

CONSOLIDATED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION

Frederick Memorial Hospital, Inc. and Subsidiaries
Years Ended June 30, 2010 and 2009
With Reports of Independent Auditors

Frederick Memorial Hospital, Inc. and Subsidiaries
Consolidated Financial Statements and Other Financial Information

Years Ended June 30, 2010 and 2009

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Report of Independent Auditors

The Board of Directors
Frederick Memorial Hospital, Inc. and Subsidiaries

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

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company at June 30, 2010 and 2009, and the consolidated results of their operations, changes in net assets, and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst + Young LLP

October 22, 2010

Frederick Memorial Hospital, Inc. and Subsidiaries

Consolidated Balance Sheets

(In Thousands)

	June 30	
	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 34,805	\$ 32,552
Short-term investments	–	3,644
Patient receivables, net	43,158	39,328
Other receivables	2,391	2,523
Inventory	4,156	3,974
Prepaid expenses	2,291	1,404
Assets limited as to use	2,841	2,790
Promises to give, net	711	1,116
Total current assets	<u>90,353</u>	<u>87,331</u>
Net property and equipment	181,666	179,611
Other assets:		
Assets limited as to use	11,091	11,016
Investments – donor restricted	2,552	2,468
Promises to give, net	2,402	3,579
Long-term investments	67,837	53,962
Other investments	4,190	4,930
Debt issuance costs, net	1,799	1,892
Other assets	320	2,244
Total other assets	<u>90,191</u>	<u>80,091</u>
Total assets	<u>\$ 362,210</u>	<u>\$ 347,033</u>

	June 30	
	2010	2009
Liabilities and net assets		
Current liabilities:		
Current maturities of long-term debt and capital lease obligations	\$ 1,568	\$ 2,307
Accounts payable	15,869	13,265
Accrued expenses	18,364	18,276
Advances from third-party payors	8,048	7,205
Other current liabilities	3,047	3,754
Total current liabilities	<u>46,896</u>	<u>44,807</u>
Long-term liabilities, net of current portion:		
Long-term debt and capital lease obligations	140,211	141,679
Interest rate swap contract	11,265	8,046
Accrued pension expense	22,416	13,307
Other long-term liabilities	6,605	4,769
Total long-term liabilities, net of current portion	<u>180,497</u>	<u>167,801</u>
Total liabilities	<u>227,393</u>	<u>212,608</u>
Net assets:		
Unrestricted	129,158	127,301
Temporarily restricted	4,683	6,148
Permanently restricted	976	976
Total net assets	<u>134,817</u>	<u>134,425</u>
Total liabilities and net assets	<u>\$ 362,210</u>	<u>\$ 347,033</u>

See accompanying notes.

Frederick Memorial Hospital, Inc. and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

(In Thousands)

	Year Ended June 30	
	2010	2009
Unrestricted revenue and other support:		
Net patient service revenue	\$ 304,786	\$ 286,829
Other operating revenues	6,719	6,929
Gifts, bequests, and contributions	1,965	4,686
Net assets released from restriction used for operations	2,368	161
Total unrestricted revenue and other support	315,838	298,605
Operating expenses:		
Salaries and wages	128,402	127,726
Employee benefits	32,228	31,163
Professional fees	11,465	9,486
Cost of goods sold	45,060	42,318
Supplies	9,295	9,724
Contract services	28,928	24,848
Other	10,711	9,158
Utilities	4,390	4,175
Insurance	2,707	1,930
Depreciation and amortization	18,301	18,196
Interest	6,975	7,221
Provision for uncollectible accounts	12,821	10,717
Total operating expenses	311,283	296,662
Operating income	4,555	1,943
Other income (loss):		
Gain (loss) on sale of assets	14	(50)
Investment loss, net	(1,802)	(4,259)
Loss on extinguishment of debt	-	(2,370)
Change in unrealized gains (losses) on trading securities, net	8,414	(5,365)
Change in fair value of interest rate swap contract	(3,218)	(2,752)
Other non-operating income	291	279
Total other income (loss)	3,699	(14,517)
Excess (deficiency) of unrestricted revenue and other support over expenses	8,254	(12,574)
Other changes in unrestricted net assets:		
Pension adjustment	(7,037)	(7,409)
Released from restriction used to purchase capital	640	907
Increase (decrease) in unrestricted net assets	\$ 1,857	\$ (19,076)

See accompanying notes.

Frederick Memorial Hospital, Inc. and Subsidiaries

Consolidated Statements of Changes in Net Assets

(In Thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets, June 30, 2008	\$ 146,377	\$ 5,900	\$ 976	\$ 153,253
Deficiency of unrestricted revenue and other support over expenses	(12,574)	–	–	(12,574)
Pension adjustment	(7,409)	–	–	(7,409)
Released from restriction used to purchase capital	907	–	–	907
Assets released from restrictions	–	(1,068)	–	(1,068)
Restricted gifts, bequests and contributions	–	1,316	–	1,316
Changes in net assets	(19,076)	248	–	(18,828)
Net assets, June 30, 2009	127,301	6,148	976	134,425
Excess of unrestricted revenue and other support over expenses	8,254	–	–	8,254
Pension adjustment	(7,037)	–	–	(7,037)
Released from restriction used to purchase capital	640	–	–	640
Assets released from restrictions	–	(3,008)	–	(3,008)
Restricted gifts, bequests and contributions	–	1,543	–	1,543
Changes in net assets	1,857	(1,465)	–	392
Net assets, June 30, 2010	\$ 129,158	\$ 4,683	\$ 976	\$ 134,817

See accompanying notes.

Frederick Memorial Hospital, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(In Thousands)

	Year Ended June 30	
	2010	2009
Cash flows provided by operating activities		
Change in net assets	\$ 392	\$ (18,828)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Loss on extinguishment of debt	–	2,370
Depreciation and amortization	18,301	18,196
Amortization of original issue discount and bond issue costs	194	235
Equity in (gains) losses of joint ventures	(362)	805
(Gain) loss on sale of property and equipment	(14)	50
Change in unrealized (gains) losses on trading securities, net	(8,414)	5,365
Proceeds from realized losses on investments – trading	4,039	6,405
Increase in investments – trading	(5,940)	(3,869)
Increase in assets limited as to use – trading, net	(140)	(2,036)
Proceeds from restricted contributions	(1,543)	(1,316)
Change in pledges receivable	1,582	(60)
Change in fair value of interest rate swap contract	3,218	2,535
Change in operating assets and liabilities:		
Receivables, patient and other	(3,698)	(523)
Inventories and other assets	717	(1,464)
Accounts payable	2,604	1,304
Accrued expenses	88	1,560
Accrued pension expense	9,109	5,859
Advances from third-party payors	843	261
Other short-term liabilities	(707)	1,330
Other long-term liabilities	1,836	655
Net cash provided by operating activities	22,105	18,834
Cash flows used in investing activities		
Decrease in assets limited as to use-non-trading, net	14	4,091
Purchases of property and equipment	(20,726)	(12,646)
Proceeds from sale of assets	523	–
Other investing activities	1,102	–
Net cash used in investing activities	(19,087)	(8,555)
Cash flows from fundraising and financing activities		
Proceeds from restricted contributions	1,543	1,316
Proceeds from borrowings	–	72,016
Payments for deferred financing costs	–	(501)
Repayments of long-term debt	(2,308)	(77,158)
Net cash used in fundraising and financing activities	(765)	(4,327)
Net increase in cash and cash equivalents	2,253	5,952
Cash and cash equivalents at beginning of year	32,552	26,600
Cash and cash equivalents at end of year	\$ 34,805	\$ 32,552
Supplemental disclosures:		
New capital lease obligations	\$ –	\$ 1,428
Cash paid for interest	\$ 6,356	\$ 6,633

