Pinnacle Health Hospitals

Financial Statement

June 30, 2012

REINSEL KUNTZ LESHER
certified public accountants & consultants

Independent Auditor's Report

To the Board of Directors
Pinnacle Health Hospitals
Harrisburg, Pennsylvania

We have audited the accompanying schedule of expenditures of federal awards of Pinnacle Health Hospitals (the Organization) for the year ended June 30, 2012. This financial statement is the responsibility of the Organization's management. Our responsibility is to express an opinion on the financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the schedule of expenditures of federal awards referred to above presents fairly, in all material respects, the expenditures of federal awards in conformity with accounting principles generally accepted in the United States of America.

Reinsel Kuntz Lesher LLP

March 26, 2013

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Pinnacle Health Hospitals

Schedule of Expenditures of Federal Awards

Federal Grantor/Pass-Through Grantor/Program or Cluster	Federal CFDA		Pass-Through Entity Identifying Number	Year Ended June 30, 2012 Federal Expenditures	
Department of Justice					
Pass-Through Programs from:					
Midwest Regional Children's Advocacy Center:					
Part E - Developing, Testing, and Demonstrating Promising New Programs	16.541		Pinnacle Health	**$ 2,984**	
Pennsylvania Commission on Crime and Delinquency:					
Crime Victim Assistance	16.575		22235	**2,309**	
Crime Victim Assistance	16.575		22236	**1,482**	
Crime Victim Assistance	16.575		22237	**26,027**	
Crime Victim Assistance	16.575		22238	**3,446**	
Crime Victim Assistance	16.575		22239	**4,730**	
National Children's Alliance:					
Improving the Investigation and Prosecution of Child Abuse and the Regional and Local Children's Advocacy Centers	16.758		384-HARR-PA-SA11	**1,445**	
	16.758		6-HARR-PA-SA12	**10,000**	
				52,423	
Department of Education					
Pass-Through Programs from:					
Cumberland/Perry County:					
Special Education - Grants for Infants and Families	84.181	#	Pinnacle Health System	**46,343**	
ARRA - Special Education - Grants for Infants and Families	84.393	#	Pinnacle Health System	**68,034**	*
Dauphin County:					
Special Education - Grants for Infants and Families	84.181	#	1110 Pinnacle Health Hospitals	**333,734**	
				448,111	
Department of Health and Human Services					
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	93.918		H76HA00617E0	**316,680**	
Pass-Through Programs from:					
Pennsylvania Department of Public Welfare:					
Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	93.505		4100056834	**59,423**	
Pennsylvania Department of Health:					
Medical Assistance Program	93.778	**	4100050701	**30,484**	
National Bioterrorism Hospitals Preparedness Program	93.889		4100051041	**92,401**	
Maternal and Child Health Block Grant to the States	93.994		4100050701	**704,196**	
Family Health Council of Central Pennsylvania:					
HIV Care Formula Grants	93.917		01BIPAMCHS	**77,356**	
				1,280,540	
Total Expenditures of Federal Awards				**$ 1,781,074**	

* Represents funds received under the American Recovery & Reinvestment Act of 2009 (ARRA)

\# Denotes the Early Intervention Services (IDEA) Cluster

** Denotes the Medicaid Cluster

Note 1 - Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Organization and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Note 2 - Grant Awards Reconciliation to Schedule of Expenditures of Federal Awards

The Organization was awarded grant contracts from various funding sources where the amounts reported on the Schedule of Expenditures of Federal Awards (SEFA) do not agree with the amounts received in total funding during the year ended June 30, 2012 due to an overlap of the grant years and the fiscal year of the Organization, as well as the inclusion of some state funding within the total award. Reconciliations of the SEFA to the contract awards, segregated by funding source, are presented below.

Commonwealth of Pennsylvania Department of Health

The contract for Childhood Lead Poisoning Prevention and Control Services is a multi-year contract comprised of federal funding through Maternal and Child Health Services Block Grant, CFDA 93.994, and Medical Assistance, CFDA 93.778. The contract also includes state funding. The reconciliation of the amounts reported on the Schedule of Expenditures of Federal Awards to the award amount consists of the following for the year ended:

	June 30, 2012
Contract 4100050701	$
Funding received July 1, 2011 - June 30, 2012	759,997
State funding per contract (3.33%)	(25,317)
Federal award expenditures	$ 734,680
Maternal and Child Health Services Block Grant per contract (92.66%) - CFDA 93.994	$ 704,196
Medical Assistance per contract (4.01%) - CFDA 93.778	30,484
Schedule of expenditures of federal awards	$ 734,680

Note 2 - Grant Awards Reconciliation to Schedule of Expenditures of Federal Awards (continued)

Pennsylvania Commission on Crime and Delinquency

The contracts with the Pennsylvania Commission on Crime and Delinquency (PCCD) for the Children's Resource Center includes multi-year grant contracts comprised of federal funding through State Victim Assistance Formula Grant Program, CFDA 16.575. The reconciliation of the amounts reported on the Schedule of Expenditures of Federal Awards to the award amounts consists of the following for the year ended:

	June 30, 2012
Contract 22235	
Total grant award - July 1, 2011 - June 30, 2013	$ 6,548
Funding carried forward to fiscal year ending June 30, 2013	(4,239)
Schedule of expenditures of federal awards - CFDA 16.575	$ 2,309
Contract 22236	
Total grant award - July 1, 2011 - June 30, 2013	$ 5,368
Funding carried forward to fiscal year ending June 30, 2013	(3,886)
Schedule of expenditures of federal awards - CFDA 16.575	$ 1,482
Contract 22237	
Total grant award - July 1, 2011 - June 30, 2013	$ 115,821
Funding carried forward to fiscal year ending June 30, 2013	(89,794)
Schedule of expenditures of federal awards - CFDA 16.575	$ 26,027
Contract 22238	
Total grant award - July 1, 2011 - June 30, 2013	$ 10,919
Funding carried forward to fiscal year ending June 30, 2013	(7,473)
Schedule of expenditures of federal awards - CFDA 16.575	$ 3,446
Contract 22239	
Total grant award - July 1, 2011 - June 30, 2013	$ 26,942
Funding carried forward to fiscal year ending June 30, 2013	(22,212)
Schedule of expenditures of federal awards - CFDA 16.575	$ 4,730

Note 2 - Grant Awards Reconciliation to Schedule of Expenditures of Federal Awards (continued)

National Children's Alliance

The contracts with the National Children's Alliance for the Children's Resource Center includes federal funding through Part E - Developing, Testing and Demonstrating Promising New Program, CFDA #16.541, and Improving the Investigation and Prosecution of Child Abuse and the Regional and Local Children's Advocacy Centers, CFDA #16.758. The reconciliation of the award amounts to the amounts reported on the SEFA consists of the following for the year ended:

	June 30, 2012
Contract 8/1/10-7/31/11 and 8/1/11-7/31/12	
Total grant award - August 1, 2010 - July 31, 2011	$ 2,400
Expenditures incurred July 1, 2010 - June 30, 2011	(1,720)
Unspent funds - August 1, 2010 - July 31, 2011	(246)
Total grant award - August 1, 2011 - July 31, 2012	2,550
Schedule of expenditures of federal awards - CFDA 16.541	$ 2,984
Contract 1/1/11-12/31/11	
Total grant award - January 1, 2011 - December 31, 2011	$ 10,000
Expenditures incurred July 1, 2010 - June 30, 2011	(8,555)
Schedule of expenditures of federal awards - CFDA 16.758	$ 1,445

Department of Health and Human Services

The contract with the Department of Health and Human Services includes a multi-year grant comprised of federal funding through the Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program, CFDA# 93.505. The reconciliation of the award amounts to the amounts reported on the SEFA consists of the following for the year ended:

	June 30, 2012
Contract 7/1/11-6/30/13	
Total grant award - July 1, 2011 - June 30, 2012	$ 112,804
Funding carried forward to fiscal year ending June 30, 2013	(53,381)
Schedule of expenditures of federal awards - CFDA 93.505	$ 59,423

Note 2 - Grant Awards Reconciliation to Schedule of Expenditures of Federal Awards (continued)

Family Health Council of Central Pennsylvania

The contract with the Family Health Council of Central Pennsylvania includes a multi-year grant comprised of federal funding through the HIV Care Formula Grants Program, CFDA #93.917. The reconciliation of the award amount to the amount reported on the SEFA consists of the following for the year ended:

	June 30, 2012
Contract 7/1/11- 6/30/13	
Total grant award - July 1, 2011 - June 30, 2013	$ 133,632
Funding carried forward to fiscal year ending June 30, 2013	(56,276)
Schedule of expenditures of federal awards - CFDA 93.917	$ 77,356

Section I. Summary of Auditor's Results:

***Financial Statements*:**

Type of auditor's report issued: Unqualified

Internal control over financial reporting:
- Material weaknesses identified? ☐ yes ☒ no
- Significant deficiencies identified? ☐ yes ☒ none reported

Noncompliance material to financial statements noted? ☐ yes ☒ no

Federal Awards:

Internal control over major programs:
- Material weaknesses identified? ☐ yes ☒ no
- Significant deficiencies identified? ☐ yes ☒ none reported

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

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

Identification of Major Programs:

CFDA Number(s)	Name of Federal Program
84.181	Special Education - Grants for Infants and Families
84.393	ARRA - Special Education - Grants for Infants and Families
93.994	Maternal and Child Health Block Grant to the States

Dollar threshold used to distinguish between Type A and Type B programs: **$300,000**

Auditee qualified as low-risk auditee ☒ yes ☐ no

Section II. Financial Statement Findings

No findings are reported

Section III. Federal Award Findings and Questioned Costs

No findings or questioned are reported

REINSEL KUNTZ LESHER
certified public accountants & consultants

Independent Auditor's Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with *OMB Circular A-133*

To the Board of Directors
Pinnacle Health Hospitals
Harrisburg, Pennsylvania

Compliance

We have audited Pinnacle Health Hospital's (the Organization) compliance with the types of compliance requirements described in the OMB Circular A-133 Compliance Supplement that could have a direct and material effect on each of the Organization's major federal programs for the year ended June 30, 2012. The Organization's major federal programs are 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 each of its major federal programs is the responsibility of the Organization's management. Our responsibility is to express an opinion on the Organization's compliance based on our audit.

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

In our opinion, the Organization complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

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Internal Control Over Compliance

Management of the Organization is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Organization's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over compliance.

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

This report is intended solely for the information and use of management, the Audit Committee, Board of Directors, others within the organization, 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.

