

DIMENSIONS HEALTH CORPORATION AND SUBSIDIARIES

Consolidated Financial Statements and Other Financial Information

For the years ended June 30, 2003 and 2002 with Report of Independent Auditors

Dimensions Health Corporation and Subsidiaries

Consolidated Financial Statements  
and Other Financial Information

For the years ended June 30, 2003 and 2002

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## Report of Independent Auditors

Board of Directors  
Dimensions Health Corporation

We have audited the accompanying consolidated balance sheets of Dimensions Health Corporation and subsidiaries, as of June 30, 2003 and 2002, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Dimensions Health Corporation and subsidiaries as of June 30, 2003 and 2002, and the results of their operations and changes in net assets, and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 14 to the financial statements, the Corporation's recurring deficit of unrestricted revenue and other support over expenses and losses from operations and net asset deficiency raise substantial doubt about its ability to continue as a going concern. Management's plans as to these matters are also described in Note 14. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the outcome of this uncertainty.

As described in Note 2, the 2002 consolidated financial statements have been restated relating to additional minimum pension liabilities and accrued expenses.

*Ernst + Young LLP*

August 29, 2003, except for Note 14,  
as to which the date is March 2, 2004

Dimensions Health Corporation and Subsidiaries

Consolidated Balance Sheets

	<b>June 30</b>	
	<b>2003</b>	<b>2002</b>
	<i>(As Restated, see Note 2)</i>	
	<i>(In Thousands)</i>	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,500	\$ 3,873
Assets limited as to use	4,103	4,086
Restricted cash <i>(Note 10)</i>	3,274	3,334
Patient accounts receivable, net of allowance for uncollectible accounts (\$15,909 and \$20,365 in 2003 and 2002, respectively)	62,177	64,646
Inventories	4,013	3,407
Prepaid expenses and other assets	8,164	7,289
Total current assets	<u>83,231</u>	<u>86,635</u>
Investments held for strategic and capital projects	4,403	4,622
Assets limited as to use:		
Held in trust under bond and note indentures	7,644	7,442
Restricted investments	1,755	255
Investments held for self insurance	16,535	19,296
Total assets limited as to use	<u>25,934</u>	<u>26,993</u>
Property and equipment, net	68,325	74,004
Intangible assets, net	903	1,390
Notes receivable from related party <i>(Note 12)</i>	2,819	2,000
Other noncurrent assets	2,268	2,248
Deferred financing costs	754	862
Total assets	<u><u>\$ 188,637</u></u>	<u><u>\$ 198,754</u></u>

	<b>June 30</b>	
	<b>2003</b>	<b>2002</b>
	(As Restated, see Note 2)	
	<i>(In Thousands)</i>	
<b>Liabilities and net assets</b>		
Current liabilities:		
Current portion of long-term debt	\$ 2,973	\$ 2,600
Current portion of accrued employee benefit liabilities	373	917
Accounts payable and accrued expenses	32,600	38,936
Advances from third-party payors	13,408	10,718
Accrued annual leave	6,764	6,886
Specific purpose funds	729	884
Total current liabilities	<u>56,847</u>	<u>60,941</u>
Long-term debt, net of current portion	84,019	89,233
Other liabilities:		
Accrued professional liabilities	23,216	20,452
Accrued employee benefit liabilities	39,144	24,127
Total other liabilities	<u>62,360</u>	<u>44,579</u>
Net (deficit) assets <i>(Note 2)</i> :		
Unrestricted	(15,589)	4,001
Restricted	1,000	-
	<u>(14,589)</u>	<u>4,001</u>
Total liabilities and net assets	<u><u>\$ 188,637</u></u>	<u><u>\$ 198,754</u></u>

*See accompanying notes.*

Dimensions Health Corporation and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	<b>Year ended June 30</b>	
	<b>2003</b>	<b>2002</b>
	<i>(As Restated, see Note 2)</i>	
	<i>(In Thousands)</i>	
Unrestricted revenue and other support:		
Net patient service revenue	<b>\$ 300,360</b>	\$ 297,394
Other income:		
Investment income	<b>904</b>	640
Other	<b>10,690</b>	12,894
Total unrestricted revenue and other support	<b>311,954</b>	310,928
Operating expenses:		
Salaries and benefits	<b>153,895</b>	147,626
Supplies	<b>43,384</b>	44,986
Purchased services	<b>52,390</b>	58,760
Bad debt expenses	<b>41,394</b>	37,271
Physician fees	<b>8,843</b>	8,164
Utilities	<b>3,495</b>	3,483
Total operating expenses	<b>303,401</b>	300,290
Operating earnings before interest, depreciation and amortization	<b>8,553</b>	10,638
Investment (loss)	<b>(734)</b>	(1,031)
Interest expense	<b>5,257</b>	5,397
Depreciation and amortization	<b>9,900</b>	10,647
Net interest, depreciation and amortization	<b>14,423</b>	15,013
Deficit of unrestricted revenue and other support over expenses and losses from continuing operations	<b>(5,870)</b>	(4,375)

Dimensions Health Corporation and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets  
(continued)

	<b>Year ended June 30</b>	
	<b>2003</b>	<b>2002</b>
	<i>(As Restated, see Note 2)</i>	
	<i>(In Thousands)</i>	
Deficit of unrestricted revenue and other support over expenses and losses from continuing operations	\$ (5,870)	\$ (4,375)
Loss on extinguishment of debt	-	(186)
Deficit of unrestricted revenue and other support over expenses and losses after extraordinary item	<b>(5,870)</b>	(4,561)
Other changes in unrestricted net assets:		
Net change in appreciation of marketable investments	690	103
Additional minimum pension liability (Note 9)	<b>(14,410)</b>	(16,596)
Decrease in unrestricted net assets	<b>(19,590)</b>	(21,054)
Changes in restricted net assets:		
Restricted grant (Notes 1 and 14)	<b>1,000</b>	-
Decrease in unrestricted and restricted net assets	<b>(18,590)</b>	(21,054)
Net assets, beginning of year as previously reported		22,034
Prior period adjustment (Note 2)	-	3,021
Net assets, beginning of year	<b>4,001</b>	25,055
Net (deficit) assets, end of year	<b>\$ (14,589)</b>	\$ 4,001

*See accompanying notes.*

Dimensions Health Corporation and Subsidiaries

Consolidated Statements of Cash Flows

	<b>Year ended June 30</b>	
	<b>2003</b>	<b>2002</b>
	<i>(As Restated, see Note 2)</i>	
	<i>(In Thousands)</i>	
<b>Operating activities</b>		
Change in net assets	<b>\$(18,590)</b>	\$(21,054)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Bad debt expense	<b>41,394</b>	37,271
Depreciation and amortization of property and equipment	<b>9,900</b>	10,647
Amortization of original issue discount and deferred financing costs	<b>188</b>	212
Amortization of intangible assets	<b>487</b>	487
Net unrealized gains on marketable investments	<b>(690)</b>	(103)
(Losses) gains on sale of assets on marketable investments	<b>(341)</b>	2
Restricted grant	<b>(1,000)</b>	-
Increase in minimum pension liability	<b>14,410</b>	16,596
Extraordinary loss	<b>-</b>	186
Other	<b>(117)</b>	-
Changes in operating assets and liabilities:		
(Increase) decrease:		
Accounts receivable, net	<b>(38,925)</b>	(44,177)
Inventories	<b>(606)</b>	(109)
Prepaid expenses and other assets	<b>(875)</b>	(183)
Other noncurrent assets	<b>(20)</b>	1,202
Increase (decrease):		
Accounts payable and accrued expenses	<b>(6,336)</b>	11,309
Accrued annual leave	<b>(122)</b>	220
Specific purpose funds	<b>(155)</b>	(20)
Accrued employee benefit liabilities	<b>63</b>	8,242
Accrued professional liabilities	<b>2,764</b>	765
Net cash provided by operating activities	<b>1,429</b>	21,493

