



**Consolidated Financial Statements,
Supplementary Information and
Report of Independent Certified Public Accountants**

Lancaster General Hospital

June 30, 2012 and 2011

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Audit • Tax • Advisory

Grant Thornton LLP
2001 Market Street, Suite 3100
Philadelphia, PA 19103-7080

T 215.561.4200
F 215.561.1066
www.GrantThornton.com

Report of Independent Certified Public Accountants

Board of Trustees
Lancaster General Hospital

We have audited the accompanying consolidated balance sheets of Lancaster General Hospital (LGH) as of June 30, 2012 and 2011 and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of LGH's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America as established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of LGH'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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lancaster General Hospital as of June 30, 2012 and 2011 and the results of its operations and changes in net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Grant Thornton LLP

Philadelphia, Pennsylvania

October 29, 2012

Lancaster General Hospital

CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)

	June 30	
	<u>2012</u>	<u>2011</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 8,126	\$ 10,970
Investments	115,530	66,749
Assets limited as to use	4,304	9,593
Patient accounts receivable, net of allowance for doubtful accounts of \$21,583 and \$21,351 at June 30, 2012 and 2011, respectively	102,820	110,123
Other receivables	12,375	14,726
Inventories	4,271	4,519
Due from related organizations	986	6,321
Prepaid expenses and other current assets	<u>10,816</u>	<u>11,985</u>
Total current assets	259,228	234,986
Investments		
Unrestricted	27,672	26,308
Donor restricted	<u>16,800</u>	<u>15,024</u>
	44,472	41,332
Interest in net assets of Lancaster General Health	999	635
Assets limited as to use, net of current portion	23,658	14,457
Property, plant and equipment, net	466,639	468,727
Beneficial interest in trusts	8,216	8,774
Investments in non-consolidated affiliates	6,975	6,247
Other assets	8,438	2,311
Total assets	<u>\$ 818,625</u>	<u>\$ 777,469</u>

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Lancaster General Hospital

CONSOLIDATED BALANCE SHEETS (continued)
(Dollars in Thousands)

	June 30	
	<u>2012</u>	<u>2011</u>
Liabilities and net assets		
Current liabilities		
Current portion of long-term debt	\$ 7,209	\$ 21,314
Accounts payable	35,949	23,847
Accrued payroll and related benefits	35,201	43,159
Estimated settlements with third-party payors	10,853	10,789
Other current liabilities	12,717	3,455
Total current liabilities	<u>101,929</u>	<u>102,564</u>
Other liabilities	27,024	19,981
Long-term debt, net of current portion	<u>228,635</u>	<u>217,515</u>
Total liabilities	357,588	340,060
Net assets		
Unrestricted		
Assets limited as to use	27,962	24,050
General	401,479	383,606
Total unrestricted net assets of LGH	<u>429,441</u>	<u>407,656</u>
Non-controlling interests	3,051	2,797
Total unrestricted net assets	432,492	410,453
Temporarily restricted	18,851	17,200
Permanently restricted	9,694	9,756
Total net assets	<u>461,037</u>	<u>437,409</u>
Total liabilities and net assets	<u>\$ 818,625</u>	<u>\$ 777,469</u>

The accompanying notes are an integral part of these statements.

Lancaster General Hospital

**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
(Dollars in Thousands)**

	Years ended June 30	
	2012	2011
Unrestricted net assets		
Unrestricted revenue and other support		
Net patient service revenue	\$ 840,004	\$ 824,450
Medical services	8,356	7,678
Other revenue	35,071	35,326
Net assets released from restrictions for operations	2,525	2,191
Contributions	338	349
Total unrestricted revenue and other support	<u>886,294</u>	<u>869,994</u>
Expenses		
Operating expenses	734,322	719,375
Depreciation and amortization	53,100	53,425
Interest	6,908	7,719
Provision for bad debts	35,849	34,650
Total expenses	<u>830,179</u>	<u>815,169</u>
Operating income	56,115	54,825
Other income (loss)		
Investment income	1,612	2,545
Net realized gains on sale of trading securities	480	413
Change in net unrealized gains and losses on trading securities	162	(204)
Change in fair value of interest rate swap agreement	(4,339)	1,937
Provision for income taxes	(8,232)	-
Other non-operating income, net	18,192	6,630
Total other income	<u>7,875</u>	<u>11,321</u>
Excess of revenue and other income over expenses	63,990	66,146
Excess of revenue attributable to non-controlling interests	<u>(2,119)</u>	<u>(1,960)</u>
Excess of revenue and other income over expenses attributable to LGH	61,871	64,186

Continued on next page

Lancaster General Hospital

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
(continued)
(Dollars in Thousands)

	Years ended June 30	
	2012	2011
Unrestricted net assets (continued)		
Excess of revenue and other income over expenses attributable to LGH <i>(from previous page)</i>	\$ 61,871	\$ 64,186
Other changes in unrestricted net assets		
Net assets released from restrictions - purchase of property, plant and equipment	450	6
Change in non-controlling interests	254	227
Equity contributions to related organizations	(40,536)	(184,237)
Increase (decrease) in unrestricted net assets	<u>22,039</u>	<u>(119,818)</u>
Temporarily restricted net assets		
Restricted contributions and gifts	2,007	6,804
Grants	2,330	1,173
Investment income	189	172
Net realized gains on sale of trading securities	73	30
Change in net unrealized gains and losses on trading securities	(347)	215
Net assets released from restrictions	(2,975)	(2,197)
Change in interest in net assets of Lancaster General Health	374	368
Increase in temporarily restricted net assets	<u>1,651</u>	<u>6,565</u>
Permanently restricted net assets		
Restricted contributions and gifts	222	875
Change in net unrealized gains and losses on trading securities	(28)	585
Change in fair value of beneficial interest in trusts	(256)	417
Other	-	37
(Decrease) increase in permanently restricted net assets	<u>(62)</u>	<u>1,914</u>
Increase (decrease) in net assets	23,628	(111,339)
Net assets, beginning of year	<u>437,409</u>	<u>548,748</u>
Net assets, end of year	<u>\$ 461,037</u>	<u>\$ 437,409</u>

The accompanying notes are an integral part of these statements.

Lancaster General Hospital

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)

	Years ended June 30	
	2012	2011
Operating activities		
Increase (decrease) in net assets	\$ 23,628	\$ (111,339)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	53,100	53,425
Provision for bad debts	35,849	34,650
Net realized and unrealized gains on trading securities	(677)	(1,039)
Equity earnings in non-consolidated affiliates	(6,904)	(5,596)
Change in fair value of interest rate swap agreement	4,339	(1,937)
Change in interest in net assets of Lancaster General Health	(364)	(405)
Contributions to related organizations	40,536	184,237
Change in fair value of beneficial interest in trusts	558	(503)
Restricted contributions, gifts, grants, and restricted income	(4,748)	(9,025)
Changes in certain assets and liabilities		
Patient accounts receivable	(28,470)	(26,521)
Other receivables	2,275	(4,660)
Inventories	248	619
Prepaid expenses and other current assets	1,169	(568)
Other assets	(5,555)	(11)
Due from related organizations	5,335	(2,659)
Accounts payable	11,782	(8,183)
Accrued payroll and related benefits	(7,958)	3,842
Estimated settlements with third-party payors	64	5,366
Other liabilities	11,966	1,344
	<hr/>	<hr/>
Net cash provided by operating activities before trading securities	136,173	111,037
Change in investments and assets limited as to use trading securities	(55,156)	90,161
	<hr/>	<hr/>
Net cash provided by operating activities	81,017	201,198

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Lancaster General Hospital

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(Dollars in Thousands)

	Years ended June 30	
	2012	2011
Investing activities		
Net purchases of property, plant and equipment	\$ (47,868)	\$ (50,317)
Distributions from non-consolidated affiliates	6,176	4,985
	<u>(41,692)</u>	<u>(45,332)</u>
Financing activities		
Restricted contributions, gifts, grants, and restricted income	4,748	4,930
Contributions to related organizations	(40,536)	(184,237)
Proceeds from long-term debt	119,005	37,200
Repayments of long-term debt	(124,139)	(19,151)
Payments for deferred financing costs	(1,247)	-
	<u>(42,169)</u>	<u>(161,258)</u>
Decrease in cash and cash equivalents	(2,844)	(5,392)
Cash and cash equivalents, beginning of year	10,970	16,362
Cash and cash equivalents, end of year	<u>\$ 8,126</u>	<u>\$ 10,970</u>
Supplemental disclosure of cash flow information		
Cash paid for interest, net of amounts capitalized	<u>\$ 6,992</u>	<u>\$ 8,017</u>
Noncash investing and financing activities		
Capital lease obligations incurred in exchange for equipment	<u>\$ 2,148</u>	<u>\$ 2,090</u>
Increase in accrual for the purchase of property, plant and equipment	<u>\$ 322</u>	<u>\$ 341</u>

The accompanying notes are an integral part of these statements.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE A - ORGANIZATION

Lancaster General Hospital (the Hospital), founded in 1893 as a private, voluntary, nonsectarian general hospital, has 638 beds and is located in the City of Lancaster, Pennsylvania. Its primary service area is comprised of Lancaster City and 14 surrounding communities. The Hospital provides a full range of primary and secondary health care services and is a major referral center. The sole member of the Hospital is Lancaster General Health (LG), a not-for-profit corporation, which has several other controlled affiliates and subsidiaries.

Lancaster General Health - Columbia Center (CHC) is a not-for-profit corporation located in Columbia, Pennsylvania. It operates a primary care physician office and provides facility management for outpatient services. CHC's sole member is the Hospital.

Lancaster General Imaging Corporation (LGIC) is a not-for-profit corporation located in the City of Lancaster, Pennsylvania and its sole member is the Hospital. LGIC has a 75% ownership interest in the Lancaster PET Partnership, LLP (PET) and a 57.5% ownership interest in the MRI Group, LLP (MRI).

Lancaster General College of Nursing & Health Sciences (LGCNHS) is a not-for-profit corporation that operates a college located in the City of Lancaster, Pennsylvania. The sole member of LGCNHS is the Hospital.