See accompanying notes.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Dollars in Thousands)

June 30, 2010

1. Organization and Mission

Frederick Memorial Hospital, Inc. (the Hospital) is a not-for-profit hospital, exempt from federal income tax under Section 501(a) of the Internal Revenue Code (the Code) as an organization described in Section 501(c)(3) whereby only unregulated business income as defined by Section 512(a)(1) of the Code, is subject to Federal income tax. The Hospital is located in Frederick, Maryland, and provides health care services primarily to residents of Frederick County.

The Hospital and Hospice of Frederick County have received determination letters from the Internal Revenue Service (IRS) stating that they are exempt from federal income taxes under Section 501(c) of the Internal Revenue Code.

Frederick Health Services Corporation (FHSC) is subject to federal and state income taxes. No provision for income taxes has been recorded for 2010 and 2009 as FHSC does not have taxable income or current tax liabilities.

2. Significant Accounting Policies

Principles of Consolidation

The accompanying financial statements include the accounts and transactions of the Hospital, its for-profit, wholly-owned subsidiary, Frederick Health Services Corporation (FHSC); Emmitsburg Properties, LLC; Hospice of Frederick County, Inc.; and Frederick Memorial Hospital Self-Insurance Trust.

Hospice of Frederick County, Inc. (HFC) is an independent 501(c)(3) organization. HFC remains a separate entity, controlled by the Hospital, and operates as a fundraising organization for the benefit of hospice services and operates the Kline Hospice House.

FHSC has three wholly-owned subsidiaries: Rosehill of Frederick, LLC and Corporate Occupational Health Solutions, LLC, which are for-profit limited liability companies, and Frederick Surgical Services Corporation (FSSC), all of which have been consolidated into FHSC in the accompanying financial statements. In 2008, FHSC sold a 50% interest in Mt. Airy Plaza, LLC and it is now accounted for under the equity method.

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Significant Accounting Policies (continued)

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets if restricted for capital or reported in the statements of operations as net assets released from restrictions if restricted for operating purposes. Donations received with no restrictions and donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated statements of operations and changes in net assets as other operating revenues.

Cash and Cash Equivalents

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

Patient Receivables and Allowances

The Hospital's policy is to write off all patient accounts that have been identified as uncollectible. An allowance for doubtful accounts is recorded for accounts not yet written off that are anticipated to become uncollectible in future periods. Insurance coverage and credit information are obtained from patients when available. No collateral is obtained for accounts receivable. Accounts receivable from third-party payors have been adjusted to reflect the difference between charges and the estimated reimbursable amounts. Recoveries of previously written off patient receivables are recorded when received.

Inventory

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

2. Significant Accounting Policies (continued)

Cost of Goods Sold

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

Investments and Assets Limited as to Use

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

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

Investment Risk and Uncertainties

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Significant Accounting Policies (continued)

Property and Equipment

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

Valuation of Long-Lived Assets

The Hospital accounts for the valuation of long-lived assets under *Accounting for the Impairment or Disposal of Long-Lived Assets*. This guidance requires that long-lived assets and certain identifiable intangible assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of the long-lived asset is measured by a comparison of the carrying amount of the asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reportable at the lower of the carrying amount or fair value, less costs to sell.

Debt Issuance Costs

Debt issuance costs related to the Series 2002 and Series 2008 MHHEFA bonds and the equipment note payable are being amortized over the life of the debt using the effective interest method. Debt issuance costs related to the 2006 Series A and B bonds were written-off during 2009 when the 2006 bonds were retired.

Patient Service Revenue and Allowances

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Significant Accounting Policies (continued)

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

Performance Indicator

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

Fair Value of Financial Instruments

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

Use of Estimates

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

Reclassification

Certain amounts in the June 30, 2009, financial statements have been reclassified to conform to the June 30, 2010, financial statement presentation. These reclassifications had no effect on change in net assets.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Significant Accounting Policies (continued)

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board, or FASB, established the FASB Accounting Standards Codification, or Codification, as the source of authoritative GAAP recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements. The Hospital adopted the Codification on July 1, 2009. The Codification does not change or alter existing GAAP and, therefore, the adoption of the Codification did not have any impact on our consolidated financial position and results of operations.

In March 2008, the FASB issued FASB ASC paragraph 815-10-65-1, *Transition and Effective Date Related to FASB No. 161, Disclosures about Derivative Instruments and Hedging Activities*, or FASB ASC paragraph 815-10-65-1. FASB ASC paragraph 815-10-65-1 requires expanded disclosures regarding the location and amounts of derivative instruments in an entity's financial statements, how derivative instruments and related hedged items are accounted for under FASB ASC Topic 815, *Derivatives and Hedging*, or FASB ASC Topic 815, and how derivative instruments and related hedged items affect an entity's financial position, operating results, and cash flows. FASB ASC Topic 815 was effective for the Hospital on January 1, 2009. The adoption of FASB ASC Topic 815 did not have an impact on our consolidated financial position or results of operations.

In August 2008, the FASB issued FASB Staff Position No. 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds* (codified by ASC 958-205, *Not-for-Profit Entities, Presentation of Financial Statements*). ASC 958-205 provides guidance on the net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to a state-enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). In April 2009, the State of Maryland enacted a version of UPMIFA. Accordingly, the Hospital adopted ASC 958-205. The adoption of ASC 958-205 did not have a material effect on the Hospital's balance sheet at June 30, 2009, or on the statement of operations and changes in net assets for the year ended June 30, 2009, reflected in other changes within unrestricted, temporarily restricted, and permanently restricted changes in net assets for the year then ended.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

2. Significant Accounting Policies (continued)

In April 2009, the FASB issued FASB ASC paragraph 820-10-65-4, *Transition Related to FASB Staff Position FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, or FASB ASC paragraph 820-10-65-4. FASB ASC paragraph 820-10-65-4 provides additional authoritative guidance to assist both issuers and users of financial statements in determining whether a market is active or inactive, and whether a transaction is distressed. The Hospital adopted FASB ASC paragraph 820-10-65-4 on April 1, 2009. The adoption of FASB ASC paragraph 820-10-65-4 did not have a material impact on the Hospital's results of operations or financial condition.

