Cash and Cash Equivalents and Assets Limited as to Use*** — The carrying amounts reported in the consolidated balance sheets approximate their fair value. Certain cash and cash equivalents are included in investments and assets limited or restricted as to use in the consolidated balance sheets.

***Marketable Securities*** — The fair value amounts of marketable securities, included in investments and assets limited or restricted as to use in the consolidated balance sheets, are based on quoted market prices, if available, or are estimated using quoted market prices for similar securities.

***Investment in Corporate Pooled Investment Program*** — Trinity Health invests in various investment vehicles of which the Hospital has included in investment in corporate pooled investment program and assets limited or restricted as to use in the consolidated balance sheets including cash, cash equivalents and marketable securities described above. In addition the following is a description of the other instruments along with the related valuation methodologies Trinity Health uses:

***Commingled Funds*** — Commingled funds are recorded at fair value as the underlying investments consist of securities that have a readily determinable market value.

***Other Investments*** — Trinity Health accounts for certain other investments using the equity method. These investments are structured as limited liability corporations and partnerships and are designed to produce positive investment returns regardless of market activity. These investments utilize diversified multi-strategy approach. Generally, redemption may be made with written notice ranging from one month to one year. Underlying investments in these funds may include other funds, equities, fixed income securities, commodities, currencies and derivatives. Audited information is only available annually based on the limited liability corporations, partnerships or funds' year-end. Trinity Health management's estimates of the fair values of alternative investments are based on information provided by the external investment and fund managers or the general partners. Trinity Health's management obtains and considers the audited financial statements of these investments when evaluating the overall reasonableness of the recorded value. In addition to a review of external information provided, Trinity Health management's internal procedures include such things as review of returns against benchmarks and discussions with fund managers on performance, changes in personnel or process, along with evaluations of current market conditions for these investments. Investment managers meet with Trinity Health's Investment Subcommittee of the Finance and Stewardship Committee of the Board of Directors on a periodic basis. Because of the inherent uncertainty of valuations, values may differ from the values that would have been used had a ready market existed.

The Hospital classifies its marketable securities as trading securities. As a result, all holding gains and losses at June 30, 2011 and 2010 are included in excess of revenue over expenses. Net holding gains (losses) recorded for trading securities in the consolidated statements of operations for the years ended June 30, 2011 and 2010 were approximately \$10.1 million and \$6.1 million, respectively.

The following tables summarize the fair values, by input hierarchy, of financial instruments measured at fair value on a recurring basis at June 30, 2011 and June 30, 2010, respectively, according to the valuation techniques the Hospital used to determine their fair values.

	<b>2011</b>			<b>Total Fair Value</b>
	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	
Cash and cash equivalents	\$ 18,044			\$ 18,044
Marketable securities	1,525			1,525
U.S. Equity securities and mutual funds	<u>33</u>			<u>33</u>
Total	<u>\$ 19,602</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 19,602</u>

	<b>2010</b>			<b>Total Fair Value</b>
	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	
Cash and cash equivalents	\$ 18,747			\$ 18,747
Marketable securities	1,120			1,120
U.S. Equity securities and mutual funds	<u>25</u>			<u>25</u>
Total	<u>\$ 19,892</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 19,892</u>

There were no transfers to or from Levels 1 and 2 during the years ended June 30, 2011 or 2010.

The aggregate cost of the Hospital's cost method investments totaled \$0.2 million at June 30, 2011 and 2010.

The following tables summarize information about the fair value of the Hospital's financial assets in the investment in the Trinity Health corporate pooled investment program at June 30, 2011 and 2010, respectively, according to asset category and the valuation techniques used to determine their fair values. Other investments accounted for under the equity method of accounting represent 25% and 15% of the investment in the Trinity Health corporate pooled investment program at June 30, 2011 and 2010 and are excluded from the table below.

