COHEN
RUTHERFORD
+ KNIGHT PC
Certified Public Accountants

Audited Consolidated Financial Statements and Other Financial Information

Doctors Community Hospital and Subsidiaries

June 30, 2013 and 2012

– Contents –

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Report of Independent Auditors

Board of Directors
Doctors Community Hospital and Subsidiaries
Lanham, Maryland

We have audited the accompanying consolidated financial statements of Doctors Community Hospital and Subsidiaries, (the Hospital) which comprise the consolidated balance sheets as of June 30, 2013 and 2012, 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 and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Doctors Community Hospital and Subsidiaries as of June 30, 2013 and 2012, and the results of its operations and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting

As further described in *Note A*, during fiscal year 2013 the Hospital adopted new accounting standards changing the presentation of the provision for bad debts in the statement of operations.

Cohen, Rutherford + Knight, P.C.

October 15, 2013
Bethesda, Maryland

Consolidated Balance Sheets

Doctors Community Hospital and Subsidiaries

ASSETS	June 30 2013	2012
CURRENT ASSETS		
Cash and cash equivalents	$ 25,123,464	$ 24,920,739
Assets limited to use for debt service - *Note B*	6,925,305	6,559,838
Patient accounts receivable, less uncollectible accounts of $7,272,543 and $6,716,030	25,529,632	28,997,879
Other amounts receivable	4,239,635	3,771,391
Inventories	3,612,320	3,698,273
Prepaid expenses	2,094,249	1,956,423
TOTAL CURRENT ASSETS	67,524,605	69,904,543
INVESTMENTS		
Marketable securities -- *Note B*	13,513,806	13,545,271
Joint ventures and equity investments -- *Note C*	4,277,759	2,888,078
	17,791,565	16,433,349
ASSETS WHOSE USE IS LIMITED -- *Note B*		
Investments held by trustee or authority, less current portion	22,658,419	24,873,121
LAND, BUILDINGS, AND EQUIPMENT -- *Note E*	121,823,767	124,502,258
DEFERRED FINANCING COSTS	2,160,314	2,317,213
GOODWILL -- *Note L*	2,494,734	2,494,734
OTHER ASSETS	21,825,131	20,928,282
TOTAL ASSETS	$ 256,278,535	$ 261,453,500

See the accompanying notes to the consolidated financial statements.

Consolidated Balance Sheets – Continued
Doctors Community Hospital and Subsidiaries

	June 30	
LIABILITIES	**2013**	**2012**
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 16,114,344	$ 15,803,954
Salaries, wages, and related items	11,182,729	10,252,151
Advances from third party payers	6,690,340	7,948,715
Interest payable to bondholders	4,102,931	4,152,632
Current portion of long-term obligations - *Note F*	4,396,299	3,796,609
TOTAL CURRENT LIABILITIES	42,486,643	41,954,061
NONCURRENT LIABILITIES		
Other noncurrent liabilities - *Notes G and I*	12,493,813	12,023,968
Pension obligation - *Note I*	5,969,173	7,575,656
Long-term obligations, net of current portion - *Note F*	148,638,270	152,694,081
TOTAL LIABILITIES	209,587,899	214,247,766
NET ASSETS		
Unrestricted	43,000,823	43,919,050
Noncontrolling interest	2,127,165	2,233,125
TOTAL UNRESTRICTED NET ASSETS	45,127,988	46,152,175
Temporarily restricted - *Note M*	1,562,648	1,053,559
TOTAL NET ASSETS	46,690,636	47,205,734
COMMITMENTS AND CONTINGENCIES - *NOTES F, G, H, I and K*		
TOTAL LIABILITIES AND NET ASSETS	$ 256,278,535	$ 261,453,500

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Operations and Other Changes in Unrestricted Net Assets

Doctors Community Hospital and Subsidiaries

	June 30 2013	June 30 2012
REVENUE		
Patient service revenue, net of contractual allowances and discounts -- *Note A*	$ 191,725,858	$ 195,269,157
Provision for bad debts	(4,317,821)	(4,298,915)
Net patient service revenue less provision for bad debts	187,408,037	190,970,242
Other operating revenue -- *Note B*	7,951,345	3,953,752
Pledges and contributions	408,247	634,838
Net assets released from restrictions used for operations	106,673	344
TOTAL OPERATING REVENUE	195,874,302	195,559,176
EXPENSES		
Salaries and wages	86,757,025	82,724,426
Employee benefits -- *Note I*	15,171,707	13,850,498
Purchased services -- *Note D*	30,476,771	31,342,267
Supplies	34,705,354	33,812,317
Other expenses -- *Notes G and H*	13,127,190	14,454,809
Depreciation -- *Note E*	9,866,727	9,909,553
Amortization	156,899	160,965
Fundraising	189,133	247,437
Interest -- *Note F*	8,140,974	8,300,741
TOTAL EXPENSES	198,591,780	194,803,013
INCOME (LOSS) FROM OPERATIONS	(2,717,478)	756,163
NONOPERATING GAINS (LOSSES)		
Gain on sale of property	117,684	100,161
Unrealized gain (loss) on trading securities -- *Note B*	(117,655)	46,615
Gain (loss) in joint ventures -- *Note C*	1,302,371	(597,184)
EXCESS OF REVENUE OVER EXPENSES (EXPENSES OVER REVENUE)	(1,415,078)	305,755
Subsidiary distributions to noncontrolling interest-holders	(1,225,600)	(1,025,288)
Pension - related changes other than net periodic pension cost - *Note I*	1,615,830	(3,993,787)
DECREASE IN UNRESTRICTED NET ASSETS	$ (1,024,848)	$ (4,713,320)

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Changes in Net Assets

Doctors Community Hospital and Subsidiaries

	Year Ended June 30, 2013			Year Ended June 30, 2012		
	Total	Controlling Interests	Noncontrolling Interests	Total	Controlling Interests	Noncontrolling Interests
UNRESTRICTED NET ASSETS						
Excess of revenue over expenses (expenses over revenue)	$ (1,415,078)	$ (2,534,718)	$ 1,119,640	$ 305,755	$ (1,400,932)	$ 1,706,687
Dividends paid to noncontrolling interest-holders	(1,225,600)	0	(1,225,600)	(1,025,288)	0	(1,025,288)
Pension - related changes other than net periodic pension cost -- *Note I*	1,615,830	1,615,830	0	(3,993,787)	(3,993,787)	0
DECREASE IN UNRESTRICTED NET ASSETS AND NONCONTROLLING INTERESTS	(1,024,848)	(918,888)	(105,960)	(4,713,320)	(5,394,719)	681,399
TEMPORARILY RESTRICTED NET ASSETS						
Restricted contributions	616,423	616,423	0	1,001,596	1,001,596	0
Net assets released from restrictions for operations	(106,673)	(106,673)	0	(344)	(344)	0
Write off of pledge receivable	0	0	0	(130,000)	(130,000)	0
INCREASE IN TEMPORARILY RESTRICTED NET ASSETS	509,750	509,750	0	871,252	871,252	0
DECREASE IN NET ASSETS	(515,098)	(409,138)	(105,960)	(3,842,068)	(4,523,467)	681,399
NET ASSETS, BEGINNING OF YEAR	47,205,734	44,972,609	2,233,125	51,047,802	49,496,076	1,551,726
NET ASSETS, END OF YEAR	$ 46,690,636	$ 44,563,471	$ 2,127,165	$ 47,205,734	$ 44,972,609	$ 2,233,125

See the accompanying notes to the consolidated financial statements.