Reinsel Kuntz Lesher LLP

March 26, 2013

Pinnacle Health System

(And controlled entities and subsidiaries)

Consolidated Financial Statements and Supplemental Data

June 30, 2012 and 2011

Pinnacle Health System
(And controlled entities and subsidiaries)
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Report of Independent Auditors

To the Board of Directors of
Pinnacle Health System

We have audited the accompanying consolidated balance sheets of Pinnacle Health System (and controlled entities and subsidiaries) (collectively, the "System") as of June 30, 2012 and June 30, 2011, and the related consolidated statements of operations, changes in net assets, and its cash flows for the years then ended. These financial statements are the responsibility of Pinnacle Health System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pinnacle Health System (and controlled entities and subsidiaries) at June 30, 2012 and June 30, 2011, and its related consolidated statements of operations, 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.

In accordance with *Government Auditing Standards,* we have also issued a report dated September 12, 2012, on our consideration of the Pinnacle Health System's internal control and its compliance and other matters for the year ended June 30, 2012. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

PricewaterhouseCoopers LLP

September 12, 2012

Pinnacle Health System
(And controlled entities and subsidiaries)
Consolidated Statements of Financial Position
June 30, 2012 and 2011

(in thousands of dollars)	2012	2011
Assets		
Current		
Cash and cash equivalents	$ 31,875	$ 35,460
Accounts receivable, less allowance for doubtful accounts of approximately $33,188 in 2012 and $25,097 in 2011	89,605	73,939
Investments	201,676	182,988
Inventories	12,191	12,023
Prepaid expenses	11,155	8,151
Investments designated for capital projects	2,161	14,247
Current portion of self-insurance trust funds	1,048	1,253
Total current assets	349,711	328,061
Assets limited as to use		
Self-insurance trust funds, net of current portion	3,610	3,158
Board-designated funds	47,909	46,799
Board-designated funds for capital acquisition	122,586	113,198
Funds held by trustee, net of current portion	14,588	14,586
Total assets limited as to use	188,693	177,741
Investments temporarily restricted as to use	11,362	15,588
Investments permanently restricted as to use	18,197	19,024
Property, plant and equipment, net	355,223	345,044
Pledges receivable	2,447	3,999
Goodwill	42,425	7,536
Other assets	18,857	10,681
Total assets	$ 986,915	$ 907,674
Liabilities and Net Assets		
Current		
Current portion of long-term debt	$ 17,201	$ 9,750
Accounts payable and accrued expenses	38,101	33,558
Accrued salaries, wages and fees	23,785	16,149
Accrued vacation	18,533	17,233
Accrued insurance costs	20,177	17,845
Accrued retirement costs	450	503
Due to third-party payors	5,895	3,087
Advances from third-party payors	3,809	3,809
Total current liabilities	127,951	101,934
Long-term liabilities		
Accrued insurance costs, net of current portion	7,003	6,242
Accrued retirement costs, net of current portion	90,757	56,728
Interest rate swap agreement	8,585	4,621
Long-term debt, net of current portion	307,329	294,484
Total long-term liabilities	413,674	362,075
Net assets		
Unrestricted net assets		
Unrestricted net assets Pinnacle Health System	411,809	403,905
Noncontrolling interests in consolidated subsidiary company	1,475	1,284
Total unrestricted net assets	413,284	405,189
Temporarily restricted net assets	13,809	19,452
Permanently restricted net assets	18,197	19,024
Total net assets	445,290	443,665
Total liabilities and net assets	$ 986,915	$ 907,674

The accompanying notes are an integral part of these financial statements.

Pinnacle Health System
(And controlled entities and subsidiaries)
Consolidated Statements of Operations
Years Ended June 30, 2012 and 2011

(in thousands of dollars)	2012	2011
Unrestricted revenues		
Net patient service revenues	$ 766,391	$ 665,150
Other revenues	21,661	12,975
Net assets released from restrictions used for operations	3,475	2,642
Total unrestricted revenues	791,527	680,767
Expenses		
Salaries and wages	301,483	260,676
Fringe benefits	85,060	83,123
Professional fees	21,274	20,093
Supplies	121,203	117,779
Purchased services	122,043	105,731
Interest	12,885	12,870
Bad debt expense	37,784	33,784
Depreciation and amortization	47,111	40,863
Total expenses	748,843	674,919
Income from operations	42,684	5,848
Nonoperating gains (losses)		
Investment income	10,098	36,379
Gain (loss) on disposal of assets	3,034	(502)
Contributed net assets in acquisition	133	906
Realized and unrealized losses on interest rate swap	(5,450)	(529)
Nonoperating gain, net	7,815	36,254
Revenues and gains over expenses and losses	50,499	42,102

The accompanying notes are an integral part of these financial statements.

Pinnacle Health System
(And controlled entities and subsidiaries)
Consolidated Statements of Changes in Net Assets
Years Ended June 30, 2012 and 2011

(in thousands of dollars)	**2012**	**2011**
Unrestricted net assets		
Revenues and gains over expenses and losses	$ 50,499	$ 42,102
Change in post-retirement liability	(48,690)	32,890
Other	461	-
Net assets released from restrictions for purchases of property, plant and equipment	6,797	3,044
Income attributable to and other changes in noncontrolling interests	(972)	(916)
Adoption of noncontrolling interests standard	-	1,358
Increase in unrestricted net assets	8,095	78,478
Temporarily restricted net assets		
Contributions	3,613	4,086
Net realized and unrealized gains on investments	1,016	6,066
Transfer to permanently restricted net assets	-	(85)
Net assets released from restrictions	(10,272)	(5,686)
(Decrease) increase in temporarily restricted net assets	(5,643)	4,381
Permanently restricted net assets		
Contributions	4	6
Net realized and unrealized (loss) gains on investments and changes in interests in beneficial trusts	(358)	3,223
Appropriation of endowment assets for spending	(473)	(471)
Transfer from temporarily restricted net assets	-	85
(Decrease) increase in permanently restricted net assets	(827)	2,843
Increase in net assets	1,625	85,702
Net assets		
Beginning of year	443,665	357,963
End of year	$ 445,290	$ 443,665

The accompanying notes are an integral part of these financial statements.

Pinnacle Health System
(And controlled entities and subsidiaries)
Consolidated Statements of Cash Flows
Years Ended June 30, 2012 and 2011

(in thousands of dollars)	2012	2011
Cash flows from operating activities		
Change in net assets	$ 1,625	$ 85,702
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Net realized and unrealized gains on investments	(729)	(34,907)
Provision for bad debts	37,784	33,784
Depreciation and amortization	47,111	40,863
(Gain) loss on disposal of assets	(3,036)	503
Change in pension liability	48,690	(32,890)
Equity in losses of joint ventures and affiliates	(420)	2,279
Changes in noncontrolling interest in consolidated subsidiary company	1,163	842
Adoption of noncontrolling interests standards	-	(1,358)
Restricted contributions and investment gain income	112	374
Change in current assets and liabilities		
Increase in accounts receivable	(51,154)	(43,946)
Decrease (increase) in pledges receivable	287	(1,422)
Increase in inventories, goodwill, and other assets	(553)	(2,923)
Increase in prepaid expenses	(2,871)	(346)
Increase in accounts payable and accrued expenses	2,916	154
Increase in accrued salaries, wages and fees and accrued vacation	8,935	3,550
(Decrease) increase in accrued insurance and retirement costs	(11,621)	2,295
Increase (decrease) in advances from and amounts due to third-party payors	2,808	(5,983)
Net cash provided by operating activities	81,047	46,571
Cash flows from investing activities		
Purchase of property, plant and equipment	(46,695)	(70,168)
Acquisitions, net of cash received	(36,692)	(7,858)
Contributions to joint ventures and affiliates	(5,615)	(1,152)
(Purchase) sale of investments, including assets limited as to use, net	(11,567)	18,114
Proceeds from sale of assets	477	176
Net cash used in investing activities	(100,092)	(60,888)
Cash flows from financing activities		
Cash paid for financing costs	-	(278)
Repayments of long-term debt	(10,530)	(73,665)
Proceeds from long-term debt	26,000	100,000
Cash receipts from pledges	1,265	2,914
Contribution to noncontrolling interests in consolidated subsidiary	(1,163)	(842)
Restricted contributions and investment income	(112)	(374)
Net cash provided by financing activities	15,460	27,755
Net increase in cash and cash equivalents	(3,585)	13,439
Cash and cash equivalents		
Beginning of year	35,460	22,021
End of year	$ 31,875	$ 35,460

The accompanying notes are an integral part of these financial statements.

1. Description of Organization

Pinnacle Health System (“Parent”), located in Harrisburg, Pennsylvania, consists of the following controlled entities and subsidiaries (collectively the “System”).

Pinnacle Health Foundation (“Foundation”), is a tax-exempt, nonprofit corporation, engaged in fund raising activities for the benefit of the controlled entities of the System.

Pinnacle Health Hospitals (“Hospital”), is a tax-exempt, nonprofit, multi-facility acute care hospital.

Pinnacle Health Emergency Department Services, LLC (“PHEDS”), is a tax-exempt, nonprofit corporation engaged in providing professional services in the Pinnacle Health Emergency Department.

Community Life Team (“CLT”), is a tax-exempt, nonprofit entity that provides both emergency and nonemergency ambulance services to citizens in the Harrisburg, PA area and surrounding counties.

Pinnacle Health Home Care and Hospice (“PHHCH”), is a tax-exempt, nonprofit entity engaged in providing home nursing and hospice services. Pinnacle Health Home Care was merged into VNA Community Care Services, Inc. on December 31, 2011 with Pinnacle Health Hospitals acquiring an 11.8% ownership interest. Pinnacle Health Hospice operations were transferred to Hospice of Central Pennsylvania on January 9, 2012. The Hospital did not receive any membership interest as a result of this transaction.

Pinnacle Health Medical Services (“PHMS”), is a tax-exempt, nonprofit entity engaged in the operation of both primary care and specialty physician practices and providing mental health services.

Pinnacle Health Cardiovascular Institute (“PHCVI”) and its wholly-owned subsidiary, Cardiology Practice Inc (“CPI”), are 100% owned for profit corporations engaged in providing comprehensive cardiac care.

Pinnacle Health Medical Group (“PHMG”) is a wholly-owned, for profit corporation engaged in the operation of primary care physician practices.

Pinnacle Health Ventures Inc. (PHVI) and Pinnacle Health Imaging Inc. (PHI) were formed as a result of the acquisition of 100% of the stock of Tristan Associates on March 1, 2012. PHVI is the stock holding company and sole shareholder of PHI. PHI owns and/or leases radiology and imaging equipment and services at four office locations. PHI leases equipment and services to Hospital.

Pinnacle Health Cumberland Condominium Association is an association wholly owned by Pinnacle Health Hospital established to oversee the operation of the Condominium located on the campus of the Frederickson Outpatient Facility. The Condominium Association agreement was terminated on January 18, 2012.