Lancaster General Ambulatory Surgical Services, Inc. (LGAMB) is a not-for-profit corporation which owns 50% of Physicians' Surgery Center - Lancaster General (PSC). The sole member of LGAMB is the Hospital.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Principles of Consolidation

The consolidated financial statements include the accounts of the Hospital, CHC, LGIC, LGCNHS, and LGAMB, including the non-controlling interests in PET and MRI reported as a component of net assets (collectively, LGH). All significant intercompany balances and transactions have been eliminated.

2. Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. The most significant management estimates and assumptions are related to the determination of allowance for doubtful accounts and contractual allowances for patient accounts receivable, useful lives of property, plant and equipment, self-insured and professional liabilities, provision for income taxes and the reported fair values of certain assets and liabilities. Actual results could differ from those estimates.

3. Cash and Cash Equivalents

Cash and cash equivalents includes various checking, savings, and money market accounts and other investments with initial maturity dates of three months or less.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

4. Inventories

Inventories are stated at the lower of cost, determined by the weighted-average cost method, or market.

5. Investments and Assets Limited as to Use

Investments and assets limited as to use include assets set aside by management and trustees for future purposes, including capital improvements. Certain investments have been restricted by donors and are designated as donor restricted. In addition, assets limited as to use include investments held by trustees under bond indenture agreements, including construction and debt service interest, principal and reserve funds. LGH has designated its investment portfolios as trading. Amounts required to meet current liabilities of LGH have been reclassified to the current portion of assets limited as to use in the consolidated balance sheets.

Direct investments in equity securities with readily determinable fair values and all direct investments in debt securities have been measured at fair value in the accompanying consolidated balance sheets. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in excess of revenue and other income over expenses unless the income or loss is restricted by donor or law.

6. Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Donated assets are recorded at their fair value at the date of donation. Depreciation is provided over the estimated useful lives of each depreciable asset and is computed using the straight-line method. Equipment under capital leases is amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Capitalized interest amounted to \$26 and \$244 for the years ended June 30, 2012 and 2011, respectively.

7. Long-Lived Assets

LGH continually evaluates whether events and circumstances have occurred that indicate the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance may not be recoverable. When factors indicate that long-lived assets should be evaluated for possible impairment, LGH uses an estimate of the related discounted operating income over the remaining life of the long-lived asset in measuring whether the long-lived asset is recoverable. At June 30, 2012, management believed that no revisions to the remaining useful lives or write-down of long-lived assets were required.

8. Deferred Financing Costs

LGH has capitalized costs incurred in obtaining and issuing the revenue bonds. These costs are amortized over the term of the bonds. Unamortized deferred financing costs of \$1,916 and \$1,343 at June 30, 2012 and 2011, respectively, are included in other assets in the consolidated balance sheets. Accumulated amortization amounted to \$2,855 and \$2,181 at June 30, 2012 and 2011, respectively.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

9. Beneficial Interest in Trusts

LGH has been named as a beneficiary of several trusts, including a charitable remainder trust, to be held in perpetuity, which are administered and controlled by independent trustees. LGH has recorded its portion of the fair value of the trusts as permanently restricted, with the exception of one trust that is temporarily restricted. LGH records the earnings from these investments as unrestricted or restricted investment income based on the donor's stipulations.

10. Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then recorded as the cost. The gifts are reported as either temporarily or permanently restricted if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is when a stipulated time restriction ends or purpose is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

Contributions received with donor-imposed restrictions that are met in the same year as received are reported as revenues of the temporarily restricted net asset class, and a reclassification to unrestricted net assets is made to reflect the expiration of such restrictions.

11. Derivative Financial Instruments

LGH recognizes its derivative financial instrument in the consolidated balance sheets at fair value. Management has elected not to designate the interest rate swap agreement as a hedge for financial reporting purposes. Consequently, the change in the fair value of the LGH interest rate swap agreement is included in other income (loss) as a component of excess of revenues and other income over expenses in the consolidated statements of operations and changes in net assets.

The interest rate swap agreement is used by LGH to manage interest rate exposures and to hedge the changes in cash flows on variable rate revenue bonds. Derivative financial instruments involve, to a varying degree, elements of market and credit risk. The market risk associated with these instruments resulting from interest rate movements is expected to offset the market risk of the liability being hedged.

12. Investments in Non-consolidated Affiliates

Investments in partnerships and limited liability companies including those with underlying interest in equity and debt securities are recorded using the equity method of accounting, with the related changes in value in earnings reported as a component of other income (loss) in the accompanying consolidated statements of operations and changes in net assets.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

13. Estimated Professional Liability

The reserve for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported and is included in other liabilities in the consolidated balance sheets. The estimate for incurred but not reported claims is actuarially determined based on LGH specific and industry experience data. Receivables for expected insurance recoveries are included in other assets in the accompanying consolidated balance sheets.

14. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets represent those whose use has been limited by donors to a specific time period or purpose. As the donors' intentions are met, the net assets are reclassified to unrestricted and reported in the consolidated statements of operations and changes in net assets as a component of unrestricted revenue and other support for operating purposes, and as other changes in unrestricted net assets for acquisitions of property, plant and equipment. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity with income to support services in accordance with donor stipulations. Gains and losses on investments are reported as increases or decreases in unrestricted net assets unless restricted by donor stipulations or law.

15. Net Patient Accounts Receivable and Net Patient Service Revenue

Net patient accounts receivable and net patient service revenue are recorded at established rates, net of contractual adjustments, charity allowances, and policy discounts. LGH recognizes bad debt expense and the allowance for doubtful accounts based upon historical experience. Patient accounts receivable are charged off against the allowance for doubtful accounts when management determines that recovery is unlikely and LGH ceases collection efforts. Losses have been consistent with management's expectations.

Contractual revenue adjustments arising from reimbursement agreement with third-party payors are accrued on an estimated basis in the period the related services are rendered. Differences between these accruals and final third-party settlements are included in the consolidated statements of operations and changes in net assets as an adjustment to net patient service revenue in the year of final settlement.

LGH has agreements with various third-party payors to provide office visits to subscribing participants. Under these agreements, LGH receives monthly capitation payments based on the number of each payor's participants, regardless of services actually performed by LGH. Capitation revenue is included in net patient service revenue in the consolidated statements of operations and changes in net assets.

16. Medical Services

LGH provides convenience pharmacy services to employees and their families as well as to patients who are discharged. Medical services revenue is recorded at the net amount collected for the pharmacy services provided.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

17. Other Revenue

Other revenue is comprised of tuition revenue, management fees, rental income, cafeteria revenue, and other miscellaneous items (see Note E).

18. Excess of Revenue and Other Income over Expenses

The consolidated statements of operations and changes in net assets include the excess of revenue and other income over expenses. Changes in unrestricted net assets that are excluded from the excess of revenue and other income over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets), change in non-controlling interests and permanent equity contributions with related organizations.

19. Community Care

LGH provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the entities do not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue (see Note C).

20. Income Taxes

The Hospital, CHC, LGIC and LGCHNS are organized and operated as nonprofit corporations and as tax-exempt organizations described in Internal Revenue Code (IRC) Section 501(c)(3).

LGAMB is a Pennsylvania nonprofit corporation. In April 2008, LGAMB filed an Application for Recognition of Exemption under IRC Section 501(c)(3) (Form 1023). On May 18, 2012, LGAMB received a determination from the Internal Revenue Service (IRS) that it does not qualify for exemption under Section 501(c)(3) of the IRC. LGAMB filed a protest letter regarding the determination with the IRS on June 15, 2012. This filing was followed by a conference on July 23, 2012 involving representatives of LGAMB and representatives of the Tax Exempt Organizations Division of the National Office of the IRS. Thereafter, on August 31, 2012, in response to a request from the IRS for additional information in connection with the pending review of the exemption application, LGAMB provided the IRS with additional supporting information and is presently awaiting a final determination from the IRS on its tax status.

Management in consultation with legal counsel strongly disagrees with the IRS's position as stated in the May 18, 2012 letter and believes that LGAMB satisfies the applicable legal standards for tax exemption.

LGH follows generally accepted accounting principles (GAAP) for uncertainties in income tax positions. Notwithstanding that management believes the IRS's determination is incorrect and that LGAMB is entitled to tax-exemption, because of the IRS's issuance of the May 18, 2012 letter, LGH has made an accrual for uncertain tax positions relating to LGAMB.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Dollars in Thousands)
June 30, 2012 and 2011

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The following table summarizes the activity related to LGH's accrued uncertain tax positions as a result of LGAMB's receipt of the May 18, 2012 letter from the IRS:

Uncertain tax positions, June 30, 2011	\$ -
Changes to tax positions related to the current year	2,504
Changes to tax positions of prior years	<u>4,399</u>
Uncertain tax positions, June 30, 2012	<u>\$ 6,903</u>

LGH accrues interest and penalties related to income tax matters as a part of the provision for income taxes. LGH accrued interest and penalties of \$1,329 as of June 30, 2012 as a result of the IRS's May 18, 2012 letter. The amount of the unrecognized tax benefit, if recognized, would reduce LGH's effective tax rate in the year of recognition. Management cannot reasonably determine whether there will be a change to the unrecognized tax benefit within the next 12 months.

The tax years subject to examination by the IRS and the Commonwealth of Pennsylvania for LGH and its affiliates, except for LGAMB, are 2010 through 2012 and for LGAMB are 2006 through 2012.

21. Recently Adopted Accounting Pronouncement

In August 2010, the Financial Accounting Standards Board (FASB) issued guidance to reduce the diversity in practice related to the accounting by health care entities for medical malpractice and similar liabilities, and their related expected insurance recoveries. The new guidance requires that insurance claims liabilities be determined without consideration of any expected insurance recoveries, consistent with practice in other industries. The guidance also clarifies that health care entities should no longer net expected insurance recoveries against the related claims liabilities. The guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. A cumulative-effect adjustment should be recognized in opening equity (net assets) in the period of adoption if a difference exists between any liabilities and insurance receivables recorded as a result of applying the amendments in this guidance. LGH has adopted this guidance in the current year, resulting in an additional liability and a corresponding asset of \$5,535 at June 30, 2012. There was no cumulative effect of this adoption.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

22. Pending New Accounting Pronouncement

In July 2011, the FASB issued authoritative guidance to provide amendments to the presentation of the statement of operations for certain health care entities and enhanced disclosure about net patient service revenue and the related allowance for doubtful accounts. These amendments require certain health care entities to present their provision for bad debts associated with patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts). These amendments also require disclosure of patient service revenue (net of contractual allowances and discounts) as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. Additionally, health care entities are required to provide enhanced disclosure about their policies for recognizing revenue and assessing bad debts. This guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2011, with early adoption permitted. The amendments to the presentation of the provision for bad debts related to patient service revenue in the statement of operations should be applied retrospectively to all prior periods presented. The disclosures required by the amendments in this update should be provided for the period of adoption and subsequent reporting periods. LGH is evaluating the impact of adopting this guidance on its results of operations and financial position.