Consolidated Statements of Cash Flows
Doctors Community Hospital and Subsidiaries

	Year Ended June 30	
OPERATING ACTIVITIES AND OTHER GAINS	**2013**	**2012**
Decrease in net assets	$ (515,098)	$ (3,842,068)
Adjustments to reconcile decrease in net assets to net cash and cash equivalents provided by operating activities:		
Restricted contributions received	(616,423)	(1,001,596)
Depreciation	9,866,727	9,909,551
Provision for bad debts	4,317,821	4,298,915
Unrealized loss (gain) on investments	117,655	(46,615)
Gain on sale of property	(117,684)	(100,161)
Realized loss (gain) on sale of investments	(2,695)	(48,416)
Amortization on bond issue	(144,975)	(153,799)
Increase (decrease) in:		
Accounts payable and accrued expenses, exclusive of accrual for equipment costs	310,387	3,923,423
Accrued salaries, wages, and related items	930,575	(683,923)
Advances from third party payers	(1,258,376)	328,167
Pension obligation	(1,606,483)	2,562,160
Interest payable	(49,701)	(48,250)
Other liabilities	469,846	6,488,549
Decrease (increase) in:		
Net patient accounts receivable	(849,571)	(10,009,143)
Other receivables	(468,247)	(1,161,292)
Inventories	85,954	(199,883)
Deferred financing costs	156,899	160,334
Prepaid expenses and other assets	(1,034,673)	(5,525,617)
NET CASH AND CASH EQUIVALENTS PROVIDED BY OPERATING ACTIVITIES AND OTHER GAINS	9,591,938	4,850,336
INVESTING ACTIVITIES		
Net sales of trading investments, including assets whose use is limited	1,765,739	3,174,048
Increase in goodwill	0	(18,943)
Increase in joint ventures and equity investments	(1,389,681)	(528,314)
Proceeds from sale on property	238,740	0
Purchase of property, plant and equipment	(6,811,033)	(7,346,485)
NET CASH AND CASH EQUIVALENTS USED IN INVESTING ACTIVITIES	(6,196,235)	(4,719,694)

(Continued)

Consolidated Statements of Cash Flows - Continued

Doctors Community Hospital and Subsidiaries

	Year Ended June 30	
FINANCING ACTIVITIES	**2013**	**2012**
Principal payments on debt	$ (3,809,406)	$ (3,560,511)
Restricted contributions received	616,423	1,001,596
NET CASH AND CASH EQUIVALENTS USED IN FINANCING ACTIVITIES	(3,192,982)	(2,558,915)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVILENTS	202,725	(2,428,273)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	24,920,739	27,349,011
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 25,123,464	$ 24,920,739
SUPPLEMENTAL DISCLOSURE OF NON CASH INFORMATION		
Acquisition of equipment under capital lease	$ 498,260	$ 0

See the accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements
Doctors Community Hospital and Subsidiaries

Note A – Organization and Summary of Significant Accounting Principles

Organization

Doctors Community Hospital (the Hospital) is a not-for-profit, non-stock corporation that operates an acute care general hospital facility licensed for 195 beds. The Hospital serves the health care needs of the residents of Prince George's County, the District of Columbia, and the greater Washington, D.C. metropolitan area. The Hospital has three wholly owned/controlled subsidiaries: Doctors Community Health Ventures, Inc. (Health Ventures), Doctors Community Hospital Foundation, Inc. (the Foundation), and Spine Team Maryland, LLC (STM).

Health Ventures is a for-profit corporation that invests in corporations and other businesses consistent with the Hospital's mission and strategic plan.

The Foundation is a not-for-profit, non-stock corporation established to raise and invest funds to support or benefit the operations of the Hospital. The Foundation's bylaws provide that all funds raised, except those required for the operation of the Foundation, be distributed to or be held for the benefit of the Hospital. The Foundation's bylaws also provide the Hospital with the authority to direct its activities, management, and policies.

STM is a limited liability company formed in Maryland for the purpose of providing medical and surgical services for the residents of Prince Georges County and surrounding areas.

The Hospital owns a 60% interest in Doctors Regional Cancer Center, LLC (DRCC) and Doctors Community Hospital Sleep Center, LLC (the Sleep Center). DRCC is a limited liability company formed in Maryland for the purpose of providing outpatient cancer treatment services to the residents of central Maryland. The Sleep Center is a limited liability company formed in Maryland for the purpose of providing diagnostic sleep services for residents of Prince Georges County and surrounding areas.

Principles of Consolidation

The consolidated financial statements include the accounts of the Hospital, Health Ventures, the Foundation, DRCC, the Sleep Center, and STM (collectively, the Company). All intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

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

Cash and Cash Equivalents

The Company has cash holdings in commercial banks routinely exceeding the Federal Deposit Insurance Corporation maximum insurance limit of $250,000. Cash and cash equivalents are reported at cost which approximates market value.

Investments

Marketable securities, including assets whose use is limited, are carried at fair value. All such investments are classified as trading. Assets whose use is limited that are required to meet current liabilities of the Hospital have been classified as current assets.

Unrestricted investment income, including realized gains and losses on the sale of trading securities, is reported as other operating revenue. The cost of securities sold is based on the specific-identification method. Unrealized gains and losses on trading securities are included in non-operating gains (losses) in the accompanying consolidated statements of operations and other changes in unrestricted net assets.

Patient Revenue and Accounts Receivable

Net patient service revenue and net patient accounts receivable are reported at estimated net realizable amounts from patients, third party payers, and others for services rendered. Discounts ranging from 2.25% to 8% of Hospital charges are given to Medicare, Medicaid, and certain approved commercial health insurance providers and health maintenance organizations. In addition, these payers routinely review patient billings and deny payments for certain charges that they deem medically unnecessary or performed without appropriate pre-authorization. Discounts and denials are recorded as reductions of net patient service revenue. Accounts receivable from these third-party payers have been adjusted to reflect the difference between charges and the estimated reimbursable amounts.

Gross patient revenue was comprised of the following for the years ended June 30:

	2013	2012
Medicare	43%	43%
Medicaid	15%	13%
Blue Cross Blue Shield	18%	20%
Other third-party payers	19%	20%
Self-pay patients	5%	5%
	100%	100%

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

Patient Revenue and Accounts Receivable – Continued

The Company bills third party payers directly for services provided. Insurance coverage and credit information are obtained from patients upon admission when available. No collateral is obtained for patient accounts receivable. Patient accounts receivable deemed to be uncollectible by management have been written off. An allowance for doubtful accounts is recorded based on historical trends for patient accounts receivable that are anticipated to become uncollectible in future periods.

Gross patient accounts receivable were comprised of the following for the years ended June 30:

	2013	2012
Medicare	32%	32%
Medicaid	16%	23%
Blue Cross Blue Shield	9%	7%
Other third-party payers	18%	17%
Self-pay patients	25%	21%
	100%	100%

Patient service revenue, net of contractual allowances and discounts and after the provision for bad debts, is described in the following table for the year ended June 30, 2013. Amounts classified as self pay do not include coinsurance and deductibles related to third party payer amounts.

	2013
Gross Patient Revenue:	
Third-Party Payers	$ 238,344,007
Self Pay	11,410,812
Total Gross Patient Revenue	249,754,819
Deductions:	
Discounts and allowances	(42,139,465)
Charity care	(15,889,496)
Net Patient Service Revenue	191,725,858
Less: Provisions for Bad Debts	(4,317,821)
Net Patient Service Revenue	$ 187,408,037

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on the consolidated financial statements. 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.