United Health Risk, Ltd. (“UHR”) is a wholly-owned, for profit, offshore captive insurance company.

United Central Pennsylvania Reciprocal Risk Retention Group ("RRG") is a wholly-owned, for profit, Vermont captive insurance company.

West Shore Surgery Center, LLP ("WSSC") is a limited liability partnership owned 2% by PHMS, the general partner, 49% by the Hospital and 49% by physicians.

Pinnacle Health System Obligated Group ("Obligated Group"), consists of the Parent, Hospital, and PHMS.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Parent and its controlled entities and subsidiaries. The accounts of the controlled entities have been included in the consolidated financial statements to reflect the results of operations of entities under common control. All significant intercompany transactions have been eliminated.

Basis of Financial Reporting

The preparation of 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 financial statements and the reported amounts of revenues and expenses during the reporting period. These significant estimates include the accounts receivable allowance for doubtful accounts, contractual allowances, due to third party payors, accrued pension liabilities, accrued retirement costs and accrued insurance costs. Actual results could differ from those estimates as they are prepared based on certain assumptions which are subject to change.

Reclassification of Prior Year Balances

Certain 2011 balances have been reclassified to conform to the 2012 presentation.

Net Patient Service Revenues

The hospital has agreements with third party payors that provide for payments to the hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods for tentative and final settlements.

Allowance for Doubtful Accounts

Accounts receivable are recorded at their estimated net realizable value. The allowance for doubtful accounts is estimated based upon historical collection rates.

Revenues and Gains over Expenses and Losses

The consolidated statements of operations include revenues and gains over expenses and losses. Changes in unrestricted net assets which are excluded from revenues and gains over expenses and losses, consistent with industry practice, include changes in the post-retirement liability, noncontrolling interests and net assets released from donor restrictions to be used for purchases of property, plant and equipment.

Cash and Cash Equivalents
Cash and cash equivalents include cash management funds with original maturities of three months or less, excluding amounts whose use is limited by Board-designation or other arrangements under trust agreements. The System maintains cash and cash equivalents in local banks.

Investments
The System follows standards issued by the Financial Accounting Standards Board ("FASB") related to fair value accounting. The standards define fair value, establish a framework for measuring fair value and expand disclosures about fair value measurements. The standards also provide an option to report selected financial assets and liabilities at fair value and establish presentation and disclosure requirements. The fair value option permits the System to elect to measure eligible items at fair value on an instrument-by-instrument basis and then report the unrealized gains and losses for those items in the System's revenues and gains over expenses and losses. The System has chosen to record all of its investments under the fair value option permitted under these standards.

Under these fair value standards, the System is required to categorize and disclose certain assets and liabilities, including investments, at fair value, according to three levels of inputs that may be used to measure fair value:

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

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

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

The following is a description of the System's valuation methodologies for investments carried at fair value. These methods may produce a fair value calculation that may not be reflective of future fair values. Furthermore, while the System believes that its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of investments could result in a different estimate of fair value at the reporting date.

Where quoted prices are available in an active market, investments are classified in Level 1 of the valuation hierarchy. Investments in Level 1 are exchange-trade equity securities and debt securities. If quoted prices are not available, other accepted valuation methodologies, such as quotes for similar securities are used. These valuation services estimate fair values using pricing models and other accepted valuation methodologies, such as quotes for similar securities and observable yield curves and spreads. As part of the System's overall valuation process, management evaluates these third-party methodologies to ensure that they are representative of exit prices in the System's principal markets. Investments in Level 2 include cash management funds, corporate obligations, fixed income investments, other domestic equity investments, foreign equity investments and funds held in trust by others. See Note 5 for additional details related to the System's investments.

Investment partnerships include limited partnerships and limited liability corporations that do not price shares on a daily basis or require notice to redeem shares. The partnerships invest in securities traded in foreign and domestic markets and are carried in the balance sheet at a net asset value as determined by the general partner which approximates fair value. There are no unfunded commitments for these investments.

Derivative Instruments
The System accounts for derivative financial instruments in accordance with standards issued by the FASB. These standards require that all derivative instruments be recorded on the balance sheet at fair value as either assets or liabilities. Since the derivatives entered into by the System do not qualify for hedge accounting, changes in fair value of the derivative are recognized in nonoperating gains/(losses). The use of derivative instruments by the System is generally limited to interest rate swaps.

Inventories
Inventories are stated at lower of cost (first-in, first-out method) or market.

Assets Limited as to Use
Assets limited as to use include Board-designated funds, Board-designated funds for capital acquisition and the portion of self-insurance funds and funds held by trustee that have not been reflected as current assets to meet the current portion of self-insured liabilities and long-term debt. Insurance collateral funds represent monies that are designated as collateral for a letter of credit that is designated to fund current and future liabilities for payment of professional liability and workers' compensation claims. Board-designated funds and Board-designated funds for capital acquisition represent funds designated by the Board of Directors for capital acquisition and replacement and to support Hospital initiatives.

Property, Plant and Equipment
Property, plant and equipment is stated at cost, net of accumulated depreciation and amortization. Depreciation is computed on the straight-line method over the estimated useful lives of the assets. Gains and losses resulting from the sale or disposal of property, plant and equipment are included in nonoperating gains (losses). Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements.

Investments in and Advances to Joint Ventures and Affiliates
The System, through its controlled entities and subsidiaries, maintains an ownership interest in several joint ventures which provide various clinical and nonclinical services. These investments, with the exception of VNA Community Care Services, Inc., are accounted for by the equity method since the ownership interest is between 20% and 50% and control is not exercised. The System maintains an 11.8% ownership interest in VNA Community Care Services, Inc. and accounts for it on the cost method. Under the terms of the agreements, the System may be required from time to time to make additional cash contributions and provide working capital advances to the joint ventures.

Pledges Receivable
The System records its pledges receivable at the estimated net realizable value, discounted at a rate of 4% at June 30, 2012 and 2011. Pledges receivable in the amounts of $2,107, $478 and $363 are due in fiscal years 2013, 2014 and 2015, respectively.

Deferred Financing Costs
Deferred financing costs are amortized over the life of the bonds using the effective interest method.

During 2012 and 2011, the System capitalized costs of $0 and $278, respectively, incurred as a result of the issuance of the Series 2011A Health System Revenue Bond. During 2011, deferred financing costs of $497 were written off due to extinguishment of the Series 2009B Revenue Note.

Amortization expense was $115 and $133 for the years ended June 30, 2012 and 2011, respectively.

Accrued Insurance Costs
Accrued insurance costs consist of estimated liabilities for reported and incurred but not reported claims related to professional liability, workers' compensation and employee health care. The System discounts its liabilities for professional liability and workers' compensation claims. As of June 30, 2012 and 2011, the discount rate was 3.5%.

Temporarily and Permanently Restricted Net Assets
Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose. Permanently restricted net assets, excluding interest and dividend income earned on such assets which is unrestricted, have been restricted by donors to be maintained by the System or outside beneficial trusts in perpetuity.

Donor Restricted Gifts
Unconditional promises to give cash and other assets to the System are reported at estimated fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at estimated fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose or restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

Income Taxes
The majority of the System is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. On such basis, the exempt entities will not incur any liability for federal income taxes, except for possible unrelated business income.

The System evaluates uncertain tax positions using a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in an unrelated business activity tax return and disclosures regarding uncertainties in tax positions. No adjustments to the consolidated financial statements were required as a result of this evaluation.

The following entities are not exempt from federal income tax: PHCVI, PHMG, PHVI, RRG and WSSC, and therefore, may incur liabilities for federal and state income taxes.

Fair Value of Financial Instruments
Financial instruments include cash and cash equivalents, accounts receivable, investments, interest rate swap agreement, and long-term debt. The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, investments, interest rate swap agreement and long-term debt approximates its fair value as of June 30, 2012 and 2011.

Supplemental Disclosure of Cash Flow Information
Interest paid for the years ended June 30, 2012 and 2011 was $14,639 and $14,676, respectively.

There were no income taxes paid in fiscal 2012 and 2011.

During 2012 and 2011, capital lease obligations of $5,388 and $9,639 were incurred when the System entered into lease agreements to provide surgical and imaging equipment. These obligations are considered to be a noncash financing activity.

During 2012 and 2011, property, plant and equipment of $2,681 and $3,591 were included in accounts payable and accrued expenses.

Accounting for Defined Benefit and Other Postretirement Benefits
The System follows FASB standards over employer’s accounting for defined benefit pension and other postretirement plans. Included in these standards is a requirement for an entity to recognize in its balance sheet, the overfunded or underfunded status of its defined benefit postretirement plans measured as the difference between the fair value of the plan assets and the benefit obligation. For a pension plan, this would be the projected benefit obligation; for any other postretirement plan, the benefit obligation would be the accumulated postretirement benefit obligation. These standards also require measurement dates for the pension plan obligation to be measured as of the date of the entity’s balance sheet.

Recently Issued Accounting Pronouncements
In December 2007, the FASB issued a standard for consolidations. The standard established a new accounting and reporting standard for the noncontrolling interest (minority interest) in a subsidiary. Specifically, the guidance requires the recognition of noncontrolling interest within net assets on the consolidated statement of financial position and changes in net assets in the consolidated statement of operations. The guidance also included expanded disclosure requirements regarding the interests of the parent in its noncontrolling interest. For not-for-profit entities, the standard is effective for fiscal years beginning after December 15, 2009. The System adopted this standard on July 1, 2010 and prospectively presented amounts as of and for the year ending June 30, 2012 and 2011.

The System adopted Accounting Standards Update No. 2011-08 (“ASU 2011-08”), Testing Goodwill for Impairment, effective September 30, 2011. The System performs its annual goodwill impairment test as of March 31. Under ASU 2011-08, the Company assessed certain qualitative factors to determine if it was more likely than not that the fair value of certain segments within Pinnacle Health Medical Services, Pinnacle Health Hospitals, and Pinnacle Health Cardiovascular Institute were less than their carrying amount. As a result of this assessment, it was determined that it was not more likely than not that the fair value of these segments were less than their carrying amounts; therefore, the performance of the two-step impairment test was not required.

3. Acquisitions

Pinnacle Health acquired all of the outstanding stock of an outpatient imaging center with four locations throughout the Harrisburg area on March 1, 2012, purchased all of the assets of a professional medical group with eleven primary care offices and an imaging center on April 1, 2012, and purchased the assets if a large cardiovascular practice with two locations each including ancillary services on August 1, 2011. The purchase transactions were accounted for using the acquisition method of accounting, which requires all assets and liabilities to be measured at their fair value. The fair values at the acquisition date have been determined using various fair value techniques from outside third parties. All of the practices are located in and around the Harrisburg area. These acquisitions were performed to expand and diversify the services Pinnacle Health System offers to its patients. The total cost of all of the acquisitions was $38,945 including $34,893 of goodwill.

