The Reading Hospital and Controlled Entities

Reports on Federal Awards in Accordance with OMB Circular A-133
June 30, 2012
Federal Entity Identification Number: 23-1352204

The Reading Hospital and Controlled Entities
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June 30, 2012

Part I
Financial Statements

Report of Independent Auditors

To the Board of Directors of
The Reading Hospital and Controlled Entities:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in net assets, and cash flows present fairly, in all material respects, the financial position of The Reading Hospital and Controlled Entities (the "Hospital") as of June 30, 2012 and 2011, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 2, 2012 on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters for the year ended June 30, 2012. The purpose of that report 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards for the year ended June 30, 2012 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. The information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The Schedule of Expenditures of Federal Awards 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 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 Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

PricewaterhouseCoopers LLP

November 2, 2012

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The Reading Hospital and Controlled Entities
Consolidated Balance Sheets
June 30, 2012 and 2011

	2012	2011
Assets		
Current		
Cash and cash equivalents	$ 191,713,225	$ 153,711,135
Patient accounts receivable, less allowance for uncollectible accounts of $41,451,392 and $37,523,872 in 2012 and 2011, respectively	110,747,136	99,564,208
Other receivables	4,914,466	10,137,129
Receivable from affiliates	1,454,833	1,260,326
Inventories	12,175,915	12,938,623
Prepaid expenses and other current assets	12,072,896	8,839,669
Assets whose use is limited - required for current liabilities		
Self-insurance funding arrangements	10,782,507	10,783,761
Revenue bond indentures - debt service requirements	7,252,138	3,026,508
Total current assets	351,113,116	300,261,359
Assets whose use is limited		
Self-insurance funding arrangements	19,640,559	18,714,026
Under regulatory requirements	2,912,455	2,912,455
By board for capital improvements	856,349,684	859,787,462
Total assets whose use is limited, net of current portion	878,902,698	881,413,943
Investments	17,741,189	18,067,783
Temporarily restricted funds	654,010	672,471
Property, plant and equipment, net	615,065,637	605,772,321
Deferred financing expense, net	4,996,857	5,708,931
Deferred compensation fund	3,023,129	3,443,533
Other assets	14,879,319	11,931,603
Total assets	$ 1,886,375,955	$ 1,827,271,944

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

The Reading Hospital and Controlled Entities
Consolidated Balance Sheets
June 30, 2012 and 2011

	2012	2011
Liabilities and Net Assets		
Current		
Current installments of long-term debt	$ 7,680,255	$ 31,810,387
Bonds backed by self-liquidity	-	141,700,000
Accounts payable	43,125,836	24,272,470
Estimated third-party payor settlements	5,659,555	6,565,671
Current portion of estimated self-insurance costs	10,877,737	8,670,086
Accrued expenses	29,659,159	22,800,653
Accrued vacation	20,114,473	18,004,683
Advance from third-party payor	3,832,000	3,832,169
Other current liabilities	7,985,863	10,720,097
Total current liabilities	128,934,878	268,376,216
Long-term debt, net of current portion and unamortized discount	603,758,661	443,328,021
Accrued pension liabilities	200,514,393	99,855,961
Deferred revenue	34,903,416	35,652,680
Deferred compensation	2,999,484	3,443,533
Gift annuities	586,343	652,081
Estimated self-insurance costs, net of current portion	40,574,001	29,389,700
Swap contracts	82,635,153	52,332,357
Total liabilities	1,094,906,329	933,030,549
Commitments and contingencies (Note 13)		
Net assets		
Unrestricted	774,002,732	876,200,090
Temporarily restricted	654,010	672,471
Permanently restricted	16,812,884	17,368,834
Total net assets	791,469,626	894,241,395
Total liabilities and net assets	$ 1,886,375,955	$ 1,827,271,944

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

The Reading Hospital and Controlled Entities
Consolidated Statements of Operations
Years Ended June 30, 2012 and 2011

	2012	2011
Unrestricted revenues and other support		
Net patient service revenue	$ 874,307,259	$ 826,837,399
Residential revenue	19,875,080	22,619,836
Other revenue	28,536,854	30,352,509
Total revenues and other support	922,719,193	879,809,744
Expenses		
Salaries and benefits	480,444,099	467,196,170
Supplies	111,362,303	97,264,087
Provision for uncollectible accounts	49,489,385	40,579,629
Utilities	12,853,524	14,982,854
Interest	20,443,050	21,022,300
Depreciation and amortization	64,965,124	64,058,459
Purchased services	70,323,048	63,669,198
Repairs and maintenance	19,421,008	17,435,657
Other	58,947,523	46,349,025
Total expenses	888,249,064	832,557,379
Income from operations	34,470,129	47,252,365
Nonoperating gains (losses)		
Investment income	20,829,827	31,030,024
Gifts and bequests	(164,362)	1,809,342
Other (losses) gains	(562,805)	901,156
Loss on extinguishment of debt	(5,302,466)	-
Realized and unrealized (losses) gains on swap contracts	(36,240,771)	548,623
Nonoperating (losses) gains, net	(21,440,577)	34,289,145
Excess of revenue, gains and other support over expenses	$ 13,029,552	$ 81,541,510

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

The Reading Hospital and Controlled Entities
Consolidated Statements of Changes in Net Assets
Years Ended June 30, 2012 and 2011

	2012	2011
Unrestricted net assets		
Excess of revenues, gains and other support over expenses	$ 13,029,552	$ 81,541,510
Change in unrealized gains (losses) on investments	(19,373,757)	37,544,646
Change in pension liability	(96,257,226)	24,434,865
Change in deferred compensation	-	(370,088)
Other net assets	404,072	51,983
Increase in unrestricted net assets	(102,197,359)	143,202,916
Temporarily restricted net assets		
Contributions	-	119,178
Net assets released from restrictions - for operations	(18,461)	(7,951)
Increase in temporarily restricted net assets	(18,461)	111,227
Permanently restricted net assets		
Contributions	29,254	-
Change in beneficial interest in trusts	(585,204)	2,278,824
Increase in permanently restricted net assets	(555,950)	2,278,824
Change in net assets	(102,771,770)	145,592,967
Net assets		
Beginning of year	894,241,396	748,648,429
End of year	$ 791,469,626	$ 894,241,396

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

The Reading Hospital and Controlled Entities
Consolidated Statements of Cash Flows
Years Ended June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities		
Change in net assets	$ (102,771,770)	$ 145,592,966
Adjustments to reconcile change in net assets to net cash provided by operating activities		
Change in unrealized (losses)/gains on investments	19,373,757	(37,544,646)
Change in fair value of swap contracts	30,302,796	548,623
Loss on extinguishment of debt	5,302,466	-
Premium on issuance of bonds	6,882,971	-
Amortization of bond discount	136,815	-
Amortization of deferred financing expense	353,318	377,841
Change in pension liability, net	100,658,432	(24,434,865)
Depreciation	64,965,124	63,680,618
Loss on disposal of fixed assets	605,118	55,096
Provision for uncollectible accounts	49,489,385	40,579,629
Realized gains on investments	(7,440,377)	(19,768,383)
Equity income of affiliates	(185,740)	(1,008,512)
Restricted contributions and investment income received	(29,254)	(120,000)
Change in cash due to changes in operating assets and liabilities		
Receivable from patients and others	(55,449,650)	(34,685,771)
Receivable from affiliates	(194,507)	(644,828)
Inventories	762,708	(7,498,689)
Prepaid expenses and other assets	(8,110,770)	1,133,623
Accounts payable and accrued expenses	26,889,819	5,531,299
Deferred compensation	(23,645)	603,765
Gift annuities	(65,738)	(86,885)
Deferred revenue	(749,264)	171,322
Net cash provided by operating activities	130,701,994	132,482,203
Cash flows from investing activities		
Acquisition of property, plant and equipment	(64,282,208)	(34,755,790)
Proceeds from sale of fixed assets	913	110,380
Distribution from equity investees	1,773,740	-
Purchases and sales of investments and assets whose use is limited, net	(12,959,628)	(35,780,318)
Net cash used in investing activities	(75,467,183)	(70,425,728)
Cash flows from financing activities		
Restricted contributions and investment income received	29,254	120,000
Proceeds from issuance of new debt, net of bond discount	472,471,969	-
Repayment of bonds	(470,215,013)	-
Increase in deferred financing expense	(3,548,378)	-
Payments of long-term debt	(15,970,553)	(13,950,000)
Net cash used in financing activities	(17,232,721)	(13,830,000)
Net increase in cash and cash equivalents	38,002,090	48,226,475
Cash and cash equivalents		
Beginning of year	153,711,135	105,484,660
End of year	$ 191,713,225	$ 153,711,135
Supplemental cash flow information		
Cash paid during the year for interest	$ 21,208,003	$ 21,489,698
Fixed asset additions included in accounts payable	12,627,200	2,044,935

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

1. Organizational Structure and Nature of Operations

The Reading Hospital ("Parent") is a tax-exempt not-for-profit corporation under Section 501(c)(3) of the Internal Revenue Code. The Parent is located in West Reading, Pennsylvania and provides inpatient, outpatient and emergency care for residents of the greater Berks County area. Admitting physicians are primarily practitioners in the local area.