NOTE C - COMMUNITY CARE

LGH maintains records to identify and monitor the level of community care it provides. Charges related to charitable services are recorded at cost by applying a cost to charge ratio. The level of community benefits provided as identified in accordance with LGH's accounting policies is as follows:

	Years ended June 30	
	<u>2012</u>	<u>2011</u>
Charitable services		
Unpaid cost of state programs to the financially disadvantaged (e.g., Medicaid)	\$ 70,706	\$ 64,760
Unpaid cost of services to other financially disadvantaged persons	9,205	11,214
Other community services		
Unpaid cost of education programs	7,631	7,429
Cost of other community services	<u>6,122</u>	<u>6,764</u>
Total community care at cost	<u>\$ 93,664</u>	<u>\$ 90,167</u>

LGH's policy is to accept all patients regardless of their ability to pay. This policy results in LGH's assumption of higher-than-normal patient receivable credit risks. Any additional losses realized as a result of this assumption are included in the provision for bad debts. LGH's threshold for financial assistance is 400% of federal poverty guidelines. LGH uses a sliding scale to determine actual discounts to be provided to patients who have income less than 400% of the federal poverty guidelines.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE D - NET PATIENT SERVICE REVENUE

LGH has agreements with third-party payors that provide for payments at amounts different from established charges. Hospital inpatient acute care services and outpatient services for Medicare and Medicaid program beneficiaries are paid at prospectively determined rates per inpatient discharge or outpatient visit. These payments vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

Certain services for Medicare beneficiaries are paid based on a cost reimbursement methodology, subject to certain limitations. These services are paid at a tentative rate, with final settlement determined after submission of annual cost reports and audits thereof by the programs' fiscal intermediary. Provisions for estimated adjustments resulting from audit and final settlements have been recorded. Differences between the estimated adjustments and the amounts settled are recorded in the year of settlement. Fiscal intermediaries have not audited the cost reports for the years ended June 30, 2012 and 2011. The years ended June 30, 2010, 2009, and 2008 have been audited but not yet finalized.

In December 2010, the Department of Public Welfare (DPW) received approval from the Centers for Medicare and Medicaid Services (CMS) for the Pennsylvania state plan amendments pursuant to Pennsylvania Act 49 of 2010 that, among other things, established a new inpatient hospital fee-for-service payment system (using APR-DRG), established enhanced hospital payments through the state's Medical Assistance (MA) managed care program, and secured additional matching Medicaid funds through the establishment of the Quality Care Assessment. In February 2011, the DPW received the approvals necessary from CMS on the final technical language for the DPW contracts with managed care organizations. The Hospital and Healthcare Association of Pennsylvania issued hospital-specific impacts of the MA payment modernization for the years ended June 30, 2012 and 2011. LGH has recorded the results in operating income in its consolidated statements of operations and changes in net assets for the years ended June 30, 2012 and 2011.

LGH has also entered into payment agreements with certain commercial third-party payors and administrators. The basis for payments under these agreements includes prospectively determined rates per discharge, per diems and discounts from established charges. Certain agreements have retrospective clauses allowing the payor to review and adjust claims subsequent to initial payment.

In the opinion of management, adequate provision has been made for adjustments that may result from the final settlement of cost reports and other adjustments. The consolidated financial statements include a decrease to net patient service revenue related to the settlement and/or adjustments of the prior-year cost reports and other third-party settlement estimates of approximately \$1,356 and \$6,530 for the years ended June 30, 2012 and 2011, respectively.

Revenues from the Medicare and Medicaid programs collectively accounted for approximately 36% of net patient service revenues for the years ended June 30, 2012 and 2011. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Management 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. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretations as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE E - OTHER REVENUE

The composition of other revenue is presented in the following table:

	June 30	
	<u>2012</u>	<u>2011</u>
Tuition	\$ 13,667	\$ 11,810
Management fee from related parties	6,661	6,365
Cafeteria	4,187	4,149
Rental income		
Related party	683	732
Non-related party	5,744	5,923
Other	<u>4,129</u>	<u>6,347</u>
	<u>\$ 35,071</u>	<u>\$ 35,326</u>

NOTE F - INVESTMENTS AND ASSETS LIMITED AS TO USE

The composition of investments is presented in the following table:

	June 30	
	<u>2012</u>	<u>2011</u>
Cash and cash equivalents	\$ 20,822	\$ 47,652
Equity		
Domestic	3,505	3,300
International	535	592
Government securities	93,480	22,515
Fixed income		
Domestic	38,437	33,642
International	<u>3,223</u>	<u>380</u>
	160,002	108,081
Less current portion	<u>(115,530)</u>	<u>(66,749)</u>
	<u>\$ 44,472</u>	<u>\$ 41,332</u>

The composition of assets limited as to use is presented in the following table:

	June 30	
	<u>2012</u>	<u>2011</u>
Cash and cash equivalents	\$ 27,503	\$ 23,595
Equity		
Domestic	238	234
International	30	36
Fixed income		
International	<u>191</u>	<u>185</u>
	27,962	24,050
Less current portion	<u>(4,304)</u>	<u>(9,593)</u>
	<u>\$ 23,658</u>	<u>\$ 14,457</u>

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE G - FAIR VALUE MEASUREMENTS

LGH measures fair value as the price that would be received to sell an asset or paid to transfer a liability (the exit price) in an orderly transaction between market participants at the measurement date. The accounting guidance outlines a valuation framework and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and the related disclosures.

The fair value hierarchy is broken down into three levels based on the source of inputs: Level 1 - defined as observable inputs such as quoted prices in active markets; Level 2 - defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3 - defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

In determining fair value, LGH uses the market approach, which utilizes prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurements.

The following fair value hierarchy table presents information about each major category of LGH's financial assets and liabilities measured at fair value on a recurring basis as of:

Description	Level 1	Level 2	Level 3	Total
June 30, 2012				
Cash and cash equivalents	\$ 56,451	\$ -	\$ -	\$ 56,451
Equity				
Domestic	3,743	-	-	3,743
International	565	-	-	565
Government securities	6,764	86,716	-	93,480
Fixed income				
Domestic	1,131	37,306	-	38,437
International	3,414	-	-	3,414
Beneficial interest in trusts	-	8,216	-	8,216
Total assets	<u>\$ 72,068</u>	<u>\$ 132,238</u>	<u>\$ -</u>	<u>\$ 204,306</u>
Interest rate swap	\$ -	\$ 8,734	\$ -	\$ 8,734
Total liabilities	<u>\$ -</u>	<u>\$ 8,734</u>	<u>\$ -</u>	<u>\$ 8,734</u>

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE G - FAIR VALUE MEASUREMENTS (continued)

Description	Level 1	Level 2	Level 3	Total
June 30, 2011				
Cash and cash equivalents	\$ 82,217	\$ -	\$ -	\$ 82,217
Equity				
Domestic	3,534	-	-	3,534
International	628	-	-	628
Government securities	5,338	17,177	-	22,515
Fixed income				
Domestic	1,556	32,086	-	33,642
International	565	-	-	565
Beneficial interest in trusts	-	8,774	-	8,774
Total assets	<u>\$ 93,838</u>	<u>\$ 58,037</u>	<u>\$ -</u>	<u>\$ 151,875</u>
Interest rate swap	\$ -	\$ 4,395	\$ -	\$ 4,395
Total liabilities	<u>\$ -</u>	<u>\$ 4,395</u>	<u>\$ -</u>	<u>\$ 4,395</u>

NOTE H - PROPERTY, PLANT AND EQUIPMENT

	Range of useful lives	June 30	
		2012	2011
Land		\$ 33,737	\$ 33,737
Land improvements	10 to 25 years	14,613	14,463
Equipment	5 to 20 years	523,227	496,237
Buildings and building improvements	25 to 40 years	371,901	363,657
Construction in progress		<u>33,436</u>	<u>20,198</u>
		976,914	928,292
Less accumulated depreciation and amortization		<u>(510,275)</u>	<u>(459,565)</u>
		<u>\$ 466,639</u>	<u>\$ 468,727</u>

Total depreciation and amortization expense for property, plant and equipment for the years ended June 30, 2012 and 2011 was \$52,426 and \$53,300, respectively.