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

Inventories

Inventories consist of supplies and drugs and are carried at the lower of cost or market using the average-cost method.

Land, Buildings, and Equipment

Land, buildings, and equipment are recorded at cost. Depreciation is recorded over the estimated useful lives of the assets using the straight-line method. Maintenance and repairs are charged to expense as incurred. The straight-line method is used to amortize the cost of equipment under capital leases over the estimated useful lives of the equipment or the term of the lease, whichever is appropriate.

Restricted Net Assets

Temporarily restricted net assets are those whose use by the Hospital and the Foundation has been limited by donors to a specific time period or purpose. As of June 30, 2013 and 2012, the Company had no permanently restricted net assets. Temporarily restricted net assets are available to fund various health care services and other community benefits provided by the Hospital. The Company's policy is to treat restricted contributions recorded and released in the same fiscal year as unrestricted contributions.

Excess of Revenue over Expenses

The consolidated statements of operations and other changes in unrestricted net assets include the excess of revenue over expenses/expenses over revenue (the "performance indicator"). Changes in unrestricted net assets, which are excluded from the excess of revenue over expenses/expenses over revenue, consistent with industry practice, include contributions received and used for additions of long-lived assets, distributions to non-controlling interest-holders, and changes in the pension obligation other than net periodic pension cost.

Charity Care

A patient is classified as a charity patient by reference to certain established policies of the Hospital. These policies define charity services as those services for which no payment is anticipated. In assessing a patient's ability to pay, the Hospital utilizes the generally recognized poverty income levels in the local community, but also includes certain cases where incurred charges are significant when compared to income.

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

Charity Care – continued

Under current accounting standards, the Company is required to report the cost of providing charity care. The cost of charity care provided by the Hospital and DRCC totaled $15,889,496 and $12,806,833 for the years ended June 30, 2013 and 2012, respectively. Rates charged by the Hospital for regulated services are determined based on assessment of direct and indirect cost calculated pursuant to the methodology established by the Maryland Health Services Cost Review Commission ("HSCRC" – see *Note J*), and therefore the cost of charity services noted above for the Hospital are equivalent to its established rates for those services. For any charity services rendered by the Company other than from the Hospital, the cost of charity care is calculated by applying the estimated total cost-to-charge ratio for the non-Hospital services to the total amount of charges for services provided to patients benefitting from the charity care policies of the Company's non-Hospital affiliates. These charges are excluded from consolidated net patient service revenue.

The Hospital receives a payment from the HSCRC with respect to an Uncompensated Care Fund ("UCC") established for rate-regulated hospitals in Maryland. The UCC is intended to provide Maryland hospitals with funds to support the provision of uncompensated care at those hospitals. The Hospital received $923,876 for 2013 and $3,116,258 for 2012 in UCC payments.

Contributions and Pledges

Unconditional promises to give cash and other assets to the Hospital and the Foundation 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 or when the conditions for receiving the donation have been satisfied. 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. Contributions restricted by donors for additions to the Hospital's operating property are transferred from temporarily restricted net assets to unrestricted net assets when the expenditure is made. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of changes in net assets as net assets released from restriction.

The Hospital and Foundation write off any grants and pledges receivable that are considered uncollectible; accordingly, there is no allowance for doubtful accounts recorded for these grants and pledges. Grants and pledges receivable have not been discounted because management considers the effect to be immaterial. The balance of pledges receivable was $333,062 and $141,605 at June 30, 2013 and 2012, respectively, and is included in other amounts receivable in the accompanying consolidated balance sheets.

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

Other Operating Revenue

The Hospital met compliance requirements to receive incentive payments for upgrading and implementing certified electronic health record systems and becoming a meaningful user under the provisions of the American Recovery and Reinvestment Act of 2009. The Hospital recognized $5,165,622 of meaningful use incentives during fiscal year 2013 and reported this amount as other operating revenue in the accompanying consolidated statements of operations and other changes in unrestricted net assets. The portion of the meaningful use incentive earned during fiscal year 2013 that was not yet received is $1,785,555 and is recorded as other amounts receivable in the accompanying consolidated balance sheets.

Advertising Costs

The Hospital expenses advertising costs as they are incurred. Advertising expense was $533,778 and $1,510,646 for the fiscal years June 30, 2013 and 2012, respectively, and is reported as other expense in the accompanying consolidated statements of operations and other changes in unrestricted net assets.

Functional Expenses

The Company's consolidated operating expenses by functional classification are as follows:

	Year Ended June 30	
	2013	**2012**
Health care services	$ 142,518,752	$ 139,914,716
Management and general	55,423,959	54,411,279
Fundraising	649,069	477,018
	$ 198,591,780	$ 194,803,013

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

Deferred Financing Costs

Financing costs incurred in issuing the Maryland Health and Higher Educational Facilities Authority (the Authority or MHHEFA) Revenue Bonds have been capitalized by the Hospital. These costs are being amortized over the life of the related bond issue using the bonds-outstanding method, which approximates the interest method. Deferred financing costs and accumulated amortization, which are included in other noncurrent assets in the accompanying consolidated balance sheets, are as follows:

	2013	2012
Deferred financing costs	$ 3,008,043	$ 3,008,043
Accumulated amortization	(847,729)	(690,830)
	$ 2,160,314	$ 2,317,213

The estimated aggregate amortization expense anticipated for the next five years is as follows:

2014	$ 153,096
2015	149,133
2016	144,974
2017	140,603
2018	136,014

Fair Value of Financial Instruments

The following methods and assumptions were used by the Company to estimate the fair value of financial instruments:

- **Cash and cash equivalents, patient accounts receivable, other amounts receivable, notes receivable, accounts payable and accrued expenses, employee compensation and related payroll taxes, and advances from third-party payers***:* The carrying amount reported in the balance sheets for each of these assets and liabilities approximates their fair value.

- **Marketable securities and assets limited as to use***:* Fair values are based on quoted market prices of individual securities or investments if available, or are estimated using quoted market prices for similar securities (see *Note B*).

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

Fair Value of Financial Instruments - continued

- **Long-term debt***:* Fair values of the Hospital's fixed-rate debt are based on current traded values. The fair value of variable rate debt approximates carrying value (see *Note F*).

Income Taxes

The Hospital and the Foundation are exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code as public charities. Both entities are entitled to rely on this determination as long as there are no substantial changes in their character, purposes, or methods of operation. Management has concluded that there have been no such changes, and therefore the Hospital and Foundation's status as public charities exempt from federal income taxation remain in effect.

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

The Hospital and the Foundation 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. Although informational returns were filed for the Hospital and the Foundation, no tax returns were filed during 2013 and 2012.

Health Ventures is subject to corporate income tax, and incurred an income tax liability of $0 for each year ended June 30, 2013 and 2012.

DRCC and Sleep Center are Maryland limited liability companies that have not elected to be taxed as a corporation under current Treasury regulations. DRCC and Sleep Center are owned by more than one member. As such, DRCC and Sleep Center are subject to the partnership tax rules under Subchapter K of the Internal Revenue Code of 1986 (IRC), as amended. Under these rules DRCC and Sleep Center are not subject to federal or state income tax, but must file annual information returns indicating their gross and taxable income to determine the tax results to their members.

STM is a Maryland limited liability company that has not elected to be taxed as a corporation under current treasury regulations. STM is wholly owned by the Hospital. As such, STM is a "disregarded entity" under current IRC regulations.