Dimensions Health Corporation and Subsidiaries  
Consolidated Statements of Cash Flows (continued)

	<b>Year ended June 30</b>	
	<b>2003</b>	<b>2002</b>
	<i>(As Restated, see Note 2)</i>	
	<i>(In Thousands)</i>	
<b>Investing activities</b>		
Purchase of property and equipment	\$ (4,524)	\$ (7,121)
Proceeds from sale of assets	467	52
Issuance of note receivable	(838)	(106)
Payments on notes receivable	19	12
Net proceeds from sale (purchases) of investments	3,203	(13,354)
Net cash used in investing activities	(1,673)	(20,517)
<b>Financing activities</b>		
Payments of long-term debt and capital lease obligations	(4,819)	(2,484)
Advances from third-party payors	2,690	677
Net cash used in financing activities	(2,129)	(1,807)
Decrease in cash and cash equivalents	(2,373)	(831)
Cash and cash equivalents at beginning of year	3,873	4,704
Cash and cash equivalents at end of year	\$ 1,500	\$ 3,873
<b>Noncash transactions</b>		
Acquisitions of property and equipment through capital leases	\$ 15	\$ 523

*See accompanying notes.*

# Dimensions Health Corporation and Subsidiaries

## Notes to Consolidated Financial Statements

June 30, 2003 and 2002

### 1. Summary of Significant Accounting Policies

#### Organization

Dimensions Health Corporation (the Corporation) is a not-for-profit, non-stock corporation, incorporated in Maryland for charitable and scientific purposes. The Corporation is operating under the name Dimensions Healthcare System. The principal mission of the Corporation is the provision of health care through various delivery sites and the provision of services supporting health care. The Corporation's principal facilities, subsidiaries, and affiliates are as follows:

#### *Acute and Ambulatory Care Facilities:*

- Prince George's Hospital Center (PGHC)
- Laurel Regional Hospital (LRH)
- Bowie Health Center (BHC)

#### *Long-term Care Facilities:*

- Gladys Spellman Specialty Hospital and Nursing Center (GSSHNC)
- Madison Manor, Inc. (MM), a wholly owned subsidiary, which holds a 25% interest in the Larkin Chase Nursing and Restorative Center

#### *Health Care Supporting Subsidiaries and Affiliates:*

- Dimensions Healthcare Associates (DHA), a wholly owned, not-for-profit corporation established to provide physician services to Dimensions' acute and ambulatory care facilities.
- Affiliated Enterprises, Inc. (AEI), a wholly owned, for-profit corporation, which owns and operates Mullikin Medical Center, a medical office building, on the Bowie campus, and holds a 50% interest in Bowie Assisted Living (BAL), LLC, the owner and operator of Woodward Estates, an 80-unit assisted-living facility also located on the Bowie campus.
- Dimensions Assurance, Ltd. (DAL), a wholly owned, for-profit captive insurance company located in the Cayman Islands.

Dimensions Health Corporation and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**1. Summary of Significant Accounting Policies (continued)**

**Use of Estimates**

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

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Corporation and its subsidiaries. Investments in affiliates for which the Corporation does have the ability to significantly influence operations, but does not control, are accounted for under the equity method. Significant intercompany accounts and transactions have been eliminated in consolidation.

**Cash and Cash Equivalents**

Cash and cash equivalents include cash and certain investments in highly liquid debt instruments and certificates of deposit, both with maturities of three months or less when purchased. The Corporation routinely invests its surplus operating funds in overnight repurchase agreements. These funds generally invest in highly liquid U.S. government and agency obligations. Restricted cash represents amounts held by a commercial bank under a custody agreement as collateral for outstanding letters of credit.

**Marketable Investments and Investment Income**

Marketable investments are carried at fair value. Marketable investments are classified as short or long-term, based on management's intention as to use. Unrealized gains and losses are reported as changes in unrestricted net assets within the statements of operations and changes in net assets.

Investments held for capital and strategic purposes are internally designated for future projects of the Corporation.

Investments included in assets limited as to use are restricted under debt and bank agreements and self-insurance arrangements and are not available for the general operations of the Corporation. Assets limited as to use which will be utilized to meet related current liabilities have been classified in the balance sheet as current assets.

Dimensions Health Corporation and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**1. Summary of Significant Accounting Policies (continued)**

**Marketable Investments and Investment Income (continued)**

Investment income includes realized gains and losses from investments. The cost of the securities sold is based on the specific identification method. Investment income on investments held by DAL for insurance purposes is included in other operating income. Investment income on all other investments is excluded from operating earnings before interest, depreciation and amortization.

The Corporation periodically evaluates whether any declines in the fair value of investments are other than temporary. This evaluation consists of a review of several factors, including but not limited to: length of time and extent that a security has been in an unrealized loss position, the existence of an event that would impair the issuer's future earnings potential, the near term prospects for recovery of the market value of a security, and the intent and ability of the Company to hold the security until the market value recovers. Declines in value below cost for debt securities where it is considered probable that all contractual terms of the security will be satisfied, the decline is due primarily to changes in interest rates (and not because of increased credit risk), and where the Corporation intends and has the ability to hold the investment for a period of time sufficient to allow a market recovery, are not assumed to be other than temporary. Unrealized losses related to equity and debt securities greater than one year are not significant.

**Accounts Receivable and Contractual Allowances**

The Corporation provides services to patients in Prince George's County and surrounding jurisdictions, the majority of whom are covered by third-party health insurance. The Corporation bills the insurers directly for the services provided. Insurance and credit information is obtained from patients at time of service or upon admission when available. No collateral is obtained for accounts receivable.

The Corporation's policy is to write off all patient accounts that have been identified as uncollectible. An allowance for doubtful accounts is recorded for accounts not yet written off, which are anticipated to become uncollectible in future periods.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **1. Summary of Significant Accounting Policies (continued)**

##### **Accounts Receivable and Contractual Allowances (continued)**

Discounts ranging from 2% to 6% of hospital charges are given to Medicare, Medicaid and certain approved commercial health insurance and health maintenance organizations (HMOs). Also these payors routinely review patient billings and deny payment for certain procedures that they deem medically unnecessary or performed without appropriate pre-authorization. Discounts and denials are recorded as reductions of net patient revenue. Accounts receivable from these third-party payors have been adjusted to reflect the difference between charges and the estimated reimbursable amounts.

At June 30, 2003 and 2002, approximately 20.2% and 21.7% of patient accounts receivable were due from commercial and Medicaid HMOs, 13.0% and 19.1% from the Medicare program, 9.0% and 8.8% from the Medicaid program, 23.1% and 25.5% from self pay, and 34.3% and 24.9% from all other payors, including Blue Cross and other commercial insurance.

##### **Inventories**

Inventories, consisting principally of drugs and supplies, are carried at the lower of cost or market, using the average cost method.