Construction in progress relates to building renovations and construction, information systems and medical equipment. At June 30, 2012, LGH has commitments for these projects of \$29,030.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE H - PROPERTY, PLANT AND EQUIPMENT (continued)

The following equipment is held under capital lease and is included in the equipment category of property, plant and equipment:

	June 30	
	<u>2012</u>	<u>2011</u>
Equipment	\$ 12,198	\$ 10,034
Less accumulated amortization	<u>(3,432)</u>	<u>(1,986)</u>
	<u>\$ 8,766</u>	<u>\$ 8,048</u>

NOTE I - LONG-TERM DEBT

Long-term debt consists of the following:

	June 30	
	<u>2012</u>	<u>2011</u>
Bonds payable - \$25,250, Hospital Revenue Bonds, Series 2012A, with annual payments beginning on July 1, 2014 ranging from \$550 to \$1,400 through 2042, with interest rates varying monthly.	\$ 25,250	\$ -
Bonds payable - \$93,755, Hospital Revenue Bonds, Series 2012B, with annual principal payments beginning on July 1, 2013 ranging from \$760 to \$10,165 through 2043, with interest rates varying from 2.0% to 5.0% due on January 1 and July 1. Amounts include original issue net premium of \$4,698 at June 30, 2012.	98,453	-
Bonds payable - \$12,200, Hospital Revenue Bonds, Series 2011, with a fixed interest rate of 2.34%. The Series 2011 Bonds were refinanced using proceeds from the Series 2012B Bonds in June 2012.	-	12,200
Bonds payable - \$25,000, Hospital Revenue Bonds, Series 2010, with a fixed interest rate of 2.5%. The Series 2010 Bonds were refinanced using proceeds from the Series 2012B Bonds in June 2012.	-	21,047
Bonds payable - \$96,730, Hospital Revenue Bonds, Series 2008, with a variable interest rate of 0.06% at June 30, 2011 based on the Daily Interest Rate determined by the Remarketing Agent for the Series 2008 Bonds due on the first business day of each month. The Series 2008 Bonds were refinanced using proceeds from the Series 2012A and 2012B Bonds in June 2012.	-	86,510

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE I - LONG-TERM DEBT (continued)

	June 30	
	<u>2012</u>	<u>2011</u>
Bonds payable - \$96,825, Hospital Revenue Bonds, Series 2007, with principal payments beginning on March 15, 2019 ranging from \$3,480 to \$7,760 through 2036, with interest rates varying from 4.25% to 5.00% due on March 15 and September 15. Amounts include original issue premium of \$2,030 and \$2,179 at June 30, 2012 and 2011, respectively.	\$ 98,855	\$ 99,004
Bonds payable - \$15,945, GE Capital Public Finance, Inc., with monthly principal and interest payments of \$182 through July 2012, with a fixed interest rate of 4.12% due monthly.	182	2,313
Bonds payable - \$45,055, Hospital Revenue Bonds, Series 1998, insured by AMBAC Assurance Corporation, with a remaining principal payment on July 1, 2012 of \$4,150 with an interest rate of 5.0%. At June 30, 2011, amount includes original issue premium of \$13.	4,150	8,123
Note payable, secured by MRI accounts receivable, inventory, and equipment, matures September 2018, in monthly installments of \$20 including interest at a fixed rate of 5.8% through March 2018, then at LIBOR plus 1.5% through September 2018 (1.74% and 1.69% at June 30, 2012 and 2011, respectively).	1,245	1,405
Note payable, secured by MRI accounts receivable, inventory, and equipment, matures April 2013, principal at various amounts and interest are paid at LIBOR plus 1.5% (1.74% and 1.69% at June 30, 2012 and 2011, respectively).	201	558
Note payable, secured by MRI equipment, matured in June 2012, interest at a fixed rate of 6.95%.	-	249
Note payable LGCNHS, secured by the Hospital, matures July 2015, monthly principal payments of \$6 and interest at LIBOR plus 1.15% (1.39% and 1.34% at June 30, 2012 and 2011, respectively).	1,244	1,319
Capital lease obligations, with various interest rates, secured by related leased equipment. Amounts included original issue discount of \$10 and \$6 at June 30, 2012 and 2011, respectively.	<u>6,264</u>	<u>6,101</u>
	235,844	238,829
	<u>(7,209)</u>	<u>(21,314)</u>
Less current portion	<u>\$ 228,635</u>	<u>\$ 217,515</u>

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Dollars in Thousands)
June 30, 2012 and 2011

NOTE I - LONG-TERM DEBT (continued)

Proceeds from the revenue bonds and notes payable were used to finance various capital and information technology projects, as well as refinancing of previously existing long-term debt.

In June 2012, LGH issued \$25,250 variable rate Series 2012A revenue bonds and \$93,755 fixed rate Series 2012B revenue bonds through Lancaster County Hospital Authority. The proceeds from the Series 2012A Bonds were used to refund a portion of the Series 2008 Bonds, and the Series 2012B Bonds were used to refund a portion of the Series 2008, Series 2010 and Series 2011 Bonds and a portion to be used for future construction projects. The early extinguishments of the Series 2008, 2010 and 2011 Bonds resulted in a loss of \$550 for the year ended June 30, 2012, which consisted of the write-off of unamortized deferred financing costs and is included in depreciation and amortization in the consolidated statements of operations and changes in net assets.

Covenants under the Master Trust Indenture for all the bonds include requirements as to the permitted level of indebtedness, restrictions on the sale of certain assets, mergers, and other significant transactions, including a requirement that the Obligated Group (the Hospital and Lancaster General Health - Parent Only) generate funds available for debt service (as defined) equivalent to at least 110% of maximum annual debt service. At June 30, 2012 and 2011, the Obligated Group is in compliance with all financial covenants related to the bonds.

LGH uses current quoted market prices in estimating the fair value of its Revenue Bonds, and the carrying value of the other long-term debt approximates fair value. The fair value of LGH's long-term debt, excluding capital lease obligations, at June 30, 2012 and 2011 is \$233,011 and \$228,318, respectively.

Annual maturities of long-term debt and capital leases (net of bond and lease premium of \$6,738) are as follows:

2013	\$	7,209
2014		6,545
2015		5,374
2016		5,149
2017		4,962
Thereafter		<u>199,867</u>
	\$	<u><u>229,106</u></u>

NOTE J - LETTERS AND LINES OF CREDIT

LGH maintains various letters of credit totaling \$4,500 at June 30, 2012 to cover balances due on construction projects. No amounts are outstanding under the letters of credit at June 30, 2012.

The College maintains a \$1,500 line of credit with a bank, which may be used for various items. The interest rate is LIBOR plus 1.75 percent. No amounts were outstanding at June 30, 2012.

MRI maintains a demand note payable to a bank which remains open for advances up to the sum of \$1,000. The interest rate is LIBOR plus 2.50 percent. No amounts were outstanding at June 30, 2012.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE K - DERIVATIVE FINANCIAL INSTRUMENTS

LGH has an interest rate swap agreement to manage its risk relating to the changes in cash flow associated with a portion of its variable rate debt. LGH does not use derivative financial instruments for trading or speculative purposes. The interest rate swap allows LGH to raise long-term borrowings at variable rates and effectively swap the rates into a fixed rate that is lower than that available to LGH if fixed-rate borrowings were made directly.

Under the interest rate swap, LGH agrees to exchange monthly the difference between fixed-rate and variable rate interest amounts calculated by reference to the agreed notional amount.

The following table indicates the terms of the interest rate swap and the average interest rate. The variable rate is based on rates implied in the yield curve at the reporting date; those may change significantly, affecting future cash flows:

Fixed swap - notional amount	\$ 25,000
Fixed rate	3.98%
Variable rate at June 30, 2012	0.17%
Variable rate at June 30, 2011	0.13%
Maturity date	July 1, 2041

The change in the fair value of LGH's interest rate swap for the years ended June 30, 2012 and 2011 was an increase (decrease) in the liability of \$4,339 and \$(1,937), respectively. The change is included in other income (loss) as a component of excess of revenue and other income over expenses in the consolidated statements of operations and changes in net assets. At June 30, 2012 and 2011, the fair value of the interest rate swap represented a liability of \$8,734 and \$4,395, respectively.

LGH has established policies and procedures to limit the potential for counterparty credit risk, including establishing limits for credit exposure and continually assessing the creditworthiness of counterparties. As a matter of practice, LGH will enter into transactions only with counterparties whose obligations are rated "A-" or above as rated by Standard & Poor's, or "A3" or above as rated by Moody's.

LGH's exposure to credit risk, associated with its interest rate swap, is measured on an individual counterparty basis, as well as by groups of counterparties that share similar attributes. As of October 29, 2012, LGH was not exposed to any risk of loss.

NOTE L - PENSION PLANS

LGH participates in the Lancaster General Health defined benefit noncontributory pension plan covering all eligible employees, sponsored by Lancaster General Health. Lancaster General Health and its affiliates make annual contributions to the plan to the extent permitted under applicable federal regulations. LGH contributed to LG and recognized pension expense of \$44,662 and \$35,800 for the years ended June 30, 2012 and 2011, respectively, based upon actuarial calculations prepared in accordance with authoritative guidance for pension accounting. For the year ending June 30, 2013, it is expected that LGH and affiliates will be required to make contributions to the pension plan.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE L - PENSION PLANS (continued)

LGH participates in the LG defined contribution 403(b) plans covering all eligible employees. For those employees hired between March 29, 2008 and December 31, 2010, LGH has an employer matching contribution equal to 100% of the first 3% contributed to the plan for participants who elected this option. For those hired after December 31, 2010, LGH has an employer matching contribution equal to 50% on the first 6% plus a 2% employer basic contribution. Total expense under these plans for the years ended June 30, 2012 and 2011 was \$3,421 and \$2,960, respectively.

MRI has a 401(k) plan for its eligible employees to contribute to their respective retirement accounts. Total expense under the plan for the years ended June 30, 2012 and 2011 was \$35 and \$37, respectively.

NOTE M - MALPRACTICE AND GENERAL LIABILITY INSURANCE

All LGH entities are insured through a self-insured malpractice insurance program with Lancaster General Insurance Company, Ltd., Lancaster General Health's wholly owned captive insurance company, except for certain employed physicians who are commercially insured. The Hospital and employed physicians participate in the Medical Care Availability and Reduction of Error (MCARE) Fund. LGH is self-insured up to certain amounts, including excess coverage for professional liability losses. In addition, LGH obtains additional coverage from the MCARE Fund and other commercial carriers.

The MCARE Act was enacted by the legislature of the Commonwealth of Pennsylvania (Commonwealth) in 2002. This Act created the MCARE Fund, which replaced The Pennsylvania Medical Professional Liability Catastrophe Loss Fund (the Medical CAT Fund) as the agency for the Commonwealth to facilitate the payment of medical malpractice claims exceeding the primary layer of professional liability insurance carried by LGH and other health care providers practicing in the Commonwealth.

The MCARE Fund is funded on a "pay as you go basis" and assesses health care providers, based on a percentage of the rates established by the Joint Underwriting Association (also a Commonwealth agency) for basic coverage. The MCARE Act of 2002 provides for a further reduction to the current MCARE coverage of \$500 per occurrence to \$250 per occurrence and the eventual phase-out of the MCARE Fund, subject to the approval of the Pennsylvania Insurance Commissioner. To date, the Pennsylvania Insurance Commissioner has deferred a change in coverage and eventual phase-out of the MCARE Fund to future years.