In January 2010, the FASB issued ASC Accounting Standards Update (ASU) No. 2010-06 (ASU 2010-06), which guidance clarifies certain existing fair value measurement disclosure requirements of ASC Topic 820, *Fair Value Measurements and Disclosures*, and also requires additional fair value measurement disclosures. Specifically, ASU 2010-06 clarifies that assets and liabilities must be leveled by major class of asset or liability, and provides guidance regarding the identification of such major classes. Additionally, disclosures are required about valuation techniques and the inputs to those techniques, for those assets or liabilities designated as level 2 or level 3 instruments. Disclosures regarding transfers between level 1 and level 2 assets and liabilities are required, as well as a deeper level of disaggregation of activity within existing rollforwards of the fair value of level 3 assets and liabilities. See the Fair Value Measurements note for these additional fair value measurement disclosure requirements for the year ended June 30, 2010, excluding the additional requirements related to level 3 rollforward activity, which are not required to be adopted until the Hospital fiscal year ended June 30, 2012. The adoption of this guidance did not have a significant impact on the Hospital's consolidated financial statements for the year ended June 30, 2010.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

3. Patient Receivables and Patient Service Revenue

Patient receivables consist of the following at June 30:

	<u>2010</u>	<u>2009</u>
Gross patient receivables	\$ 61,580	\$ 56,410
Less: estimated uncollectible accounts and contractual allowances	18,422	17,082
Net patient receivables	<u>\$ 43,158</u>	<u>\$ 39,328</u>

Patient service revenue consists of the following for the years ended June 30, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Inpatient charges	\$ 185,415	\$ 175,876
Outpatient charges	187,008	177,765
Gross charges	<u>372,423</u>	353,641
Less: Allowances, contractual and other	67,637	66,812
Net patient service revenue	<u>\$ 304,786</u>	<u>\$ 286,829</u>

The Hospital provides care to patients who meet certain criteria under its charity care policy. The Hospital charges at its established rates but waives all or a portion of reimbursement. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these revenues are not reported as net patient service revenue. Charity care provided for the years ended June 30, 2010 and 2009, was \$4,355 and \$5,895, respectively.

4. Other Receivables

During the year ended June 30, 2009, the Hospital obtained notice of final probate court settlement of an estate in the amount of \$2,800. As of June 30, 2009, the current portion of this receivable is included in gifts, bequests, and contributions in other receivables in the accompanying consolidated financial statements. The long-term portion of this receivable, which totals \$1,800, is recorded in other long-term assets as of June 30, 2009. The Hospital collected \$2,500 during the year ended June 30, 2010. The Hospital expects to receive the remaining \$300

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

4. Other Receivables (continued)

during the fiscal year ending June 30, 2011. The remaining portion of this receivable is included in other receivables in the accompanying consolidated financial statements for the year ended June 30, 2010.

5. Assets Limited as to Use

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

	<u>2010</u>	<u>2009</u>
Current:		
Principal and interest due – bonds	\$ 2,841	\$ 2,790
Noncurrent:		
Debt service reserve funds	\$ 6,499	\$ 6,565
Self insurance trusts	4,268	4,128
Deferred compensation trusts	324	323
	<u>\$ 11,091</u>	<u>\$ 11,016</u>

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

	<u>2010</u>	<u>2009</u>
Current:		
Cash and money market accounts	\$ 2,550	\$ 1,725
U.S. government obligations	291	1,065
	<u>\$ 2,841</u>	<u>\$ 2,790</u>
Noncurrent:		
Cash and money market accounts	\$ 698	\$ 4,827
U.S. government obligations	6,194	6,189
Corporate obligations	60	–
Equity securities	260	–
Mutual funds	3,879	–
	<u>\$ 11,091</u>	<u>\$ 11,016</u>

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

6. Promises to Give

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

	<u>2010</u>	<u>2009</u>
Less than one year	\$ 838	\$ 1,298
One to five years	1,967	1,887
More than five years	1,441	2,641
	<u>4,246</u>	<u>5,826</u>
Less: discounting and allowance for uncollectible promises	1,133	1,131
Total promises to give, net	<u>3,113</u>	4,695
Less: current portion of promises to give, net	711	1,116
	<u>\$ 2,402</u>	<u>\$ 3,579</u>

Promises to give include \$615 related to charitable remainder trusts. This net amount represents the excess of the fair value of the related trust accounts over the net present value of the annuities to be paid out of the trust to the named beneficiaries over their estimated life expectancy.

7. Investments

Short-term investments consist of the following at June 30:

	<u>2010</u>	<u>2009</u>
Cash and money market funds	\$ —	\$ 675
U.S. government obligations	—	810
Corporate obligations	—	431
Mortgage-backed securities	—	148
Equity securities	—	1,551
Mutual funds	—	29
	<u>\$ —</u>	<u>\$ 3,644</u>

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

7. Investments (continued)

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

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

	2010		2009	
	Cost	Fair Value	Cost	Fair Value
Cash and cash equivalents	\$ 12,746	\$ 12,746	\$ 14,603	\$ 14,603
U.S. government obligations	1,835	1,927	5,211	5,302
Corporate obligations	2,418	2,555	3,868	3,869
Mortgage-backed securities	3,481	3,713	858	817
Hedge funds	7,300	7,530	-	-
Equity securities	20,050	18,547	9,512	9,092
Mutual funds	24,147	23,371	32,659	22,747
	<u>\$ 71,977</u>	<u>\$ 70,389</u>	<u>\$ 66,711</u>	<u>\$ 56,430</u>

The hedge fund is accounted for under the equity method of accounting. Valuation of this equity investment is primarily based on financial data supplied by the underlying investee fund. The Hospital has the ability to liquidate this investment on a quarterly basis. The Hospital must provide notice of intent to redeem its shares 65 days prior to the redemption date. Ninety percent of the redemption value will be returned to the Hospital within 45 days of the redemption date, with the balance payable 30 days after the receipt of the fund's annual audited financial statements.

Value may be based on historical cost, appraisals, or other estimates that require varying degrees of judgment.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

7. Investments (continued)

Investments are allocated as follows at June 30:

	<u>2010</u>	<u>2009</u>
Investment allocation:		
Unrestricted long-term investments	\$ 67,837	\$ 53,962
Donor restricted investments	2,552	2,468
	<u>\$ 70,389</u>	<u>\$ 56,430</u>

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

	<u>2010</u>	<u>2009</u>
Unrestricted:		
Net realized losses	\$ (4,039)	\$ (6,405)
Interest and dividends, net of investment expense	1,875	2,951
Income (loss) from joint ventures	362	(805)
	<u>\$ (1,802)</u>	<u>\$ (4,259)</u>

Investment expense was \$235 and \$338 for the fiscal years ended June 30, 2010 and 2009, respectively.