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

Income Taxes – continued

The effect of the tax status of the Company's taxable subsidiaries is not material to the consolidated financial statements. There were no income taxes paid on unrelated business activities in the years ended June 30, 2013 or 2012. The Company's taxable subsidiaries have net operating losses that expire at various dates through 2032. The deferred tax assets of the Company's taxable subsidiaries are fully reserved as they are not expected to be utilized.

Goodwill

Goodwill represents the excess of cost over the fair value of assets acquired. Management evaluates goodwill for impairment on an annual basis. Management reviewed the carrying value reported for goodwill in the accompanying consolidated balance sheets for impairment and believes there is none as of June 30, 2013 (see *Note L*).

Recent Changes in Accounting Standards

During July 2011, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. ASU 2011-07 affects entities within the scope of Topic 954, Health Care Entities that recognize significant amounts of patient service revenue at the time services are rendered even though the entities do not assess a patient's ability to pay. ASU 2011-07 required certain health care entities to change the presentation of their statements of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). Management has adopted this change in accounting for fiscal year 2013 and retrospectively for 2012.

Reclassification

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

Subsequent Events

Subsequent events have been evaluated by management through October 15, 2013, which is the date the consolidated financial statements were available to be issued.

Note B – Investments

The following is a summary of investment securities:

	As of June 30 2013	As of June 30 2012
Marketable securities		
Cash and cash equivalents		
Cash	$ 679	$ 4,007
Money market funds	10,394,775	6,352,485
Fixed maturity		
U.S. Government Agency Bonds/Notes	0	3,999,880
Equity		
Mutual funds	3,118,352	3,188,899
	$ 13,513,806	$ 13,545,271
Assets whose use is limited:		
Cash and cash equivalents		
Money market funds	$ 8,941,538	$ 13,920,292
Fixed maturity		
U.S. Government Agency Bonds/Notes	20,642,186	17,512,667
	$ 29,583,724	$ 31,432,959

Assets whose use is limited are held in the following funds:

	2013	2012
Funds held by Trustee or Authority	$ 29,583,724	$ 31,432,959
Less assets required for current obligations	(6,925,305)	(6,559,838)
	$ 22,658,419	$ 24,873,121

Note B – Investments – Continued

Investment return is summarized as follows:

	Other Operating Revenue	Non Operating Gains (Losses)	Total
2013			
Interest and dividend income	$ 195,125	$ 0	$ 195,125
Net realized gains	2,695	0	2,695
Net unrealized loss	0	(117,655)	(117,655)
Investment fees	(26,038)	0	(26,038)
	$ 171,783	$ (117,655)	$ 54,128
2012			
Interest and dividend income	$ 275,449	$ 0	$ 275,449
Net realized gains	48,416	0	48,416
Net unrealized gains	0	46,615	46,615
Investment fees	(33,545)	0	(33,545)
	$ 290,320	$ 46,615	$ 336,935

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

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

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

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

Note B – Investments – Continued

The following discussion describes the valuation methodologies used for the Company's financial assets and liabilities 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 and liabilities presented below.

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial asset or liability, 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 or liability. 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 or liability. Potential taxes and other expenses that would be incurred in an actual sale or settlement are not reflected in the amounts disclosed.

Fair values for the Company's fixed income securities are primarily valued based on the income approach. The fair value is based on level 2 inputs such as data points for benchmark constant maturity curves and spreads. The prices are provided to the Company by its investment managers and its custodian bank. Fair values of mutual funds 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. Fair values of money market funds are based on the net asset value.

Note B – Investments – Continued

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2013.

	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Cash	$ 679	$ 0	$ 0	$ 679
Money market funds	0	19,338,720	0	19,338,720
Fixed Income				
U.S. Government Agency Bonds/Notes	0	20,642,187	0	20,642,187
Equity Securities				
Mutual Funds				
Short government	1,146,782	0	0	1,146,782
Ultrashort bond	798,149	0	0	798,149
Short-term bond	1,618,506	0	0	1,618,506
Intermediate government	768,331	0	0	768,331
Market neutral	10,101	0	0	10,101
World bond	291,125	0	0	291,125
High-yield bond	221,094	0	0	221,094
Intermediate-term bond	216,217	0	0	216,217
Moderate allocation	74,735	0	0	74,735
Mid-cap growth	368,443	0	0	368,443
Real estate	181,215	0	0	181,215
Foreign large blend	917,340	0	0	917,340
Large blend	216,532	0	0	216,532
Diversified emerging markets	231,627	0	0	231,627
Large growth	117,348	0	0	117,348
Small growth	263,029	0	0	263,029
Total assets	$ 7,441,253	$ 39,980,907	$ 0	$ 47,422,160

Note B – Investments – Continued

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

	Level 1	Level 2	Level 3	Total Fair Value
Cash and cash equivalents				
Cash	$ 4,007	$ 0	$ 0	$ 4,007
Money market funds	0	20,272,777	0	20,272,777
Fixed Income				
U.S. Government Agency Bonds/Notes	0	21,512,547	0	21,512,547
Equity Securities				
Mutual Funds				
Short government	783,636	0	0	783,636
Ultrashort bond	797,746	0	0	797,746
Short-term bond	2,128,013	0	0	2,128,013
Intermediate government	816,418	0	0	816,418
Market neutral	-	0	0	0
World bond	322,736	0	0	322,736
High-yield bond	228,372	0	0	228,372
Intermediate-term bond	228,433	0	0	228,433
Moderate allocation	102,123	0	0	102,123
Mid-cap growth	332,803	0	0	332,803
Real estate	162,815	0	0	162,815
Foreign large blend	838,395	0	0	838,395
Large blend	199,995	0	0	199,995
Diversified emerging markets	219,808	0	0	219,808
Large growth	124,803	0	0	124,803
Small blend	286,521	0	0	286,521
Total assets	$ 7,576,624	$ 41,785,324	$ 0	$ 49,361,948

There were no significant transfers between fair value hierarchy levels for the years ended June 30, 2013 and 2012.

Note C – Joint Ventures and Equity Investments

Health Ventures invests in corporations and other forms of business consistent with the mission and strategic plan of the Company. Health Ventures' unconsolidated investments are carried at cost or at equity depending on the percentage of ownership and control. Health Venture's investment in Magnolia Gardens L.L.C. is not consolidated with the financial statements of the Company because Health Ventures does not control the investee. The investment income of these joint ventures and equity investments is reported in non-operating gains/losses in the accompanying consolidated statements of operations and other changes in unrestricted net assets. These investments, which are reported as noncurrent assets in the accompanying consolidated financial statements, are summarized as follows as of June 30:

Name	Percent Ownership	Accounting Method	2013	2012
Magnolia Gardens LLC	51.0%	Equity	$ 3,240,305	$ 2,864,253
Metropolitan Ambulatory Urological Institute, LLC	30.0%	Equity	78,330	143,667
Diagnostic Imaging, LLC	50.0%	Equity	959,124	(119,842)
			$ 4,277,759	$ 2,888,078

Note D – Related Party Transactions

The Hospital has income guarantee agreements with certain physicians. These advances are held as promissory notes and are often forgiven based on the established terms of these notes, such as maintaining an active practice in the Hospital's community.

The Hospital advanced funds to Health Ventures in its establishment of Metropolitan Medical Specialists, LLC (MMS). Since MMS is wholly owned by Health Ventures, the amounts loaned to MMS have been eliminated in consolidation.