During fiscal year ended June 30, 2011, Pinnacle Health System recorded acquisitions of $7,858 and goodwill of $4,453.

4. Net Patient Service Revenues

The System has arrangements with third-party payors that provide for payments to the System at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

- **Medicare**: Inpatient acute care and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Medical education and transplant costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. Outpatient services are reimbursed based on the ambulatory payment classification. The System is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare fiscal intermediary.

- **Medicaid**: Inpatient services are rendered to Medicaid program beneficiaries based on a patient classification system similar to Medicare. Outpatient services are reimbursed on a predetermined fee schedule.

- **Capital Blue Cross and Highmark Blue Shield**: Inpatient acute care services and certain outpatient procedures rendered to Blue Cross and Blue Shield program beneficiaries are paid at prospectively determined rates per discharge or per procedure. Other outpatient services are reimbursed at a discount from established rates.

- **Other Payors**: The System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Revenue received under agreements with several third-party payors is subject to audit and retroactive adjustment. Adjustments related to settlements with third-party payors are included in the determination of revenues and gains over expenses and losses in the year in which such adjustments become known. Such adjustments resulted in an increase in revenue of approximately $11,242 and $4,535 in 2012 and 2011, respectively, due to the receipt of tobacco settlement payments, Medicare budget neutrality appeal payment and changes in general reserve estimates and other miscellaneous estimates.

5. Charity Care and Community Service

The System provides services to patients who meet the criteria of its charity care policy without charge or at amounts less than the established rates. Criteria for charity care consider family income levels, household size and ability to pay. Federal poverty guidelines are used as a means to determine the patient's ability to pay. Individuals who qualify for charity care are either uninsured or are extremely indigent and cannot afford their deductibles or coinsurance amounts.

The System maintains records to identify and monitor the level of charity care and community service it provides. These records include the amount of charges foregone based on established rates for services and the estimated cost of those services furnished under its charity care policy. The System provides community service programs to the community at large. A report is issued annually to inventory community benefits in furtherance of its exempt purpose.

Charges foregone associated with charity care service to individuals were approximately $20,976 and $16,360 for 2012 and 2011, respectively. The charity care amounts have been excluded from net patient service revenues. The cost incurred to provide such care was approximately $7,371 and $6,511 for 2012 and 2011, respectively.

6. Investments

Investments at June 30, 2012 and 2011, consist of:

	2012	2011
Investments		
Cash management funds	$ 29,789	$ 16,039
U.S. Government obligations	10,077	5,754
U.S. Treasuries	18,821	21,226
Corporate obligations	89,292	93,133
Fixed income investments	12,110	5,438
Domestic common stock	14,571	16,121
Other domestic equity investments and pooled trusts	17,364	18,306
Foreign equity investments	8,628	6,010
Accrued income	1,024	961
	$ 201,676	$ 182,988
Investments designated for capital projects		
Cash management funds	$ 2,161	$ 14,247
	$ 2,161	$ 14,247
Assets whose use is limited		
Insurance Collateral Funds		
Cash management funds	$ 481	$ 100
U.S. Government obligations	504	1,164
U.S. Treasuries	1,646	1,400
Corporate obligations	2,000	1,723
Accrued income	27	24
	4,658	4,411
Less: Current portion	1,048	1,253
	$ 3,610	$ 3,158
Board-designated funds		
Cash management funds	$ 408	$ 407
Fixed income investments	14,907	13,967
Domestic common stock	14,047	15,577
Other domestic equity investments and pooled trusts	12,482	11,518
Foreign equity investments	6,043	5,308
Accrued income	22	22
	$ 47,909	$ 46,799

	2012	2011
Board designated for capital acquisition		
Cash management funds	$ 1,885	$ 1,388
U.S. Government obligations	6,128	3,106
U.S. Treasuries	9,004	9,468
Corporate obligations	56,212	50,290
Fixed income investments	5,683	5,517
Domestic common stock	18,860	20,980
Other domestic equity investments and pooled trusts	16,068	14,828
Foreign equity investments	8,126	7,079
Accrued income	620	542
	$ 122,586	$ 113,198
Funds held by trustee		
Cash management funds	$ 14,588	$ 14,586
	$ 14,588	$ 14,586
Investments temporarily restricted as to use		
Cash management funds	$ 1,093	$ 121
U.S. Government obligations	11	399
U.S. Treasuries	7	222
Corporate obligations	110	5,706
Fixed income investments	3,817	3,300
Domestic common stock	2,333	2,432
Other domestic equity investments and pooled trusts	2,829	2,414
Foreign equity investments	1,159	952
Accrued income	3	42
	$ 11,362	$ 15,588
Investments permanently restricted as to use		
Cash management funds	$ 101	$ 56
Fixed income investments	3,177	3,149
Domestic common stock	3,413	3,860
Other domestic equity investments and pooled trusts	2,477	2,414
Foreign equity investments	1,479	1,377
Funds held in trust by others	7,543	8,161
Accrued income	7	7
	$ 18,197	$ 19,024

Investment partnerships, which are non-readily marketable investments, included in cash management funds, fixed income investments, other domestic equity and pooled trusts and foreign equity investments in the above totalled $67,655 and $59,745, respectively, at June 30, 2012 and 2011.

Investments designated for capital projects represent unspent proceeds from the 2011A Revenue Bonds for June 30, 2012 and June 30, 2011, respectively, which are required to be expended on capital projects.

Assets whose use is limited include investments pledged as collateral for a letter of credit to satisfy the requirements of the State of Pennsylvania to fund current and future payments of professional liability and worker's compensation claims.

At the time of issuance of the 2009A bonds, the System was required to deposit an amount equal to $14,584 into a Debt Service Reserve Fund. These funds are invested in cash management funds and are classified as "Funds held by trustee, net of current portion" on the System's balance sheet.

Investment income, including interest and dividend income, realized gains or losses on sales of securities, unrealized gains and losses from certain wholly owned insurance captives, investment partnerships, and unrestricted income from temporarily restricted funds and investments permanently restricted as to use, is comprised of the following for the years ended June 30, 2012 and 2011.

	2012	2011
Investment income		
Interest and dividend income	$ 10,031	$ 11,258
Realized and unrealized income, net	67	25,121
	$ 10,098	$ 36,379

The System's investments are managed by investment managers and bank trust departments. Because the System's investments include a variety of financial instruments, the related values as presented in the consolidated financial statements are subject to various market fluctuations which include changes in the equity markets, interest rate environment and general economic conditions.

The following table represents the fair value measurement levels for all assets and liabilities, which the System has recorded at fair value:

		Fair Value Measurement Using		
	June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash management funds (1)	$ 50,506	$ 50,406	$ 100	$ -
U.S. Government obligations (2)	16,720	16,720	-	-
U.S. Treasuries (2)	29,478	29,478	-	-
Corporate obligations (3)	147,614	-	147,614	-
Fixed income investments (3)	39,694	14,769	24,925	-
Domestic common stock (4)	53,224	53,224	-	-
Other domestic equity investments and pooled trusts (5)	51,220	28,078	23,142	-
Foreign equity investments (5)	25,435	5,947	19,488	-
Funds held in trust by others (6)	7,543	-	7,543	-
Accrued income	1,703	1,703	-	-
	$ 423,137	$ 200,325	$ 222,812	$ -
Liabilities				
Interest rate swap	$ 8,585	$ -	$ 8,585	$ -

	June 30, 2011	Fair Value Measurement Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash management funds (1)	$ 46,941	$ 46,941	$ -	$ -
U.S. Government obligations (2)	10,423	10,423	-	-
U.S. Treasuries (2)	32,316	32,316	-	-
Corporate obligations (3)	144,673	-	144,673	-
Fixed income investments (3)	37,550	14,238	23,312	-
Domestic common stock (4)	58,970	58,970	-	-
Other domestic equity investments and pooled trusts (5)	48,055	26,169	21,886	-
Foreign equity investments (5)	22,151	-	22,151	-
Funds held in trust by others (6)	8,161	-	8,161	-
Accrued income	1,601	1,601	-	-
	$ 410,841	$ 190,658	$ 220,183	$ -
Liabilities				
Interest rate swap	$ 4,621	$ -	$ 4,621	$ -

(1) Cash management funds include investments with original maturities of three months or less, including cash, money market funds, overnight investments and commercial paper. Commercial paper and money market funds are carried at market value.

(2) U.S. Government Agencies and Treasuries, are individually owned and held through the System's investment portfolio and are readily marketable securities, therefore, they are considered level 1.

(3) Corporate obligations and fixed income securities are investments in mutual funds and investment partnerships whose underlying investments include corporate bonds, mortgage backed securities, collateralized mortgage obligations and other fixed income securities. The mutual funds investments are considered level 1. The investment partnership holdings are valued each month using NAV per unit and are considered level 2.

(4) Domestic common stock includes individual equities held. All individual equities are considered level 1.

(5) Other domestic equity investments and foreign equity investments are investments in mutual funds and investment partnerships whose underlying investments are individual equity securities. Mutual funds are considered level 1. The investment partnership holdings are valued each month using NAV per unit and are considered level 2.

(6) Funds held in trust are investments held in trust instruments that have been either donated or received as a testamentary trust from the grantors will where the System is the beneficiary of the trust instrument. The underlying securities in each trust are typically individually owned fixed income or equity securities or mutual funds which are invested in fixed income or equity securities. The trustee of each trust is responsible for managing and investing the assets in accordance with the trust arrangement. The funds held in trust are classified as level 2.

As of June 30, 2012 and 2011, cash management funds of $100 and $0, fixed income securities of $24,925 and $17,133, respectively, other domestic equity investments and pooled trusts of $23,142 and $21,886, respectively and foreign equity investments of $19,488 and 20,726, respectively are considered level 2 due to being included in investment partnerships where the partners determine the fair value of the investment.

The System adopted the updated GAAP valuation standard related to investment funds that do not have a readily determinable fair value effective July 1, 2010. The guidance allows the fair value measurements for these funds to be based on reported NAV if certain criteria are met, and establishes additional disclosures related to these investment funds. Accordingly, the fair values of the following investment funds have been estimated using reported NAV:

	2012		
Category of Investment	**Fair Value**	**Redemption Frequency (if Currently Eligible)**	**Redemption Notice Period**
Equity - Global	$ 19,488	Weekly/Monthly	1 to 15 days
Equity - Domestic	23,142	Daily	3 to 5 days
Fixed income	24,925	Daily/Weekly	1 to 5 days
Cash Management	100	Daily	1 to 2 days
	$ 67,655		

	2011		
Category of Investment	**Fair Value**	**Redemption Frequency (if Currently Eligible)**	**Redemption Notice Period**
Equity - Global	$ 20,726	Monthly	15 days
Equity - Domestic	21,886	Daily	3 to 5 days
Fixed income	17,133	Daily	3 to 5 days
	$ 59,745		

7. Goodwill

Goodwill is reported in other assets in the Consolidated Balance Sheets. Accounting standards do not allow goodwill to be amortized but requires that it be tested for impairment annually or more frequently when events or circumstances indicates that the carrying value of a reporting unit more likely than not exceeds its fair value. The System's annual goodwill impairment testing date is March 31 of each year.