Controlled Entities and Subsidiaries of the Parent Include:

- The Reading Hospital and Medical Center ("Hospital or THRMC"), a tax-exempt not-for-profit acute and post-acute care hospital;

- Reading Professional Services ("RPS"), a tax-exempt entity established for charitable, educational and scientific purposes. RPS recruits physicians, provides physician billing and administrative services for the Hospital, including supervision and instruction for medical students completing their residency training;

- MC Realty, Inc. ("MC Realty"), a wholly owned subsidiary, established to strategically acquire real estate in Berks County and the surrounding areas. MC Realty is consolidated into the Parent;

- The Reading Hospital Medical Group ("TRHMG"), a not-for-profit entity, established on January 1, 2007 to assure access to high quality primary care physicians and specialty physicians in sufficient numbers to meet the community need; and

- The Highlands at Wyomissing ("Highlands"), a not-for-profit corporation is a fully controlled entity of The Reading Hospital. The purpose of the Highlands is to operate a continuing care retirement community including residential, recreational, and health care facilities and services specially designed to meet the physical, social, and psychological needs of elderly persons. The Highlands facility is located in Wyomissing, Pennsylvania and its residents are principally from the Wyomissing, and Reading, Pennsylvania area. The facility contains 289 residential living units, an 80-bed skilled nursing unit and 70 personal care units. Certain members of the board of directors from the Hospital are also members of the board of directors of the Highlands.

Other Noncontrolled Related Entities Include:

- Berkshire Health Partners ("BHP") is licensed by the Commonwealth of PA as a fully integrated, non-risk bearing preferred provider organization. A nonprofit corporation in PA, BHP was established by hospitals and physicians and offers a provider network of physicians, hospitals, and ancillary providers and services. Certain members of the Hospital's Board of Directors are directors of BHP. In September 2011, BHP entered into a Membership Repurchase Agreement giving the Parent full ownership of the hospital side of BHP. The other 50% is owned by Reading Physicians Organization.

    - Medicus Resource Management ("MRM"), a wholly owned subsidiary of BHP, is a for-profit company for PA tax purposes that coordinates the utilization management process and provides precertification, case management, concurrent reviews and short term disability reviews.

- Reading Berks Physical Therapy LLC (“RBPT”), a limited liability corporation established to provide physical therapies at eight locations within the greater Berks County area. The Hospital maintains a 40% interest in RBPT under the equity method of accounting. This interest is included in other assets on the accompanying balance sheets;

- The Reading Hospital Surgicenter at Springridge, LLC (“Springridge LLC”), a limited liability company was established to provide ambulatory surgery services to the surrounding community. The Hospital maintains a 50% ownership under the equity method of accounting. This interest is included in other assets on the accompanying balance sheets;

- The Parent, along with several other acute care service hospitals throughout the central Pennsylvania area, contributed capital to form Central Pennsylvania Alliance Laboratories (“CPAL”), a joint venture to combine laboratory operations. The Parent maintains a 20% ownership interest in CPAL. This interest is recorded under the equity method of accounting and is included in other assets on the accompanying balance sheet;

- Effective January 1, 2012, the Parent’s ownership of Central Pennsylvania Homecare, Inc. (d.b.a. Visiting Nurse Association, “VNA”) changed from 50% to 44.1%. As part of the change, THRMC received the distribution of $1,042,000. Additional owners include Lancaster General with 44.1% and Pinnacle with 11.8% shares. VNA provides visiting home nursing services to outpatients of the Hospital and other healthcare providers in the surrounding community. This investment is recorded under the equity method of accounting and is included in other assets on the accompanying balance sheets;

- The Parent is a 20% owner, along with Central Pennsylvania Healthcare Alliance (“CPHA”) members: Ephrata Community Hospital, Lancaster General, Pinnacle Health System, Summit Health Alliance and WellSpan Health, of Quest Behavioral Health, Inc (“Quest”). Quest is a not-for-profit corporation providing full service managed behavioral healthcare, with over 1000 network clinicians (behavioral health specialists, psychiatrists, psychologists, clinical social workers, licensed mental health professionals and clinical nurse practitioners) to over 120,000 members in 40 counties in Central Pennsylvania, 7 counties in Northern Maryland and 200 employer groups. This investment is recorded under the equity method of accounting and is included in other assets on the accompanying balance sheets; and

- Horizon, a for-profit limited liability partnership which provides in-home infusion drug therapy to customers in central Pennsylvania was restructured on December 1, 2011. The transaction altered the previous ownership shares of Lancaster General at 60%, The Reading Hospital and Medical Center at 30%, and Pinnacle Health at 10%. The revised ownership structure equals 25% ownership shares for each of four parties, including Lancaster General, The Reading Hospital and Medical Center, Pinnacle Health, and Hershey Medical Center. As part of the restructuring, TRHMC received a distribution of $732,000. The investment is recorded under the equity method of accounting and is included in other assets on the accompanying balance sheets.

2. Summary of Significant Accounting Policies

These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("US GAAP"). The significant accounting policies followed by The Reading Hospital and Controlled Entities ("Company") are as follows:

Principles of Consolidation
The consolidated financial statements of the Company include the accounts of the Parent, the Hospital, RPS, TRHMG, Highlands and MC Realty. All significant intercompany balances and transactions have been eliminated.

Use of Estimates
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, estimated third-party payor settlements, investments, accrued pension liabilities, accrued retirement costs and accrued insurance costs. Actual results could differ from those estimates.

Reclassifications
Certain reclassifications to amounts previously reported have been made to conform with the **current period presentation.**

Cash and Cash Equivalents
Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less, excluding amounts whose use is limited by board designation, indenture agreements and self-insurance trust agreements.

Net Patient Service Revenue
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 revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments due to future audits, reviews and investigations. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined or as years are no longer subject to such audits, reviews and investigations.

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

Residential Revenue
The Highlands' entrance fees are refundable for a period of time up to 50 months. During this time, for refund purposes only, a resident's entrance fee is amortized at the rate of 2% per month for 50 months beginning on the date of occupancy. Entrance fees which are no longer refundable are recorded as deferred entrance fee revenue. Entrance fees are amortized to income using the straight-line method over the estimated remaining life expectancy of the resident. For all contracts entered into prior to January 1, 2005, a portion of the entrance fee, referred to as the health fund, equal to 30% of the total entrance fee, is reserved to be accounted for individually for each resident/couple. All health funds are refundable to extent not amortized. Amortization of the health fund occurs when a resident utilizes health services (Nursing or Personal Care). The amortization rate is the incremental difference between the daily rate for health services and the monthly fee prorated on a daily basis.

Other Revenue
Significant components of other revenue include; rental income on leased properties, tuition revenue for The Reading Hospital and Medical Center School of Health Sciences and cafeteria revenues.

Charity Care
The Company provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Company does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Donor Restricted Gifts
Unconditional promises to give cash and other assets to the Hospital 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.

Gifts are reported as either temporarily or permanently restricted if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose 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.

Excess of Revenues, Gains and Other Support Over Expenses
The consolidated statements of operations include the excess of revenues, gains and other support over expenses. Changes in unrestricted net assets which are excluded from the excess of revenues, gains and other support over expenses, consistent with industry practice, include changes in unrealized gains and losses on investments other than certain not readily marketable investments, adjustments for defined benefit and other post-retirement benefits and contributions of long-lived assets (including assets acquired using contributions which by donor-restriction were to be used for the purposes of acquiring such assets).

Assets Whose Use is Limited
Assets whose use is limited include designated assets set aside by the Board of Directors for future capital improvements over which the Board retains control and may at its discretion subsequently use for other purposes, assets held by trustees under indenture agreements and self-insurance trust arrangements.

The Pennsylvania Continuing Care Provide Registration and Disclosure Act requires a statutory reserve equivalent to the greater of the total of debt service payments due during the next 12 months on account of any loan or 10% of the projected annual operating expenses of the facilities exclusive of depreciation, computed only on the proportional share of financing or operating expenses that is applicable to residents under entrance agreement contracts. For the Reading Hospital and controlled entities this statutory requirement applies only to The Highlands at Wyomissing. This statutory reserve requirement is considered to be fulfilled from board-designated funds included within assets limited as to use.