Professional and general liability indemnity losses and loss adjustment expenses are determined using individual case-based evaluations and statistical analyses and represent an estimate of reported claims and claims incurred but not reported. Those estimates are subject to the effects of trends in loss severity and frequency. Although considerable variability is inherent in such estimates, management believes that the reserves for professional and general liability losses and loss adjustment expenses are reasonable. The estimates are reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are included in current operations. Professional and general liability and related anticipated insurance recoveries were \$5,535 at June 30, 2012, and are included in other liabilities and other assets, respectively. Of the \$5,535 of recoveries, \$4,947 will ultimately be reimbursed by external insurers and \$588 from the Lancaster General Insurance Company, Ltd., which is wholly owned by LG. Professional and general liability for incurred but not reported claims of approximately \$3,112 and \$4,650, undiscounted, are recorded in other long-term liabilities as of June 30, 2012 and 2011, respectively.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE N - LEASES

LGH leases certain buildings, equipment, and vehicles under operating lease agreements, with initial terms expiring at various dates through fiscal year 2028. In addition, the leases generally contain renewal options that give LGH the right to extend the leases for varying additional periods. Rental expense under operating leases for the years ended June 30, 2012 and 2011 was \$7,191 and \$7,220, respectively.

Future minimum rental payments are as follows for the years ending June 30:

	<u>Related party</u>	<u>Other</u>
2013	\$ 632	\$ 3,543
2014	260	3,518
2015	255	2,844
2016	255	2,566
2017	255	2,434
Thereafter	<u>1,158</u>	<u>8,920</u>
	<u>\$ 2,815</u>	<u>\$ 23,825</u>

LGH acts as lessor for certain office space under operating lease agreements, with initial lease terms expiring at various dates through fiscal year 2062. In addition, the leases generally contain renewal options that give the lessee the right to extend the leases for varying additional periods. Rental revenue under operating leases where LGH acts as lessor, for the years ended June 30, 2012 and 2011, was \$3,977 and \$4,248, respectively, and is classified as other revenue in the consolidated statements of operations and changes in net assets.

Future minimum rental revenue receipts in the aggregate are as follows for the years ending June 30:

	<u>Related party</u>	<u>Other</u>
2013	\$ 706	\$ 3,055
2014	719	2,681
2015	664	2,111
2016	670	1,764
2017	624	1,333
Thereafter	<u>1,029</u>	<u>5,135</u>
	<u>\$ 4,412</u>	<u>\$ 16,079</u>

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE O - INVESTMENTS IN NON-CONSOLIDATED AFFILIATES

LGH and its controlled affiliates and subsidiaries have the following joint ventures, which are accounted for under the equity method of accounting:

The Hospital has a 50% interest in Lancaster Emergency Medical Services Association (LEMSA), a not-for-profit corporation providing emergency medical services and medical transportation to persons in the general area of Lancaster County, Pennsylvania.

The Hospital has a 20% interest in Central Pennsylvania Alliance Laboratory, LLP, a limited liability partnership providing lab services to member hospitals located in the central Pennsylvania area.

The Hospital has a 20% interest in Quest Behavioral Health, Inc., a not-for-profit corporation, which is a central Pennsylvania behavioral health managed care plan for employers and health plans.

The Hospital has a 49.5% interest in The NeuroSpine Center, LP, a limited partnership, conducting business in the operation of an ambulatory surgical center in Lancaster, Pennsylvania.

The Hospital has a 50% interest in The Neurological Surgery Center of LNSA, LLC, a limited liability company, operating a single-specialty ambulatory surgery center for neurosurgery services located in Lancaster, Pennsylvania.

LGAMB has a 50% ownership interest in Physicians' Surgery Center - Lancaster General, LLC, a limited liability company formed to own and operate an ambulatory surgery center.

The annual return recognized, which is included in other non-operating income, net, related to the entities described above was \$6,904 and \$5,596 for the years ended June 30, 2012 and 2011, respectively.

NOTE P - RELATED ORGANIZATION TRANSACTIONS

Routinely, LGH provides to and/or receives from Lancaster General Health and its controlled affiliates certain management services, including salaries and wages, employee benefits, and other operating expenses, including rental of property and professional services. These amounts are included in the related revenue and expense categories in the consolidated statements of operations and changes in net assets.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Dollars in Thousands)

June 30, 2012 and 2011

NOTE P - RELATED ORGANIZATION TRANSACTIONS (continued)

The amounts due from (to) related organizations for these services and other items are noted below:

	June 30	
	<u>2012</u>	<u>2011</u>
Lancaster General Health	\$ 568	\$ 726
Lancaster General Medical Group	42	2,082
The Heart Group of LG Health	44	2,567
Visiting Nurse Association of Lancaster County, Inc.	-	119
Lancaster Cleft Palate Clinic	(11)	567
Lancaster General Insurance Company, Ltd.	181	2
Lancaster General Services Business Trust and Subsidiaries	8	130
Lancaster General Health Foundation	<u>154</u>	<u>128</u>
	<u>\$ 986</u>	<u>\$ 6,321</u>

LGH recorded its change in interest in the net assets of Lancaster General Health as other revenue for unrestricted amounts and for the restricted amounts as changes in restricted net assets.

LGH made permanent equity contributions, net, to Lancaster General Health and its controlled affiliates of \$40,536 and \$184,237 for the years ended June 30, 2012 and 2011, respectively.

NOTE Q - FUNCTIONAL EXPENSES

LGH provides health care and education services within its geographical area. Expenses related to providing these services are as follows:

	Years ended June 30	
	<u>2012</u>	<u>2011</u>
Health care services	\$ 499,353	\$ 493,931
Health education services	14,098	12,671
General and administrative	<u>316,728</u>	<u>308,567</u>
	<u>\$ 830,179</u>	<u>\$ 815,169</u>

NOTE R - TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes:

	June 30	
	<u>2012</u>	<u>2011</u>
Health care services	\$ 18,474	\$ 16,793
Health education services	<u>377</u>	<u>407</u>
	<u>\$ 18,851</u>	<u>\$ 17,200</u>

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Dollars in Thousands)
June 30, 2012 and 2011

NOTE R - TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS (continued)

Permanently restricted net assets are restricted to:

	June 30	
	<u>2012</u>	<u>2011</u>
Investments to be held in perpetuity, the income of which is temporarily restricted (reported as temporarily restricted income)	\$ 5,356	\$ 5,162
Beneficial interest in perpetual trusts	<u>4,338</u>	<u>4,594</u>
	<u>\$ 9,694</u>	<u>\$ 9,756</u>

During 2012 and 2011, net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose of health care services, health care education, and purchase of property, plant and equipment in the amounts of \$2,975 and \$2,197, respectively.

NOTE S - ENDOWMENT

Changes in restricted endowment net assets for the years ended June 30, 2012 and 2011 are as follows:

	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Net assets, June 30, 2010	\$ 2,124	\$ 3,653	\$ 5,777
Investment return			
Investment income	155	-	155
Amortization of pledges	7	4	11
Net appreciation (realized and unrealized)	<u>272</u>	<u>585</u>	<u>857</u>
Net investment return	434	589	1,023
New gifts	-	871	871
Appropriation of endowment assets for expenditure	(105)	-	(105)
Income distributed or drawn on permanently restricted endowments	(63)	-	(63)
Other	(1)	-	(1)
Adjustment for fair value deficiencies	<u>(67)</u>	<u>-</u>	<u>(67)</u>
Net assets, June 30, 2011	<u>\$ 2,322</u>	<u>\$ 5,113</u>	<u>\$ 7,435</u>

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Dollars in Thousands)
June 30, 2012 and 2011

NOTE S - ENDOWMENT (continued)

	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Net assets, June 30, 2011	\$ 2,322	\$ 5,113	\$ 7,435
Investment return			
Investment income	166	-	166
Amortization of pledges	-	15	15
Net appreciation (depreciation) (realized and unrealized)	<u>66</u>	<u>(28)</u>	<u>38</u>
Net investment return	232	(13)	219
New gifts	-	207	207
Appropriation of endowment assets for expenditure	(487)	-	(487)
Income distributed or drawn on permanently restricted endowments	(47)	-	(47)
Other	(2)	-	(2)
Adjustment for fair value deficiencies	<u>(5)</u>	<u>-</u>	<u>(5)</u>
Net assets, June 30, 2012	<u>\$ 2,013</u>	<u>\$ 5,307</u>	<u>\$ 7,320</u>

LGH has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets.

From time to time, the fair value of certain donor-restricted endowment funds may fall below the level that the donor requires the organization to retain as a fund of perpetual duration. In accordance with authoritative accounting standards, deficiencies of this nature that are reported in unrestricted net assets were \$10 and \$15 as of June 30, 2012 and 2011, respectively.

LGH accounts for endowment funds based upon explicit donor stipulations in accordance with the direction of the applicable gift instrument.

Lancaster General Hospital

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)
(Dollars in Thousands)
June 30, 2012 and 2011

NOTE T - CONCENTRATION OF CREDIT RISK

LGH grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	June 30,	
	<u>2012</u>	<u>2011</u>
Medicare	31%	34%
Medicaid	11	8
Commercial/HMO	40	35
Self-pay	10	17
Other	<u>8</u>	<u>6</u>
	<u>100%</u>	<u>100%</u>

LGH invests a portion of its operating and Board-designated cash and cash equivalents in various checking, savings, and certificates of deposit accounts with several commercial banks. Certain deposits with these banks exceeded Federal Depository Insurance Corporation limits.

NOTE U - COMMITMENTS AND CONTINGENCIES

LGH has commitments for laboratory reagent purchases. At June 30, 2012, the remaining amount on these commitments is approximately \$3,658, and they are expected to be completed through fiscal year 2018.

LGH is involved in various legal actions, other than malpractice actions, arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on LGH's consolidated financial position, results of operations or liquidity.

NOTE V - SUBSEQUENT EVENTS

LGH has evaluated its June 30, 2012 consolidated financial statements for subsequent events through October 29, 2012, the date the consolidated financial statements were available to be issued. LGH is not aware of any other subsequent events which require recognition or disclosure in the consolidated financial statements.