A member of the board of directors maintains a business that had transactions with the Hospital that amounted to $465,317 and $505,575 for the years ended June 30, 2013 and 2012, respectively. The Medical Director of Radiology for the Hospital is an investor in Diagnostic Imaging, LLC, which is an unconsolidated subsidiary of Health Ventures.

Note E – Land, Buildings, and Equipment

Land, buildings, and equipment are summarized as follows:

		June 30	
Name	**Useful Life**	**2013**	**2012**
Land improvements	10-40 Years	$ 3,809,176	$ 7,125,095
Buildings	4-40 Years	124,956,992	124,167,197
Leasehold improvements	4-40 Years	2,506,001	5,200,217
Furniture and equipment	2-20 Years	80,940,538	69,516,781
Equipment under capital lease obligations	2-20 Years	10,209,215	10,062,859
		222,421,922	216,072,149
Less accumulated depreciation		107,654,905	98,821,201
		114,767,017	117,250,948
Construction in progress		918,248	1,112,808
Land		6,138,502	6,138,502
		$ 121,823,767	$ 124,502,258

Accumulated depreciation includes accumulated amortization of capital leased equipment in the amount of $3,625,467 and $2,486,100 as of June 30, 2013 and 2012, respectively. Depreciation expense related to capital leased equipment was $1,139,367 and $560,291 for fiscal year 2013 and 2012, respectively.

Note F – Long-Term Debt

Long-term indebtedness consisted of the following:

	June 30 2013	June 30 2012
Maryland Health and Higher Education Facilities Authority Revenue Bonds, Series 2007A:		
4.00% term bonds due July 1, 2013	$ 2,580,000	$ 5,065,000
5.00% term bonds due July 1, 2020	21,890,000	21,890,000
5.00% term bonds due July 1, 2027	30,795,000	30,795,000
5.00% term bonds due July 1, 2029	10,915,000	10,915,000
Maryland Health and Higher Education Facilities Authority Revenue Bonds, Series 2010:		
5.30% term bonds due July 1, 2025	5,330,000	5,330,000
5.625% term bonds due July 1, 2030	9,095,000	9,095,000
5.75% term bonds due July 1, 2038	68,245,000	68,245,000
Capital leases	4,291,670	5,117,816
	153,141,670	156,452,816
Current portion of long-term debt	(4,396,299)	(3,796,608)
Original issue premium, net of accumulated amortization	1,658,412	1,839,562
Original issue discount, net of accumulated amortization	(1,765,513)	(1,801,688)
	$ 148,638,270	$ 152,694,081

The fair value of the Company's long-term debt, based on quoted market prices, was $149,981,460 and $153,252,644 at June 30, 2013 and 2012, respectively.

Note F – Long-Term Debt – Continued

The aggregate maturities of long-term debt, including sinking fund principal requirements during the next five fiscal years, are as follows:

2014	$	4,396,299
2015		4,586,541
2016		4,171,014
2017		3,414,844
2018		3,537,971
2019 and after		133,035,001
	$	153,141,670

Total interest paid for the years ended June 30, 2013 and 2012 was $7,888,343 and $8,312,043, respectively.

Revenue Bonds

On May 15, 2010, the Hospital issued $82,670,000 principal amount of Revenue Bonds, Series 2010 (Series 2010 Bonds). The proceeds of this issue were used to retire the Revenue Bonds, Series 2008 and to finance the costs of renovation and equipment purchases.

On January 4, 2007, the Hospital issued $77,685,000 principal amount of Revenue Bonds, Series 2007A (Series 2007 Bonds). The proceeds of this issue were used to retire certain existing bonds, pooled loans, and to finance the costs of renovation and equipment purchases.

The Series 2010 Bonds and the Series 2007 Bonds are secured by the revenue and accounts receivable of the Hospital. The Hospital is required to maintain certain debt ratios as defined by the Agreement. In the opinion of the management, the Hospital has complied with the required covenants for 2013 and 2012.

Note F – Long-Term Debt – Continued

Other Debt

During 2008, DRCC obtained a $4,000,000 revolving line of credit from a commercial lender to finance the acquisition of certain medical equipment. The line of credit was converted to a capital lease during 2009. The outstanding principal balance was $2,523,453 and $2,630,576 on June 30, 2013 and 2012, respectively. Beginning in October 2009, monthly payments of principal and interest at 6.8% per annum become due. Aggregate future principal payments as of June 30, 2013 are as follows:

2014	$ 757,074
2015	784,871
2016	813,688
2017	104,849
2018 and after	62,971
	$ 2,523,453

In July 2012, the DRCC refinanced the capital lease. The refinanced balance was $2,711,191 at an interest rate of 3.6%. Other debt includes the Hospital's obligations under various other capital leases (see *Note H*).

Note G – Medical Malpractice and Workers' Compensation Insurance

From October 18, 2001 to October 31, 2004, the Hospital maintained occurrence-based professional liability insurance with a per-claim limit of $8,000,000 and aggregate annual limit of $10,000,000 with a commercial carrier. The Hospital was liable for a deductible up to $250,000 for each occurrence up to a maximum of $750,000. Prior to October 18, 2001, the Hospital's policy had no deductible. Effective November 1, 2004, due to the commercial carrier discontinuing services in Maryland and rising insurance costs, the Hospital purchased coverage on a claims-made basis from Freestate Healthcare Insurance Company, Ltd., a group captive formed by several Maryland hospitals. The Hospital owns a partial interest in the captive that is accounted for using the cost method. The cost of $15,000 is recorded in other noncurrent assets in the accompanying consolidated balance sheets as of June 30, 2013 and 2012. Premiums are expensed as incurred and are established based on the Hospital's historical experience supplemented as necessary with industry experience. The total premium is allocated to each of the shareholders based on their experience. Retrospective premium assessments and credits are calculated based on the aggregate experience of all named insured under the policy. Each named insured's assessment of 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, 2013. If the financial condition of Freestate were to materially deteriorate in the future, and Freestate was unable to pay its claim obligations, the responsibility to pay those claims would return to the member hospitals.

Note G – Medical Malpractice and Workers' Compensation Insurance – Continued

The captive is responsible for claims up to $1,000,000 for each and every loss event. Additional coverage has been purchased for all claims in excess of $1,000,000 to a limit of $6,000,000 effective March 1, 2006. The estimated unpaid loss liability reserved by the captive for the Hospital was $7,332,914 and $6,356,004 at June 30, 2013 and 2012, respectively. These amounts are included in long term assets and long term liabilities in the accompanying consolidated balance sheets. The liability for all claims incurred but not reported for the Hospital was $1,314,231 and $1,200,643 at June 30, 2013 and 2012, respectively. In accordance with current accounting standards, the June 30, 2013 and 2012 unpaid loss liabilities are recorded in noncurrent liabilities and the related anticipated insurance recoveries were reported in noncurrent assets in the accompanying consolidated balance sheets. The Hospital engages a consulting actuary to assist in the determination of all professional liability claims incurred but not reported.

The Hospital is self-insured for workers' compensation claims up to a per-claim limit of $400,000 with an annual limitation of approximately $1,200,000. A liability has been recorded for all known claims and an estimate for claims incurred but not reported in the amount of $713,992 and $646,076 at June 30, 2013 and 2012, respectively. These amounts are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

Note H – Leases

The Company has operating leases covering various medical and other equipment and facilities. Generally, the leases carry renewal provisions and require the Hospital to pay maintenance costs.