Other investments consist of the following at June 30:

	<u>Carrying Value</u>		<u>Income</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Joint ventures	\$ 3,502	\$ 3,640	\$ 362	\$ (805)
Cash surrender value of life insurance policy	688	1,290	5	14
	<u>\$ 4,190</u>	<u>\$ 4,930</u>	<u>\$ 367</u>	<u>\$ (791)</u>

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

7. Investments (continued)

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

	Entity	Interest %	2010	2009
Colonial Regional Alliance	FMH	14.3%	\$ 30	\$ 30
Carroll Occupational Health, LLC	FHSC	25.0%	(18)	1
Comp Claim Management, LLC	FHSC	50.0%	5	15
Open MRI of Frederick, LLC	FHSC	50.0%	245	291
Glade Valley Nursing and Rehabilitation Center, Inc.	FMH	50.0%	768	263
Premier Purchasing Partners (cost method)	FMH	<1.0%	447	447
Mt. Airy Health Services, LLC	FMH	50.0%	510	1,058
Mt. Airy Plaza	FHSC	50.0%	(343)	(322)
Mt. Airy Surgical Center LLC	FHSC	50.0%	167	229
Frederick Surgical Center, LLC	FHSC	39.0%	1,691	1,628
			\$ 3,502	\$ 3,640

8. Fair Value Measurements

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

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

8. Fair Value Measurements (continued)

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

The determination of the fair value level within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Hospital's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the assets or liabilities. The following table presents the Hospital's assets and liabilities measured at fair value on a recurring basis, aggregated by the level in the fair value hierarchy within which those measurements fall, as of June 30, 2010:

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

8. Fair Value Measurements (continued)

	Fair Value Measurements at Reporting Date Using			
	Fair Value at June 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	\$ 50,799	\$ 50,799	\$ –	\$ –
Equity securities	18,807	18,807	–	–
U.S. government obligations	8,413	–	8,413	–
Corporate and other bonds	2,615	–	2,615	–
Mutual funds	27,250	27,250	–	–
Mortgage-backed securities	3,713	–	3,713	–
Contributions receivable	3,113	–	–	3,113
Total assets	<u>\$ 114,710</u>	<u>\$ 96,856</u>	<u>\$ 14,741</u>	<u>\$ 3,113</u>
Liabilities				
Interest rate swap liability	\$ (11,265)	\$ –	\$ (11,265)	\$ –
Total liabilities	<u>\$ (11,265)</u>	<u>\$ –</u>	<u>\$ (11,265)</u>	<u>\$ –</u>

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

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

8. Fair Value Measurements (continued)

Interest Rate Swap

The Hospital entered into an interest rate swap agreement in conjunction with the issuance of variable rate bonds. The swap contract is valued using models based on readily observable market parameters for all substantial terms of the contract. The fair market value of the swap agreement is included as interest rate swap contract in the accompanying balance sheets. The fair market value calculation at June 30, 2010, includes a credit valuation adjustment (CVA) as required by the FASB. At June 30, 2010, the valuation of the interest rate swap agreement liability position was reduced by \$1,354 when applying the CVA. The change in the fair market value of the swap agreement is included in excess (deficiency) of unrestricted revenue and other support over expenses, as the swap is not designated as an effective hedge.

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

Assets utilizing Level 3 inputs are contributions receivable. Contributions receivable are recorded net of allowance for uncollectible pledges and discounted to net present value. The present value of estimated future cash flows using a discount rate commensurate with the risks involved is an appropriate measure of fair value for unconditional promises to give cash and is considered Level 3.

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

	Contributions	
	Receivable	Total
Balance at June 30, 2009	\$ 4,695	\$ 4,695
Purchases, issuances and settlements	(1,582)	(1,582)
Balance at June 30, 2010	<u>\$ 3,113</u>	<u>\$ 3,113</u>

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

9. Property and Equipment

Property and equipment consist of the following at June 30:

	Estimated Useful Lives	2010	2009
Land	–	\$ 3,765	\$ 3,765
Land improvements	8 – 20 years	1,249	1,249
Buildings	20 – 40 years	176,601	174,589
Fixed equipment	10 – 20 years	16,338	16,345
Movable equipment	3 – 20 years	133,826	124,009
Leasehold improvements	5 – 20 years	18,815	13,001
		350,594	332,958
Less accumulated depreciation		171,073	154,922
		179,521	178,036
Construction in process, renovations, and deposits	–	2,145	1,575
		\$ 181,666	\$ 179,611

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

The net book value of assets under capital lease arrangements totaled \$1,487 and \$2,013 as of June 30, 2010 and 2009, respectively. Depreciation expense related to assets under capital lease arrangements was \$525 and \$332 for the fiscal years ended June 30, 2010 and 2009, respectively.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

10. Long-Term Debt

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

	<u>2010</u>	<u>2009</u>
MHHEFA Series 2002 Bonds	\$ 67,733	\$ 68,458
MHHEFA Series 2008 Bonds	72,035	72,025
Equipment note payable	–	894
Note payable – Emmitsburg	461	543
Capital lease obligations	1,550	2,066
	<u>141,779</u>	143,986
Less current maturities	1,568	2,307
	<u>\$ 140,211</u>	<u>\$ 141,679</u>

Series 2008 MHHEFA Revenue Bonds

In July 2008, the Hospital advance refunded its Series 2006 MHHEFA Revenue Bonds (auction rate securities) totaling \$75,000 in part through the issuance of Series 2008 MHHEFA Revenue Bonds (Series 2008 Bonds) in the amount of \$72,160. The Series 2008 Bonds are variable rate demand bonds. The bond insurance securing the Series 2006 Bonds was terminated. The general terms of the original \$75,000 interest rate swap contract remained in place. However, due to the lower principal amount on the new issuance, a portion of the swap was terminated (\$2,840) and a partial termination fee was incurred of approximately \$218. A loss on extinguishment of debt of \$2,370 was recognized as a result of the write-off of unamortized deferred financing cost and original issue discounts. In conjunction with the issuance of the Series 2008 Bonds, the Hospital secured a three-year letter of credit with a bank covering the entire bond issue. The letter of credit was amended on June 25, 2010, with terms for tender advances of the greater of LIBOR +2.75% or 4.00% for the first 90 days, and the greater of LIBOR +3.25% or 4.00% for days 91-366. Tender advances are due 366 days after initial draw. The new termination date of the letter of credit is July 8, 2013.