SUPPLEMENTARY INFORMATION



Audit • Tax • Advisory

Grant Thornton LLP
2001 Market Street, Suite 3100
Philadelphia, PA 19103-7080

T 215.561.4200
F 215.561.1066
www.GrantThornton.com

**Report of Independent Certified Public Accountants
on Supplementary Information**

Board of Directors
Lancaster General Hospital

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating balance sheets as of June 30, 2012 and 2011 and consolidating statements of operations and changes in net assets for the years then ended are presented for purposes of additional analysis, rather than to present the financial position, results of operations and cash flows of the individual companies, and are not a required part of the consolidated financial statements. Such supplementary 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 audits of the consolidated financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America established by the American Institute of Certified Public Accountants. In our opinion, the consolidating information is fairly stated in all material respects, in relation to the consolidated financial statements as a whole.

Grant Thornton LLP

Philadelphia, Pennsylvania

October 29, 2012

Lancaster General Hospital

CONSOLIDATING BALANCE SHEET
(Dollars in Thousands)
 June 30, 2012

	Lancaster General Hospital	Lancaster General Health Columbia Center	Lancaster General Imaging Corporation	Lancaster General College of Nursing and Health Sciences	Lancaster General Ambulatory Services	Eliminations	Consolidated Lancaster General Hospital
						Dr. Cr.	
Assets							
Current assets							
Cash and cash equivalents	\$ 5,340	\$ 8	\$ 2,259	\$ 519	\$ -	\$ -	\$ 8,126
Investments	114,490	-	-	1,040	-	-	115,530
Assets limited as to use	4,254	-	-	50	-	-	4,304
Patient accounts receivable, net	100,596	267	1,957	-	-	-	102,820
Other receivables	11,704	1	13	981	-	324	12,375
Inventories	4,271	-	-	-	-	-	4,271
Due from (to) related organizations	1,154	(29)	(157)	(14)	-	32	986
Prepaid expenses and other current assets	10,082	103	270	361	-	-	10,816
Total current assets	251,891	350	4,342	2,937	-	324	259,228
Investments							
Unrestricted	27,672	-	-	-	-	-	27,672
Donor restricted	15,422	-	-	1,378	-	-	16,800
	43,094	-	-	1,378	-	-	44,472
Interest in net assets of Lancaster General Health	927	-	-	72	-	-	999
Assets limited as to use, net of current portion	23,158	-	-	500	-	-	23,658
Property, plant and equipment, net	447,733	2,226	9,734	6,946	-	-	466,639
Beneficial interest in trusts	6,662	-	-	1,554	-	-	8,216
Investments in non-consolidated affiliates	3,713	-	-	-	3,262	-	6,975
Other assets	7,451	-	802	185	-	-	8,438
Total assets	\$ 784,629	\$ 2,576	\$ 14,878	\$ 13,572	\$ 3,262	\$ 324	\$ 818,625

Continued on next page

Lancaster General Hospital

CONSOLIDATING BALANCE SHEET (continued)
(Dollars in Thousands)
 June 30, 2012

	Lancaster General Hospital	Lancaster General Health Columbia Center	Lancaster General Imaging Corporation	Lancaster College of Nursing and Health Sciences	Lancaster General Ambulatory Services	Eliminations	Consolidated Lancaster General Hospital
						Dr. Cr.	
Liabilities and net assets							
Current liabilities							
Current portion of long-term debt	\$ 5,035	\$ -	\$ 2,167	\$ 75	\$ -	\$ 68	\$ 7,209
Accounts payable	35,486	2	153	308	-	-	35,949
Accrued payroll and related benefits	33,650	332	363	856	-	-	35,201
Estimated settlements with third-party payors	10,853	-	-	-	-	-	10,853
Other current liabilities	2,506	-	806	1,142	8,232	-	12,717
Total current liabilities	87,530	334	3,489	2,381	8,232	68	101,929
Other liabilities	26,755	4	40	225	-	-	27,024
Long-term debt, net of current portion	224,067	-	3,657	1,169	-	258	228,635
Total liabilities	338,352	338	7,186	3,775	8,232	326	357,588
Net assets (deficit)							
Unrestricted							
Assets limited as to use	27,412	-	-	550	-	-	27,962
General	393,335	2,238	4,641	6,232	(4,970)	3	401,479
Total unrestricted net assets (deficit) of LGH	420,747	2,238	4,641	6,782	(4,970)	3	429,441
Non-controlling interests	-	-	3,051	-	-	-	3,051
Total unrestricted net assets (deficit)	420,747	2,238	7,692	6,782	(4,970)	3	432,492
Temporarily restricted	18,474	-	-	377	-	-	18,851
Permanently restricted	7,056	-	-	2,638	-	-	9,694
Total net assets (deficit)	446,277	2,238	7,692	9,797	(4,970)	3	461,037
Total liabilities and net assets	\$ 784,629	\$ 2,576	\$ 14,878	\$ 13,572	\$ 3,262	\$ 326	\$ 818,625

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS
(Dollars in Thousands)

For the year ended June 30, 2012

	Lancaster General Hospital	Lancaster General Health Columbia Center		Lancaster General Imaging Corporation		Lancaster General College of Nursing and Health Sciences		Lancaster General Ambulatory Services		Eliminations		Consolidated Lancaster General Hospital
						Dr.	Cr.					
Unrestricted net assets												
Unrestricted revenue and other support	\$ 812,161	\$ 3,136	\$ 24,707	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 840,004
Net patient service revenue	8,333	23	-	-	-	-	-	-	-	-	-	8,356
Medical services	29,252	592	-	20,416	-	15,189	-	-	-	-	-	55,071
Other revenue	2,259	-	-	266	-	-	-	-	-	-	-	2,525
Net assets released from restrictions for operations	11	-	-	327	-	-	-	-	-	-	-	338
Contributions	852,016	3,751	24,707	21,009	-	15,189	-	-	-	-	-	886,294
Total unrestricted revenue and other support												
Expenses												
Operating expenses	705,362	5,062	16,469	20,528	149	-	13,248	-	-	-	-	734,322
Depreciation and amortization	50,284	284	1,942	590	-	-	-	-	-	-	-	53,100
Interest	6,542	-	378	18	-	-	30	-	-	-	-	6,908
Provision for bad debts	34,827	187	736	99	-	-	-	-	-	-	-	35,849
Total expenses	797,015	5,533	19,525	21,235	149	-	13,278	-	-	-	-	830,179
Operating income (loss)	55,001	(1,782)	5,182	(226)	(149)	15,189	13,278	-	-	-	-	56,115
Other income (loss)												
Investment income	1,611	-	1	30	-	30	-	-	-	-	-	1,612
Net realized gains on sale of trading securities	476	-	-	4	-	-	-	-	-	-	-	480
Change in net unrealized gains and losses on trading securities	156	-	-	6	-	-	-	-	-	-	-	162
Change in fair value of interest rate swap agreement	(4,339)	-	-	-	-	-	-	-	-	-	-	(4,339)
Provision for income taxes	-	-	-	-	-	(8,232)	-	-	-	-	-	(8,232)
Other non-operating income, net	12,119	-	35	-	6,038	-	-	-	-	-	-	18,192
Total other income (loss)	10,023	-	36	40	(2,194)	30	-	-	-	-	-	7,875
Excess of (deficiency in) revenue and other income over expenses	65,024	(1,782)	5,218	(186)	(2,343)	15,219	13,278	-	-	-	-	63,990
Excess of revenue attributable to non-controlling interests	-	-	(2,119)	-	-	-	-	-	-	-	-	(2,119)
Excess of (deficiency in) revenue and other income over expenses attributable to LGH	65,024	(1,782)	3,099	(186)	(2,343)	15,219	13,278	-	-	-	-	61,871

Continued on next page

Lancaster General Hospital

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (continued)
(Dollars in Thousands)

For the year ended June 30, 2012

	Lancaster General Hospital	Lancaster General Health Columbia Center	Lancaster General Imaging Corporation	Lancaster General College of Nursing and Health Sciences	Lancaster General Ambulatory Services	Eliminations	Cr.	Consolidated Lancaster General Hospital
						Dr.		
Unrestricted net assets (continued)								
Excess of (deficiency in) revenue and other income over expenses attributable to LGH <i>(from previous page)</i>	\$ 65,024	\$ (1,782)	\$ 3,099	\$ (186)	\$ (2,343)	\$ 15,219	\$ 13,278	\$ 61,871
Other changes in unrestricted net assets								
Net assets released from restrictions - purchase of property, plant and equipment	450	-	-	-	-	-	-	450
Change in non-controlling interests	-	-	254	-	-	-	-	254
Equity contributions (to) from related organizations	(35,488)	1,357	(2,712)	123	(5,757)	-	1,941	(40,536)
Increase (decrease) in unrestricted net assets	29,986	(425)	641	(63)	(8,100)	15,219	15,219	22,039
Temporarily restricted net assets								
Restricted contributions and gifts	1,800	-	-	207	-	-	-	2,007
Grants	2,330	-	-	-	-	-	-	2,330
Investment income	166	-	-	23	-	-	-	189
Net realized gains on sale of trading securities	67	-	-	6	-	-	-	73
Change in net unrealized gains and losses on trading securities	(347)	-	-	-	-	-	-	(347)
Net assets released from restrictions	(2,709)	-	-	(266)	-	-	-	(2,975)
Change in interest in net assets of Lancaster General Health	374	-	-	-	-	-	-	374
Increase (decrease) in temporarily restricted net assets	1,681	-	-	(30)	-	-	-	1,651
Permanently restricted net assets								
Restricted contributions and gifts	157	-	-	65	-	-	-	222
Change in net unrealized gains and losses on trading securities	(28)	-	-	-	-	-	-	(28)
Change in fair value of beneficial interest in trusts	(175)	-	-	(81)	-	-	-	(256)
Decrease in permanently restricted net assets	(46)	-	-	(16)	-	-	-	(62)
Increase (decrease) in net assets	31,621	(425)	641	(109)	(8,100)	15,219	15,219	23,628
Net assets, beginning of year	414,656	2,663	7,051	9,906	3,130	59,203	59,206	437,409
Net assets (deficit), end of year	\$ 446,277	\$ 2,238	\$ 7,692	\$ 9,797	\$ (4,970)	\$ 74,422	\$ 74,425	\$ 461,037

Lancaster General Hospital

CONSOLIDATING BALANCE SHEET
(Dollars in Thousands)