The calculation of the 10% of the annual operating expenses for 2013 is as follows:

Budgeted operating expenses for 2013	$ 24,396,493
Less: Budgeted depreciation and amortization expense	(3,202,352)
Net budgeted operating expenses for 2013	21,194,141
Required reserve as of July 1, 2012 (10%)	$ 2,119,414

The principal and interest due in the next 12 month period for long-term financing of the Highlands is the greater of the two options and is calculated as follows:

Principal due	$ 1,479,658
Interest due	1,432,797
Required reserve as of July 1, 2012	$ 2,912,455

Property, Plant and Equipment
Property, plant and equipment are carried at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of each class of depreciable asset. Gains and losses resulting from the retirement or sale of property, plant and equipment are included in the consolidated statements of operations. Useful lives range as follows:

Land improvements	5–25 years
Buildings and improvements	10–40 years
Fixed equipment	5–10 years
Movable equipment	3–7 years

Gifts of long-lived operating assets such as land, buildings, or equipment are reported as unrestricted support, excluded from the excess of revenues, gains and other support over expenses, unless explicit donor stipulations specify how the donated asset must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Temporarily and Permanently Restricted Net Assets
Temporarily restricted net assets are those whose use by the Company has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Company in perpetuity.

Inventories
Inventories are stated at lower of cost (first-in, first-out method) or market. At June 30, 2011, a physical inventory was taken and supplies totaling approximately $7,600,000 were capitalized which resulted in a reduction in operating expenses in the statement of operations. Physical inventories are conducted annually.

Investments and Investment Income
The Company 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 the 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 Company 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 Company’s revenues, gains and support over expenses. The Company has chosen to record all of its investments under the fair value option permitted under these standards with the exception of limited partnerships and private equity investments which are recorded at cost.

Under these fair value standards, the Company 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 Company’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 Company 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 cash exchange-trade equity securities, debt securities, and mutual funds with daily NAV. Investments in Level 2 include corporate obligations, other fixed income investments, other domestic equity investments, and foreign equity investments. 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 Company's overall valuation process, management evaluates these third-party methodologies to ensure that they are representative of exit prices in the Company's principal markets. Investments in Level 3 include nonreadily marketable alternative investments and auction rate securities. See Note 5 for additional details related to the Company's investments.

The Company's nonreadily marketable investments include limited partnerships and limited liability corporations that do not price shares on at least a monthly basis or require notice to redeem shares. These nonreadily marketable investments invest in securities traded in foreign and domestic markets and are carried in the balance sheet at net asset value as determined by the general partner.

The Company has used an investment advisor to assist managing their investment portfolio. The advisor is authorized to execute transactions to the Pension Fund and provides advisory services for the Long Range Capital fund. Effective FY 2012 Q4, the Company has engaged an investment consultant and four new investment advisors who will assist in managing the funds. A full discretionary investment mandate, guided by the Company's Investment Policy Statement, will be transitioned to the new advisors beginning in FY 2013 Q1.

Deferred Financing Expense

Deferred financing expense is amortized over the period the debt is outstanding using the straight-line method, which approximates the effective interest method.

Bond Premiums (Discounts)

Bond premiums (discounts) are reported as direct additions (reductions) of the carrying values of the related debt instruments from which the discounts arose. Bond premiums (discounts) are amortized over the period during which the debt is outstanding using the straight-line method which approximates the effective interest method; with current period adjustments included as a component of interest expense. Prior year amortization of bond discounts were not reclassified to interest expense.

Estimated Self-Insurance Costs

The provision for estimated self-insured claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The Company self-insures its medical malpractice, general liability, and workers' compensation risks. Reserve estimates are subject to the impact of changes in claim trends as well as prevailing social, economic, and legal conditions. The ultimate net cost of settling these liabilities may vary from the estimated amounts. Accordingly, reserve estimates are continually reviewed and updated and any resulting adjustments are reflected in the current financial statements. Insurance recoveries are recognized at the same time as related claims liabilities.

Derivative Instruments
The Company accounts for derivative financial instruments in accordance with standards issued by FASB. The Company owns free-standing derivatives that are not designated as part of a qualifying hedge relationship. As such, the derivatives are recorded at fair value and are marked-to-market through the excess of revenues over expenses.

Income Taxes
The Company is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. On such basis, the exempt entities do not incur liability for federal income taxes, except in the case of unrelated business income.

The Company 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 financial statements were required as a result of this evaluation.

Fair Value of Financial Instruments
Financial instruments include cash and cash equivalents, accounts receivable, investments, interest rate swap agreements and long-term debt. The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, investments, interest rate swap agreements and long-term debt approximates its fair value as of June 30, 2012. Private equity investments are carried on the balance sheet at cost.

Deferred Revenue
The Highlands has deferred revenue pertaining to refundable entrance fees of $17,078,000 and $19,533,000 at June 30, 2012 and 2011, respectively, and deferred entrance fee revenue of $16,821,000 and $16,121,000 at June 30, 2012 and 2011, respectively. Entrance fees are refundable for a period of time up to 50 months before they are transferred to deferred entrance fee revenue. The deferred entrance fee revenue is amortized to income using the straight-line method over the estimated remaining life expectancy of the resident.

Deferred Compensation
The Company was a party to a deferred compensation plan that provided retirement benefits to certain individuals employed by the Company. Assets were deposited pursuant to this agreement such that the market value of the assets approximates the related accrued deferred compensation liability. The plan is no longer active. No new participants nor any additional contributions are allowed. The original contributions were funded entirely by the participating employees through payroll deferral.

Accounting for Defined Benefit Plan
Substantially all employees of the Company are covered under a qualified noncontributory defined benefit pension plan. Pension costs are funded as accrued except when not permitted by regulations, such as full funding limitations. Unfunded prior service costs are amortized over an initial term of thirty years.

The Company follows the 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 January 2010, the FASB issued ASU 2010-06, "Fair Value Measurements and Disclosures about Fair Value Measurements." The new guidance requires that information, such as description of and reasoning for transfers, be disclosed for all transfers to and from Level's 1, 2 and 3 in the fair value hierarchy. Another requirement under this guidance is the gross, rather than net, presentation of purchases, sales, issuances and settlements in Level 3 roll-forward tables. The new guidance is effective for fiscal years beginning after December 15, 2009 for transfer disclosures and December 15, 2010 for gross presentation and as such, disclosures pertaining to these topics have be made in accordance with this guidance for consolidated financial statements beginning in Fiscal Year 2011 and Fiscal Year 2012, respectively.

In August 2010, the FASB issued ASU 2010-24, "Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries," which clarifies that a health care entity should not net insurance recoveries against a related claim liability. The guidance provided is effective for the fiscal years and interim periods within those years beginning after December 15, 2010. The adoption of this pronouncement did not have a material effect on the financial statements.

In August 2010, the FASB issued ASU 2010-23, "Health Care Entities (Topic 954): Measuring Charity Care for Disclosure," which prescribes a specific measurement basis of charity care for disclosure. The guidance provided in this ASU is effective for fiscal years beginning after December 15, 2010. The amendment to GAAP requires the use of both direct and indirect costs as the measurement basis for charity care disclosures. This change does not impact the amounts recorded within the primary financial statements.

In July 2011, the FASB issued Accounting Standards Update ("ASU") 2011-07, "Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities," which requires health care entities to change the presentation in their statement of operations by reclassifying the provision for bad debts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). For nonpublic entities, the amendments are effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2012, with early adoption permitted. While this standard will have no impact on the Hospital's financial position or results of operations, it will require reclassification of the provision for doubtful accounts from operating expenses to a component of net revenues beginning with the first quarter of 2013, with retrospective application required.

3. Charity Care and Community Service

The Company provides services to patients who meet the criteria of its charity service policy without charge or at amounts less than the established rates. Criteria for charity care consider the patient's family income, family size, and ability to pay. Individuals who qualify for charity care do not have insurance or other coverage.

The Company 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 supplies furnished under its charity care and community service policies and the estimated cost of those services.

Charges foregone for charity service as determined in accordance with the Company's policy approximate $21,168,000 and $19,212,000 in 2012 and 2011, respectively. Such amounts have been excluded from revenue. The cost to provide these services was approximately $7,524,000 and $7,225,000 for the years ended 2012 and 2011, respectively. The estimated costs were based on a calculation which multiplied the cost to charge ratio by the gross charges. The cost to charge ratio was obtained from our most recent Medicare Cost report.

Additionally, the Company sponsors certain other service programs and charity services which provide substantial benefit to the broader community. Such programs include services to needy populations requiring special services and support, including community service programs and charity services as well as health promotion and education.