The Series 2008 MHHEFA Revenue Bonds are net of original issue discounts of \$144 which are being amortized over the life of the bonds using the yield method. Accumulated amortization was \$19 at June 30, 2010. During the year ended June 30, 2010, the interest rate on these variable rate demand bonds has varied from 0.15% – 0.35%. Interest is payable monthly through

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

10. Long-Term Debt (continued)

July 1, 2035. The fair value of the Series 2008 MHHEFA Revenue Bonds is estimated based on the quoted market prices for the same or similar issues. As of June 30, 2010, the carrying value of the MHHEFA Series 2008 Bonds approximates fair value. Under the provisions of the bond agreement, the Hospital has granted to the Authority a security interest in all receipts now owned and hereafter acquired. The Series 2008 Bonds are secured ratably with the Series 2002 Bonds.

There is no debt service reserve requirement associated with the Series 2008 Bonds.

The bond agreement contains certain financial covenants.

Series 2002 MHHEFA Revenue Bonds

In August 2002, the Hospital obtained a loan of \$71,715 in MHHEFA Revenue Bonds, Frederick Memorial Hospital Issue, Series 2002. The MHHEFA Series 2002 Bonds were issued to finance and refinance costs of construction, renovation, and equipping certain Hospital facilities. The Series 2002 Bonds are net of an original issue discount of \$2,361 which is being amortized over the life of the bonds using the yield method. Accumulated amortization was \$734 and \$644 at June 30, 2010 and 2009, respectively. The annual interest rate on the bond loan ranges between 3.25% and 5.125%. Interest is payable semiannually on each January 1 and July 1, through July 1, 2035.

After refunding the Series 2006 Bonds and the issuance of Series 2008 Bonds, the debt service reserve requirement for the Series 2002 Bonds is \$6,208.

Series 2002 Bonds maturing on or after July 1, 2012 are subject to redemption or purchase prior to maturity, beginning on July 1, 2012, at the option of the Authority at the principal amount of the Series 2002 Bonds to be redeemed plus accrued interest thereon to the date set for redemption.

Under the provisions of the bond agreement, the Hospital has granted to the Authority a security interest in all receipts now owned and hereafter acquired. The Series 2002 Bonds are secured ratably with the 2008 Bonds. The fair value of the Series 2002 MHHEFA Revenue Bonds is estimated based on the quoted market prices for the same or similar issues. As of June 30, 2010, the fair value of the MHHEFA Series 2002 Bonds is estimated as \$64,862.

The bond agreement contains certain financial covenants.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

10. Long-Term Debt (continued)

Equipment Note Payable

In June 2004, the Hospital obtained a \$5,367 loan from GE Capital Public Finance, Inc. to finance the acquisition of certain equipment. The Hospital was required to place the loan proceeds into a trustee-held escrow account until all equipment was purchased. The Hospital expended all remaining loan proceeds in 2007. The note is payable in monthly installments of principal and interest of \$88 and is due on July 1, 2010. The note bears interest at 4.83% and is collateralized by certain property and equipment. This loan has been paid in full as of June 30, 2010.

Note Payable – Emmitsburg

In December 1994, the Hospital acquired a 100% interest in Emmitsburg Properties, LLC and subsequently conveyed a 1% interest in the limited liability company to FHSC. In accordance with the terms of the purchase agreement, the Hospital executed two notes payable to the former owners aggregating \$1,219. The notes are payable in monthly installments of principal and interest of \$10, bear interest at 8%, and are due December 31, 2014.

Capital Lease Obligations

During the fiscal year ended June 30, 2010, the Hospital entered into certain capital lease obligations to secure major medical diagnostic equipment. Future payments under these obligations are as follows:

Years ending June 30:	
2011	\$ 584
2012	535
2013	302
2014	206
Total payments	<u>1,627</u>
Less: interest payments	<u>77</u>
Total lease obligations, principal	1,550
Less: current portion	<u>539</u>
Long-term obligations under capital leases	<u>\$ 1,011</u>

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

10. Long-Term Debt (continued)

Debt service requirements on long-term debt and capital lease obligations, excluding the original issue discounts on the MHHEFA Bonds at June 30, 2010 and 2009, of \$1,752 and \$1,852, respectively, are as follows:

	<u>Principal</u>
Years ending June 30:	
2011	\$ 1,568
2012	2,485
2013	2,348
2014	2,356
2015	3,840
Thereafter	<u>130,934</u>
	<u>\$ 143,531</u>

11. Interest Rate Swap Contract

In conjunction with the issuance of the Series 2008 Bonds, the Hospital modified its interest rate swap contract with a third party to a notional amount of \$72,160 until July 1, 2010, at which point the notional amount amortizes over the term of the underlying Series 2008 Bonds, with a final maturity of July 1, 2035. The Hospital is exposed to credit loss in the event of nonperformance by the counterparty to the interest rate swap contract. However, the Hospital does not anticipate nonperformance by the counterparty. Under the swap contract, the Hospital pays interest at a fixed rate of 3.804% and receives interest at a variable rate equal to 67% of the one-month London Interbank Offered Rate (LIBOR) (0.3484% as of June 30, 2010). The swap contract requires payments to be made or received monthly. The fair value of the swap contract was a liability of \$11,265 and \$8,046 at June 30, 2010 and 2009, respectively.

The Hospital records their derivatives as assets or liabilities at fair value. A derivative is typically defined as an instrument whose value is “derived” from an underlying instrument, index or rate, has a notional amount, requires little or no initial investment, and can be net settled. The Hospital participates in an interest rate swap contract that is considered a derivative financial instrument. The interest rate swap contract is not designated as an effective cash flow hedge. The Hospital’s objectives of entering into the interest rate swap contract include limiting or hedging variable interest rate payments, to achieve lower overall borrowing costs than a comparable unhedged

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

11. Interest Rate Swap Contract (continued)

fixed rate borrowing, to alter the pattern of debt service payments, and to improve asset/liability matching. Changes in the fair value of the derivative financial instrument are recognized in the consolidated statements of operations and changes in net assets as a component of other loss. The carrying value of the Hospital's derivative financial instrument approximates fair value. The interest rate swap contract is valued using models based on readily observable market parameters for all substantial terms of the contract.

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

Our derivative agreements do not contain any credit support provisions that require us to post collateral if there are declines in the derivative value or our credit rating.