##### **Property and Equipment**

Property and equipment is carried at cost or, if donated, at fair market value at the date of the gift. Depreciation is provided over the estimated useful life of each class of depreciable asset, ranging from two to thirty years. Amortization of assets under capital lease obligations is computed using the straight-line method over the estimated useful life of the equipment and is included in depreciation and amortization in the financial statements. Maintenance and repairs are charged to expense as incurred.

##### **Deferred Financing Costs**

Financing costs incurred in issuing the Prince George's County, Maryland Hospital Revenue Bonds, Series 1994, and the Dimensions Health Corporation Flexible Term Notes, Series 1996 have been capitalized and are being amortized over the life of the issues using the bonds-outstanding method.

Dimensions Health Corporation and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**1. Summary of Significant Accounting Policies (continued)**

**Deferred Financing Costs (continued)**

The following table summarizes the annual deferred financing costs:

	<b>June 30</b>	
	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Series 1994 revenue bonds	<b>\$ 891</b>	\$ 891
Flex term notes	<b>216</b>	216
Other	<b>226</b>	226
Accumulated amortization	<b>(579)</b>	(471)
Total	<b>\$ 754</b>	\$ 862

**Intangible Assets**

Intangible assets, representing licenses and permits, are being amortized on the straight-line basis over the shorter of the term of the underlying asset or seven years. Accumulated amortization of the intangible assets was \$2,413,000 and \$1,926,000 at June 30, 2003 and 2002, respectively.

**Impairment of Long-Lived Assets**

The Corporation evaluates its long-lived assets and certain identifiable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of any asset to future net undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the future discounted cash flows compared to the carrying amount of the asset.

Dimensions Health Corporation and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**1. Summary of Significant Accounting Policies (continued)**

**Net Patient Service Revenue**

During 2003 and 2002, respectively, approximately 28.6% of the net patient service revenue was recorded under the Medicare Program; 25.0% and 24.5% under the state Medicaid Program; 18.7% and 19.5% under commercial and Medicaid HMOs; and 27.7% and 27.4% under all other payors, including contracts with Blue Cross, other commercial insurance, and self pay. Revenue from the State of Maryland Medicaid program is primarily derived from independent managed care organizations that have contracted with the State of Maryland to cover eligible beneficiaries.

The following table sets forth the detail of net patient service revenue:

	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Gross patient service revenue	<b>\$ 336,558</b>	\$ 337,212
Revenue deductions:		
Charity care	<b>849</b>	1,832
Contractual allowances	<b>35,349</b>	37,986
Net patient service revenue	<b>\$ 300,360</b>	\$ 297,394

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Corporation believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on the financial statements. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs.

**Other Income**

Other income is primarily composed of private and government restricted and non-restricted donation and grant income. Restricted donations and grants are held as restricted assets and recorded as revenue once the restrictions are satisfied. Other income is also composed of miscellaneous hospital revenue such as cafeteria, parking garage and vending machine income.

Dimensions Health Corporation and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**1. Summary of Significant Accounting Policies (continued)**

**Other Income (continued)**

The following one-time operating grants were recorded in other income as of June 30, 2003 and 2002:

	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Prince George's County Government	<b>\$ 3,000</b>	\$ 3,000
State of Maryland	–	2,000
Magruder Memorial Hospital Trust	<b>2,042</b>	–

Also as of June 30, 2003, the Corporation had recorded \$1,000,000 in restricted net assets composed of a one-time operating grant from the State of Maryland. The \$1,000,000 state grant became unrestricted on July 1, 2003 (see Note 14) as the restrictions were satisfied.

**Charity Care**

The Corporation provides care to patients who meet certain criteria under federal poverty and Hill-Burton guidelines, which determine its charity-care policy. The Corporation does not pursue collection of amounts determined to qualify as charity care and, consequently, these amounts are not reported as net patient service revenue.

**Estimated Professional Liability Costs**

The provision for estimated professional liability claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The Corporation utilizes outside actuarial services in determining the aggregate professional liability reserve.

**Income Tax**

The Corporation is a not-for-profit corporation as described under Section 501(c)(3) of the Internal Revenue Code and is exempt from income taxes on related income pursuant to Section 501(a) of the Code. The Corporation's for-profit subsidiaries are subject to federal and state income taxes.

Dimensions Health Corporation and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**1. Summary of Significant Accounting Policies (continued)**

**Fair Value of Financial Instruments**

The carrying amount reported in the balance sheets for cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, advances from third-party payors, and accrued annual leave approximates their fair value. The fair values of assets limited as to use and investments are based on quoted market prices of the individual securities or investments. The fair value of the Corporation's fixed-rate debt is based on current traded values. The fair value of the variable-rate debt approximates the carrying rate. The fair values of investments are discussed in Note 3.

**2. Restatement of Financial Information**

The balance of net assets as of July 1, 2001, has been restated from the balance previously reported to reflect an adjustment of \$3,021,000 for an overstatement of certain operating expenses and the corresponding accrued expense liability during the fiscal years 1991 to 2001. In addition, certain 2002 operating expenses, as originally reported, were overstated by an additional \$328,000. Consequently, the deficit of unrestricted revenue and other support over expenses for 2002 has been restated to reflect this decrease in operating expenses. The aggregate effect of this adjustment resulted in an increase to net assets of \$3,349,000 as of June 30, 2002.

Additionally, the balance of net assets as of June 30, 2002, has been restated from the balance previously reported to reflect an adjustment of \$16,596,000 in additional minimum pension liability (unfunded accumulated benefit obligation) that was required to be recorded as of June 30, 2002 (see Note 9).

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 2. Restatement of Financial Information (continued)

The aggregate effect of these adjustments resulted in a decrease of \$13,247,000 to net assets as of June 30, 2002. The impact of these adjustments on the Corporation's change in net assets, as originally reported in the 2002 consolidated financial statements, is summarized below:

	<b>As Reported</b>	<b>As Restated</b>
	<i>(In Thousands)</i>	
Net assets, beginning of year	\$ 22,034	\$ 25,055
Deficit of unrestricted revenue and other support over expenses from continuing operations	(4,786)	(4,375)
Loss on extinguishment of debt	(186)	(186)
Deficit of unrestricted revenue and other support over expenses and losses after extraordinary items	(4,972)	(4,561)
Other changes in unrestricted net assets:		
Net change in appreciation of marketable investments	103	103
Additional minimum pension liability	-	(16,596)
Decrease in net assets	(4,869)	(21,054)
Net assets, end of year	\$ 17,165	\$ 4,001

#### 3. Investments

Marketable investments are included in the balance sheet in the captions investments held for strategic and capital projects (\$4,403,000 and \$4,622,000 at June 30, 2003 and 2002, respectively) and assets limited as to use, including restricted cash, (\$33,311,000 and \$34,413,000 at June 30, 2003 and 2002, respectively). Only those investments included in investments held for strategic and capital projects are available for general use by the Corporation.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 3. Investments (continued)

Marketable investments at fair value:

	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Cash and cash equivalents	<b>\$ 8,545</b>	\$ 11,558
Cash equivalent fixed maturities	<b>186</b>	1,034
Government and agency	<b>16,120</b>	15,419
Corporate bonds	<b>7,133</b>	7,187
Common stock	<b>3,425</b>	3,446
Asset-backed securities	<b>71</b>	12
Other	<b>342</b>	379
Total marketable investments	<b>35,822</b>	39,035
Less:		
Amount needed for current debt service	<b>(4,103)</b>	(4,086)
Restricted cash-current	<b>(3,274)</b>	(3,334)
Long-term investments	<b>\$ 28,445</b>	\$ 31,615

Gross unrealized gains at June 30, 2003 and 2002, were approximately \$1,439,000 and \$769,000, respectively. Gross unrealized losses at June 30, 2003 and 2002, were approximately \$(754,000) and \$(698,000), respectively.