The Hospital and DRCC have entered into capital leases for certain equipment. The cost of assets under capital leases is included in land, building, and equipment (see *Note E*), and related capital lease obligations are included in long-term debt (see *Note F*) in the accompanying consolidated balance sheets. Depreciation expense on these assets is included with depreciation expense in the consolidated statements of operations and other changes in unrestricted net assets.

Note H – Leases - Continued

Future minimum lease payments as of June 30, 2013 are as follows:

	Capital Leases	Operating Leases
2014	$ 1,516,298	$ 2,024,148
2015	1,586,540	1,916,842
2016	1,021,013	1,876,380
2017	104,849	1,446,584
2018 and thereafter	62,970	4,712,686
Total minimum lease payments	4,291,670	$ 11,976,640
Current portion of capital leases	(1,516,298)	
Capital lease obligations, less current portion	$ 2,775,372	

Total rental expense reported in the accompanying consolidated statements of operations and other changes in unrestricted net assets for the years ended June 30, 2013 and 2012 was $4,039,310 and $3,806,038, respectively.

Note I – Retirement Plans

The Hospital froze the defined benefit pension plan that it sponsors (the Plan) in 2011, which covered substantially all employees. The Plan curtailment was recognized in 2011. The decision to terminate in the Plan has not been made by the board of directors. The benefits are based on years of service and the employee's compensation during years of employment. The Hospital's funding policy is to make sufficient contributions to the Plan to comply with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 (ERISA). The Hospital expects to contribute $580,941 to the Plan during 2014 to keep the funding levels at the IRS requirements. The measurement date of the Plan is June 30.

The following table provides a reconciliation of the benefit obligation, Plan assets, and funded status of the Plan in the Company's consolidated financial statements based on actuarial valuations:

Note I – Retirement Plans – Continued

	For the Year Ended			
	2013		2012	
Accumulated Benefit Obligation	$	21,113,509	$	22,021,920
Change in Benefit Obligation				
Benefit Obligation at beginning of year	$	22,021,920	$	18,093,874
Interest cost		770,733		904,053
Actuarial loss/(gain)		(1,240,851)		3,410,330
Benefits paid		(438,293)		(386,337)
Benefit Obligation at End of Year	$	21,113,509	$	22,021,920
Change in Plan Assets				
Fair value of plan assets at beginning of year	$	14,446,264	$	13,080,379
Actual return on plan assets		789,666		(203,019)
Employer contributions		346,699		1,955,241
Benefits paid		(438,293)		(386,337)
Fair Value of Plan Assets at End of Year	$	15,144,336	$	14,446,264
Funded Status (Pension Obligation)	$	(5,969,173)	$	(7,575,656)
Components of Net Periodic Benefit Costs				
Interest cost		770,733		904,053
Expected return on plan assets		(889,123)		(833,540)
Recognition of loss from change in measurement date		474,436		453,101
Net Period Pension Costs	$	356,046	$	523,614

Note I – Retirement Plans – Continued

The total amount recognized in unrestricted net assets in the accompanying consolidated financial statements for 2013 and 2012 is as follows:

	2013	2012
Net loss	$ 8,419,308	$ 10,035,138
Prior service costs	0	0
	$ 8,419,308	$ 10,035,138

The Plan's assets are invested primarily in cash and cash equivalents and mutual funds as follows as of June 30:

	2013	2012
Equity securities	40%	34%
Fixed maturity	60%	66%
Other	0%	0%
	100%	100%

Plan assets are invested to ensure that the Plan has the ability to pay all benefit and expense obligations when due, to maximize return within prudent levels of risk for pension assets, and to maintain a funding cushion for unexpected developments. The target weighted-average asset allocation of pension investments was 50% equities and 50% fixed maturity securities and cash as of June 30, 2013.

The Plan's estimated future benefit payments are as follows:

2014	$ 3,093,817
2015	556,098
2016	730,858
2017	950,736
2018	991,170
2019 - 2023	6,858,168
Total	$ 13,180,847

Note I – Retirement Plans – Continued

The weighted-average assumptions used to determine net periodic benefit cost and the projected benefit obligation for the years ended June 30 were as follows:

	2013	2012
Discount rate	4.30%	3.70%
Expected return on Plan assets	6.50%	6.50%
Rate of compensation increase	N/A	N/A

The following table presents the Company's fair value hierarchy for financial instruments measured at fair value on a recurring basis as of June 30, 2013:

	Level 1	Level 2	Level 3	Total Fair Value
Equity Securities				
Mutual Funds				
Diversified emerging markets	$ 302,772	$ 0	$ 0	$ 302,772
Foreign large blend	317,085	0	0	317,085
Foreign small/mid growth	168,542	0	0	168,542
Inflation-protected bond	1,438,426	0	0	1,438,426
Intermediate government	2,072,049	0	0	2,072,049
Intermediate-term bond	3,281,486	0	0	3,281,486
Large growth	1,371,019	0	0	1,371,019
Large value	1,239,208	0	0	1,239,208
Mid-cap growth	839,180	0	0	839,180
Mid-cap value	857,523	0	0	857,523
Multisector bond	2,358,510	0	0	2,358,510
Small growth	375,371	0	0	375,371
Small value	523,165	0	0	523,165
Total assets	$ 15,144,336	$ 0	$ 0	$ 15,144,336

Note I – Retirement Plans – Continued

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

	Level 1	Level 2	Level 3	Total Fair Value
Equity securities				
Mutual funds				
Diversified emerging ma	$ 276,721	$ 0	$ 0	$ 276,721
Foreign large growth	274,963	0	0	274,963
Foreign small/mid grow	140,472	0	0	140,472
Inflation-protected bonc	1,495,079	0	0	1,495,079
Intermediate governmer	2,090,077	0	0	2,090,077
Intermediate-term bond	3,705,588	0	0	3,705,588
Large growth	1,134,024	0	0	1,134,024
Large value	1,014,110	0	0	1,014,110
Mid-cap blend	1,388,545	0	0	1,388,545
Multisector bond	2,202,025	0	0	2,202,025
Small growth	292,759	0	0	292,759
Small value	431,901	0	0	431,901
Total assets	$ 14,446,264	$ 0	$ 0	$ 14,446,264

There were no significant transfers between fair value hierarchy levels for the years ended June 30, 2013 and 2012.

The Hospital has a deferred compensation plan that permits certain executives to defer receiving a portion of their compensation. The deferred amounts are included in other assets in the accompanying consolidated balance sheets. The associated liability of an equal amount is included in other liabilities in the accompanying consolidated balance sheets. The liability recorded regarding the deferred compensation was $3,846,668 and $4,467,320 as of June 30, 2013 and 2012, respectively. During 2013 and 2012, distributions of $1,075,072 and $622,271 were made to participants in the deferred compensation plan, respectively.

The Hospital is the beneficiary of split dollar life insurance policies in place for certain executives. Approximately $9,400,000 is included in other assets at June 30, 2013 and 2012, which is the amount that could be realized by the Hospital under the insurance contracts.

Note J – 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). Hospital management has filed the required forms with the Commission and believes the Hospital is in compliance with Commission requirements.

The current rate of reimbursement for principally all inpatient services and certain other services to patients under the Medicare and Medicaid programs is based on an agreement between the Centers for Medicare and Medicaid Services and the Commission. This agreement is based upon a waiver from Medicare reimbursement principles under Section 1814(b) of the Social Security Act and will continue as long as all third-party payers elect to be reimbursed under this program and the rate of increase for costs per hospital inpatient admission is below the national average. Maryland Hospital Association is leading an effort with the State and HSCRC to recommend a new CMS waiver program based on population health. Management believes that a waiver program will remain in effect at least through June 2014.