	(in thousands)			Total Fair Value
	2011			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Assets:</b>				
<b>Cash and cash equivalents</b>	19 %	1 %	0 %	20 %
<b>Marketable Securities:</b>				
<b>Equity Securities</b>	12 %	0 %	0 %	12 %
<b>Debt Securities</b>				
U.S. and non-U.S. Government and government agency obligations	0 %	4 %	0 %	4 %
U.S. and non U.S. Corporate Debt Securities	0 %	5 %	0 %	5 %
Asset backed Securities	0 %	2 %	0 %	2 %
<b>Mutual Funds</b>				
Equity Mutual Fund	3 %	0 %	0 %	3 %
<b>Total marketable Securities</b>	<u>15 %</u>	<u>11 %</u>	<u>0 %</u>	<u>26 %</u>
<b>Investment Funds</b>				
Bond Funds	0 %	22 %	0 %	22 %
<b>Commingled Funds</b>	<u>0 %</u>	<u>7 %</u>	<u>0 %</u>	<u>7 %</u>
Total investment in Trinity Health Corporate pooled investment program	<u>34 %</u>	<u>42 %</u>	<u>0 %</u>	<u>75 %</u>
Other Investments			Total %	25 % 100 %

	(in thousands)			
	2010			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
<b>Assets:</b>				
<b>Cash and cash equivalents</b>	24 %	1 %	0 %	25 %
<b>Marketable Securities:</b>				
<b>Equity Securities</b>	16 %	0 %	0 %	16 %
<b>Debt Securities</b>				
U.S. and non-U.S. Government and government agency obligations	0 %	7 %	0 %	7 %
U.S. and non U.S. Corporate Debt Securities	0 %	6 %	0 %	6 %
Asset backed Securities	0 %	4 %	0 %	4 %
<b>Mutual Funds</b>				
Equity Mutual Fund	3 %	0 %	0 %	3 %
Fixed Income Mutual Fund	8 %	0 %	0 %	8 %
<b>Total marketable Securities</b>	<u>28%</u>	<u>17%</u>	<u>0%</u>	<u>45 %</u>
<b>Investment Funds</b>				
Bond Funds	0 %	11%	0%	11 %
<b>Commingled Funds</b>	<u>0 %</u>	<u>5%</u>	<u>0%</u>	<u>5 %</u>
Total investment in Trinity Health Corporate pooled investment program	<u>52%</u>	<u>34%</u>	<u>0%</u>	<u>86%</u>
Other Investments			Total %	14%
				100%

There were no significant transfers to or from Levels 1 and 2 during the years ended June 30, 2011 or 2010.

The composition of investment returns, including earnings on investments in the Trinity Health corporate pooled investment program, included in the consolidated statements of operations and changes in net assets for the year ending June 30, 2011 are as follows:

	2011	2010
	(in thousands)	
Dividend, interest income, and other	\$ 2,434	\$ 2,574
Net realized gains	5,459	1,533
Change in net unrealized gains on investments	<u>10,131</u>	<u>6,088</u>
<b>Total investment return</b>	<u>\$ 18,024</u>	<u>\$ 10,195</u>
Included in:		
Nonoperating items	\$ 18,016	\$ 10,192
Permanently restricted net assets	<u>8</u>	<u>3</u>
<b>Total investment return</b>	<u>\$ 18,024</u>	<u>\$ 10,195</u>

Unconditional promises to give at June 30, 2011 and 2010, consist of the following (in thousands):

	2011	2010
Amount expected to be collected in:		
Less than one year	\$ 62	\$ 64
One to five years	<u>21</u>	<u>24</u>
Total contributions receivable	83	88
Discount to present value of future cash flows	(1)	(2)
Allowance for uncollectible amounts	<u>(43)</u>	<u>(43)</u>
Total unconditional promises to give — net	<u>\$ 39</u>	<u>\$ 43</u>

***Patient Accounts Receivable, and Current Liabilities*** — The carrying amounts reported in the consolidated balance sheets approximate their fair value.