As a result of the goodwill impairment testing at March 31, 2012, it was determined that no impairment loss needed to be recognized. The factors that management considered in determining that it was not more likely than not that the fair value of the segments containing goodwill was less than its carrying amount included industry and market conditions, overall financial performance compared to projected results, and volume growth.

Goodwill recorded on the Consolidated Balance Sheets at June 30, 2012 and 2011 amounted to $42,425 and $7,536 respectively.

8. Net Assets

A summary of changes in consolidated unrestricted net assets attributable to Pinnacle Health System and transfers (to) from the noncontrolling interest in West Shore Surgery Center for the years ended June 30, 2012 and 2011 are as follows:

	Total	Pinnacle Health System	Noncontrolling Interest in West Shore Surgery Center
Balance June 30, 2010	$ 326,711	$ 326,711	$ -
Revenues and gains over expenses and losses	42,102	41,260	842
Change in post-retirement liability	32,890	32,890	-
Net assets released from restrictions for purchase of property, plant, and equipment	3,044	3,044	-
Adoption of noncontrolling interests standard	1,358	-	1,358
Distributions to noncontrolling interests	(916)	-	(916)
Change in net assets	78,478	77,194	1,284
Balance June 30, 2011	405,189	403,905	1,284
Revenues and gains over expenses and losses	50,499	49,336	1,163
Change in post-retirement liability	(48,690)	(48,690)	-
Net assets released from restrictions for purchase of property, plant, and equipment	6,797	6,797	-
Change in equity accounting - Horizon	680	680	-
Gain on disposal of assets	(219)	(219)	-
Distributions to noncontrolling interests	(972)	-	(972)
Change in net assets	8,095	7,904	191
Balance June 30, 2012	$ 413,284	$ 411,809	$ 1,475

Temporarily restricted net assets are available for the following purposes at June 30, 2012 and 2011:

	2012	2011
Health care services		
Purchase of equipment	$ 6,171	$ 11,523
Health education	5,697	6,029
Research and development	579	699
Indigent care	1,362	1,201
	$ 13,809	$ 19,452

In August 2008, FASB issued ASC 958-205, which requires enhanced disclosure requirements about an organization's endowment funds. Although the state of Pennsylvania did not enact the Uniform Prudent Management of Institutional Funds "UPMIFA" Act, the System has disclosed its changes in net asset composition in accordance with ASC 958-205.

Changes to the reported amount of the System's endowments as of June 30th are as follows:

	Permanently Restricted
Net assets, June 30, 2010	$ 9,138
Investment return	
Investment income	408
Net appreciation (realized and unrealized)	1,697
Total investment return	2,105
New gifts	6
Appropriation of endowment assets for spending	(471)
Transfers	85
Net assets, June 30, 2011	10,863
Investment return	
Investment income	277
Net appreciation (realized and unrealized)	(18)
Total investment return	259
New gifts	4
Appropriation of endowment assets for spending	(473)
Net assets, June 30, 2012	$ 10,653

Permanently restricted net assets include investments held in perpetuity by others for the benefit of the Hospital of $7,544 and $8,161 and investments to be held in perpetuity by the Foundation for the benefit of the Hospital and PHHCH of $ 10,653 and $10,863, respectively, at June 30, 2012 and 2011. The income from these investments is expendable to support health care services and is reported as either a temporary restricted fund balance or as non-operating income in the consolidated statements of operations depending upon the donor instructions.

9. Property, Plant and Equipment

Property, plant and equipment at June 30, 2012 and 2011 consists of:

	2012	2011
Land	$ 12,904	$ 12,650
Land improvements	10,449	10,361
Leasehold Improvements	23,119	15,153
Building and building improvements	451,419	434,235
Equipment	284,481	289,878
	782,372	762,277
Accumulated depreciation and amortization	(441,538)	(432,703)
Construction in progress	14,389	15,470
	$ 355,223	$ 345,044

Depreciation expense was $46,696 and $40,684 for the years ended June 30, 2012 and 2011, respectively. Accumulated amortization for equipment under capital lease obligations was $10,815 and $6,359 at June 30, 2012 and 2011, respectively. Construction purchase commitments at June 30, 2012 and 2011 have been disclosed in note 10.

10. Long-Term Debt

Long-term debt at June 30, 2012 and 2011 consists of:

	2012	2011
Dauphin County General Authority, Health System Revenue Bonds, Series 2009A, due at various dates through 2036 with a fixed interest rate that varies at intervals specified in the bond document between 3.00% to 6.00% and an average rate of 5.81% to 5.75% at June 30, 2012 and 2011, respectively	$ 175,829	$ 179,575
Dauphin County General Authority, Health System Revenue Bond, Series 2011A, due at various dates through 2041 with interest at 70% of a variable monthly interest rate plus 80 basis points. The rate was 0.97% and 0.93% at June 30, 2012 and 2011, respectively.	98,750	100,000
PNC Bank, NA taxable bank loan, due March 1, 2017 with interest equal to a variable monthly interest rate plus 58 basis points. At June 30, 2012 the rate was 0.82%	24,700	-
Various capital leases and loans at various interest rates	25,251	24,659
	324,530	304,234
Less: Current portion	17,201	9,750
	$ 307,329	$ 294,484

Lines of Credit

At June 30, 2012 and 2011, the System had unused lines of credit of $5,095 and $2,730, which bear interest at fixed and variable rates. A variable rate line in the amount of $2,960 and $2,730 bears interest at a variable rate of 1.74% and 1.69% at June 30, 2012 and 2011, respectively. Two fixed rate lines totaling $2,135 bear interest at fixed rates between 4.00% and 3.25% at both June 30, 2012 and June 30, 2011.

Letters of Credit

The System was contingently liable for outstanding letters of credit in the amounts of approximately $5,449 and $4,876 for the years ended June 30, 2012 and 2011, respectively, to satisfy the requirements of professional liability insurance policies, future worker's compensation claims, current construction site work and security deposits on certain real estate leases.

Bank Note

On March 1, 2012, the System secured a $26,000 taxable five year term bank loan through PNC Bank, N. A. which was primarily used to finance the acquisition of Tristan Associates. The interest rate is reset monthly and equals the 1 month LIBOR Index plus a margin of 58 basis points. The interest rate will not exceed the maximum rate permitted by law. All transaction related fees were paid directly from Pinnacle Health System operating funds.

During fiscal year 2011, the Series 2011A Bond was issued to extinguish $70,000 of the outstanding 2009B Revenue Note as well as to provide an additional $30,000 in order to fund certain capital projects at the Hospital.

Revenue Bonds

The Series 2009A Bonds and the Series 2011A Revenue Bonds, were issued under Master Trust Indentures which contains certain covenants of the Obligated Group, including, but not limited to, covenants regarding the payment of debt service on all the Master Notes and Master Guarantees issued there under, rates and charges, liquidity, indebtedness, transfers of assets, the incurrence of additional indebtedness and the granting of security interests in property and a pledge of gross receipts to collateralize such indebtedness.

A summary of scheduled principal repayments on long-term debt is as follows:

Fiscal Year	Debt	Capital Leases and Loans	Total
2013	10,550	6,651	17,201
2014	10,790	5,686	16,476
2015	11,060	4,326	15,386
2016	11,370	2,339	13,709
2017	10,400	1,337	11,737
Thereafter	245,109	4,912	250,021
	$ 299,279	$ 25,251	$ 324,530

11. Interest Rate Swaps

The System has used derivative instruments, such as interest rate swaps, to manage certain interest rate exposures. Derivative instruments are viewed as risk management tools by the System and are not used for trading and speculative purposes.

When quoted market prices are not available, the valuation of derivative instruments is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including interest rate curves and implied volatilities. The estimates of fair value are made by an independent third-party valuation service using a standardized methodology based on observable market inputs. As part of the System's overall valuation process, management evaluates this third-party methodology to ensure that it is representative of exit prices in the principal markets. These future net cash flows, however, are susceptible to change primarily due to fluctuations in interest rates. As a result, the estimated values of these derivatives will change over time as cash is received and paid and also as market conditions change. As these changes take place, they may have a positive or negative impact on estimated valuations. Based on the nature and limited purposes of the derivatives that the System employs, fluctuation in interest rates have had only a modest effect on its results of operations. As such, fluctuations are generally expected to be countered by offsetting changes in income, expense, and/or values of assets and liabilities.

As of July 14, 2005, in conjunction with the Series 2005 Bond, the Hospital entered into an interest rate swap agreement with an initial notional amount of $55,000. Under the agreement the Hospital paid the counterparty, Citigroup, a fixed rate of 3.36% and in exchange Citigroup pays the Hospital 61.80% of LIBOR plus 0.32%. Due to the redemption of the Series 2005 Bonds, the interest rate swap agreement was amended and restated on June 24, 2009 in conjunction with the Series 2009A Bond. As of June 30, 2012, the Hospital recorded a liability of $8,585 and a related loss of $5,451, which was recorded in loss on interest rate swaps in the consolidated statement of operations. As of June 30, 2011, the Hospital recorded a liability of $4,621 and a related loss of $529, which was recorded in loss on interest rate swaps in the consolidated statement of operations.

The System has classified its interest rate swap in Level 2 of the fair value hierarchy, as the significant inputs to the overall valuations are based on market-observable data or information derived from or corroborated by market-observable data. For over-the-counter derivatives that trade in liquid markets, such as interest rate swaps, model inputs (i.e. contractual terms, market prices, yield curves, credit curves, and measures of volatility) can generally be verified, and model selection does not involve significant management judgment.

A summary of the related liabilities and income statement impact of the swaps at June 30, 2012 and 2011 is as follows:

	Balance Sheets		Statements of Operations	
Interest Rate Swap	**2012**	**2011**	**2012**	**2011**
Series 2005/2009A swap	$ 8,585	$ 4,621	$ (5,450)	$ (529)
	$ 8,585	$ 4,621	$ (5,450)	$ (529)

12. Funds Held by Trustee and Other

Certain funds are required to be established and controlled by the trustee during the periods certain bonds are outstanding.