#### 4. Property and Equipment

A summary of property and equipment at June 30, 2003 and 2002, is as follows:

	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Buildings and improvements	<b>\$ 60,988</b>	\$ 61,362
Leasehold improvements	<b>29,485</b>	29,135
Equipment	<b>96,791</b>	98,513
Equipment under capital lease obligation	<b>523</b>	1,551
	<b>187,787</b>	190,561
Less: Accumulated depreciation and amortization	<b>(120,650)</b>	(116,836)
Construction in progress	<b>1,188</b>	279
Property and equipment, net	<b>\$ 68,325</b>	\$ 74,004

Dimensions Health Corporation and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**4. Property and Equipment (continued)**

Accumulated amortization for equipment under capital leases was \$196,000 and \$942,000 at June 30, 2003 and 2002, respectively. The Corporation recognized amortization expense for assets under capital lease obligations of approximately \$282,000 and \$395,000 for the periods ended June 30, 2003 and 2002, respectively. These amounts are included in depreciation and amortization expense within the statements of operations and changes in net assets.

The Corporation has outstanding construction contracts aggregating approximately \$152,000 for the remodeling and construction of certain facilities. At June 30, 2003, the remaining commitment on these contracts approximated \$43,000.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 5. Long-Term Debt

Long-term debt and capital lease obligations at June 30, 2003 and 2002, are summarized as follows:

	2003	2002
	<i>(In Thousands)</i>	
Series 1992 Bonds:		
7.20%—Term bonds payable in full July 1, 2002	\$ —	\$ 1,160
Series 1994 Bonds:		
4.50%—Serial bonds payable July 1, 2003	1,990	715
4.50% – 5.35%—Serial bonds payable in periodic installments through 2008	11,530	13,520
5.375%—Term bonds due in 2014 with periodic sinking fund payments	18,370	18,370
5.30%—Term bonds due in 2024 with periodic sinking fund payments	46,710	46,710
	78,600	80,475
Less: Original issue discount	(1,651)	(1,732)
Total bonds	76,949	78,743
Magruder Trust Mortgage, three-year adjustable rate (9.50% at June 30, 2003), repayable in periodic installments through 2025	4,365	4,419
Series 1996 Flexible Term Notes, variable rate (1.10% – 1.35% at June 30, 2003), repayable in periodic installments through 2007	2,821	5,379
Pooled Loan Program—Series D, Maryland Health and Higher Educational Facilities Authority variable rate (1.20% at June 30, 2003), repayable in periodic installments through 2016	2,450	2,585
Capital Lease obligations, payable in monthly installments through 2006 collateralized by leased equipment	407	707
	86,992	91,833
Current portion of long-term debt and capital lease obligations	(2,973)	(2,600)
Long-term debt	\$ 84,019	\$ 89,233

Dimensions Health Corporation and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**5. Long-Term Debt (continued)**

Scheduled principal repayments on long-term debt and capital leases are as follows:

	<b>Long-Term Debt</b>	<b>Obligations Under Capital Leases</b>
<i>(In Thousands)</i>		
Year ending:		
2004	\$ 2,849	\$ 124
2005	2,955	146
2006	3,076	137
2007	3,198	–
2008 and thereafter	76,158	–
	\$ 88,236	\$ 407

The Series 1992 and 1994 Bonds, the Series 1996 Flexible Term Notes and the Pooled Loan Program are secured under the Corporation's Master Trust Indenture by the revenues and receipts and certain assets of the Corporation, including those leased from Prince George's County.

The Master Trust Indenture, the Series 1996 Flexible Term Notes and the Pooled Loan Program require the satisfaction of certain restrictive covenants. A default under any of these covenants cross-defaults the remaining agreements.

The Master Trust Indenture specifically limits additional borrowing. Further, the Corporation is required to satisfy a debt-service coverage ratio of 1.10 to 1 (subject to certain exceptions), measured at the end of each fiscal year, as long as the long-term debt is outstanding. Debt-service coverage is defined as the ratio of the excess of revenues over expenses before interest expense and depreciation to the maximum annual debt service. The debt-service coverage is only measured on the Corporation's obligated group, which is comprised of the following operating divisions: PGHC, LRH, GSSHNC, BHC and Corporate. The results of the obligated group may differ from the results of the entire Corporation. At June 30, 2003, the Corporation was in compliance with this covenant. Management believes that it will be in compliance at the next annual measurement date of June 30, 2004. The maximum annual debt service is currently estimated to be \$6,930,000 for the year ending June 30, 2004.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 5. Long-Term Debt (continued)

Management believes, but can provide no assurance, that its operating plan for the year ending June 30, 2004, will result in sufficient excess of revenues over expenses and cash flow to allow compliance with the above covenants. Based on these conclusions, management continues to classify the Series 1994 Bonds as long-term debt in the accompanying financial statements.

The Corporation maintains a letter of credit in the amount of \$3,348,000 supporting the Series 1996 Flexible Term Notes, which expires on January 26, 2005. This letter of credit requires payment of an annual fee of 4.0% of the letter of credit amount outstanding.

The Corporation maintains a letter of credit in the amount of \$2,485,000 that supports the outstanding borrowings under the MHHEFA Pooled Loan program, which expires on July 15, 2005. This letter of credit requires the payment of an annual fee of 4.0% of the letter of credit amount outstanding.

Interest costs on long-term debt and notes payable incurred and paid for the years ended June 30, 2003 and 2002, net of interest income, were \$4,522,000 and \$4,366,000, respectively.

The assets held in trust under the Series 1992 and 1994 Bonds as of June 30, 2003, are as follows (*in thousands*):

Construction fund	\$	4
Interest reserve fund (Series 1996 Flexible Term Notes)		50
Debt-service reserve fund		7,614
Debt-service fund		4,079
Total trust fund investments		<u>\$ 11,747</u>

The fair value of the Corporation's Series 1992 and 1994 Bond indentures, based on the quoted market prices at June 30, 2003 and 2002, was \$53,702,000 and \$37,883,000, respectively.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 6. Functional Expenses

The Corporation considers health care services and management & general to be its primary functional categories for purposes of expense classification. The Corporation's operating expenses by functional classification for the years ended June 30, 2003 and 2002, are as follows:

	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Health care services	<b>\$ 301,352</b>	\$ 298,204
Management & general	<b>17,206</b>	18,458
	<b>\$ 318,558</b>	\$ 316,662

#### 7. Insurance Programs

The Corporation maintains a wholly owned, captive insurance company, located in the Cayman Islands, to administer certain professional and general liability exposures incurred by the Corporation and its employees and voluntary staff. Prior to January 1, 1998, the Corporation was self-insured for professional and general liability claims up to a limit of \$2,000,000 per occurrence and \$6,000,000 in the annual aggregate. Effective January 1, 1998, the Corporation's wholly owned, captive insurance company assumed this liability exposure, retroactive to the date of the Corporation's inception, with the same limits of liability. Effective January 1, 2002, the limits were increased to \$3,000,000 per occurrence and \$14,000,000 in the annual aggregate, with an inner aggregate of \$1,000,000. Effective January 1, 2003, the limits were changed to \$5,000,000 per occurrence with no annual aggregate.