The Commission and the Hospital entered into an agreement that is based on a rate methodology for those Hospital service centers that provide only inpatient services. Under this methodology, a target average charge per case is established for the Hospital, based on past actual charges and case mix indices. The actual average charge per case is compared with the target average charge-per-case and to the extent that the actual average exceeds the target, the overcharge plus applicable penalties will reduce the approved target for future years. At June 30, 2013, 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 and 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. Overcharges 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 to patients are performed and billed.

Note K – Commitments and Contingencies

Litigation

There are several lawsuits pending in which the Hospital has been named as defendant. In the opinion of Hospital management, after consultation with legal counsel, the potential liability, in the event of adverse settlement, will not have a material impact on the Hospital's consolidated financial position.

Risk Factors

The Company's ability to maintain and/or increase future revenues could be adversely affected by:

- the growth of managed care organizations promoting alternative methods for health care delivery and payment of services such as discounted fee for service networks and capitated fee arrangements (the rate setting process in the State of Maryland prohibits hospitals from entering into discounted fee arrangements; however, managed care contracts may provide for exclusive service arrangements);

- proposed and/or future changes in the laws, rules, regulations, and policies relating to the definition, activities, and/or taxation of not-for-profit tax-exempt entities;

- the enactment into law of all or any part of the current budget resolutions under consideration by Congress related to Medicare and Medicaid reimbursement methodology and/or further reductions in payments to hospitals and other health care providers;

- the future of Maryland's certificate of need program, where future deregulation could result in the entrance of new competitors, or future additional regulation may eliminate the Company's ability to expand new services; and

- the ultimate impact of the federal Patient Protection and Affordable Care Act and the Health Care Education Affordability Reconciliation Act of 2010.

The Joint Commission, a non-governmental privately owned entity, provides accreditation status to hospitals and other health care organizations in the United States. Such accreditation is based upon a number of requirements such as undergoing periodic surveys conducted by Joint Commission personnel. Certain managed care payers require hospitals to have appropriate Joint Commission accreditation in order to participate in those programs. In addition, the Center for Medicare and Medicaid Services (CMS), the agency with oversight of the Medicare and Medicaid programs, provides "deemed status" for facilities having Joint Commission accreditation. By being Joint Commission accredited, facilities are "deemed" to be in compliance with the Medicare and Medicaid conditions of participation. Termination as a Medicare provider or exclusion from any or all of these programs/payers would have a materially negative impact on the future financial position,

Note K – Commitments and Contingencies – Continued

Risk Factor - Continued

operating results and cash flows of the Hospital. In June 2013 the Hospital was surveyed by Joint Commission and received a full three-year Joint Commission accreditation through July 2016.

The Company invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in values of investment securities will occur in the near term, and such changes could materially affect the amounts reported as investments on the consolidated balance sheets.

Note L – Goodwill

During June 2007, the Hospital purchased a 60% interest in DRCC. Goodwill in the amount of $1,062,531 resulted from the transaction and has been included in the accompanying consolidated balance sheets as of June 30, 2013 and 2012.

Health Ventures has a 51% ownership interest in Magnolia Gardens, LLC. Goodwill in the amount of $766,285 resulted from the purchase of ownership and has been included in the accompanying consolidated balance sheets as of June 30, 2013 and 2012.

Upon inception of DRCC in 2007, and as part of its initial capital contribution, Maryland Regional Cancer Care, LLC, the founding member of DRCC, transferred a portion of its goodwill to DRCC. The amount of goodwill transferred to DRCC was $646,975 and has been included in the accompanying consolidated balance sheets at June 30, 2013 and 2012.

Note M – Temporarily Restricted Net Assets

Temporarily restricted net assets are available as of June 30 for the following programs and projects:

	2013	2012
Nancy Heilman Scholarship Fund	$ 1,479	$ 1,479
Brian Erfan Memorial Fund	5,850	5,850
Jane Schafer Scholarship Fund	10,784	10,784
Rehabilitation Services	12,937	13,594
Borden Breast Center	20,000	20,000
Cardiac Rehab Services	3,962	0
Surgical Services	591,032	0
Diabetes Center	1,424	0
Lymphedema Center	20,000	0
Komen Grant	892,984	999,656
UASI 2008 grant	2,177	2,177
MHA HPP Disaster Grant	19	19
	$ 1,562,648	$ 1,053,559

COHEN
RUTHERFORD
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Certified Public Accountants

Report of Independent Auditors on Other Financial Information

Board of Directors
Doctors Community Hospital and Subsidiaries
Lanham, Maryland

The 2013 and 2012 audited consolidated financial statements of Doctors Community Hospital and Subsidiaries and our report thereon are presented in the preceding section of this report. Those audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary information presented hereinafter as of and for the year ended June 30, 2013 is presented for purposes of additional analysis of the basic consolidated financial statements, and is not a required part of the basic consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Cohen, Rutherford + Knight, P.C.

October 15, 2013
Bethesda, Maryland

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

Consolidating Balance Sheet Information
Doctors Community Hospital and Subsidiaries
June 30, 2013

ASSETS	Doctors Community Hospital	Doctors Community Hospital Foundation, Inc.	Doctors Community Health Ventures, Inc.	Doctors Regional Cancer Center, LLC	Doctors Community Hospital Sleep Center, LLC	Spine Team Maryland, LLC	Eliminations	Consolidated
CURRENT ASSETS								
Cash and cash equivalents	$ 22,795,211	$ 288,381	$ 214,013	$ 1,312,307	$ 387,184	$ 126,368	$ 0	$ 25,123,464
Assets limited to use for debt service	6,925,305	0	0	0	0	0	0	6,925,305
Patient accounts receivable, net	23,020,611	0	1,238,267	943,240	140,747	186,767	0	25,529,632
Other amounts receivable	3,557,693	449,103	39,904	175,879	845	16,211	0	4,239,635
Inventories	3,518,697	0	3,951	0	89,672	0	0	3,612,320
Prepaid expenses	1,853,796	37,536	29,099	125,919	0	47,899	0	2,094,249
TOTAL CURRENT ASSETS	61,671,313	775,020	1,525,234	2,557,345	618,448	377,245	0	67,524,605
INVESTMENTS								
Marketable securities	13,350,845	162,961	0	0	0	0	0	13,513,806
Investment in Doctors Regional Cancer Center	2,631,369	0	0	0	0	0	(2,631,369)	0
Investment in Sleep Services of America, Inc.	559,400	0	0	0	0	0	(559,400)	0
Joint ventures and equity investments	0	0	4,277,759	0	0	0	0	4,277,759
Due to DCH	15,579,582	0	0	0	386,888	0	(15,966,470)	0
	32,121,196	162,961	4,277,759	0	386,888	0	(19,157,239)	17,791,565
ASSETS WHOSE USE IS LIMITED								
Investments held by trustee or authority, less current portion	22,658,419	0	0	0	0	0	0	22,658,419
Land and land improvements	9,947,678	0	0	0	0	0	0	9,947,678
Building and fixed equipment	116,894,897	0	0	0	0	0	0	116,894,897
Medical office building	8,062,095	0	0	0	0	0	0	8,062,095
Major movable equipment	81,800,929	0	800,522	9,342,575	1,307,585	404,143	0	93,655,754
Construction in progress	918,248	0	0	0	0	0	0	918,248
Accumulated depreciation	(101,323,758)	0	(407,242)	(4,696,839)	(1,135,685)	(91,381)	0	(107,654,905)
LAND, BUILDINGS, AND EQUIPMENT	116,300,089	0	393,280	4,645,736	171,900	312,762	0	121,823,767
DEFERRED FINANCING COSTS	2,160,314	0	0	0	0	0	0	2,160,314
GOODWILL	1,062,531	0	766,285	646,975	0	18,943	0	2,494,734
OTHER ASSETS	21,915,131	0	10,000	0	0	0	(100,000)	21,825,131
TOTAL ASSETS	$ 257,888,993	$ 937,981	$ 6,972,558	$ 7,850,056	$ 1,177,236	$ 708,950	$ (19,257,239)	$ 256,278,535