The Company's community service includes the Medical Assistance program which makes payment for services provided to families with dependent children, the aged, the blind, and the permanently and totally disabled, whose income and resources are insufficient to meet the costs of necessary medical services. Payments from the Medical Assistance program are generally less than the Company's charge of providing the service.

In addition, community service represents the cost to deliver services to the community, net of any payment received for those services. Included in these services are the Company's subsidy of outpatient clinics, education of medical professionals who work with various health care providers in the community upon graduation, and community mental health programs. The Company also sponsors health fairs and other wellness programs throughout the community.

4. Net Patient Service Revenue

The Company has agreements with third-party payors that provide for payments 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. Outpatient services are reimbursed by Medicare under the Ambulatory Payment Classification System. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with Medicare. The Hospital's Medicare cost reports have been closed and settled by the Medicare fiscal intermediary through June 30, 2007.

Medicaid
Historically, inpatient and outpatient services rendered to Medicaid program beneficiaries were paid at prospectively determined rates with inpatient services being reimbursed on a rate-per-discharge basis and outpatient services on a predetermined fee schedule basis.

On December 29, 2010, the Pennsylvania Department of Public Welfare ("DPW") received approval from the Centers for Medicare & Medicaid Services for the state plan amendments pursuant to Act 49 of 2010, passed by the Pennsylvania General Assembly on July 3, 2010, that established a new inpatient hospital fee for service payment system, new supplemental payments and the waiver to establish the statewide Quality Care Assessment. DPW also received approval on final language for the DPW contracts with managed care organizations. The estimated net impact on the Hospital for the year ended June 30, 2012 was $6,708,000 (based on total payment adjustments of $17,683,000 offset by assessments of $10,974,000).

Capital Blue Cross
Beginning July 1, 2010, inpatient services rendered to Capital Blue Cross subscribers are reimbursed at negotiated case rates and per diem rates. Previously, inpatient services had been reimbursed on a negotiated percentage of covered charges. The prospectively determined rates are not subject to retroactive adjustment. The Hospital continues to be reimbursed for outpatient services at a negotiated percentage of covered charges.

Workers' Compensation
The payment method by which all employers and/or insurers of workers' compensation policies will pay for the services provided by health care providers to employees covered by workers' compensation is a percentage of the Medicare payment for these services.

Other Contractual Arrangements
The Company has various payment agreements with preferred provider organizations and health maintenance organizations. The basis for payment under these agreements includes discounts from established charges.

Revenue received under agreements with third-party payors is subject to audit and retroactive adjustment. Adjustments related to tentative and final settlements with third-party payors are included in the determination of the excess of revenues, gains and other support over expenses in the year in which such adjustments become known. Such adjustments relating to prior years increased net patient service revenues by approximately $7,446,000 in 2012 but reduced 2011 by $964,000.

During fiscal year 2012, the hospital received and recorded a $4,841,000 multi-year settlement (FYE05-FYE11) of the Rural Floor Budget Neutrality group appeal. The Company also recorded litigation and resolution fees of 25% of settlement.

The health care industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at the time. Recently, government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed.

5. Investments

	2012	2011
Deferred compensation		
Cash and cash equivalents	$ 469	$ 507
Mutual funds	3,022,660	3,443,026
Total deferred compensation	$ 3,023,129	$ 3,443,533

Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets. The composition of assets whose use is limited at June 30, 2012 and 2011, is set forth in the following tables.

	2012	2011
Under self-insurance funding arrangements		
Professional liability		
Cash and cash equivalents	$ 9,066,781	$ 8,329,642
U.S. Government securities	7,625,681	6,991,769
Corporate bonds	4,221,267	4,928,840
Mutual funds	78,752	84,586
	20,992,481	20,334,837
Workers' compensation		
Cash and cash equivalents	742,031	427,969
U.S. Government securities	4,015,106	3,432,321
Corporate bonds	2,995,656	3,476,579
Mutual funds	1,677,792	1,826,081
	9,430,585	9,162,950
Total assets whose use is limited under self-insurance funding arrangements	$ 30,423,066	$ 29,497,787

	2012	2011
Under revenue bond indenture agreements - held by trustee		
Cash and cash equivalents	$ 7,252,138	$ 299,913
U.S. Government securities	-	2,726,595
Total assets whose use is limited under revenue bond indenture agreements	$ 7,252,138	$ 3,026,508
By board for capital improvement		
Cash and cash equivalents	$ 190,763,607	$ 189,089,394
U.S. Government securities	40,404,646	28,923,332
Corporate and foreign bonds	-	6,395,486
Common, preferred and foreign stocks	1,092,580	2,188,389
Mutual funds	136,277,951	161,208,026
Fixed income funds	281,138,349	332,728,555
Hedge funds and private equity funds	209,585,006	142,166,734
Total assets whose use is limited by the board for capital improvements	$ 859,262,139	$ 862,699,916
Temporarily restricted funds		
Cash and cash equivalents	$ 654,010	$ 672,471
Investments		
Beneficial interest in trusts	$ 12,671,566	$ 13,248,118
Cash and equivalents	152,048	124,917
Common, foreign and preferred stock	3,038,983	2,699,556
Mutual funds	-	254,148
Corporate and foreign bonds	563,550	549,998
U.S. Government securities	1,315,042	1,191,046
Total assets whose use is permanently restricted as to use	$ 17,741,189	$ 18,067,783

A summary of the Company’s total investment return for the years ended June 30, 2012 and 2011 as reflected in the Consolidated Statements of Operations and Changes in Net Assets is as follows:

	2012	2011
Nonoperating gains and losses		
Investment income	$ 20,829,827	$ 31,030,024
Change in unrealized gains (losses) on investments	(19,373,757)	37,544,646

The Company’s investments are managed by investment managers and bank trust departments. Because the Company’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 Company performs an annual impairment analysis, no impairments were identified in 2012. Impairment charges of $1,328,000 were recorded at June 30, 2011.

The following tables represent the fair value measurement levels for all assets and liabilities, which the Company has recorded at fair value:

	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)	June 30, 2012
Assets				
Cash and cash equivalents	$ 208,631,105	$ -	$ -	$ 208,631,105
State and Local Govt Sec.	-	-	9,639,052	9,639,052
Corporate and foreign bonds	-	7,780,474	-	7,780,474
Common, preferred and foreign stock	4,131,563	-	-	4,131,563
U.S. Government securities	-	43,721,423	-	43,721,423
Mutual funds	75,505,626	65,551,528	-	141,057,154
Fixed income funds	281,138,349	-	-	281,138,349
Beneficial interests in trusts	-	-	12,671,566	12,671,566
Hedge funds	-	-	184,726,200	184,726,200
Total investments	$ 569,406,643	$ 117,053,425	$ 207,036,818	$ 893,496,886
Liabilities				
Swap contracts	$ -	$ 82,635,153	$ -	$ 82,635,153

	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)	June 30, 2011
Assets				
Cash and cash equivalents	$ 198,837,156	$ -	$ -	$ 198,837,156
Corporate and foreign bonds	-	9,283,805	10,295,179	19,578,984
Common, preferred and foreign stock	4,887,945	-	-	4,887,945
U.S. Government securities	-	43,265,063	-	43,265,063
Mutual funds	77,580,968	-	-	77,580,968
Fixed income funds	332,728,554	-	-	332,728,554
Beneficial interests in trusts	-	-	13,248,119	13,248,119
Hedge funds	-	-	205,508,553	205,508,553
Total investments	$ 614,034,623	$ 52,548,868	$ 229,051,851	$ 895,635,342
Liabilities				
Swap contracts	$ -	$ 52,332,357	$ -	$ 52,332,357

The following table represents the nonreadily marketable investments and auction rate securities for which fair value was measured under Level 3:

	Hedge Funds	Beneficial Interests in Trusts	State and Local Government Securities
Fair value at July 1, 2011	$ 205,508,553	$ 13,248,119	$ 10,295,179
Purchases	-	-	-
Sales	(11,774,209)	-	(100,000)
Realized gains (losses)	2,872,165	-	-
Net change in unrealized gains (losses)	(11,880,309)	(576,553)	(556,127)
Fair value at June 30, 2012	$ 184,726,200	$ 12,671,566	$ 9,639,052

	Hedge Funds	Beneficial Interests in Trusts	State and Local Government Securities
Fair value July 1, 2010	$ 181,027,159	$ 10,989,659	$ 10,265,719
Purchases	-	-	-
Sales	(7,442,510)	-	-
Realized gains (losses)	-	-	-
Net change in unrealized gains (losses)	31,923,904	2,258,460	29,460
Fair value June 30, 2011	$ 205,508,553	$ 13,248,119	$ 10,295,179

The corporate and foreign bonds, and hedge funds reflected as being Level 3 were valued by fund managers. Management believes that these values reflect fair value.