The Corporation provides claims-management services to the captive insurance company. Losses from asserted claims and unasserted potentially compensable events identified under the Corporation's incident reporting system are accrued based on estimates that incorporate the Corporation's past experience, as well as other considerations. These include the nature of each claim or incident and various relevant trend factors. An additional amount is accrued for potential incurred but not reported claims.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 7. Insurance Programs (continued)

The captive insurance company also provides professional liability coverage with limits of \$1,000,000 per occurrence and \$3,000,000 in the annual aggregate for certain of the Corporation's employed physicians. All other employed physicians are insured for professional liability under policies with commercial insurance companies with coverage limits of either \$1,000,000 or \$2,000,000 per occurrence and corresponding annual aggregates of either \$3,000,000 or \$4,000,000, respectively.

The captive insurance company assets are included in assets limited as to use in the balance sheet. The combined fund activity is as follows:

	<b>June 30</b>	
	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Balance at beginning of year	<b>\$ 19,296</b>	\$ 12,344
Deposits	<b>900</b>	11,878
Investment income	<b>1,521</b>	555
Claims and expenses paid	<b>(5,182)</b>	(5,481)
Balance at end of year	<b>\$ 16,535</b>	\$ 19,296

In 2003 and 2002, the captive insurance company provided umbrella excess liability coverage to the Corporation for general and professional liability exposures, providing coverage limits totaling \$10,000,000 and \$25,000,000, respectively. This coverage is 100% reinsured through other commercial insurance companies.

As of June 30, 2003 and 2002, the Corporation had unfunded professional insurance liabilities of \$8,357,000 and \$1,825,000, respectively. Subsequently, on August 14, 2003, the Corporation provided cash funding in the amount of \$3,000,000 to the captive insurance company.

#### 8. Employee Annuities

The Corporation maintains certain employee annuity contributions invested with an insurance company. The Corporation does not bear the risk of loss for these investments. The amount of the employee annuity investment was \$1,778,000 and \$2,708,000 at June 30, 2003 and 2002, respectively.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **9. Pension and Postretirement Benefits**

The Corporation has a noncontributory defined benefit pension plan (the Plan) covering substantially all employees. For employees not covered under collective bargaining agreements and employees who are represented by Local No. 63, the Plan operates as a cash balance plan. The annual contribution by the Corporation is allocated to individual employee accounts based on years of service and the individual's retirement account. For employees represented by the PSNA union, benefits are based on years of service and compensation.

The Corporation's funding policy is to contribute such actuarially determined amounts as necessary to provide assets sufficient to meet the benefits to be paid to the Plan members and to meet the funding requirements of the Employees Retirement Income Security Act (ERISA). On September 15, 2003 and September 15, 2004, the Corporation will be required to fund \$2,556,000 and \$15,769,000, respectively, to the Plan. Under ERISA regulations, the Corporation may have the ability to defer a portion of the required funding to subsequent years based on the funding waiver application process. As of June 30, 2003 and 2002, the Plan had unfunded accumulated benefit obligations and therefore, during the years ended June 30, 2003 and 2002, recorded increases to additional minimum pension liabilities as direct changes to net assets of \$14,410,000 and \$16,596,000, respectively (see Note 2).

The Corporation also sponsors two defined benefit postretirement plans that cover both salaried and non-salaried employees. One plan provides health care benefits and the other provides life insurance benefits. The postretirement health care plan is provided to employees who have retired and certain other employees who were eligible to retire prior to July 1, 1995. The plan is contributory, with retiree contributions adjusted annually. The life insurance plan is noncontributory and is provided to employees who retired prior to July 1, 2001, and are not covered under collective bargaining agreements or represented by the Local No. 63 union. The plan is also provided to employees who retired prior to July 1, 1999, and are represented by the PSNA union. The Corporation's policy has been to fund its share of these benefits as they are incurred.

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Pension and Postretirement Benefits (continued)**

	Pension Benefits		Postretirement Benefits	
	2003	2002	2003	2002
	<i>(In Thousands)</i>			
<b>Change in benefit obligation</b>				
Benefit obligation at beginning of year	\$ 84,320	\$ 69,165	\$ 6,302	\$ 6,007
Service cost	3,002	3,207	–	–
Interest cost	5,985	5,392	513	496
Plan participants contribution	–	–	389	348
Actuarial loss	10,987	10,108	742	882
Benefits paid	(3,750)	(3,552)	(1,151)	(1,432)
Benefit obligation at end of year	<b>\$ 100,544</b>	<b>\$ 84,320</b>	<b>\$ 6,795</b>	<b>\$ 6,301</b>

	Pension Benefits		Postretirement Benefits	
	2003	2002	2003	2002
	<i>(In Thousands)</i>			
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	\$ 56,016	\$ 65,747	\$ –	\$ –
Actual return on plan assets	2,138	(6,180)	–	–
Employer contribution	3,100	–	762	1,084
Plan participants contributions	–	–	389	348
Benefits paid	(3,750)	(3,551)	(1,151)	(1,432)
Fair value of plan assets at end of year	<b>\$ 57,504</b>	<b>\$ 56,016</b>	<b>\$ –</b>	<b>\$ –</b>

	Pension Benefits		Postretirement Benefits	
	2003	2002	2003	2002
	<i>(In Thousands)</i>			
Funded status	\$ (43,040)	\$ (28,304)	\$ (6,795)	\$ (6,301)
Unrecognized actuarial loss	38,931	24,158	2,756	463
Unrecognized prior service cost	(782)	(1,054)	(1,591)	–
Unrecognized obligation	–	–	2,770	3,022
Accrued benefit cost	(4,891)	(5,200)	(2,860)	(2,816)
Additional minimum pension liability	(31,007)	(16,596)	–	–
	<b>(35,898)</b>	<b>(21,796)</b>	<b>(2,860)</b>	<b>(2,816)</b>
Additional accrual	–	(333)	(759)	(99)
Total accrued employee benefit liabilities	<b>\$ (35,898)</b>	<b>\$ (22,129)</b>	<b>\$ (3,619)</b>	<b>\$ (2,915)</b>



Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Pension and Postretirement Benefits (continued)**

The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets in excess (deficit) of projected accumulated obligations for the pension plan were as follows:

	<b>June 30</b>	
	<b>2003</b>	<b>2002</b>
	<i>(In Thousands)</i>	
Projected benefit obligation	<b>\$ 100,544</b>	\$ 84,321
Accumulated benefit obligation	<b>93,401</b>	69,550
Fair value of plan assets in excess (deficit) of projected accumulated obligations	<b>(43,040)</b>	(28,304)

For measurement purposes related to postretirement benefits, a 3.00% annual rate of increase in the per capita cost of covered health care benefits was assumed. The health care trend rate assumption has a significant effect on the amounts reported. For example, changing the assumed health care cost trend rates by one percentage point will have the following effects:

	<b>1-Percentage- Point Increase</b>	<b>1-Percentage- Point Decrease</b>
	<i>(In Thousands)</i>	
Effect on interest cost component	\$ 36	\$ (33)
Effect on postretirement benefit obligation	529	(473)

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 10. Commitments and Contingencies

##### Operating Leases

The Corporation leases the land and buildings used by PGHC, LRH, BHC, and GSSHNC from Prince George's County under a lease agreement. In connection with the Series 1992 Bond Issue, the lease was restated and amended to provide for the use of the related facilities through June 30, 2042, for a one-time, lump sum payment of \$13,352,000 and future annual rental payments of \$1 for the remaining term of the lease. The lump sum payment, made on June 17, 1992, was allocated to the related buildings \$(8,958,000) and to reduce the deferred rent liability recorded by the Corporation at the time of the restatement and amendment \$(4,394,000). The amount allocated to the buildings is being amortized over the lesser of the useful life of the assets or the remaining lease term.