Balance Sheet Location	Fair Value	
	2010	2009
Asset derivatives		
Derivatives not designated as hedging instruments:		
Interest rate contracts	\$ —	\$ —
Liability derivatives		
Long-term liabilities	\$ 11,265	\$ 8,046
Total derivatives not designated as hedging instruments	<u>\$ 11,265</u>	<u>\$ 8,046</u>

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

11. Interest Rate Swap Contract (continued)

A summary of the effect of the non-hedging derivatives on the Hospital's income statement for the year ended June 30, 2010, is as follows:

Type of Non-Hedging Derivatives	Income Statement Location of Loss Recognized	Derivative Loss Recognized
Interest rate swap contract	Other loss	\$ (3,218)
Total		<u>\$ (3,218)</u>

12. Employee Benefit Plans

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

The Plan was amended during 2009 to provide a 4% minimum interest crediting rate on participant account balances, effective for all prior and future years. This amendment was reflected as of January 1, 2009. There were no changes in the Plan provisions since the last actuarial valuation as of June 30, 2009.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

12. Employee Benefit Plans (continued)

The following provides a reconciliation of the changes in fair value of the Plan's assets and projected benefit obligations, and the Plan's funded status based on a June 30, 2010 and 2009, measurement date:

	2010	2009
	<i>(In Thousands)</i>	
Accumulated benefit obligation	\$ 72,489	\$ 58,978
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year	58,978	59,820
Adjustments due to change in measurement date:		
Service cost plus interest cost during gap period	–	954
Benefits paid during gap period	–	(268)
Service cost	293	253
Interest cost	3,782	3,605
Amendments	–	1,402
Actuarial loss (gain)	10,858	(5,651)
Benefits paid	(1,422)	(1,137)
Projected benefit obligation at end of year	72,489	58,978
Change in plan assets:		
Fair value of plan assets at beginning of year	45,671	52,062
Adjustments due to change in measurement date:		
Contributions during gap period	–	309
Benefits payments during gap period	–	(268)
Actual return on plan assets	5,742	(7,461)
Employer contribution	82	2,166
Benefits paid	(1,422)	(1,137)
Fair value of plan assets at end of year	50,073	45,671
Funded status	(22,416)	(13,307)
Net amount recognized	\$ (22,416)	\$ (13,307)

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

12. Employee Benefit Plans (continued)

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

	June 30	
	2010	2009
Net actuarial loss	\$ 25,177	\$ 18,013
Prior service cost	1,212	1,339
Total recognized in unrestricted net assets	<u>\$ 26,389</u>	<u>\$ 19,352</u>

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

	June 30	
	2010	2009
Discount rate	5.50%	6.50%
Rate of compensation increase	n/a	n/a

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

	Year Ended June 30	
	2010	2009
Discount rate	6.50%	6.00%
Expected return on plan assets	7.00%	7.25%
Rate of compensation increase	n/a	n/a

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

12. Employee Benefit Plans (continued)

Net periodic pension cost included the following components:

	<u>2010</u>	<u>2009</u>
Service cost	\$ 293	\$ 254
Interest cost	3,782	3,605
Expected return on plan assets	(3,142)	(3,824)
Amortization of prior service cost	127	63
Recognized net actuarial loss	1,094	518
Net periodic pension cost	<u>\$ 2,154</u>	<u>\$ 616</u>

The estimated net loss that is expected to be amortized from other changes in unrestricted net assets into net periodic benefit cost for the year ending June 30, 2011, is \$1,649.

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

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

	<u>2010</u>	<u>2009</u>
Equity securities	29.5%	43.8%
Debt securities	55.9	56.0
Cash	1.8	0.2
Hedge funds	12.8	-
Total	<u>100.0%</u>	<u>100.0%</u>

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

12. Employee Benefit Plans (continued)

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

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

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

12. Employee Benefit Plans (continued)

The Hospital's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the assets or liabilities. The following table presents the Plan's assets and liabilities measured at fair value on a recurring basis, aggregated by the level in the fair value hierarchy within which those measurements fall, as of June 30, 2010:

	Fair Value Measurements at Reporting Date Using			
	Fair Value at June 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents	\$ 875	\$ 875	\$ -	\$ -
Equity securities	14,769	14,769	-	-
Fixed income mutual funds	28,023	28,023	-	-
Hedge funds	6,406	-	-	6,406
Total assets	\$ 50,073	\$ 43,667	\$ -	\$ 6,406

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

	Hedge Funds	Total
Balance at June 30, 2009	\$ -	\$ -
Purchases, issuances and settlements	6,406	6,406
Balance at June 30, 2010	\$ 6,406	\$ 6,406

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

12. Employee Benefit Plans (continued)

The hedge fund is accounted for at fair value which has been estimated using the net asset value per share of the fund as of June 30, 2010. The Plan has the ability to liquidate this investment on a quarterly basis. The Plan must provide notice of intent to redeem its shares 65 days prior to the redemption date. Ninety percent of the redemption value will be returned to the Plan within 45 days of the redemption date, with the balance payable 30 days after the receipt of the fund's annual audited financial statements.

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

- Achieve an annualized total return that equals or exceeds the actuarial target
- Preserve the value of the Plan's assets
- Diversify assets sufficiently, and, in accordance with modern portfolio theory, avoid large specific risks (losses) and minimize the volatility of the portfolio
- Provide sufficient liquidity to plan benefit payment outflows and meet the Plan's requirements

The strategic target asset allocation for the Plan is 24% in equities, 59% in debt securities, and 17% in other investments.

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

2011	\$	1,727
2012		1,955
2013		2,205
2014		2,445
2015		2,669
2016 – 2020		17,316

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

12. Employee Benefit Plans (continued)

The Hospital also has a tax-deferred annuity savings (403b) plan available to substantially all employees. In conjunction with the curtailment of the defined benefit pension plan, the Hospital modified the 403b plan effective July 1, 2007. Under the terms of the modified plan, every eligible employee receives a base contribution of 2.5% of earnings. The Hospital will match 50% – 70% on employee contributions up to 5% of employee earnings depending on years of service. In addition, certain employees are eligible for transition credits based on age and years of service to the Hospital. The Hospital's contribution for base matching and transition credits totaled \$5,466 and \$5,035 for Plan years 2010 and 2009, respectively.

The Hospital is partially self-insured against employee medical claims. Plan expenses include claims paid and a provision for claims incurred but not reported. As of June 30, 2010 and 2009, the Hospital has recorded a liability for claims incurred but not reported of \$1,250 and \$1,905, respectively. The program has an annual aggregate stop loss provision of \$250 per employee.

In December 2005, the Hospital adopted two non-qualified deferred compensation plans with an effective date of December 15, 2004, for certain members of executive management. Under the plans, participating employees may contribute amounts from their compensation to the plan and may receive a discretionary employer contribution. Employees are fully vested in all employee contributions to the plans. Vesting in employer contributions occurs in accordance with the underlying plan documents. All assets of the plans are held in separate trusts. Total Hospital contributions to the plans were \$211 and \$141 for the years ended June 30, 2010 and 2009, respectively.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

13. Concentration of Credit Risk

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

	<u>2010</u>	<u>2009</u>
Medicare	22%	25%
Medicaid	13	11
Blue Cross	16	14
HMOs and PPOs	17	19
Commercial insurance and other third-party payors	6	8
Patients	26	23
	<u>100%</u>	<u>100%</u>

14. Functional Expenses

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

	<u>2010</u>	<u>2009</u>
Health care services	\$ 280,617	\$ 266,796
General and administrative	30,666	29,866
	<u>\$ 311,283</u>	<u>\$ 296,662</u>

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)
(Dollars in Thousands)

15. Temporarily and Permanently Restricted Net Assets

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

	<u>2010</u>	<u>2009</u>
Health care services:		
Buildings and equipment	\$ 1,240	\$ 1,396
Restricted by time only	2,240	3,472
Education programs	667	770
Indigent care and research	536	510
	<u>\$ 4,683</u>	<u>\$ 6,148</u>

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

	<u>2010</u>	<u>2009</u>
General health care services (reported as operating income)	\$ 971	\$ 971
Specific health care services (reported as temporarily restricted income)	5	5
	<u>\$ 976</u>	<u>\$ 976</u>

During 2010 and 2009, net assets were released from donor restrictions by incurring expenses or capital expenditures satisfying the restricted purposes in the amounts of \$3,008 and \$1,068, respectively.