The additional proceeds of $30,000 from the 2011A Revenue Bonds received June 28, 2011 were to be used to fund approved capital projects at both the Harrisburg Hospital and Community General Osteopathic Hospital, plus pay issuance costs. As of June 30, 2012, $27,839 of the proceeds were expended on included projects leaving $2,161 unspent. This amount is included in investments designated for capital projects until such time as approved invoices are paid to satisfy the requirements of the Bond agreement.

Nonoperating gains include $3 and $27 interest earned on the funds held by trustee and other for the years ended June 30, 2012 and 2011, respectively.

13. Retirement Plans

The System sponsors defined contribution plans covering substantially all of its employees and employees of certain wholly- and partially-owned subsidiaries. The plans allow participating employees to contribute a percentage of their annual salary subject to current Internal Revenue Service ("IRS") limitations. Employee contributions are matched by the System at various percentages. The System's contributions to the savings plans are $13,943 and $12,257 for 2012 and 2011, respectively.

The System sponsors a noncontributory defined benefit pension plan (the "Plan") covering substantially all of its employees and employees of certain wholly owned subsidiaries employed prior to January 1, 2007. Effective December 31, 2006, the System amended the Plan by freezing benefits for all participants. Additional retirement benefits are provided through increased contributions to the defined contribution plans. The Parent also sponsors a supplemental noncontributory defined benefit pension plan covering certain executives of the controlled entities of the System. The supplemental plan is unfunded and the Hospital has recorded a liability of $3,612 and $3,710 at June 30, 2012 and 2011, respectively.

The System sponsors a nonqualified deferred compensation plan covering certain employees of PHCVI. The plan allows participating employees to defer a percentage of their compensation during the plan year as well as allowing company contributions subject to plan limitations. The System's contributions to the plan are $582 and $67 for 2012 and 2011, respectively.

Pension costs are funded to the limits specified by the Employee Retirement Income Security Act of 1974, as amended. From time to time, the System may contribute additional amounts to the Plan as it deems appropriate, subject to funding limitations. During fiscal year 2013, the System expects to contribute approximately $15,800 to the Plan.

Other benefits provided by the System are a defined benefit postretirement health plan and a defined benefit postretirement life plan both covering employees of the former Capital Area Health Foundation who retired by December 31, 1996. The plan is unfunded and the Hospital has recorded a liability of $5,162 and $4,869 at June 30, 2012 and 2011, respectively.

The following is the status of the various employee benefit plans as of the measurement dates of June 30, 2012 and 2011.

	Pension Benefits		Other Postretirement Benefits	
	2012	**2011**	**2012**	**2011**
Change in benefit obligations				
Benefit obligation at beginning of year	$ 272,816	$ 267,794	$ 4,869	$ 4,772
Service cost	-	-	72	68
Interest cost	14,946	14,278	264	254
Participant contributions	-	-	29	21
Benefit payments from assets	(206)	(2,890)	(143)	(101)
Benefit payments from plan	(9,974)	(9,177)	-	-
Actuarial (gain) loss	42,063	2,811	71	(146)
Benefit obligation at end of year	319,645	272,816	5,162	4,869
Change in plan assets				
Fair value of plan assets at beginning of year	220,620	179,602	-	-
Actual return on plan assets	4,331	38,895	-	-
Participant contributions	-	-	29	21
Employer contributions	18,750	11,300	114	80
Benefit payments	(9,974)	(9,177)	(143)	(101)
Fair value of plan assets at end of year	233,727	220,620	-	-
Funded status	$ (85,918)	$ (52,196)	$ (5,162)	$ (4,869)
Amounts recognized in the balance sheet consist of				
Current accrued retirement costs	-	-	(450)	(503)
Long-term accrued retirement costs	(85,917)	(52,196)	(4,712)	(4,365)
	$ (85,917)	$ (52,196)	$ (5,162)	$ (4,868)
Amounts recognized in net assets consist of				
Unrecognized net actuarial loss (gain)	125,392	76,763	51	(20)
Net prior service benefit	(60)	(90)	-	-
	$ 125,332	$ 76,673	$ 51	$ (20)

The accumulated benefit obligation for pension benefits at June 30, 2012 and 2011 is $319,645 and $272,816, respectively.

The assumptions used in the measurement of the System's net periodic benefit obligations are shown in the following table:

	Pension Benefits		Postretirement Benefits	
(benefit obligations)	**2012**	**2011**	**2012**	**2011**
Weighted-average assumptions at the years ending June 30				
Discount rate	4.40 %	5.60 %	4.40 %	5.50 %
Rate of compensation increase	N/A	N/A	2.50 %	2.50 %

The following table provides the components of net periodic benefit cost for the years ended June 30, 2012 and 2011:

	Pension Benefits		Other Postretirement Benefits	
	2012	2011	2012	2011
Service cost	$ -	$ -	$ 72	$ 68
Interest cost	14,946	14,278	264	254
Expected return on plan assets	(17,555)	(14,204)	-	-
Amortization of prior service cost	(31)	(30)	-	-
Amortization of net actuarial loss	6,658	10,799	-	-
Net periodic benefit cost	$ 4,018	$ 10,843	$ 336	$ 322

The assumptions used in the measurement of the System's benefit cost are shown in the following table:

	Pension Benefits		Other Postretirement Benefits	
(net periodic benefit cost)	2012	2011	2012	2011
Weighted-average assumptions at the years ending June 30				
Discount rate	5.60 %	5.50 %	5.60 %	5.50 %
Expected return on plan assets	8.00 %	8.00 %	N/A	N/A
Rate of compensation increase	N/A	N/A	2.50 %	3.50 %

A 9.0% annual rate of increase in the per capita costs of covered health care benefits was assumed for 2011 gradually decreasing to 5.00% by the year 2018.

Sensitivity Analysis, Postretirement Benefits
Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. At June 30, 2012, a one-percentage-point change in assumed health care cost trend rates would have the following effects:

	One-Percentage-Point	
	Increase	Decrease
Effect on total of service and interest cost components	$ 6	$ (5)
Effect on postretirement benefit obligation	129	(114)

Expected benefit payments for the years ended June 30 are as follows:

	Pension Benefits	Other Benefits
2013	$ 13,397	$ 237
2014	14,260	244
2015	15,038	251
2016	15,864	258
2017	16,734	263
2018 - 2022	93,865	1,300

The pension plan's asset allocation at June 30, 2012 and 2011, by asset category, is as follows:

	2012	2011
Pension plan assets		
Equity securities	53.3 %	53.9 %
Fixed income securities	36.0 %	35.6 %
Tactical allocation	10.3 %	9.8 %
Cash and cash equivalents	0.4 %	0.7 %
	100.0 %	100.0 %

The primary investment objective for the plan assets is to achieve maximum rates of return commensurate with safety of principal. Target asset allocation, credit quality and diversification guidelines and restrictions are approved by the Investment Committee of the Board of Directors of the Parent. The plan asset allocation is reviewed quarterly to determine whether the portfolio mix is within an acceptable range of the target allocation. Target asset allocations are based on asset and liability studies.

The target asset allocation for the portfolio is 55.0% equity and 35.0% fixed income securities, 10.0% tactical allocation and 0.0% cash equivalents.

The following table represents the fair value measurement levels for all pension assets, which the System has recorded at fair value:

		Fair Value Measurement Using		
	June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash management funds	$ 2,609	$ 2,609	$ -	$ -
Fixed income investments	107,912	23,924	83,988	-
Domestic common stock	55,934	55,934	-	-
Other domestic equity investments				-
and pooled trusts	40,135	20,706	19,429	-
Foreign equity investments	27,049	133	26,916	-
Accrued income	87	87	-	-
	$ 233,726	$ 103,393	$ 130,333	$ -

		Fair Value Measurement Using		
	June 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Cash management funds	$ 2,713	$ 2,713	$ -	$ -
Fixed income investments	100,227	21,685	78,542	-
Domestic common stock	49,748	49,748	-	-
Other domestic equity investments				
and pooled trusts	37,142	18,761	18,381	-
Foreign equity investments	30,717	-	30,717	-
Accrued income	73	73	-	-
	$ 220,620	$ 92,980	$ 127,640	$ -

As of June 30, 2012 and 2011, fixed income securities of $83,988 and $78,542, respectively, other domestic equity investments and pooled trusts of $19,429 and $18,381, respectively and foreign equity investments of $26,916 and $30,717, respectively are considered level 2 due to being included in investment partnerships where the partners determine the fair value of the investment.

The System adopted the updated GAAP valuation standard related to investment funds that do not have a readily determinable fair value effective July 1, 2010. The guidance allows the fair value measurements for these funds to be based on reported NAV if certain criteria are met, and establishes additional disclosures related to these investment funds. Accordingly, the fair values of the following investment funds have been estimated using reported NAV:

	2012		
Category of Investment	**Fair Value**	**Redemption Frequency (if Currently Eligible)**	**Redemption Notice Period**
Equity - Global	$ 26,916	Monthly	15 days
Equity - Domestic	19,429	Daily	3 to 5 days
Fixed income	83,988	Daily	3 to 5 days
	$ 130,333		

	2011		
Category of Investment	**Fair Value**	**Redemption Frequency (if Currently Eligible)**	**Redemption Notice Period**
Equity - Global	$ 30,717	Monthly	15 days
Equity - Domestic	18,381	Daily	3 to 5 days
Fixed income	78,542	Daily	3 to 5 days
	$ 127,640		

14. Insurance Coverage

The System maintains self-insurance trust funds for professional liability claims that are not insured by captive insurance arrangements. The System's contributions to its self-insurance trust funds and the related self-insured liabilities are based on actuarial assumptions and methodologies, which are reviewed continuously with any adjustments reflected in current operations. Management believes that the accrual for self-insured liabilities is adequate as of June 30, 2012; however, it is reasonably possible the estimated reserve for self-insurance claims could change in the near term due to the inherent variability in determining such estimates.

Effective December 31, 2002, primary professional and general liability insurance is provided through the System's wholly owned for profit captive insurance company, RRG. Professional liability is provided on a claims-made basis meeting statutory limit requirements of $500 per claim subject to a $2,500 annual aggregate for the Hospital, and a $1,500 annual aggregate for physician and skilled nursing claims. Additional coverage of $500 per claim and $1,500 in the aggregate is provided by the Mcare Fund (formerly the Medical Professional Liability Catastrophic Fund – "CAT Fund") established under the Medical Care Availability and Reduction of Error Act ("Mcare Act"). Coverage for general liability is on an occurrence basis providing $1,000 per claim subject to a $2,000 aggregate.

Prior to December 31, 2002, malpractice coverage was provided by commercial carriers on a claims-made basis with statutory/primary limits of $500 per claim and $2,500 for hospital claims and $1,500 for physician and skilled nursing claims in the aggregate with additional coverage of $700 per claim and $2,100 in the aggregate by the Mcare Fund. Coverage for general liability was on an occurrence basis providing $1,000 per claim subject to a $1,000 aggregate.