Upon termination of the lease, the Corporation is obligated to deliver to the County all of the assets attributable to the operations, as defined, including all fixed and moveable equipment. All such assets will be transferred and conveyed in "as is" condition without warrant as to condition or serviceability.

The Corporation also leases various equipment and computer services under long-term operating lease agreements. Total rental expense for noncancelable operating leases approximated \$6,553,000 and \$7,111,000 for the years ended June 30, 2003 and 2002, respectively.

The following is a schedule of future minimum lease payments under operating leases as of June 30, 2003, that have initial or remaining lease terms in excess of one year.

	<u>Amount</u>
	<i>(In Thousands)</i>
Year ending June 30:	
2003	\$ 853
2004	926
2005	1,004
2006	—
2007 and thereafter	—

Dimensions Health Corporation and Subsidiaries  
Notes to Consolidated Financial Statements (continued)

**10. Commitments and Contingencies (continued)**

**Operating Leases (continued)**

The Corporation entered into agreements with outside vendors to outsource the management information services (MIS) function and maintenance, and provision of software services. The annual payments are expected to be as follows:

	<u>Amount</u> <i>(In Thousands)</i>
Year ending June 30:	
2004	\$ 5,988
2005	6,399
2006	6,851
2007 and thereafter	—

**Professional Liability and Litigation**

The Corporation is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against the Corporation. For such claims, management has accrued a reserve for potential liability in the amount of \$23,216,000. There is at least a reasonable possibility that some of these cases will be settled against the Corporation, resulting in varying degrees of monetary damages in excess of the recorded reserve. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Corporation's future financial position or results of operations. The Corporation incurred professional liability expenses of \$14,111,000 and \$22,265,000 for the years ended June 30, 2003 and 2002, respectively.

**Other**

Letters of credit in the amount of \$1,274,000 and \$2,000,000 expiring September 30, 2003 are maintained in support of various insurance arrangements and require the payment of an annual commitment fee of 0.50% and 0.75%, respectively. The Corporation has pledged \$3,274,000 as cash collateral for these letters of credit. The cash pledged is classified within restricted cash in the consolidated balance sheets. The September 30, 2003 letters of credit were renewed in amounts of \$1,352,000 through September 30, 2005 and \$2,500,000 through September 30, 2004, respectively.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **10. Commitments and Contingencies (continued)**

##### **Other (continued)**

The Corporation is self-insured against workers compensation claims up to \$300,000 per claim and an annual aggregate amount of \$2,000,000. The Corporation maintains a commercial insurance policy for claims liability exceeding these limits. A liability of \$1,776,000 and \$2,014,000, as of June 30, 2003 and 2002, respectively, has been established for known claims and an estimate for claims incurred but not reported.

#### **11. Maryland Health Services Cost Review Commission**

Certain of the Corporation's charges to patients are subject to review and approval by the Maryland Health Services Cost Review Commission. Management has filed the required forms with the Commission and believes the Corporation to be in compliance with Commission requirements.

The current rate of reimbursement for principally all inpatient services and certain other services to patients under the Medicare and Medicaid programs is based on an agreement between the Health Care Financing Administration and the Commission. This agreement is based upon a waiver from Medicare prospective payment system reimbursement principles granted to the State of Maryland under Section 1814(b) of the Social Security Act and will continue as long as Medicare and Medicaid do not pay rates any higher than those offered to other third-party payors and the rate of increase for costs per hospital inpatient admission in Maryland is below the national average. Management expects this agreement will remain in effect at least through June 30, 2004.

Effective April 1, 1999, the Corporation adopted, and PGHC and LRH agreed to, a rate methodology for hospital inpatient services. Under this methodology, a target average charge per case is established for PGHC and for LRH based on past actual charges, inflation, and case mix indices. The average charge per case for the applicable facility is compared with the target average charge per case for the applicable facility and, to the extent that the actual average exceeds the target, the overcharge plus applicable penalties will reduce the approved target for the subsequent rate year. To the extent that the actual average is short of the target, the undercharge will increase the approved target for the subsequent rate year. At June 30, 2003, PGHC and LRH were in compliance, defined as within 1%, with their average charge per case targets.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 11. Maryland Health Services Cost Review Commission (continued)

The Commission's rate-setting methodology for service centers that provide both inpatient and outpatient services or only outpatient services consists of establishing an acceptable unit rate for these centers within the applicable facility. The actual average unit charge for each service center is compared to the approved rate on a monthly basis. The rate variances, plus penalties where applicable, are applied to decrease (in the case of overcharges) or increase (in the case of undercharges) future approved rates on an annual basis.

The timing of the Commission's rate adjustments for the Corporation could result in an increase or reduction due to the variances and penalties described above in a year subsequent to the year in which such items occur. The Corporation's policy is to accrue revenue based on actual charges for services to patients in the year in which the services are performed and billed.

The Commission has implemented a methodology substantially the same as that described above for the fiscal year beginning July 1, 2003. While technical improvements are continually studied, this methodology will continue to serve as the core of the regulatory system for the fiscal year 2004.

#### 12. Related-Party Transaction

The Corporation accounts for its 50% interest in Bowie Assisted Living, LLC (BAL) under the equity method of accounting. A summary of the Corporation's joint venture investment in BAL for the years ended June 30, 2003 and 2002, are as follows:

	<i>(In Thousands)</i>
Investment at June 30, 2001	\$ 309
Capital distributions	(51)
Equity in net loss	(36)
Investment at June 30, 2002	<u>222</u>
Equity in net loss	<u>(136)</u>
Investment at June 30, 2003	<u><u>\$ 86</u></u>

The Corporation has recorded its investment within other noncurrent assets in the consolidated balance sheet.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 12. Related-Party Transaction (continued)

The following is a summary of BAL's financial position at June 30, 2003 and 2002, and the results of operations for the period ended June 30, 2003 and 2002:

	2003	2002
	<i>(In Thousands)</i>	
<b>Financial position</b>		
Total assets	\$ 9,063	\$ 9,296
Total liabilities	8,958	8,918
Net assets	105	378
<b>Results of operations</b>		
Revenue	\$ 2,828	\$ 3,016
Net loss	(272)	(72)

On June 28, 2001, the Corporation loaned Bowie Assisted Living (BAL), LLC \$2,000,000 in the form of a subordinated promissory note. Periodic interest payments are made at a variable interest rate based on the weekly remarketing rate for the BAL bonds. At June 30, 2003, this rate was 2.3%. Interest payments, payable monthly in arrears, began on August 1, 2002, and principal payments begin on September 30, 2004. The principal payments will be due on the last day of each calendar quarter. The remaining balance plus interest will be payable on July 30, 2006.