16. Contingencies

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

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

16. Contingencies (continued)

The Hospital was insured for professional liability under an occurrence basis policy through June 30, 2005. Effective July 1, 2005, the Hospital established a new irrevocable self-insurance trust to set aside funds to cover future professional liability claims. The initial funding to the trust was \$1,500. Total disbursements from the fund for a covered loss by one or more persons as a result of any one occurrence shall not exceed \$1,000 and \$3,000 in the aggregate in any one fiscal year. Concurrently, the Hospital purchased excess “umbrella” coverage through a commercial carrier with a per-occurrence and aggregate limit of \$10,000 per policy period. The funded balance of the trust was \$4,268 and \$4,128 at June 30, 2010 and 2009, respectively, and is included as assets limited as to use on the consolidated balance sheets.

There are known claims and incidents that could result in the assertion of additional claims, as well as claims from unknown incidents that could be asserted arising from services provided to patients. The Hospital maintains reserves, in the amount of \$4,807 and \$3,969 at June 30, 2010 and 2009, respectively, to cover estimated costs incurred within the self-insured period. The Hospital employs an independent actuary to estimate the ultimate settlement of such claims.

These reserves are recorded at a discounted interest rate of 5%. In management’s opinion, the amounts recorded provide an adequate reserve for loss contingencies. However, changes in circumstances affecting professional liability claims could cause these estimates to change by material amounts in the short term.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

17. Commitments

Operating Leases

The Hospital and its subsidiaries lease facilities under various operating leases, the last of which expires in November 2015. The Hospital has various options to renew the leases. The Hospital also leases equipment under various operating leases. Rent expense under all operating leases was \$4,808 and \$4,447 for 2010 and 2009, respectively. Future minimum payments under non-cancelable operating leases are as follows:

Years ending June 30:	
2011	\$ 4,084
2012	3,237
2013	2,082
2014	1,712
2015	1,656
Thereafter	1,481
	<u>\$ 14,252</u>

Workers' Compensation

The Hospital is self-insured against worker's compensation claims, up to \$400 per occurrence, and has excess insurance coverage of \$1,000 per occurrence. Expenses include claims paid and a provision for claims incurred but not reported.

Supply Chain Management Agreement

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

Letter of Credit

The Hospital has a letter of credit issued by a lending institution in the amount of \$1,200. This letter of credit is renewed on an annual basis and is required by the State of Maryland as collateral for unemployment benefits.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued) (Dollars in Thousands)

18. Regulatory Environment

Medicare and Medicaid

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

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

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

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

State of Maryland Health Services Cost Review Commission

Rates charged by Maryland hospitals are subject to review and certification by the State of Maryland Health Services Cost Review Commission (HSCRC). Maryland hospitals are not permitted to charge for regulated services, defined as services provided on the Hospital's campus or Hospital based services, at rates other than those approved by the HSCRC.

Frederick Memorial Hospital, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

(Dollars in Thousands)

18. Regulatory Environment (continued)

In April 1999, the HSCRC implemented a rate methodology for inpatient hospital services. Under this methodology, a target average charge per case is established annually for each hospital based on past actual charges, case mix indices, and other annual adjustments. The actual average charge per case is compared with the target average charge per case and to the extent that the actual average is above or below the target, the variance plus applicable penalties will increase or decrease the approved target for the succeeding fiscal year.

The HSCRC's rate setting methodology for service centers that provide either inpatient and outpatient services, or only outpatient services, establishes an acceptable unit rate for each inpatient and outpatient center. The actual average unit charge for each service center is compared to the approved rate monthly. Variances due to volume or price plus applicable penalties are applied to decrease or increase approved rates for the succeeding fiscal year.

The timing of the HSCRC's rate adjustments in any given year could result in an increase or decrease in the succeeding year's rates due to the variances and penalties described above. The Hospital accrues revenue based on actual charges for services to patients in the year in which the services are performed.

The HSCRC established an uncompensated care fund whereby certain hospitals are required to contribute to the fund to help cover the costs associated with uncompensated care for all Maryland hospitals equitably. The Hospital's contribution to the fund was \$3,173 and \$2,427 for the years ended June 30, 2010 and 2009, respectively.

19. Subsequent Events

The Hospital has evaluated subsequent events for the year ended June 30, 2010 through October 22, 2010, the date these financial statements were issued.

During September 2010, the Hospital divested of the 50% ownership in Glade Valley Nursing and Rehabilitation Center, Inc. resulting in a \$3,800 gain.

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

Other Financial Information

Report of Independent Auditors

The Board of Directors
Frederick Memorial Hospital, Inc. and Subsidiaries

Our audit was conducted for the purpose of forming an opinion on the June 30, 2010, consolidated financial statements taken as a whole. The accompanying consolidating schedules are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audit of the June 30, 2010, consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the June 30, 2010, consolidated financial statements taken as whole.

Ernst + Young LLP

October 22, 2010

Frederick Memorial Hospital, Inc. and Subsidiaries

Consolidated Statements of Changes in Net Assets

(In Thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Net assets, June 30, 2008	\$ 146,377	\$ 5,900	\$ 976	\$ 153,253
Deficiency of unrestricted revenue and other support over expenses	(12,574)	–	–	(12,574)
Pension adjustment	(7,409)	–	–	(7,409)
Released from restriction used to purchase capital	907	–	–	907
Assets released from restrictions	–	(1,068)	–	(1,068)
Restricted gifts, bequests and contributions	–	1,316	–	1,316
Changes in net assets	(19,076)	248	–	(18,828)
Net assets, June 30, 2009	127,301	6,148	976	134,425
Excess of unrestricted revenue and other support over expenses	8,254	–	–	8,254
Pension adjustment	(7,037)	–	–	(7,037)
Released from restriction used to purchase capital	640	–	–	640
Assets released from restrictions	–	(3,008)	–	(3,008)
Restricted gifts, bequests and contributions	–	1,543	–	1,543
Changes in net assets	1,857	(1,465)	–	392
Net assets, June 30, 2010	\$ 129,158	\$ 4,683	\$ 976	\$ 134,817

See accompanying notes.