Hedge Funds
Investments in the Hedge Fund segment of the Fair Value Measurement tables include investments in hedge funds that invest in asset backed securities, long-short equity or fixed-income securities, commodities, long–short real estate and multi-strategies. The fair values of other investments in this category have been estimated using the net asset value per share of the investments.

Many of these hedge fund strategies are subject to various liquidity availability or lock-up periods that range from monthly, quarterly, semi-annual, annual and biennial liquidity. The bulk of hedge fund balances are available monthly with only 34% available annually or biennially at specific anniversary dates. Normal holdback for liquidation of these funds range between 5% and 10% of balances, paid out after fund final audits.

Private Equity:
Investments in Private Equity include eleven private equity funds placed with six managers who invest primarily in smaller mature secondary interests in high-quality private equity and venture capital partnerships, intellectual properties, and natural gas. These are long-term investments that cannot be redeemed. Instead, the nature of the investments in this category is such that distributions are received through the liquidation of the underlying assets within the fund. As of June 30, 2012, Total Committed investments funds to the Company's Private Equity portfolio were $65 million. Capital Calls and Distributions totaled $40.4 and $12.1 million respectively. Remaining capital commitments total $24.6 million.

The Company has investments in limited partnerships that are accounted for at cost of $24,859,000 and $21,665,000 at June 30, 2012 and 2011, respectively.

6. Property, Plant and Equipment

Property, plant and equipment and related accumulated depreciation at June 30, 2012 and 2011 consist of:

	2012	2011
Land and land improvements	$62,907,873.00	$62,713,360.00
Buildings and improvements	524,663,808	521,470,570
Fixed equipment	266,202,182	260,704,008
Movable equipment	279,426,761	275,323,419
Property, plant, equipment before depreciation and AIP	1,133,200,624	1,120,211,357
Less: Accumulated depreciation	(570,689,459)	(524,712,086)
Property, plant, equipment before AIP, net of depreciation	562,511,165	595,499,271
AIP nonequipment (EPIC & Construction Projects)	52,554,472	10,273,050
Net property, plant and equipment	$ 615,065,637	$ 605,772,321

Depreciation expense was approximately $64,965,000 and $63,681,000 for the years ended June 30, 2012 and 2011, respectively.

In preparation for the Asset Management Module implementation, a fixed asset physical inventory was conducted by CBIZ in March 2012. As a result of this inventory, equipment with a net book value of $711,000 was written-off, offset by a gain on the disposal of other equipment of $106,000 recognized in prior periods, netting to a loss on the disposal of assets for the year of $605,000.

7. Long-Term Debt

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

	2012		2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Berks County Municipal Authority Hospital Revenue Bond Series of 2012, net of unamortized discount and premium	$ 479,354,940	$ 480,768,793	$ -	$ -
Berks County Municipal Authority Hospital Revenue Bond Series of 2009, net of unamortized discount	121,438,220	140,138,046	442,711,083	448,406,439
Berks County Municipal Authority Hospital Revenue Bond Series of 2008,	-	-	100,000,000	103,171,924
Berks County Municipal Authority Hospital Revenue Bond Series of 1999, net of unamortized discount	1,204,746	1,226,344	2,338,954	2,373,795
Berks County Municipal Authority Hospital Revenue Bond Series of 1998, net of unamortized discount	-	-	53,768,060	53,768,060
Dauphin County General Authority Hospital Revenue Bond Series A of 1994,	-	-	6,285,000	6,285,000
Berks County Municipal Authority Hospital Revenue Bond Series of 1993,	6,965,000	7,355,191	9,040,000	9,537,200
Term loans	2,476,010	2,476,010	2,695,311	2,695,311
Total long-term debt	611,438,916	$ 631,964,384	616,838,408	$ 626,237,729
Less: Amounts due within one year	7,680,255		31,810,387	
Hospital Revenue Bonds backed by self-liquidity - 2009 A-4 & A-5	-		141,700,000	
Long-term debt, net of current portion	$ 603,758,661		$ 443,328,021	

Under the terms of the various debt agreements, the Company is required to maintain certain deposits with a trustee. Such deposits are included with assets whose use is limited in the consolidated financial statements. The various agreements also place limits on the incurrence of additional borrowings and require that the Company satisfy certain measures of financial performance as long as the debt is outstanding. The Company was in compliance with these covenants at June 30, 2012 and 2011.

Scheduled principal repayments on long-term debt are as follows for the years ending June 30:

2013	$ 7,680,255
2014	6,733,536
2015	7,074,468
2016	5,274,162
2017	5,528,648
Thereafter	574,399,941
Total long-term debt	606,691,010
Plus: Unamortized net premium (discount)	4,747,906
Long term-debt, net of unamortized discount	$ 611,438,916

Berks County Municipal Authority Hospital Revenue Bond Series of 2012
On June 28, 2012, The Berks County Municipal Authority ("Authority") issued $473,275,000 (notional) of Revenue Bonds in four series, 2012 A, B, C and D.

The Authority issued $160,065,000 of Fixed Rate Serial Revenue Bonds ("2012 A") for the purpose of refunding the Dauphin Country General Authority Hospital Revenue Bond Series 1994A, Berks County Bond Series 1998 and 2008.

Mandatory annual principal redemptions by the Company for the 2012 A bonds due November 1, 2039 through November 1, 2044 range from $7,590,000 to $33,555,000 with final maturity on November 1, 2044. Effective interest rate of the bonds range from 4.23% to 4.50%.

The Authority issued $91,775,000 of Variable Rate Serial Revenue bonds ("2012 B") for the purpose of refunding the Authority Series 2009 A-5.

Mandatory annual principal redemptions by the Company for the 2012 B bonds due November 1, 2035 through November 1, 2039 range from $3,225,000 to $24,955,000 with final maturity on November 1, 2039. Interest on these bonds is calculated on a SIFMA Municipal Index rate plus a fixed spread of 1.50%. The SIFMA rate at June 30, 21012 was .18%.

The Authority issued a $47,235,000 Floating Rate Bond (2012 C) used to refund the Series 2009 A-4 and a $174,000,000 Floating Rate Bond ("2012 D") used to Refund the Series 2009 A-1 and A-2. Both Series 2012 C and 2012 D were privately placed with commercial banks.

Mandatory monthly principal redemptions by the Company for the 2012 C bonds commence August 1, 2012 through July 1, 2022 and range from $39,363 to $128,823 with final maturity date on July 1, 2022. Interest on these bonds is calculated using a 1 Month Libor Index rate plus a fixed spread of 1.20% times an Applicable Factor of 70.0%. The 1 Month Libor rate at June 30, 2012 was .25%.

Mandatory annual principal redemptions by the Company for the 2012 D bonds due November 1, 2022 through November 1, 2035 range from $8,625,000 to $21,120,000 with final maturity on November 1, 2035. Interest on these bonds is calculated on a SIFMA Municipal Index rate plus a fixed spread of .70%. The SIFMA rate at June 30, 21012 was .18%.

Berks County Municipal Authority Hospital Revenue Bond Series of 2009
Series 2009 A-1, A-2, A-4 and A-5 were refunded on June 28, 2012 with the aforementioned Bond Series 2012. The 2009 A-3 bond remains outstanding.

The 2009 A-3 bond was issued on July 15, 2009. The Authority issued $133,665,000 of Fixed Rate Revenue Bonds, Series 2009 A-3 for the primary purpose of redeeming $115,520,000 of 2001 Bonds and $14,965,000 for major renovation projects.

The 2009 A-3 bonds are comprised of $44,285,000 of serial bonds and $89,380,000 of term bonds. The serial bonds are due in installments payable November 1, 2009 through 2019, with payments ranging from $120,000 to $4,895,000. The term bonds are due on November 1 of 2024, 2031 and 2039, with payments ranging from $820,000 to $9,380,000. The effective interest rate on the serial bonds ranges from 3% to 5% and 5.25% to 5.75% for the term bonds.

Berks County Municipal Authority Hospital Revenue Bond Series of 1999
On November 1, 1999, the Authority issued $45,805,000 of Hospital Revenue Bonds, Series 1999 (“1999 Bonds”) for the primary purpose of providing funds for the cost of certain capital projects relating to the facilities, buildings, and equipment of the Hospital (the “project”) and to pay certain costs incurred with the issuance of the 1999 Bonds. The project consists of certain improvements to the Hospital’s campus, the construction of new facilities, the renovation of existing facilities, and the acquisition of certain medical equipment. The Company granted to the Authority a security interest in certain assets and substantially all revenues as collateral for its obligation under the indenture. The principal amount outstanding was $1,205,000.