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

Consolidating Balance Sheet Information
Doctors Community Hospital and Subsidiaries
June 30, 2013

LIABILITIES AND NET ASSETS	Doctors Community Hospital	Doctors Community Hospital Foundation, Inc.	Doctors Community Health Ventures, Inc.	Doctors Regional Cancer Center, LLC	Doctors Community Hospital Sleep Center, LLC	Spine Team Maryland, LLC	Eliminations	Consolidated
CURRENT LIABILITIES								
Accounts payable and accrued expenses	$ 15,332,114	$ 10,538	$ 102,507	$ 845,842	$ 191,324	$ 18,907	$ (386,888)	$ 16,114,344
Due to DCH	0	259,974	0	95,160	53,578	4,085,250	(4,493,962)	0
Salaries, wages, and related items	10,692,063	0	490,666	0	0	0	0	11,182,729
Advances from third party payers	6,690,340	0	0	0	0	0	0	6,690,340
Interest payable to bondholders	4,102,931	0	0	0	0	0	0	4,102,931
Current portion of long-term obligation	3,639,223	0	0	757,076	0	0	0	4,396,299
TOTAL CURRENT LIABILITIES	40,456,671	270,512	593,173	1,698,078	244,902	4,104,157	(4,880,850)	42,486,643
NONCURRENT LIABILITIES								
Other noncurrent liabilities	12,493,813	0	0	0	0	0	0	12,493,813
Pension obligation, net of current portion	5,969,173	0	0	0	0	0	0	5,969,173
Long-term obligations, net of current portion	146,871,892	0	11,085,620	1,766,378	0	0	(11,085,620)	148,638,270
TOTAL LIABILITIES	205,791,549	270,512	11,678,793	3,464,456	244,902	4,104,157	(15,966,470)	209,587,899
NET ASSETS AND OTHER EQUITY								
Unrestricted	51,202,265	0	0	0	0	0	(8,201,442)	43,000,823
Stockholder's equity	0	0	(4,706,235)	0	0	0	4,706,235	0
Members' equity	0	0	0	4,385,600	932,334	(3,395,207)	(1,922,727)	0
Noncontrolling interest	0	0	0	0	0	0	2,127,165	2,127,165
Total unrestricted net assets	51,202,265	0	(4,706,235)	4,385,600	932,334	(3,395,207)	(3,290,769)	45,127,988
Temporarily restricted	895,179	667,469	0	0	0	0	0	1,562,648
TOTAL NET ASSETS	52,097,444	667,469	(4,706,235)	4,385,600	932,334	(3,395,207)	(3,290,769)	46,690,636
TOTAL NET ASSETS AND LIABILITIES	$ 257,888,993	$ 937,981	$ 6,972,558	$ 7,850,056	$ 1,177,236	$ 708,950	$ (19,257,239)	$ 256,278,535

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

Consolidating Statement of Operations Information

Doctors Community Hospital and Subsidiaries

For the Year Ended June 30, 2013

	Doctors Community Hospital	Doctors Community Hospital Foundation, Inc.	Doctors Community Health Ventures, Inc.	Doctors Regional Cancer Center, LLC	Doctors Community Hospital Sleep Center, LLC	Spine Team Maryland, LLC	Eliminations	Consolidated
UNRESTRICTED NET ASSETS								
OPERATING REVENUE								
Net patient service revenue, net of contractual allowances and discounts	$ 174,861,794	$ 0	$ 5,777,886	$ 7,404,855	$ 4,343,520	$ 973,699	$ (1,635,896)	$ 191,725,858
Provision for bad debts	(4,276,040)	0	0	(19,594)	0	(22,187)	0	(4,317,821)
Net patient service revenue less provision for bad debt	170,585,754	0	5,777,886	7,385,261	4,343,520	951,512	(1,635,896)	187,408,037
Other operating revenue	8,197,442	274	122,453	226,224	0	114,090	(709,138)	7,951,345
Pledges and contributions	40,000	368,247	0	0	0	0	0	408,247
Net assets released from restrictions used for operations	106,673	0	0	0	0	0	0	106,673
TOTAL OPERATING REVENUE	178,929,869	368,521	5,900,339	7,611,485	4,343,520	1,065,602	(2,345,034)	195,874,302
EXPENSES								
Salaries and wages	80,289,473	228,730	5,032,458	0	894,627	311,737	0	86,757,025
Employee benefits	14,277,151	15,223	638,525	0	178,772	62,036	0	15,171,707
Purchased services	21,612,145	132,672	2,140,116	5,031,047	267,674	1,293,117	0	30,476,771
Supplies	34,050,791	18,094	205,645	140,435	232,347	58,042	0	34,705,354
Other expenses	10,782,782	65,217	1,090,754	1,079,738	321,984	495,853	(709,138)	13,127,190
Depreciation	8,879,441	0	102,585	721,513	121,017	42,171	0	9,866,727
Amortization	156,899	0	0	0	0	0	0	156,899
Fundraising	0	189,133	0	0	0	0	0	189,133
Interest	7,974,219	0	0	166,755	0	0	0	8,140,974
TOTAL EXPENSES	178,022,901	649,069	9,210,083	7,139,488	2,016,421	2,262,956	(709,138)	198,591,780
INCOME (LOSS) FROM OPERATIONS	906,968	(280,548)	(3,309,744)	471,997	2,327,099	(1,197,354)	(1,635,896)	(2,717,478)
NONOPERATING INCOME								
Gain from sale of property	117,684	0	0	0	0	0	0	117,684
Unrealized loss on trading securities	(117,655)	0	0	0	0	0	0	(117,655)
Equity (loss) in joint ventures	1,679,458	0	302,371	0	0	0	(679,458)	1,302,371
EXCESS OF REVENUE OVER EXPENSES (EXPENSES OVER REVENUE)	2,586,455	(280,548)	(3,007,373)	471,997	2,327,099	(1,197,354)	(2,315,354)	(1,415,078)
Net asset transfer	(279,888)	279,888	0	0	0	0	0	0
Dividends paid	0	0	0	(500,000)	(2,564,000)	0	1,838,400	(1,225,600)
Contributions	0	616,423	0	0	0	0	0	616,423
Net assets released from restrictions for use in operations	(106,673)	0	0	0	0	0	0	(106,673)
Pension - related changes other than net periodic pension cost	1,615,830	0	0	0	0	0	0	1,615,830
Increase (decrease) in net assets	3,815,724	615,763	(3,007,373)	(28,003)	(236,901)	(1,197,354)	(476,954)	(515,098)
Net assets, beginning of year	48,281,720	51,708	(1,698,862)	4,413,603	1,169,234	(2,197,854)	(2,813,815)	47,205,734
Net assets, end of year	$ 52,097,444	$ 667,471	$ (4,706,235)	$ 4,385,600	$ 932,333	$ (3,395,208)	$ (3,290,769)	$ 46,690,636

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