June 30, 2011

	Lancaster General Hospital		Lancaster General College of Nursing and Health Sciences		Lancaster General Ambulatory Services		Eliminations		Consolidated Lancaster General Hospital
	Lancaster General Hospital	Lancaster General Health Center	Lancaster General Imaging Corporation	Lancaster General College of Nursing and Health Sciences	Lancaster General Ambulatory Services	Dr.	Ct.		
	\$	\$	\$	\$	\$	\$	\$		
Assets									
Current assets									
Cash and cash equivalents	8,067	66	2,310	527	-	-	-	-	10,970
Investments	66,042	-	-	707	-	-	-	-	66,749
Assets limited as to use	9,528	-	-	65	-	-	-	-	9,593
Patient accounts receivable, net	107,491	502	2,130	-	-	-	-	-	110,123
Other receivables	14,634	12	7	474	-	3	404	-	14,726
Inventories	4,519	-	-	-	-	-	-	-	4,519
Due from (to) related organizations	5,891	8	(35)	419	-	38	-	-	6,321
Prepaid expenses and other current assets	11,125	114	230	516	-	-	-	-	11,985
Total current assets	227,297	702	4,642	2,708	-	41	404	-	234,986
Investments									
Unrestricted	26,308	-	-	-	-	-	-	-	26,308
Donor restricted	13,673	-	-	1,351	-	-	-	-	15,024
	39,981	-	-	1,351	-	-	-	-	41,332
Interest in net assets of Lancaster General Health	563	-	-	72	-	-	-	-	635
Assets limited as to use, net of current portion	13,957	-	-	500	-	-	-	-	14,457
Property, plant and equipment, net	449,924	2,362	9,780	6,661	-	-	-	-	468,727
Beneficial interest in trusts	7,139	-	-	1,635	-	-	-	-	8,774
Investments in non-consolidated affiliates	3,117	-	-	-	-	-	3,130	-	6,247
Other assets	1,343	-	802	166	-	-	-	-	2,311
Total assets	\$ 743,321	\$ 3,064	\$ 15,224	\$ 13,093	\$ 3,130	\$ 41	\$ 404	\$	\$ 777,469

Continued on next page

Lancaster General Hospital

CONSOLIDATING BALANCE SHEET (continued)
(Dollars in Thousands)
 June 30, 2011

	Lancaster General Hospital	Lancaster General Health Center		Lancaster General Imaging Corporation	Lancaster General College of Nursing and Health Sciences		Lancaster General Ambulatory Services		Eliminations		Consolidated Lancaster General Hospital
					Dr.	Cr.					
Liabilities and net assets											
Current liabilities											
Current portion of long-term debt	\$ 19,090	\$ -	\$ 2,212	\$ 75	\$ -	\$ 63	\$ -	\$ -	\$ -	\$ 21,314	
Accounts payable	23,557	4	129	157	-	-	-	-	-	23,847	
Accrued payroll and related benefits	41,341	390	327	1,101	-	-	-	-	-	43,159	
Estimated settlements with third-party payors	10,789	-	-	-	-	-	-	-	-	10,789	
Other current liabilities	2,227	2	815	388	-	-	-	-	23	3,455	
Total current liabilities	97,004	396	3,483	1,721	-	63	23	-	23	102,564	
Other liabilities	19,693	5	61	222	-	-	-	-	-	19,981	
Long-term debt, net of current portion	211,968	-	4,629	1,244	-	326	-	-	-	217,515	
Total liabilities	328,665	401	8,173	3,187	-	389	23	-	23	340,060	
Net assets											
Unrestricted											
Assets limited as to use	23,485	-	-	565	-	-	-	-	-	24,050	
General	367,276	2,663	4,254	6,280	3,130	-	3	-	3	383,606	
Total unrestricted net assets of LGH	390,761	2,663	4,254	6,845	3,130	-	3	-	3	407,656	
Non-controlling interests	-	-	2,797	-	-	-	-	-	-	2,797	
Total unrestricted net assets	390,761	2,663	7,051	6,845	3,130	-	3	-	3	410,453	
Temporarily restricted	16,793	-	-	407	-	-	-	-	-	17,200	
Permanently restricted	7,102	-	-	2,654	-	-	-	-	-	9,756	
Total net assets	414,656	2,663	7,051	9,906	3,130	-	3	-	3	437,409	
Total liabilities and net assets	\$ 743,321	\$ 3,064	\$ 15,224	\$ 13,093	\$ 3,130	\$ 389	\$ 26	\$ -	\$ 26	\$ 777,469	

Lancaster General Hospital

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS

(Dollars in Thousands)

For the year ended June 30, 2011

	Lancaster General Hospital	Lancaster General Health Columbia Center	Lancaster General Imaging Corporation	Lancaster General College of Nursing and Health Sciences	Lancaster General Ambulatory Services	Eliminations		Consolidated Lancaster General Hospital
						Dr.	Cr.	
Unrestricted net assets								
Unrestricted revenue and other support								
Net patient service revenue	\$ 797,168	\$ 3,199	\$ 24,083	\$ -	\$ -	\$ -	\$ -	\$ 824,450
Medical services	7,645	33	-	-	-	-	-	7,678
Other revenue	31,827	581	-	18,951	-	16,033	-	35,326
Net assets released from restrictions for operations	1,910	-	-	281	-	-	-	2,191
Contributions	142	-	-	207	-	-	-	349
Total unrestricted revenue and other support	838,692	3,813	24,083	19,439	-	16,033	-	869,994
Expenses								
Operating expenses	693,993	4,933	15,944	17,874	164	-	13,533	719,375
Depreciation and amortization	50,797	279	1,881	468	-	-	-	53,425
Interest	7,264	-	472	18	-	-	35	7,719
Provision for bad debts	33,497	203	846	104	-	-	-	34,650
Total expenses	785,551	5,415	19,143	18,464	164	-	13,568	815,169
Operating income (loss)	53,141	(1,602)	4,940	975	(164)	16,033	13,568	54,825
Other income (loss)								
Investment income	2,547	-	3	30	-	35	-	2,545
Net realized gains on sale of trading securities	407	-	-	6	-	-	-	413
Change in net unrealized gains and losses on trading securities	(410)	-	-	206	-	-	-	(204)
Change in fair value of interest rate swap agreement	1,937	-	-	-	-	-	-	1,937
Other non-operating income, net	475	-	37	-	6,118	-	-	6,630
Total other income	4,956	-	40	242	6,118	35	-	11,321
Excess of (deficiency in) revenue and other income over expenses	58,097	(1,602)	4,980	1,217	5,954	16,068	13,568	66,146
Excess of revenue attributable to non-controlling interests	-	-	(1,960)	-	-	-	-	(1,960)
Excess of (deficiency in) revenue and other income over expenses attributable to LGH	58,097	(1,602)	3,020	1,217	5,954	16,068	13,568	64,186

Continued on next page

Lancaster General Hospital

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS (continued)
(Dollars in Thousands)

For the year ended June 30, 2011

	Lancaster General Hospital	Lancaster General Health Columbia Center	Lancaster General Imaging Corporation	Lancaster General College of Nursing and Health Sciences	Lancaster General Ambulatory Services	Dr.	Cr.	Consolidated Lancaster General Hospital
Unrestricted net assets (continued)								
Excess of (deficiency in) revenue and other income over expenses attributable to LGH <i>(from previous page)</i>	\$ 58,097	\$ (1,602)	\$ 3,020	\$ 1,217	\$ 5,954	\$ 16,068	\$ 13,568	\$ 64,186
Other changes in unrestricted net assets	6	-	-	-	-	-	-	6
Net assets released from restrictions - purchase of property, plant and equipment	-	-	227	-	-	-	-	227
Change in non-controlling interests	(180,077)	1,495	(2,722)	153	(5,586)	-	2,500	(184,237)
Equity contributions (to) from related organizations (Decrease) increase in unrestricted net assets	(121,974)	(107)	525	1,370	368	16,068	16,068	(119,818)
Temporarily restricted net assets								
Restricted contributions and gifts	6,521	-	-	283	-	-	-	6,804
Grants	1,173	-	-	-	-	-	-	1,173
Investment income	154	-	-	18	-	-	-	172
Net realized gains on sale of trading securities	23	-	-	7	-	-	-	30
Change in net unrealized gains and losses on trading securities	215	-	-	-	-	-	-	215
Net assets released from restrictions	(1,916)	-	-	(281)	-	-	-	(2,197)
Change in interest in net assets of Lancaster General Health	368	-	-	-	-	-	-	368
Increase in temporarily restricted net assets	6,538	-	-	27	-	-	-	6,565
Permanently restricted net assets								
Restricted contributions and gifts	755	-	-	120	-	-	-	875
Change in net unrealized gains and losses on trading securities	585	-	-	-	-	-	-	585
Change in fair value of beneficial interest in trusts	229	-	-	188	-	-	-	417
Other	-	-	-	37	-	-	-	37
Increase in permanently restricted net assets	1,569	-	-	345	-	-	-	1,914
(Decrease) increase in net assets	(113,867)	(107)	525	1,742	368	16,068	16,068	(111,339)
Net assets, beginning of year	528,523	2,770	6,526	8,164	2,762	43,135	43,138	548,748
Net assets, end of year	\$ 414,656	\$ 2,663	\$ 7,051	\$ 9,906	\$ 3,130	\$ 59,203	\$ 59,206	\$ 437,409



**Report of Independent Certified Public Accountants on
Supplementary Information and Single Audit Report in
Accordance with OMB Circular A-133**

Lancaster General Hospital

June 30, 2012

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Audit • Tax • Advisory

Grant Thornton LLP
2001 Market Street, Suite 3100
Philadelphia, PA 19103-7080

T 215.561.4200
F 215.561.1066
www.GrantThornton.com

**Report of Independent Certified Public Accountants
on Supplementary Information**

Board of Trustees
Lancaster General Hospital

We have audited, in accordance with auditing standards generally accepted in the United States of America (US GAAS) established by the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Lancaster General Hospital (LGH) as of and for the years ended June 30, 2012 and 2011, and our report, issued under separate cover dated October 29, 2012, expressed an unqualified opinion on those financial statements. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole.