Berks County Municipal Authority Hospital Revenue Bond Series of 1993
On June 1, 1993, the Authority issued Hospital Revenue Bonds, Series of 1993 (“1993 Bonds”) for the primary purpose of providing funds for the advance refunding of the Berks County Municipal Authority Hospital Revenue Bonds Series of 1986 (“1986 Bonds”), the retirement of certain other indebtedness, and the funding of certain medical and computer equipment to be located on Hospital premises.

Remaining mandatory annual principal redemptions by the Hospital for the 1993 Bonds are $2,195,000 in 2012, $2,320,000 in 2013 and $2,450,000 in 2014. All mandatory redemptions are at par value. The Hospital granted to the Authority a security interest in certain assets and substantially all revenues as collateral for its obligation under the indenture.

The stated maturity dates and interest rates of the 1993 Bonds at June 30, 2012 are as follows:

Type	Face Amount	Maturity	Interest Rate
Term bonds	$ 6,965,000	2010–2014	5.70 %

Term Loans
Effective retroactive to January 1, 2004, the Hospital replaced NMG Limited Partnership as the borrower on three promissory notes. The Hospital was previously the guarantor for the notes. The original notes were issued as follows: $2,100,000 due March 31, 2020, $2,000,000 due December 31, 2019 and $165,000 due March 31, 2006. In conjunction with the assumption of debt, the Hospital received assets which have been purchased with the proceeds from the debt.

Mandatory annual principal redemptions by the Hospital for the notes for the 2012-2019 period range from $219,000 to $411,000 in 2019. The interest rate is calculated based upon the London Interbank Offered Rate plus1.70%. This rate was 1.94% at June 30, 2012.

Line of Credit
At June 30, 2012, the Company had available a line of credit of $10,000,000 with M&T Bank. The amounts outstanding on the available letters of credit at June 30, 2012 and 2011, equaled $1,976,309 and $3,992,459, respectively.

8. Interest Rate Swaps

The Company 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 Company 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 leg of the 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 Company'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. 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 Company employs, fluctuations 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.

The Company 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.

The fair market value of the swap contracts and the related realized and unrealized gains (losses) were as follows, as of June 30, 2012:

Classification of derivatives in Balance Sheets	Fair Market Value 2012	Fair Market Value 2011
Derivatives not designated as hedging instrument		
2008 Bond Issuance	$ 191,717	$ 4,794,719
2005 Bond Issuance	(7,149,360)	(4,846,052)
2002 Bond Issuance	(31,355,502)	(21,898,577)
2001 Bond Issuance	(41,389,318)	(28,219,095)
1997 Bond Issuance	(623,313)	(624,604)
1992 Bond Issuance	(1,620,320)	(878,307)
Term loans	(689,057)	(660,441)
Total swap contracts	$ (82,635,153)	$ (52,332,357)

Classification of derivatives gain (loss) in Statements of Operations	Amount of Gain (Loss) Recognized in Excess of Revenue Over Expenses 2012	2011
Derivatives not designated as hedging instrument		
Unrealized gain (loss) on swap contracts	$ (30,302,796)	$ 157,141
Realized gain (loss) on swap contracts	(5,937,975)	391,482
Realized and unrealized gains (losses) on swap contracts	$ (36,240,771)	$ 548,623

In connection with the 2008 bond issuance, the Company entered into an interest rate swap agreement with a third party. The swap economically converts the fixed rate obligation of the 2008 bonds from a fixed rate of 7.5% to variable rates which averaged .46% at June 30, 2012. Notional amount of the swap is $100 million.

In connection with the 2005 bond issuance, the Company entered into an interest rate swap agreement with a third party. The swap economically converts the variable rate obligation of the 2005 bonds to a fixed rate of 3.584%. Notional amount of the swap is $42 million.

In connection with the 2001 and 2002 bonds issuances, the Company entered into two interest rate swap agreements with a third party. The swaps economically convert the variable rate obligations of the 2001 and 2002 bonds to a fixed rate of 4.30% and 4.69%, respectively. Notional amounts of the swaps are $148.6 million and $77.3 million.

On June 26, 2006, the Company entered into an interest rate swap agreement on the 2001, 2002 and 2005 bond issuances which was effective as of August 4, 2006. The swap has a variable effective interest rate at 68% of the London Inter-bank Offering Rate (“LIBOR”).

In connection with the 2002 bond issuance, the Company entered into two interest rate swap agreements. The swaps effectively convert the variable rate obligation of the Series A and B Bonds to fixed rates of 4.69% and 6.28%, respectively. Notional amounts of the swaps are $4.7 million and $9.5 million.

In connection with the 1997 bond issuance, the Company entered into an interest rate swap agreement which was effective as of May 26, 2005. The swap effectively converts the variable rate obligation of the Bonds to a fixed rate of 3.397%. Notional amount of the swap is $7 million.

In connection with the 1992 bond issuance, the Company entered into an interest rate swap agreement which was effective as of May 26, 2005. The swap effectively converts the variable rate obligation of the Bonds to a fixed rate of 3.607%. Notional amount of the swap is $8.1 million.

In connection with the term loans, the Company assumed two interest rate swap agreements with a third party. The swaps effectively convert the variable obligations to fixed rates of 9.13% for the $2,100,000 note and 9.06% for the $2,000,000 note. The fair value of the interest rate swap agreements is the amount at which they would be settled based on estimates of market rates, which was a liability of $689,000 at June 30, 2012 and $660,000 at June 30, 2011.

The change in the value of the interest rate swap agreements and the interest expense associated with these swaps are recorded in other nonoperating gains (losses) on the Statements of Operations.

9. Pension Plans

The Company participates in The Reading Hospital and Medical Center Pension Plan (“Plan”), a noncontributory defined benefit pension plan covering substantially all employees of the Company. Employees are eligible to join the Plan upon completion of one year of service provided they have attained age 21. Benefits are based upon years of credited service and the employee’s highest average monthly compensation. The Hospital also sponsors a defined contribution plan which allows employees to defer income for retirement. The Hospital also sponsors a supplemental employee retirement plan (“SERP”) for certain members of management. In 2011, the Company settled “SERP” obligation with participated employee. The Hospital’s funding policy is to contribute annually amounts required by Section 412(b) of the Internal Revenue Code so that no deficiency exists at the end of any Plan year.

The following table sets forth the Plan's funded status and amounts recognized in the consolidated balance sheets at June 30, 2012 and 2011 and the amounts charged to operations during the years ended June 30, 2012 and 2011:

Obligations and Funded Status at June 30 for the Plan

	2012	2011
Change in projected benefit obligation		
Benefit obligation at beginning of year	$ 378,415,249	$ 372,760,226
Service cost	15,919,894	16,246,275
Interest cost	21,595,137	20,221,240
Actuarial loss (gain)	73,636,234	(13,018,594)
Benefits paid	(11,513,918)	(17,793,898)
Benefit obligation at end of year	$ 478,052,596	$ 378,415,249
Change in plan assets		
Fair value of plan assets at beginning of year	$ 278,882,822	$ 248,792,934
Actual return on assets	(3,907,167)	24,401,092
Employer contributions	14,400,000	23,482,694
Benefits paid	(11,513,918)	(17,793,898)
Fair value of plan assets at end of year	$ 277,861,737	$ 278,882,822

The accrued liability of the plan at June 30, 2012 and 2011 consists of the following components:

	2012	2011
Funded status	$ (200,190,859)	$ (99,532,427)

The accumulated benefit obligations totaled $408,166,000 and $322,148,000 at June 30, 2012 and 2011, respectively, for the Plan.

Amounts recognized in the balance sheet consist of:

	2012	2011
Accrued pension	$ 200,190,859	$ (99,532,427)
Total accrued liability	$ 200,190,859	$ (99,532,427)
Amounts recognized in net assets consist of		
Net actuarial loss	$ 179,386,937	$ 82,913,748
Prior service cost (benefit)	1,448,866	1,664,829
Pension cost charged to net assets	$ 180,835,803	$ 84,578,577

Net periodic benefit cost components include the following:

	2012	2011	
	Plan	Plan	SERP
Service cost - benefits earned during the period	$ 15,919,894	$ 16,143,178	$ 103,097
Interest cost on projected benefit obligation	21,595,137	20,074,172	147,068
Expected return on plan assets	(22,446,051)	(20,499,749)	-
Amortization of prior service cost	215,963	215,963	-
Amortization of net gain	3,516,263	5,181,268	424,663
Settlement charge	-	-	1,695,084
Effect of curtailment	-	-	-
Net periodic pension cost charged to operations	$ 18,801,206	$ 21,114,832	$ 2,369,912

The amounts expected to be amortized from unrestricted net asset to net periodic pension costs during fiscal year 2013 are a net loss of $10,122,000 and a prior service cost of $216,000.