Frederick Memorial Hospital, Inc. and Subsidiaries

Consolidating Balance Sheet

(In Thousands)

June 30, 2010

	Frederick Memorial Hospital Inc.	Hospice of Frederick County, Inc.	Emmitsburg Properties, LLC	Frederick Health Services Corporation	Elimination	Consolidated
Assets						
Current assets:						
Cash and cash equivalents	\$ 34,175	\$ 223	\$ –	\$ 407	\$ –	\$ 34,805
Short-term investments	–	–	–	–	–	–
Patient receivables, net	41,645	88	–	1,425	–	43,158
Other receivables	2,284	–	–	107	–	2,391
Inventory	4,156	–	–	–	–	4,156
Prepaid expenses	2,182	6	–	103	–	2,291
Assets limited as to use	2,841	–	–	–	–	2,841
Promises to give, net	711	–	–	–	–	711
Total current assets	87,994	317	–	2,042	–	90,353
Net property and equipment	175,285	1,058	–	5,323	–	181,666
Other assets:						
Assets limited as to use	11,091	–	–	–	–	11,091
Investments – donor restricted	2,552	–	–	–	–	2,552
Promises to give, net	2,402	–	–	–	–	2,402
Long-term investments	64,219	1,377	2,241	–	–	67,837
Other investments	19,881	–	–	1,747	(17,438)	4,190
Debt issuance costs, net	1,799	–	–	–	–	1,799
Other assets	3,691	–	–	254	(3,625)	320
Intangible assets, net	–	–	–	–	–	–
Total other assets	105,635	1,377	2,241	2,001	(21,063)	90,191
Total assets	\$ 368,914	\$ 2,752	\$ 2,241	\$ 9,366	\$ (21,063)	\$ 362,210

Frederick Memorial Hospital, Inc. and Subsidiaries

Consolidating Balance Sheet (continued)

(In Thousands)

June 30, 2010

	Frederick Memorial Hospital Inc.	Hospice of Frederick County, Inc.	Emmitsburg Properties, LLC	Frederick Health Services Corporation	Elimination	Consolidated
Liabilities and net assets						
Current liabilities:						
Current maturities of long-term debt and capital lease obligations	\$ 1,568	\$ —	\$ —	\$ —	\$ —	\$ 1,568
Accounts payable	15,564	65	—	305	(65)	15,869
Accrued expenses	17,707	—	—	657	—	18,364
Advances from third-party payors	8,048	—	—	—	—	8,048
Loans payable, affiliates	75	—	—	3,500	(3,575)	—
Other current liabilities	3,047	—	—	—	—	3,047
Total current liabilities	46,009	65	—	4,462	(3,640)	46,896
Long-term liabilities, net of current portion:						
Long-term debt and capital lease obligations	140,211	—	—	—	—	140,211
Interest rate swap contract	11,265	—	—	—	—	11,265
Accrued pension expense	22,416	—	—	—	—	22,416
Other long-term liabilities	6,605	—	—	—	—	6,605
Total long-term liabilities, net of current portion	180,497	—	—	—	—	180,497
Total liabilities	226,506	65	—	4,462	(3,640)	227,393
Net assets:						
Unrestricted	136,749	2,687	2,241	4,904	(17,423)	129,158
Temporarily restricted	4,683	—	—	—	—	4,683
Permanently restricted	976	—	—	—	—	976
Total net assets	142,408	2,687	2,241	4,904	(17,423)	134,817
Total liabilities and net assets	\$ 368,914	\$ 2,752	\$ 2,241	\$ 9,366	\$ (21,063)	\$ 362,210

Frederick Memorial Hospital, Inc. and Subsidiaries

Consolidating Statement of Operations and Changes in Net Assets

(In Thousands)

Year Ended June 30, 2010

	Frederick Memorial Hospital Inc.	Hospice of Frederick County, Inc.	Emmitsburg Properties, LLC	Frederick Health Services Corporation	Elimination	Consolidated
Unrestricted revenue and other support:						
Net patient service revenue	\$ 301,269	\$ 113	\$ -	\$ 3,694	\$ (290)	\$ 304,786
Other operating revenues	3,423	-	-	4,603	(1,307)	6,719
Gifts, bequests, and contributions	1,232	733	-	-	-	1,965
Net assets released from restriction used for operations	2,368	-	-	-	-	2,368
Total unrestricted revenue and other support:	<u>308,292</u>	<u>846</u>	<u>-</u>	<u>8,297</u>	<u>(1,597)</u>	<u>315,838</u>
Operating expenses:						
Salaries and wages	123,673	-	-	4,887	(158)	128,402
Employee benefits	31,338	-	-	978	(88)	32,228
Professional fees	11,446	-	-	47	(28)	11,465
Cost of goods sold	44,486	-	-	574	-	45,060
Supplies	9,202	99	-	-	(6)	9,295
Contract services	28,793	603	-	320	(788)	28,928
Other	10,189	124	-	927	(529)	10,711
Utilities	4,290	14	-	86	-	4,390
Insurance	2,595	2	-	110	-	2,707
Depreciation and amortization	17,708	79	-	514	-	18,301
Interest	6,975	-	-	115	(115)	6,975
Provision for uncollectible accounts	12,801	-	-	20	-	12,821
Total operating expenses	<u>303,496</u>	<u>921</u>	<u>-</u>	<u>8,578</u>	<u>(1,712)</u>	<u>311,283</u>
Operating income (loss)	<u>4,796</u>	<u>(75)</u>	<u>-</u>	<u>(281)</u>	<u>115</u>	<u>4,555</u>

Frederick Memorial Hospital, Inc. and Subsidiaries

Consolidating Statement of Operations and Changes in Net Assets (continued)

(In Thousands)

Year Ended June 30, 2010

	Frederick Memorial Hospital Inc.	Hospice of Frederick County, Inc.	Emmitsburg Properties, LLC	Frederick Health Services Corporation	Elimination	Consolidated
Other income (loss):						
Gain on sale of assets	\$ 14	\$ -	\$ -	\$ -	\$ -	\$ 14
Investment (loss) income, net	(1,658)	42	109	(180)	(115)	(1,802)
Change in unrealized gains on trading securities, net	8,267	40	107	-	-	8,414
Change in fair value of interest rate swap contract	(3,218)	-	-	-	-	(3,218)
Other non-operating income	291	-	-	-	-	291
Total other income (loss)	3,696	82	216	(180)	(115)	3,699
Excess (deficiency) of unrestricted revenue and other support over expenses	8,492	7	216	(461)	-	8,254
Other changes in unrestricted net assets:						
Pension adjustment	(7,037)	-	-	-	-	(7,037)
Released from restriction used to purchase capital	640	-	-	-	-	640
Increase (decrease) in unrestricted net assets	\$ 2,095	\$ 7	\$ 216	\$ (461)	\$ -	\$ 1,857