***Long-term Debt*** - The fair value of the Hospital's intercompany debt under the Trinity Health intercompany loan program is based on its proportionate share of Trinity Health's fair value for its fixed and variable rate bonds issued under its master indenture. The carrying amounts of the Trinity Health's variable-rate long-term debt approximate its fair values. The fair value of the Trinity Health's fixed-rate long-term debt is estimated using discounted cash flow analyses, based on current incremental borrowing rates for similar types of borrowing arrangements. The fair value of the fixed-rate long-term debt was \$1,576.0 million and \$1,474.0 million for 2011 and 2010, respectively. The related carrying value of the fixed-rate long-term debt was \$1,509.0 million and \$1,402.0 million for 2011 and 2010, respectively.

## 12. SUBSEQUENT EVENTS

Management has evaluated subsequent events through September 29, 2011 the date the financial statements were available to be issued.

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## **SUPPLEMENTAL INFORMATION**

**HOLY CROSS HOSPITAL**  
**(A Member of Trinity Health)**  
**CONSOLIDATING SCHEDULE — BALANCE SHEET INFORMATION**  
**AS OF JUNE 30, 2011**  
**(In thousands)**

	Holy Cross Hospital	Holy Cross Foundation	Maryland Care Group	Total
<b>ASSETS</b>				
<b>CURRENT ASSETS:</b>				
Cash and cash equivalents	\$ 10,939	\$ 1,066	\$ 6,039	\$ 18,044
Investments in Trinity Health corporate pooled investment program	176,272	122		176,394
Inventories	6,346			6,346
Prepaid expenses and other current assets	10,464	10	(4,944)	5,530
	<u>204,021</u>	<u>1,198</u>	<u>1,095</u>	<u>206,314</u>
Receivables:				
Patient accounts receivable	66,607		310	66,917
Allowance for charity	(3,183)			(3,183)
Allowance for doubtful accounts	(11,540)		(39)	(11,579)
	<u>51,884</u>		<u>271</u>	<u>52,155</u>
Patient accounts receivable — net				
	<u>255,905</u>	<u>1,198</u>	<u>1,366</u>	<u>258,469</u>
<b>ASSETS LIMITED OR RESTRICTED AS TO USE BY:</b>				
Deferred compensation	48			48
Donors	174	2,674		2,848
	<u>222</u>	<u>2,674</u>		<u>2,896</u>
<b>OTHER ASSETS:</b>				
Property and equipment — net	130,073		8	130,081
Investments in unconsolidated affiliates	1,687		150	1,837
Prepaid charges for shared information services	17,890			17,890
Other assets	85			85
	<u>149,735</u>		<u>158</u>	<u>149,893</u>
<b>TOTAL</b>	<u>\$ 405,862</u>	<u>\$ 3,872</u>	<u>\$ 1,524</u>	<u>\$ 411,258</u>
<b>LIABILITIES AND NET ASSETS</b>				
<b>CURRENT LIABILITIES:</b>				
Current portion of long-term debt	\$ 517	\$	\$	517
Current portion of notes payable to Trinity Health	1,991			1,991
Accounts payable and accrued expenses	20,804		83	20,887
Salary, wages, and related liabilities	23,433		18	23,451
Estimated payables to third-party payors	16,893			16,893
	<u>63,638</u>		<u>101</u>	<u>63,739</u>
<b>NONCURRENT LIABILITIES:</b>				
Long-term debt — net of current portions	154			154
Notes Payable to Trinity Health, net of current portion	97,402			97,402
Other long-term liabilities	792			792
	<u>98,348</u>			<u>98,348</u>
Total noncurrent liabilities				
	<u>161,986</u>		<u>101</u>	<u>162,087</u>
<b>NET ASSETS:</b>				
Unrestricted	243,702	1,198	1,423	246,323
Temporarily restricted	141	2,674		2,815
Permanently restricted	33			33
	<u>243,876</u>	<u>3,872</u>	<u>1,423</u>	<u>249,171</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 405,862</u>	<u>\$ 3,872</u>	<u>\$ 1,524</u>	<u>\$ 411,258</u>