On April 25, 2003, the Corporation loaned Bowie Center Limited Partnership (BCLP) \$819,000 in the form of a commercial promissory note. Periodic interest payments are made at a variable interest rate based on the floating 180-day LIBOR rate plus 2.75%. At June 30, 2003, this rate was 3.99%. Interest payments commenced on May 1, 2003. The principal balance, together with all interest accrued and unpaid thereon, shall be due and payable in full on the earlier of March 31, 2008, or the sale, lease, transfer, or disposition of all or substantially all of the Borrower's assets, or the merger or consolidation of the Borrower with any other entity. The Corporation holds a 25% partnership interest in BCLP and accounts for it under the equity method.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### 13. Restructuring Charge

On June 6, 2002, the Corporation announced a reduction in force. As part of this restructuring, 15 employees were terminated. A one-time operating charge of approximately \$193,000 was recorded as of June 30, 2002, to account for severance and other costs associated with this restructuring, and is included within salaries and benefits expense on the statement of operations and changes in net assets. The following table summarizes the activity related to the liability for restructuring costs as of June 30, 2002:

	<b>Employee Separation Benefits</b> <i>(In Thousands)</i>
Balance as of June 30, 2002	\$ 193
Cash payments	(195)
Adjustments	2
Balance as of June 30, 2003	\$ –

#### 14. Going Concern and Subsequent Events (dated as of March 2, 2004)

Subsequent to June 30, 2003, the Corporation entered into litigation with Parkside Senior Services (PSS). PSS and the Corporation each hold a 50% interest in the BAL, LLC partnership. The outcome of the litigation may include the Corporation's future assumption and consolidation of 100% interest in the BAL, LLC partnership.

On February 13, 2004, the Corporation and PSS reached a settlement. Under the terms of the settlement, PSS will execute documents transferring its interest in BAL to the Corporation or its designee upon receiving a cash payment in the amount of \$125,000. Upon the sale of the facility, PSS will be entitled to 50% of any proceeds of such sale in excess of \$8,700,000 up to a maximum of \$9,650,000 after which all proceeds go to the Corporation and its subsidiaries.

As part of the settlement, all law suits have been stayed or withdrawn. The necessary legal documents will be prepared and executed as soon as practicable. A sale of the BAL facility will be pursued by the Corporation upon its receipt of executed legal documents supporting the transfer of PSS's ownership interest to the Corporation or its designee.

In January 2003, the State of Maryland approved a restricted operating grant (SB-899) in the amount of \$2,000,000 to be paid to PGHC to support the cost of providing continued

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **14. Going Concern and Subsequent Events (dated as of March 2, 2004) (continued)**

health services to state and county residents. The Corporation received \$1,000,000 of the grant on June 27, 2003. On July 1, 2003, the restrictions were satisfied and the \$1,000,000 operating grant will be recorded as revenue for the fiscal year ending June 30, 2004. The remaining \$1,000,000 operating grant was received on July 22, 2003 and will be included as revenue in the fiscal year ending June 30, 2004.

On October 23, 2003, the Prince George's County Government announced a five-year operating grant commitment, of \$5,000,000 per year, to be paid to PGHC to support the cost of providing uncompensated health care services to county residents. The County also announced that in fiscal year 2004, an additional \$5,000,000 would be provided from the proceeds of the County's sale of surplus land. Each annual commitment is subject to annual budget appropriation by the County. On October 28, 2003, the County adopted council resolution 75-2003, approving the initial unrestricted operating cash grant in the amount of \$5,000,000 to be paid in fiscal year 2004. These grants have been incorporated into the Memorandum of Understanding discussed below.

The Corporation has experienced operating losses and decreases in net assets each year for the past five fiscal years. At June 30, 2003, the Corporation has a deficit in net assets, significant unfunded pension obligations and limited cash resources. The Corporation has become increasingly reliant upon government and other grant funding to finance continuing operations. Management and the Board of Directors determined that as a result of these issues, additional financial resources were necessary to ensure the Corporation's continued financial stability. These circumstances raise substantial doubt about the ability of the Corporation to continue as a going concern. Management's plans to address this situation are as follows:

On February 20, 2004, the Corporation, the Prince George's County Executive (the County), and the Governor of the State of Maryland (the State) signed a Memorandum of Understanding to provide the following support to the Corporation:

- An Oversight Committee, comprised of 5 voting and 1 ex-officio members has been established to provide ongoing advice and consultation regarding the development and implementation of a Financial Action Plan and a Recovery Restructuring Plan. These plans will be developed and implemented to improve the long-term financial stability of the Corporation. The members of the Oversight Committee are appointed by the Prince George's County Executive and the Governor of the State of Maryland.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **14. Going Concerns and Subsequent Events (dated as of March 2, 2004) (continued)**

- The Corporation will engage a management consultant who will advise the County, the State, the Oversight Committee, and the Corporation on appropriate short and long-term approaches to managing and financing the Prince George's County health care delivery system. The Corporation will be responsible for paying the fees and expenses associated with the management consultant not to exceed \$2,000,000.
- In October 2003, the County has appropriated a cash operating grant in the amount of \$5,000,000 to the Corporation for fiscal 2004. The Corporation will receive this amount in March 2004.
- In October 2003, the County has also committed to contribute the proceeds from the sale of certain surplus property with a market value of at least \$5,000,000 to the Corporation. These funds are expected to be made available to the Corporation before June 30, 2004.
- In October 2003, the County has further pledged additional cash operating grants to the Corporation in the amount of \$5,000,000 each for the fiscal years ending June 30, 2005, 2006, 2007, and 2008. These grants are subject to approval by the Prince George's County Council through the County's annual budget approval process.
- The Maryland Health Services Cost Review Commission (HSCRC) approved an emergency rate increase on regulated services for the Corporation of 3.2% effective February 13, 2004. This rate increase, which expires on February 13, 2005, is anticipated to generate an additional \$7,200,000 in net revenue during the period February 13, 2004 through February 13, 2005. The HSCRC has also approved an additional \$2,800,000 of direct funding through its Uncompensated Care Pool Program.
- The Governor of the State of Maryland has pledged to support during the 2004 legislative session, an appropriation of \$5,000,000 in state bond funding for the benefit of the Corporation's capital needs. The availability of these funds is subject to the State's legislative approval of the bond funding as well as the successful grant application by the County and subsequent review by the Maryland Board of Public Works in order to provide the funding to the Corporation.

## Dimensions Health Corporation and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

#### **14. Going Concern and Subsequent Events (dated as of March 2, 2004) (continued)**

The Corporation has identified certain properties that it currently owns that are not strategic to its operations and is in the process of selling these assets. Management estimates that the proceeds from the sales of these assets will generate an additional \$4,000,000 in cash and will be completed in the 2004 calendar year.

The successful completion of the actions needed to secure the funding described above is contingent upon the continued support and cooperation of the Prince George's County Government, the State of Maryland, and Management of the Corporation. On March 2, 2004, the County Council of Prince George's County, Maryland (Council) passed a resolution stating that absent satisfactory responses to certain concerns raised by the source and use of funding from the County, that the Council does not intend to authorize further appropriations for the Corporation. Management believes, but can provide no assurances that these conditions will be satisfied and that the additional funding will be secured. Management further believes that this additional funding combined with cash flow from operations will provide resources sufficient to meet the obligations of the Corporation and therefore continue as a going concern. If the funding committed in the Memorandum of Understanding is not provided or if the Corporation's operating results are less favorable than expected, then the Corporation's health-care operations may not be sustained in its current form.