Effective January 1, 2012, the System purchased $25,000 in excess liability limits with separate limits established for professional liability exposure and general liability and other underlying coverage. A $4,000 self-insured retention layer for professional and general liability exposure is underwritten by the System's wholly owned captive, UHR. For period January 1, 2010 to December 31, 2011, excess limits were $20,000 with separate limits for Professional and General Liability. For period January 1, 2007 to December 31, 2009, excess limits were $10,000 with separate limits for Professional and General Liability. At January 1, 2006, coverage included a $2,000 self-insured retention with an $8,000 annual aggregate limit for professional and general liability exposure. Effective January 1, 2004 through December 31, 2005, a shared $8,000 excess layer over a $1,000 self-insured retention layer. Claims in the $8,000 excess layer are shared 50% by a commercial insurance carrier and 50% self-insured. Self insured exposure is re-insured through the Parent's wholly owned captive, UHR. Effective January 1, 2003 through December 31, 2003, the System maintained excess liability coverage of $4,000 per claim and in the aggregate provided through UHR, with an additional $5,000 per claim and in the aggregate provided by a commercial insurance carrier. Prior to January 1, 2003, the System maintained excess liability coverage with a commercial carrier in the amount of $25,000 over the above limits.

At June 30, 2012 and 2011, the System also maintained Directors and Officers liability coverage with limits of $20,000 and $15,000, respectively, and Excess Workers' Compensation coverage over a self-insured retention of $750.

The actuarially computed liability to all health care providers (hospitals, physicians, and others) participating in the Mcare Fund at June 30, 2012 is expected to be substantially in excess of the amount the Mcare Fund has available to pay these claims. The Commonwealth of Pennsylvania has indicated that the unfunded liability will be funded exclusively through surcharge assessments in future years as claims are settled and paid. No provision has been made for any future Mcare Fund assessments in the accompanying June 30, 2012 and 2011 consolidated financial statements as the System's portion of the Mcare Fund unfunded liability could not be reasonably estimated.

15. Significant Concentrations of Credit Risk

The System's operations are located in Harrisburg, Pennsylvania. Its primary service area includes Harrisburg, Pennsylvania and the surrounding Greater Harrisburg Metropolitan Area. Financial instruments which subject the System to concentrations of credit risk consist primarily of cash and cash equivalents, investments, and accounts receivable.

The System typically maintains cash and cash equivalents and temporary investments in local banks. As of July 21, 2010, cash and cash equivalents and temporary investments are insured by the FDIC up to a limit of $250.

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2012 and 2011 was as follows:

	2012	2011
Medicare	27 %	28 %
Medicaid	18	17
Capital Blue Cross/Highmark Blue Shield	24	23
HMO	5	5
Other third-party payors	11	11
Patients	15	16
	100 %	100 %

16. Commitments and Contingencies

Strategic Business Arrangement

Effective April 24, 2008, the System signed a Strategic Business Alliance Agreement with Toshiba America Medical Systems, Inc. This agreement provides for the purchase or lease of medical equipment from Toshiba over a three year period. The System will receive marketing, training and support services from Toshiba as part of this agreement. This agreement is effective for a term of five years and each purchase or lease is subject to board approval.

Operating Leases

The System has entered into various lease arrangements for equipment, office space, and storage. Lease expense was $9,935 and $6,523 for the years ended June 30, 2012 and 2011, respectively. As of June 30, 2012, the System's lease commitments for the years ended June 30, 2013, 2014, 2015, 2016 and 2017 are $10,458, $8,014, $7,462, $6,712 and $6,325, respectively, and $45,784 in the aggregate for the years thereafter.

Loan Commitment and Debt Guarantees

As of June 30, 2012 and 2011 there was no outstanding debt guaranteed.

Purchase Commitments
The System has outstanding purchase commitments related to various projects of approximately $5,775 and $13,336 at June 30, 2012 and 2011, respectively.

Equity Contribution Commitments
The System is committed to provide equity contributions to PPI to fund any losses. During 2012 and 2011, the System provided equity contributions of $2,050 and $1,883, respectively.

Regulatory Compliance
Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The System believes that it is in compliance with all applicable laws and regulations through the years ended June 30, 2012 and 2011. Compliance with such laws and regulations can be subject to government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid program.

17. Functional Expenses

The System provides general health care services to residents within its geographical area. Expenses related to providing these services for the years ended June 30, 2012 and 2011 are approximately as follows:

	2012	2011
Health care services	$ 586,718	$ 475,143
General and administrative	162,125	199,776
	$ 748,843	$ 674,919

18. Subsequent Events

The System evaluated subsequent events through September 12, 2012, which is the date the financial statements are considered widely distributed. Management reviews for and identifies subsequent events through participation at Board of Director meetings and subcommittee meetings.

On August 7, 2012, the System proceeded with a tax-exempt Health System Revenue Bond issued by the Dauphin County General Authority in the amount of $135,250, which includes $7,040 of Net Original Issue Premium, due at various dates through 2042 with a fixed interest rate that varies at intervals specified in the bond document between 3.75% and 5.00% and an average rate of 4.91% at the time of issue. Bond issue costs of $1,509 were paid from the proceeds. The proceeds will be used primarily to build a new 108 bed hospital on the Cumberland Campus as well as for various capital projects at both the Harrisburg Campus and the Community General Osteopathic Campus.

On July 19, 2012, In connection with the construction of the new West Shore Hospital, a construction contract totaling $66,091 was signed.

Report of Independent Auditors
on Accompanying Consolidating Information

To the Board of Directors of Pinnacle Health System:

We have audited the consolidated financial statements of Pinnacle Health System and its controlled entities and subsidiaries (collectively, the "System") as of June 30, 2012 and for the year then ended and our report thereon appears on page 2 of this document. That audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating 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 consolidating information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and cash flows of the individual companies and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and changes in net assets of the individual companies.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
September 12, 2012

Pinnacle Health System
(And controlled entities and subsidiaries)
Consolidating Statement of Financial Position
June 30, 2012

Schedule I

(in thousands of dollars)	Parent	Hospital	PHMS	Elimin-ations	Obligated Group	RRG & UHR Combined	Foundation	PHEDS	PHHCH	PHCVI	PHMGI	PHVI	WSSC	CLT	Elimin-ations	Consolidated Balances
Assets																
Current																
Cash and cash equivalents	$ 24,509	$ 719	$ 173	$ -	$ 25,401	$ 4,849	$ -	$ -	$ -	$ 26	$ 70	$ 147	$ 1,203	$ 179	$ -	$ 31,875
Accounts receivable, net	-	77,937	2,089	-	80,026	2,275	346	1,445	-	2,449	1,539	60	769	803	(107)	89,605
Investments	132,988	40,009	-	-	172,997	28,634	-	-	-	-	-	-	-	45	-	201,676
Inventories	-	11,552	270	-	11,822	-	-	-	-	46	82	-	225	16	-	12,191
Prepaid expenses	429	8,485	636	-	9,550	195	-	121	-	310	514	239	144	82	-	11,155
Due from related parties	25,570	933	653	-	27,156	-	-	-	-	-	-	-	-	107	(27,263)	-
Current portion of investments designed for capital projects	-	2,161	-	-	2,161	-	-	-	-	-	-	-	-	-	-	2,161
Current portion of self-insurance trust funds	-	1,048	-	-	1,048	-	-	-	-	-	-	-	-	-	-	1,048
Total current assets	183,496	142,844	3,821	-	330,161	35,953	346	1,566	-	2,831	2,205	446	2,341	1,232	(27,370)	349,711
Assets limited as to use																
Self-insurance trust funds, net of current portion	-	3,610		-	3,610	-	-	-	-	-	-	-	-	-	-	3,610
Board-designated funds	-	13,661		-	13,661	-	34,248	-	-	-	-	-	-	-	-	47,909
Funded Depreciation	-	122,586		-	122,586	-	-	-	-	-	-	-	-	-	-	122,586
Funds held by trustee, net of current portion	-	14,588		-	14,588	-	-	-	-	-	-	-	-	-	-	14,588
Total assets limited as to use	-	154,445	-	-	154,445	-	34,248	-	-	-	-	-	-	-	-	188,693
Temporarily restricted funds	-	6,354	-	-	6,354	-	5,008	-	-	-	-	-	-	-	-	11,362
Temporarily restricted funds - related parties	-	-	-	-	-	-	6,354	-	-	-	-	-	-	-	(6,354)	-
Investments permanently restricted as to use	-	18,197	-	-	18,197	-	10,653	-	-	-	-	-	-	-	(10,653)	18,197
Property, plant and equipment, net	371	332,162	8,615	-	341,148	-	-	-	-	3,288	1,569	7,202	710	1,306	-	355,223
Pledges receivable	-	2,447	-	-	2,447	-	2,447	-	-	-	-	-	-	-	(2,447)	2,447
Goodwill	-	315	3,084	-	3,399	-	-	-	-	5,605	2,437	30,984	-	-	-	42,425
Other assets	52,782	16,322	210	-	69,314	-	-	-	-	2,303	884	474	-	-	(54,118)	18,857
Total assets	$ 236,649	$ 673,086	$ 15,730	$ -	$ 925,465	$ 35,953	$ 59,056	$ 1,566	$ -	$ 14,027	$ 7,095	$ 39,106	$ 3,051	$ 2,538	$ (100,942)	$ 986,915

Pinnacle Health System
(And controlled entities and subsidiaries)
Consolidating Statement of Financial Position
June 30, 2012