Weighted-average assumptions used to determine benefit obligations at June 30:

	2012	2011
Discount rate	5.00 %	5.78 %
Rate of compensation increase	3.00 %	3.00 %
Measurement date	6/30/2012	6/30/2012

Weighted-average assumptions used to determine net periodic benefit cost for years ended June 30:

	2012	2011	
	Plan	Plan	SERP
Discount rate	5.78 %	5.59 %	5.59%–1.63%
Expected long-term return on plan assets	8.00 %	8.00 %	N/A
Rate of compensation increase	3.00 %	3.00 %	5.00 %

To develop the expected long-term rate of return on assets assumption, the Hospital considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio.

Plan Assets

The Reading Hospital and Medical Center Pension Plan weighted-average asset allocations at June 30, 2012 and 2011, by asset category are as follows:

	Plan Assets at June 30	
	2012	2011
Asset category		
Cash and cash equivalents	1.7 %	1.2 %
Mutual funds	19.8	21.1
Fixed income	20.4	28.3
Equity investments	3.6	3.5
Alternate investments	54.5	45.9
	100.0 %	100.0 %

The overall investment objective of the Plan is to provide a return on investment consistent with the Plan's spending needs and to prevent erosion of purchasing power by inflation. Achievement of the return will be sought from an investment strategy that provides an opportunity for superior returns within acceptable levels of risk and volatility of returns.

The following tables represent the fair value measurement levels for all assets and liabilities, which the Hospital has recorded at fair value:

	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)	June 30, 2012
Assets				
Cash and cash equivalents	$ 4,592,602	$ -	$ -	$ 4,592,602
State and local government				-
securities	-	-	9,175,000	9,175,000
Mutual funds	55,052,978	-	-	55,052,978
Equities	9,941,823	-	-	9,941,823
Fixed income funds	47,585,136	-	-	47,585,136
Hedge funds	-	-	149,170,867	149,170,867
Total investments	$ 117,172,539	$ -	$ 158,345,867	275,518,406

	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)	June 30, 2011
Assets				
Cash and cash equivalents	$ 3,300,843	$ -	$ -	$ 3,300,843
State and local government				-
securities	-	-	9,450,000	9,450,000
Mutual funds	43,664,161	-	-	43,664,161
Equities	9,626,546	-	-	9,626,546
Fixed income funds	69,391,277	-	-	69,391,277
Hedge funds	-	-	142,291,912	142,291,912
Total investments	$125,982,827	$ -	$151,741,912	$ 277,724,739

The following table represents the nonreadily marketable investments and auction rate securities for which fair value was measured under Level 3:

	Hedge Funds	State and Local Government Securities
Fair value at July 1, 2011	$142,291,912	$ 9,450,000
Purchases	30,002,220	-
Sales	(5,065,469)	(275,000)
Realized gains (losses)	-	-
Net change in unrealized gains (losses)	(18,057,796)	-
Fair value at June 30, 2012	$149,170,867	$ 9,175,000

	Hedge Funds	State and Local Government Securities
Fair value at July 1, 2010	$ 65,010,922	$ 9,700,000
Purchases	85,500,000	-
Sales	(26,666,520)	(250,000)
Realized gains (losses)	(199,690)	-
Net change in unrealized gains (losses)	18,647,200	-
Fair value at June 30, 2011	$142,291,912	$ 9,450,000

The Company had investments in limited partnerships that are accounted for at a cost of $2,343,331 and $1,115,083 at June 30, 2012 and 2011, respectively.

Cash Flows

Contributions (Unaudited)

The Reading Hospital and Medical Center expects to contribute the minimum required contribution during the 2013 fiscal year to the Plan, which is estimated to be $14,000,000.

Estimated Future Benefit Payments (Unaudited)

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

Years Ending June 30,	
2013	$ 11,647,338
2014	12,650,261
2015	13,882,464
2016	15,820,820
2017	18,427,558
2018–2022	125,358,706

10. Related Party Transactions

Other receivables from affiliated organizations at June 30, 2012 and 2011 consist of:

	2012	**2011**
Springridge, LLC	$ 1,302,269	$ 1,163,630
Berkshire Health Partners	144,255	94,623
Central Pennsylvania Homecare Inc	8,309	2,073
Total receivables from affiliated organizations	$ 1,454,833	$ 1,260,326

These amounts are all noninterest bearing with no stated repayment terms.

Included in other assets are the following investments in affiliates at June 30, 2012 and 2011:

	2012	**2011**
CPAL	$ 350,373	$ 348,736
Quest	13,594	22,855
Springridge, LLC	1,728,372	2,133,518
Reading Berks Physical Therapy	332,774	378,266
Horizon	803,319	1,240,104
VNA Community Care Services	5,653,051	6,447,497
Berks Health Partners	920,400	818,907
Total investments in affiliated organizations	$ 9,801,883	$ 11,389,883

11. Temporarily and Permanently Restricted Net Assets

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

	2012	2011
Various health care services	$ 654,010	$ 672,471

Permanently restricted net assets at fair value at June 30, 2012 and 2011 are restricted to:

	2012	2011
Permanent endowment funds, the interest and dividend income from which is expendable to support health care services	$ 4,127,781	$ 3,920,090
Funds held in trust by others	12,685,103	13,448,744
Total permanently restricted net assets	$ 16,812,884	$ 17,368,834

12. Insurance Arrangements

The Company participates in the Pennsylvania Medical Care Availability and Reduction of Error Fund or Mcare Fund established under the Commonwealth of Pennsylvania. The Mcare Fund presently provides coverage excess of up to $500,000 to the Company's primary per occurrence retention (which is currently $500,000) with annual aggregate coverage of $1,500,000.

The Company established a self-insurance trust fund to provide protection against professional liability claims. The trust is actuarially funded on an annual basis to provide single limit professional liability coverage of $500,000 per occurrence and $2,500,000 in the annual aggregate for the Hospital and certain employees. For incidents occurring since April 30, 2009, the Company purchased commercial insurance to provide coverage on a claims-made basis in an amount up to $25,000,000 in excess of a total retention of $3,000,000 ($500,000 primary; $500,000 Mcare excess and a $2,000,000 self-insured buffer) The adoption of the ASU 2010-24 pronouncement had no impact on the Company's financial performance or cash flows. Claim liabilities are no longer netted by insurance recoveries. Claim liabilities were increased by $5,600,000 during FYE12, and a corresponding insurance receivable was recorded. Funding requirements of the plan are subject to increase depending on the plan's claim experience. Premium Payments for the Mcare Fund are based upon each individually licensed healthcare provider's rating with the Joint Underwriters Association and the amount of the surcharge to be assessed is determined by the Mcare Fund on an annual basis. The Company's annual surcharge premiums for participation in the Mcare Fund were $1,445,000 and $1,510,000 for the years ended June 30, 2012 and 2011, respectively.

Additionally, the Company self-insures its workers' compensation and minor general liability risks. The Company's self-insurance plan has been reviewed and approved by the Commissioner of Insurance of Pennsylvania.

The Company purchases excess workers' compensation insurance for all controlled entities of the hospital with statutory limits over a self-retention of $1,000,000 per occurrence subject to a policy maximum of $1,000,000 for the policy period. The Company has established a trust fund for the payment of workers' compensation benefits.

Reserves for self-insurance claims at June 30, 2012 and 2011 are summarized as follows:

	2012	2011
Professional liability claims payable	$ 37,489,000	$ 24,314,786
Workers' compensation	13,962,738	13,745,000
Total self-insurance claims reserve	51,451,738	38,059,786
Less: Current portion	10,877,737	8,670,086
Self-insurance claims reserve, net of current portion	$ 40,574,001	$ 29,389,700

13. Commitment and Contingencies

Operating Leases

The Company leases equipment and facilities under operating leases expiring at various dates through May 2026. Total rental expense under all operating leases was $10,473,000 and $10,760,000 for the years ended June 30, 2012 and 2011, respectively.

The following table summarizes future minimum rental commitments under noncancellable operating leases with initial or remaining terms of more than one year:

In accordance with ASU 2010-24, an adjustment was made to record insurance recoveries receivable and additional liabilities for Med Malpractice Claims in the amount of $5,600,000.

Years Ending June 30,	
2013	$ 6,450,914
2014	5,869,698
2015	4,497,399
2016	3,477,874
2017 and thereafter	10,155,512

SIR Asset Purchase

The Reading Hospital and Medical Center entered into an agreement on May 21, 2012 with the Surgical Institute of Reading, L.P ("SIR") to acquire substantially all of the assets of SIR. The purchase price shall be $43,000,000 adjusted by the following: (i) increased by the amount of the Meaningful Use Receivable as a result of the Buyer's right to receive the same; (ii) decreased by the amount of the accrued vacation and other paid time off; and (iii) decreased by the amount, if any, by which Seller's Working Capital as of the Closing Date is less than $2,600,000. This acquisition is currently the subject of reviews by the Federal Trade Commission and the Pennsylvania Attorney General, Antitrust Division, and the timing and certainty of the acquisition cannot be projected at the time.