# Other Financial Information

## Report of Independent Auditors

Board of Directors  
Dimensions Health Corporation

We have audited, in accordance with auditing standards generally accepted within the United States, the consolidated financial statements of Dimensions Health Corporation for the years ended June 30, 2003 and 2002 presented herein and have issued our unqualified opinion thereon dated August 29, 2003 (except for Note 14, as to which the date is March 2, 2004). Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The accompanying consolidating balance sheet and statement of operations for the year ended June 30, 2002, are presented for purposes of additional analysis and are not a required part of the consolidated financial statements. Such information has been subjected to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

*Ernst & Young LLP*

August 29, 2003, except for Note 14,  
as to which the date is March 2, 2004

Dimensions Health Corporation and Subsidiaries

Consolidating Balance Sheets—Obligated Group

June 30, 2003

	PGHC	LRH	GSSNHC	BHC	Corporate	Total Obligated Group	Other Entities	Eliminations	Consolidated Total
	<i>(In Thousands)</i>								
<b>Assets</b>									
Current assets:									
Cash and cash equivalents	\$ —	\$ —	\$ 1	\$ —	\$ 1,072	\$ 1,073	\$ 427	\$ —	\$ 1,500
Assets limited as to use	—	—	—	—	4,103	4,103	—	—	4,103
Restricted cash	—	—	—	—	3,274	3,274	—	—	3,274
Patient accounts receivable, net of allowance	31,871	16,906	4,144	3,412	—	56,333	5,844	—	62,177
Inventories	2,051	1,552	61	349	—	4,013	—	—	4,013
Prepaid expenses and other assets	419	29	13	26	3,546	4,033	4,131	—	8,164
Total current assets	34,341	18,487	4,219	3,787	11,995	72,829	10,402	—	83,231
Investments held for strategic and capital projects	—	—	—	—	4,403	4,403	—	—	4,403
Due from affiliates	—	—	14,377	7,967	79,832	102,176	—	(102,176)	—
Assets limited as to use:									
Held in trust under bond and note indentures	—	—	—	—	7,644	7,644	—	—	7,644
Restricted investments—strategic	—	—	—	—	1,100	1,100	655	—	1,755
Investments held for self insurance	—	—	—	—	—	—	16,535	—	16,535
Total assets limited as to use	—	—	—	—	8,744	8,744	17,190	—	25,934
Property and equipment, net	33,077	19,247	1,614	3,560	4,083	61,581	6,744	—	68,325
Intangible assets, net	—	—	—	—	903	903	—	—	903
Notes receivable from related party	—	—	—	—	2,819	2,819	—	—	2,819
Other noncurrent assets	1,372	—	—	—	—	1,372	896	—	2,268
Deferred financing costs	—	—	—	—	662	662	92	—	754
Total assets	\$ 68,790	\$ 37,734	\$ 20,210	\$ 15,314	\$ 113,441	\$ 255,489	\$ 35,324	\$ (102,176)	\$ 188,637

## Dimensions Health Corporation and Subsidiaries

### Consolidating Balance Sheets—Obligated Group (continued)

	PGHC	LRH	GSSNHC	BHC	Corporate	Total Obligated Group	Other Entities	Eliminations	Consolidated Total
	<i>(In Thousands)</i>								
<b>Liabilities and net assets</b>									
Current liabilities:									
Current portion of long-term debt	\$ 124	\$ —	\$ —	\$ —	\$ 2,790	\$ 2,914	\$ 59	\$ —	\$ 2,973
Current portion of accrued benefit liabilities	—	—	—	—	373	373	—	—	373
Accounts payable and accrued expenses	10,028	3,866	998	939	11,529	27,360	5,240	—	32,600
Advances from third party payors	10,897	1,803	708	—	—	13,408	—	—	13,408
Accrued annual leave	3,512	1,468	290	222	559	6,051	713	—	6,764
Specific purpose funds	561	168	—	—	—	729	—	—	729
Total current liabilities	25,122	7,305	1,996	1,161	15,251	50,835	6,012	—	56,847
Long-term debt, net of current portion	283	—	—	—	79,430	79,713	4,306	—	84,019
Due to affiliates	57,535	19,449	—	—	—	76,984	25,192	(102,176)	—
Other liabilities:									
Accrued professional liability costs	—	—	—	—	—	—	23,216	—	23,216
Accrued employee benefit liabilities	—	—	—	—	39,144	39,144	—	—	39,144
Total other liabilities	—	—	—	—	39,144	39,144	23,216	—	62,360
Net assets (deficit)	(14,150)	10,980	18,214	14,153	(20,384)	8,813	(23,402)	—	(14,589)
Total liabilities and net assets	\$ 68,790	\$ 37,734	\$ 20,210	\$ 15,314	\$ 113,441	\$ 255,489	\$ 35,324	\$ (102,176)	\$ 188,637

Dimensions Health Corporation and Subsidiaries  
Consolidating Statement of Operations—Obligated Group

For the year ended June 30, 2003

	PGHC	LRH	GSSHNC	BHC	Corporate	Total Obligated Group	Other Entities	Total
	<i>(In Thousands)</i>							
Unrestricted revenue and other support:								
Net patient service revenue	\$ 185,164	\$ 71,124	\$ 16,483	\$ 14,717	\$ —	\$ 287,488	\$ 12,872	\$ 300,360
Other income	7,187	639	83	39	433	8,381	2,309	10,690
Investment income	—	—	—	—	—	—	904	904
Other	—	—	—	—	—	—	—	—
Total unrestricted revenue and other support	192,351	71,763	16,566	14,756	433	295,869	16,085	311,954
Operating expenses:								
Salaries and benefits	92,099	38,567	8,817	3,959	—	143,442	10,453	153,895
Supplies	29,491	9,727	2,417	1,565	—	43,200	184	43,384
Purchased services	37,719	12,906	2,293	2,586	85	55,589	(3,199)	52,390
Bad debt expenses	23,957	6,732	938	2,934	—	34,561	6,833	41,394
Physician fees	4,301	2,109	112	1,373	—	7,895	948	8,843
Utilities	2,094	999	237	140	—	3,470	25	3,495
Total operating expenses	189,661	71,040	14,814	12,557	85	288,157	15,244	303,401
Operating earnings before interest depreciation, and amortization	2,690	723	1,752	2,199	348	7,712	841	8,553
Investment income	(430)	(201)	(26)	(26)	—	(683)	(51)	(734)
Interest expense	2,600	1,524	145	232	—	4,501	756	5,257
Depreciation and amortization	5,608	2,990	367	596	35	9,596	304	9,900
Net interest, depreciation, and amortization	7,778	4,313	486	802	35	13,414	1,009	14,423
(Deficit) excess of unrestricted revenue and other support over expenses from continuing operations	(5,088)	(3,590)	1,266	1,397	313	(5,702)	(168)	(5,870)
Other changes in unrestricted net assets:								
Net change in appreciation of marketable investments	—	—	—	—	690	690	—	690
Additional minimum pension liability (Note 9)	—	—	—	—	(14,410)	(14,410)	—	(14,410)
Restricted grant	—	—	—	—	1,000	1,000	—	1,000
(Deficit) excess of unrestricted revenue and other support over expenses and gain (loss) from market investments and additional minimum pension liability	\$ (5,088)	\$ (3,590)	\$ 1,266	\$ 1,397	\$ (12,407)	\$ (18,422)	\$ (168)	\$ (18,590)