Schedule I

(in thousands of dollars)	Parent	Hospital	PHMS	Elimin-ations	Obligated Group	RRG & UHR Combined	Foundation	PHEDS	PHHCH	PHCVI	PHMGI	PHVI	WSSC	CLT	Elimin-ations	Consolidated Balances
Liabilities and Net Assets																
Current																
Current portion of long-term debt	$ -	$ 16,027	$ 228	$ -	$ 16,255	$ -	$ -	$ -	$ -	$ -	$ -	$ 896	$ -	$ 157	$ (107)	$ 17,201
Accounts payable and accrued expenses	1,192	31,224	1,737	-	34,153	115	443	116	-	303	533	1,911	333	194	-	38,101
Accrued salaries, wages and fees	2,688	13,350	3,919	-	19,957	-	-	776	-	2,187	679	-	18	168	-	23,785
Accrued vacation	718	13,438	2,446	-	16,602	-	-	694	-	826	262	-	-	149	-	18,533
Accrued insurance costs	-	9,325	-	-	9,325	10,852	-	-	-	-	-	-	-	-	-	20,177
Accrued retirement costs	-	450	-	-	450	-	-	-	-	-	-	-	-	-	-	450
Due to related parties	-	-	-	-	-	-	2,292	-	-	18,235	1,538	5,199	153	-	(27,417)	-
Due to third-party payors	-	5,895	-	-	5,895	-	-	-	-	-	-	-	-	-	-	5,895
Advances from third-party payors	-	3,809	-	-	3,809	-	-	-	-	-	-	-	-	-	-	3,809
Total current liabilities	4,598	93,518	8,330	-	106,446	10,967	2,735	1,586	-	21,551	3,012	8,006	504	668	(27,524)	127,951
Long-term																
Accrued insurance costs, net of current portion	-	7,003	-	-	7,003	-	-	-	-	-	-	-	-	-	-	7,003
Accrued retirement costs, net of current portion	128	90,629	-	-	90,757	-	-	-	-	-	-	-	-	-	-	90,757
Interest rate swap agreement	-	8,585	-	-	8,585	-	-	-	-	-	-	-	-	-	-	8,585
Long-term debt, net of current portion	-	301,809	4,925	-	306,734	-	-	-	-	-	-	560	35	622	(622)	307,329
Total long-term liabilities	128	408,026	4,925	-	413,079	-	-	-	-	-	-	560	35	622	(622)	413,674
Net assets																
Unrestricted net assets:																
Unrestricted net assets Pinnacle Health System	231,923	144,544	2,475	-	378,942	24,986	31,859	(20)	-	(7,524)	4,083	30,540	1,037	1,248	(53,342)	411,809
Noncontrolling interests in consolidated subsidiary company	-	-	-	-	-	-	-	-	-	-	-	-	1,475	-	-	1,475
Total unrestricted net assets	231,923	144,544	2,475	-	378,942	24,986	31,859	(20)	-	(7,524)	4,083	30,540	2,512	1,248	(53,342)	413,284
Temporarily restricted net assets	-	8,801	-	-	8,801	-	13,809	-	-	-	-	-		-	(8,801)	13,809
Permanently restricted net assets	-	18,197	-	-	18,197	-	10,653	-	-	-	-	-		-	(10,653)	18,197
Total net assets	231,923	171,542	2,475	-	405,940	24,986	56,321	(20)	-	(7,524)	4,083	30,540	2,512	1,248	(72,796)	445,290
Total liabilities and net assets	$ 236,649	$ 673,086	$ 15,730	$ -	$ 925,465	$ 35,953	$ 59,056	$ 1,566	$ -	$ 14,027	$ 7,095	$ 39,106	$ 3,051	$ 2,538	$ (100,942)	$ 986,915

Pinnacle Health System
(And controlled entities and subsidiaries)
Consolidating Statement of Operations
Year Ended June 30, 2012

Schedule II

(in thousands of dollars)	Parent	Hospital	PHMS	Elimin-ations	Obligated Group	RRG & UHR Combined	Foundation	PHEDS	PHHCH	PHCVI	PHMGI	PHVI	WSSC	CLT	Elimin-ations	Consolidated Balances
Unrestricted revenues																
Net patient service revenues	$ -	$ 665,802	$ 41,789	$ -	$ 707,591	$ -	$ -	$ 15,211	$ 6,046	$ 18,879	$ 5,450	$ -	$ 8,446	$ 4,768	$ -	$ 766,391
Other revenues	3,249	20,834	10,179	(30,415)	3,847	5,811	239	22	72	1,579	60	2,837	-	872	6,322	21,661
Net assets released from restrictions used for operations	290	1,766	1,056	-	3,112	-	317	-	46	-	-	-	-	-	-	3,475
Total unrestricted revenues	3,539	688,402	53,024	(30,415)	714,550	5,811	556	15,233	6,164	20,458	5,510	2,837	8,446	5,640	6,322	791,527
Expenses																
Salaries and wages	9,882	200,635	42,990	-	253,507	-	-	10,673	4,888	23,622	3,464	130	1,944	3,255	-	301,483
Fringe benefits	2,280	64,087	8,575	(219)	74,723	-	-	1,941	1,829	4,547	794	26	293	922	(15)	85,060
Management and support	-	19,064	1,870	(20,934)	-	-	445	79	80	115	14	-	-	60	(793)	-
Professional fees	4,117	21,308	1,799	(7,752)	19,472	248	149	52	276	592	73	850	55	108	(601)	21,274
Supplies	294	114,161	3,087	-	117,542	-	57	4	321	502	506	8	2,060	203	-	121,203
Purchased services and other	2,268	103,750	6,909	(1,510)	111,417	5,879	402	1,541	647	4,103	998	1,523	1,511	435	(6,413)	122,043
Interest	-	12,448	300	-	12,748	-	-	-	-	-	-	137	-	55	(55)	12,885
Bad debt expense	-	28,732	1,713	-	30,445	-	-	5,131	1	305	25	-	9	1,868	-	37,784
Depreciation and amortization	47	43,263	1,163	-	44,473	-	-	-	57	1,208	214	561	199	399	-	47,111
Total expenses	18,888	607,448	68,406	(30,415)	664,327	6,127	1,053	19,421	8,099	34,994	6,088	3,235	6,071	7,305	(7,877)	748,843
Income (loss) from operations	(15,349)	80,954	(15,382)	-	50,223	(316)	(497)	(4,188)	(1,935)	(14,536)	(578)	(398)	2,375	(1,665)	14,199	42,684
Nonoperating gains (losses)																
Investment income (loss)	3,187	6,260	(77)	-	9,370	943	774	-	-	(28)	(11)	(265)	-	(3)	(682)	10,098
Loss on disposal of assets	-	2,396	(14)	-	2,382	-	-	-	(28)	-	-	471	-	209	-	3,034
Contributed net assets in acquisition	-	-	-	-	-	-	-	-	-	-	-	-	-	133	-	133
Realized and unrealized losses on interest rate swaps	-	(5,450)	-	-	(5,450)	-	-	-	-	-	-	-	-	-	-	(5,450)
Nonoperating gain (loss), net	3,187	3,206	(91)	-	6,302	943	774	-	(28)	(28)	(11)	206	-	339	(682)	7,815
Revenues and gains over (under) expenses and losses	$ (12,162)	$ 84,160	$ (15,473)	$ -	$ 56,525	$ 627	$ 277	$ (4,188)	$ (1,963)	$ (14,564)	$ (589)	$ (192)	$ 2,375	$ (1,326)	$ 13,517	$ 50,499

Pinnacle Health System
(And controlled entities and subsidiaries)
Consolidating Statement of Changes in Net Assets
Year Ended June 30, 2012 — Schedule III

(in thousands of dollars)	Parent	Hospital	PHMS	Elimin-ations	Obligated Group	RRG & UHR Combined	Foundation	PHEDS	PHHCH	PHCVI	PHMGI	PHVI	WSSC	CLT	Elimin-ations	Consolidated Balances
Unrestricted net assets																
Revenues and gains over (under) expenses and losses	$ (12,162)	$ 84,160	$ (15,473)	$ -	$ 56,525	$ 627	$ 277	$ (4,188)	$ (1,963)	$ (14,564)	$ (589)	$ (192)	$ 2,375	$ (1,326)	$ 13,517	$ 50,499
Change in post-retirement liability	-	(48,690)	-	-	(48,690)	-	-	-	-	-	-	-	-	-	-	(48,690)
Transfer of PHHCH Unrestricted Net Assets	-	44	-	-	44	-	-	-	(44)	-	-	-	-	-	-	-
Capital contributions	72,679	(92,667)	13,588	-	(6,400)	-	1	4,182	956	-	-	1	-	1,262	(2)	-
Net assets released from restrictions for purchases of property, plant and equipment	1	6,683	-	-	6,684	-	-	-	-	-	-	-	-	113	-	6,797
Other	-	678	-	-	678	-	-	-	-	2,328	4,672	30,731	-	-	(37,948)	461
Adoption of noncontrolling interests standard	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Income attributable to noncontrolling interests	-	-	-	-	-	-	-	-	-	-	-	-	(1,985)	-	1,013	(972)
Increase (decrease) in unrestricted assets	60,518	(49,792)	(1,885)	-	8,841	627	278	(6)	(1,051)	(12,236)	4,083	30,540	390	49	(23,420)	8,095
Temporarily restricted net assets																
Contributions	-	2,204	-	-	2,204	-	3,613	-	24	-	-	-	-	-	(2,228)	3,613
Net realized and unrealized gains on investments	-	419	-	-	419	-	1,016	-	-	-	-	-	-	-	(419)	1,016
Transfer from permanently restricted funds	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Transfer of PHHCH Temporarily Restricted Net Assets	-	64	-	-	64	-	-	-	(64)	-	-	-	-	-	-	-
Net assets released from restrictions	-	(9,126)	-	-	(9,126)	-	(10,272)	-	(20)	-	-	-	-	-	9,146	(10,272)
Increase in temporarily restricted assets	-	(6,439)	-	-	(6,439)	-	(5,643)	-	(60)	-	-	-	-	-	6,499	(5,643)
Permanently restricted net assets																
Contributions	-	4	-	-	4	-	4	-	-	-	-	-	-	-	(4)	4
Transfer to temporarily restricted funds	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Transfer of PHHCH Permanently Restricted Net Assets	-	82	-	-	82	-	-	-	(82)	-	-	-	-	-	-	-
Income distributions	-	(469)	-	-	(469)	-	(473)	-	(4)	-	-	-	-	-	473	(473)
Net realized and unrealized gains on investments	-	(358)		-	(358)	-	259	-	-	-	-	-	-	-	(259)	(358)
Increase in permanently restricted assets	-	(741)	-	-	(741)	-	(210)	-	(86)	-	-	-	-	-	210	(827)
Increase (decrease) in net assets	60,518	(56,972)	(1,885)	-	1,661	627	(5,575)	(6)	(1,197)	(12,236)	4,083	30,540	390	49	(16,711)	1,625
Net assets																
Beginning of year	171,405	228,514	4,360	-	404,279	24,359	61,896	(14)	1,197	4,712	-	-	2,122	1,199	(56,085)	443,665
End of year	$ 231,923	$ 171,542	$ 2,475	$ -	$ 405,940	$ 24,986	$ 56,321	$ (20)	$ -	$ (7,524)	$ 4,083	$ 30,540	$ 2,512	$ 1,248	$ (72,796)	$ 445,290

Report of Independent Auditors on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

To the Board of Directors of Pinnacle Health System:

We have audited the consolidated financial statements of Pinnacle Health System and its controlled entities and subsidiaries (collectively, the "System") as of and for the years ended June 30, 2012 and 2011, and have issued our report thereon dated September 12, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System'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*.

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We noted certain matters that we reported to management of the System in a separate letter dated September 12, 2012.

This report is intended solely for the information and use of the System's finance and audit committee, management, others within the System, and other government agencies and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

September 12, 2012