EPIC

On Sept 9, 2011, The Reading Hospital and Medical Center entered into a sale and purchase agreement ("SPA") with EPIC Systems Corporation to purchase, install, and implement EPIC software for a consideration of $22 million. As of the date of this report, The Reading Hospital and Medical Center has paid a sum of 6.1 million to EPIC Systems Corporation. Additional services and costs will be incurred toward the entire project scope, expecting to total $130 million in additional capital costs and $23 million in operating costs.

Obligation to Provide Future Services

The Highlands annually calculates the present value of the estimated net cost of future services and use of facilities to be provided to current residents and compares that amount with the balance of deferred entrance fee revenue. If the present value of the net cost of future services and use of facilities exceeds the deferred revenue, a liability is recorded with the corresponding charge to income. As of June 30, 2012 and 2011, the estimated present value of the net cost of future services and use of facilities is less than the deferred entrance fee revenue; thus, no liability has been recorded.

Litigation

The Company and its controlled entities are involved in certain litigation which involves professional and general liability. In the opinion of management and legal counsel, the ultimate liability, if any, will not have a material effect on the consolidated financial condition of the Parent and its controlled entities.

Regulatory Compliance

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations 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 programs.

14. Functional Expenses

The Company provides general health care services to residents within its geographic location. Expenses related to providing these services are as follows:

	2012	2011
Health care services	$735,499,814	$668,487,342
General and administrative	152,749,250	164,070,037
Total functional expenses	$888,249,064	$832,557,379

15. Significant Concentrations of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short term investments, U.S. Treasury obligations and patient accounts receivable.

The Company typically maintains cash and cash equivalents and short term investments in commercial banks. The short-term investments consist primarily of money market funds, U.S. Government agency notes, U.S. Treasury bills, commercial paper and corporate bonds with maturities ranging from 90 to 180 days. The FDIC insures funds up to $250,000 per depositor.

The fair value of the Company's investments is subject to various market fluctuations which include changes in the interest rate environment and general economic conditions.

The Company's operations are located in Reading, Pennsylvania. Its primary service area includes Reading, Pennsylvania and the Greater Berks County community. The Company grants credit to its patients and other third-party payors, primarily Medicare, Medical Assistance, Blue Cross and various commercial insurance companies. The Company maintains reserves for potential credit losses and such losses have historically been within management's expectations. The mix of receivables from patients and third-party payors at June 30, 2012 and 2011, was as follows:

	2012	**2011**
Medicare	29%	27%
Medical Assistance	18%	19%
Blue Cross	17%	15%
Commercial insurance	17%	19%
Self-pay	17%	18%
Other	2%	2%
	100%	100%

16. Subsequent Events

The Company has evaluated subsequent events through November 2, 2012. Management reviews and identifies subsequent events through participation at meetings of the Board of Directors and their subcommittees.

The Reading Hospital and Controlled Entities
Schedule of Expenditures of Federal Awards
June 30, 2012 and 2011

Federal Grantor/ Pass-through Grantor/ Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identification Number	Federal Expenditures
Student Financial Assistance Cluster			
United States Department of Education- Office of Student Financial Assistance Programs			
Direct Awards			
Federal Direct Student Loan Program	84.268		$ 2,401,585
Federal Pell Grant Program	84.063		570,367
Total Student Financial Assistance Cluster			2,971,952
Research and Development Cluster			
Department of Health and Human Services			
Pass-through Award			
Blood Diseases and Resources Reasearch	93.839	WU-09-338	20,450
Total Research and Development Cluster			20,450
Other Programs			
Department of Health and Human Services			
Direct Awards			
Outpatient Early Intervention Services with Respect to HIV Disease	93.918		338,531
Affordable Care Act Primary Care Residency Expansion Program	93.510		250,731
Pass-through Awards			
National Bioterrorism Hospital Preparedness Program	93.889	605659	64,544
Block Grants for the Prevention and Treatment of Substance Abuse	93.959	67044	124,595
Substance Abuse and Mental Health Services	93.243	62121	8,097
Total Other Programs			786,498
Total Expenditures of Federal Awards			$ 3,778,900

1. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the "Schedule") includes the federally funded activities of the Reading Hospital and Controlled Entities ("Reading") and is presented on the accrual basis of accounting. The Reading Hospital School of Health Sciences (“School”) at The Reading Hospital (“Hospital”) is a program sponsored by The Reading Hospital and Medical Center. The School provides a program of classroom and clinical preparation for the nursing profession and other allied health professionals. The Reading Hospital and Medical Center is an acute care hospital located in Reading, Pennsylvania and provides health care services to the Reading area. 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*. Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of the basic financial statements.

2. Federal Direct Loans

Federally-guaranteed loans distributed to students of the School during the year ended June 30, 2012 are summarized as follows:

	CFDA Numbers	Amount
Federal Stafford Student Loan	84.268	2,293,656
Federal PLUS (Parent) Loan	84.268	107,929
		$ 2,401,585

These distributions and related funding sources are not included in the School's general purpose financial statements.

Part II
Reports on Internal Control and Compliance

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
Reading Hospital and Controlled Entities:

We have audited the financial statements of The Reading Hospital and Controlled Entities (the "Hospital") as of and for the year ended June 30, 2012, and have issued our report thereon dated November 2, 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 Hospital's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital'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 entity's 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 over financial reporting 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 Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Hospital in a separate letter dated November 2, 2012.

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This report is intended solely for the information and use of the Hospital's management, The Reading Hospital and Controlled Entities' Board of Directors, others within the entity, 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.

PricewaterhouseCoopers LLP

November 2, 2012

Report of Independent Auditors 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
The Reading Hospital and Controlled Entities

Compliance

We have audited the compliance of The Reading Hospital and Controlled Entities (the "Hospital") 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 its major federal programs for the year ended June 30, 2012. The Hospital'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 Hospital's management. Our responsibility is to express an opinion on the Hospital'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 Hospital'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 Hospital's compliance with those requirements.

In our opinion, the Hospital complied, in all material respects, with the 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.

Internal Control Over Compliance

Management of the Hospital 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 Hospital's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order 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 Hospital's internal control over compliance.

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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 Reading Hospital and Controlled Entities' Board of Directors, others within the entity, 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.

PricewaterhouseCoopers LLP

March 20, 2013

Part III
Findings

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	Unqualified
Internal Control over financial reporting:	
Material weakness(es) identified?	No
Significant deficiency(ies) identified that are not considered to be material weaknesses?	None reported
Noncompliance material to financial statements noted?	No

Federal Awards

Internal Control over major programs:	
Material weakness identified?	No
Significant deficiency(ies) identified that are not considered to be material weaknesses?	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 OMB Circular A-133 section .510(a)?	No

Identification of major Federal programs:

Federal CFDA Number	*Name of Federal Program or Cluster*
84.268, 84.063	Student Financial Assistance Cluster
93.918	Outpatient Early Intervention Services with Respect to HIV Disease

Dollar threshold used to distinguish between Federal governmental assistance Type A and Type B programs:	$300,000
Auditee qualified as low-risk auditee?	No

Section II – Financial Statement Findings

No matters to report.

Section III – Federal Award Findings and Questioned Costs

No matters to report.

The Reading Hospital and Controlled Entities
Summary of Schedule of Prior Audit Findings
Year Ended June 30, 2012

Finding 2011-1: Program Income and Financial Reporting – Control Deficiency

Federal Agency:	Department of Health and Human Services
Program:	Outpatient Early Intervention Services with Respect to HIV Disease
CFDA#:	93.918
Award Year:	July 1, 2010 to June 30, 2011

Condition

During PwC's compliance testing, it was noted that the Hospital did not report program income on the annual Federal Financial Report for the fiscal year 2011. It was further noted that the Hospital did not adequately monitor and track charges to Part C patients in accordance with the terms and conditions of the grant. PwC recommended that the Hospital develop a formal process to identify and monitor program income to ensure that it is meeting the requirements set forth in the terms and conditions of the grant.

Status

Grant Accounting Policies have been updated to address Ryan White Program Income reporting. Program Income was reported on the Federal Financial Reported for the fiscal year 2012.

During the current fiscal year, the Hospital's automated billing system did not lend itself to the process of monitoring charges imposed on Part C patients. A manual process was used to review accounts and monitor the charges. The hospital has recently installed a new billing system which will flag specified groups of accounts for review. This will facilitate the review and monitoring of annual charges imposed on Part C patients.