**HOLY CROSS HOSPITAL**  
**(A Member of Trinity Health)**

**CONSOLIDATING SCHEDULE — OPERATING RESULTS AND CHANGES IN  
NET ASSETS INFORMATION  
FOR THE YEAR ENDED JUNE 30, 2011  
(In thousands)**

	Holy Cross Hospital	Holy Cross Foundation	Maryland Care Group	Total
<b>UNRESTRICTED REVENUE:</b>				
Net patient service revenue	\$ 400,576	\$	\$1,261	\$ 401,837
Net assets released from restrictions	847	419		1,266
Other revenue	<u>13,061</u>	<u>345</u>	<u>(188)</u>	<u>13,218</u>
Total unrestricted revenue	<u>414,484</u>	<u>764</u>	<u>1,073</u>	<u>416,321</u>
<b>EXPENSES:</b>				
Labor:				
Salaries and wages	161,241		922	162,163
Employee benefits	35,858		131	35,989
Contract labor	<u>5,436</u>		<u>(152)</u>	<u>5,284</u>
Total labor expense	202,535		901	203,436
Supplies	65,564	138	3	65,705
Purchased services	53,058	281	45	53,384
Depreciation and amortization	23,014		5	23,019
Provisions for bad debt	20,041			20,041
Occupancy	14,285		2	14,287
Interest	3,570			3,570
Other	<u>6,542</u>	<u>1</u>	<u>2</u>	<u>6,545</u>
Total expenses	<u>388,609</u>	<u>420</u>	<u>958</u>	<u>389,987</u>
OPERATING INCOME	<u>25,875</u>	<u>344</u>	<u>115</u>	<u>26,334</u>
<b>NONOPERATING ITEMS:</b>				
Net gains on investments in corporate pooled investment program:				
Investments held at fair value	13,091	163		13,254
Equity method investments	4,756			4,756
Other	<u>(652)</u>			<u>(652)</u>
Total nonoperating items	<u>17,195</u>	<u>163</u>		<u>17,358</u>
EXCESS OF REVENUE OVER EXPENSES	<u>\$ 43,070</u>	<u>\$ 507</u>	<u>\$ 115</u>	<u>\$ 43,692</u>

(Continued)

**HOLY CROSS HOSPITAL**  
**(A Member of Trinity Health)**

**CONSOLIDATING SCHEDULE — OPERATING RESULTS AND CHANGES IN  
NET ASSETS INFORMATION  
FOR THE YEAR ENDED JUNE 30, 2011  
(In thousands)**

	Holy Cross Hospital	Holy Cross Foundation	Maryland Care Group	Total
UNRESTRICTED NET ASSETS:				
Excess of revenue over expenses	\$ 43,070	\$ 507	\$ 115	\$ 43,692
Cumulative effect of change in accounting principal	(372)			(372)
Unrestricted contributions of Long Lived Assets	20			20
Transfers to affiliates	<u>(10,044)</u>			<u>(10,044)</u>
Increase in unrestricted net assets	<u>32,674</u>	<u>507</u>	<u>115</u>	<u>33,296</u>
TEMPORARILY RESTRICTED NET ASSETS:				
Contributions	364	1,305		1,669
Net assets released from restrictions	<u>(366)</u>	<u>(900)</u>		<u>(1,266)</u>
(Decrease) increase in temporarily restricted net assets	<u>(2)</u>	<u>405</u>		<u>403</u>
PERMANENTLY RESTRICTED NET ASSETS				
Investment income	8			8
Other	<u>(1)</u>			<u>(1)</u>
Increase in permanently restricted net assets	<u>7</u>			<u>7</u>
INCREASE IN NET ASSETS	32,679	912	115	33,706
NET ASSETS — Beginning of year	<u>211,197</u>	<u>2,960</u>	<u>1,308</u>	<u>215,465</u>
NET ASSETS — End of year	<u>\$ 243,876</u>	<u>\$ 3,872</u>	<u>\$ 1,423</u>	<u>\$ 249,171</u>

(Concluded)