The accompanying Schedule of Expenditures of Federal Awards for the year ended June 30, 2012 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the consolidated financial statements. Such supplementary 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 audits of the consolidated financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other procedures in accordance with US GAAS. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Grant Thornton LLP

Philadelphia, Pennsylvania

October 29, 2012

Lancaster General Hospital

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year ended June 30, 2012

Federal Grantor/Pass-through Grantor/ Program or Cluster title	Federal CFDA number	Pass -through Grantor number	Student Financial Assistance Cluster	Other Federal Expenditures	Total Federal Expenditures
U.S. Department of Education:					
Federal Family Education Loans	84.032	N/A	\$ 6,623,567	\$ -	\$ 6,623,567
Federal Pell Grant Program	84.063	N/A	1,161,539	-	1,161,539
Federal Supplemental Educational Opportunity Grants	84.007	N/A	<u>25,000</u>	<u>-</u>	<u>25,000</u>
Total U.S. Department of Education			7,810,106	-	7,810,106
U.S. Department of Health and Human Services:					
Nursing Student Loans	93.364	N/A	43,000	-	43,000
Outpatient Early Intervention Services with respect to HIV Disease	93.918	H76HA00556-13-02	-	408,261	408,261
HIV Care Formula Grants	93.917	N/A	-	46,335	46,335
National Bioterrorism Hospital Preparedness Program - Passed through Pennsylvania Department of Health	93.889	4100051081	-	64,486	64,486
Title X Family Planning - Family Planning Services - Passed through Family Health Counsel of Central PA	93.217	N/A	-	18,054	18,054
Maternal and Child Health Services Block Grant to the States - Passed through Pennsylvania Department of Health	93.994	39D0657399	-	1,687	1,687
Social Services Block Grant	93.667	N/A	-	2,545	2,545
CDC - Investigations and Technical Assistance	93.283	N/A	-	122,211	122,211
Community Transformation Grants and National Dissemination and Support for Community Transformation Grants	93.531	1U58DP003612-01	-	132,254	132,254
Arthritis, Musculoskeletal and Skin Disease Research	93.846	2R01AR047904-09	<u>-</u>	<u>8,309</u>	<u>8,309</u>
Total U.S. Department of Health and Human Services			43,000	804,142	847,142
U.S. Department of Justice:					
Improving the Investigation and Prosecution of Child Abuse Program	16.758	LANC-PA-PI11	<u>-</u>	<u>9,959</u>	<u>9,959</u>
Total Expenditures of Federal Awards			<u>\$7,853,106</u>	<u>\$ 814,101</u>	<u>\$ 8,667,207</u>

See the accompanying notes to the Schedule of Expenditures of Federal Awards.

Lancaster General Hospital

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

June 30, 2012

NOTE A - BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) summarizes the expenditures of Lancaster General Hospital (the Hospital) and its consolidated affiliate, Lancaster General College of Nursing & Health Sciences (LGCNHS) (collectively, LGH), for the year ended June 30, 2012. Because the Schedule presents only a selected portion of the operations of LGH, it is not intended to and does not present the financial position, statements of operations and changes in net assets or cash flows of LGH.

The Schedule is presented using the accrual method of accounting. The amounts reported in this Schedule as expenditures may differ from certain financial reports submitted to federal funding agencies due to these reports being submitted on either a cash or modified accrual basis of accounting.

NOTE B - NURSING STUDENT LOANS

During the year ended June 30, 2012, LGCNHS processed \$43,000 of new loans under the Nursing Student Loan Program (CFDA No. 93.364). Since this loan program is administered by an outside financial institution, new loans made in the year ended June 30, 2012 relating to this program are considered current-year federal expenditures, whereas the outstanding loan balances are not. The new loans made in the year ended June 30, 2012 are reported in the Schedule. The balance of loans outstanding under the Nursing Student Loan Program at June 30, 2012 was \$184,462.

NOTE C - FEDERAL FAMILY EDUCATION LOANS

During the year ended June 30, 2012, LGCNHS processed \$6,623,567 of new loans under the Federal Family Education Loans Program (CFDA No. 84.032). Since this loan program is administered by American Education Services (AES) and the Pennsylvania Higher Education Assistance Agency (PHEAA), new loans made in the year ended June 30, 2012 relating to this program are considered current-year federal expenditures, whereas the outstanding loan balances are not. The new loans made in the year ended June 30, 2012 are reported in the Schedule.



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Grant Thornton LLP
2001 Market Street, Suite 3100
Philadelphia, PA 19103-7080
T 215.561.4200
F 215.561.1066
www.GrantThornton.com

**Report of Independent Certified Public Accountants
on Internal Control Over Financial Reporting and on
Compliance and Other Matters**

Board of Trustees
Lancaster General Hospital

We have audited the consolidated financial statements, issued under separate cover, of Lancaster General Hospital (LGH) as of and for the year ended June 30, 2012, and have issued our report thereon dated October 29, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America established by the American Institute of Certified Public Accountants and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered LGH's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing an opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of LGH's internal control over financial reporting. Accordingly, we express no such opinion.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control would not necessarily identify all deficiencies in internal control over financial reporting that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in LGH's internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that were not identified.

Our audit was also not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We identified a deficiency in internal control over financial reporting, described in the accompanying Schedule of Findings and Questioned Costs as item #2012-01, that we consider to be a significant deficiency in LGH's internal control over financial reporting.

Compliance and Other Matters

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

We did not audit LGH's written response to the matters described in the accompanying Schedule of Findings and Questioned Costs, and accordingly we express no opinion on it.

This report is intended solely for the information and use of LGH's Board of Trustees, Audit Committee and management and others within LGH, the U.S. Office of Management and Budget, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Grant Thornton LLP

Philadelphia, Pennsylvania

October 29, 2012



**Report of Independent Certified Public Accountants
on Compliance Related to Major Programs (OMB
Circular A-133) and on Internal Control Over
Compliance**

Audit • Tax • Advisory

Grant Thornton LLP
2001 Market Street, Suite 3100
Philadelphia, PA 19103-7080
T 215.561.4200
F 215.561.1066
www.GrantThornton.com

Board of Trustees
Lancaster General Hospital

Compliance

We have audited the compliance of Lancaster General Hospital (LGH) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on its major federal program for the year ended June 30, 2012. LGH's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of LGH's management. Our responsibility is to express an opinion on LGH's compliance based on our audit.

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

In our opinion, Lancaster General Hospital complied, in all material respects, with the requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2012.

Internal Control Over Compliance

Management of LGH is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered LGH's internal control over compliance with requirements that could have a direct and material effect on a major federal program as a basis for designing audit procedures for the purpose of expressing an opinion on compliance, but not for the purpose of expressing an opinion of the effectiveness of LGH's internal control over compliance. Accordingly, we express no such opinion.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control would not necessarily identify all deficiencies in internal control over compliance that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in LGH's internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that were not identified.

This report is intended solely for the information and use of LGH's Board of Trustees, Audit Committee and management and others within LGH, the U.S. Office of Management and Budget, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Grant Thornton LLP

Philadelphia, Pennsylvania

November 30, 2012

Lancaster General Hospital

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Year ended June 30, 2012

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? yes no
- Significant deficiency(s) identified that are not
considered to be material weakness(es)? yes none reported
- Noncompliance material to financial statements noted? yes no

Federal Awards

Internal control over major program:

- Material weakness(es) identified? yes no
- Significant deficiency(s) identified that are not
considered to be material weakness(es)? yes none reported

Type of auditor's report issued on compliance for major program: Unqualified

Any audit findings disclosed that are required to be reported
in accordance with section 510(a) of Circular A-133? yes no

Identification of major program:

<i>CFDA Numbers</i>	<i>Name of Federal Program or Cluster</i>
84.032, 84.063, 84.007, 93.364	Student Financial Aid Cluster

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee? yes no

SCHEDULE OF FINDINGS AND QUESTIONED COSTS - CONTINUED

Year ended June 30, 2012

Section II - Financial Statement Findings

Finding #2012-01

Administrator Access

Criteria, Condition, Context, Effect, Cause

Opportunity exists to enhance the design and operating effectiveness of internal controls relating to the number of administrators with access to transport changes via Data Courier in the EPIC application.

Recommendation

To address the above finding, we recommend the following actions:

- Perform an analysis to ensure access is warranted based on needs of the environment and job function.
- Perform access review to continually assess the environment.

Management's Response

EPIC administrator rights are provided to the individuals identified within this observation for the use of Data Courier, which is a utility used to transport code and minor table updates across environments. A discussion was held between Information Systems Management and EPIC regarding the best practice models for the use of Data Courier. For health care systems of our size, most sites are utilizing a distributed model similar to what we are using. For large integrated health care systems, some utilize a central model employing a group of five to eight individuals within Information Systems to move code and table updates across environments.

Management believes with the controls in place to monitor changes in our production environment and our current process being in line with the practice of other EPIC sites, that our current level of risk mitigation is sufficient. It does not believe the cost-benefit associated with hiring an additional five to eight full-time employees to be adequate.

Section III - Findings and Questioned Costs for Federal Awards

No matters are required to be reported.

Lancaster General Hospital

SUMMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

Year ended June 30, 2012

None noted.

Internal Control Finding

Administrator Access: Opportunity exists to enhance the design and operating effectiveness of internal controls relating to the number of administrators with access to transport changes via Data Courier in the EPIC application. To address the above, the external audit firm recommended the following actions:

- Perform an analysis to ensure access is warranted based on needs of the environment and job function.
- Perform access review to continually assess the environment.

Corrective Action Plan

No further action will be taken. Management's response to the finding is as follows:

EPIC administrator rights are provided to the individuals identified within this observation for the use of Data Courier, which is a utility used to transport code and minor table updates across environments. A discussion was held between Information Systems Management and EPIC regarding the best practice models for the use of Data Courier. For health care systems of our size, most sites are utilizing a distributed model similar to what we are using. For large integrated health care systems, some utilize a central model employing a group of five to eight individuals within Information Systems to move code and table updates across environments.

Management believes with the controls in place to monitor changes in our production environment and our current process being in line with the practice of other EPIC sites, that our current level of risk mitigation is sufficient. It does not believe the cost-benefit associated with hiring an additional five to eight full-time employees to be adequate.

Responsible Person

Doug Rinehart, VP/Controller
555 North Duke Street
Lancaster, PA 17604
717-544-7239

Anticipated Completion Date

Not applicable as no further action will be taken.