

DIMENSIONS HEALTH CORPORATION AND SUBSIDIARIES

Consolidated Financial Statements and Other Financial Information

For the years ended June 30, 2004 and 2003 with Report of Independent Auditors

Dimensions Health Corporation and Subsidiaries

Consolidated Financial Statements
and Other Financial Information

For the years ended June 30, 2004 and 2003

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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, 2004 and 2003, 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, 2004 and 2003, 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 2 to the financial statements, the Corporation's recurring deficit of unrestricted revenue and other support over expenses and investment income from operations and net asset deficiency raise substantial doubt about its ability to continue as a going concern. 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.

Ernst + Young LLP

September 9, 2004, except for Note 13,
as to which the date is October 7, 2004

Dimensions Health Corporation and Subsidiaries

Consolidated Balance Sheets

	June 30	
	2004	2003
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 3,739	\$ 1,500
Assets limited as to use	4,149	4,103
Restricted cash	4,352	3,274
Patient accounts receivable, net of allowance for uncollectible accounts (\$12,946 and \$15,909 in 2004 and 2003, respectively)	57,647	62,177
Inventories	4,108	4,013
BAL LLC—assets held for sale	7,717	—
Prepaid expenses and other assets	9,329	8,164
Total current assets	<u>91,041</u>	<u>83,231</u>
Investments held for strategic and capital projects	1,174	4,403
Assets limited as to use:		
Held in trust under bond and note indentures	7,779	7,644
Restricted investments	256	1,755
Investments held for self insurance	20,649	16,535
Total assets limited as to use	<u>28,684</u>	<u>25,934</u>
Property and equipment, net	64,303	68,325
Intangible assets, net	415	903
Notes receivable from related party	819	2,819
Other noncurrent assets	2,338	2,268
Deferred financing costs	646	754
Total assets	<u><u>\$ 189,420</u></u>	<u><u>\$ 188,637</u></u>

	June 30	
	2004	2003
	<i>(In Thousands)</i>	
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt	\$ 3,165	\$ 2,973
Current portion of accrued employee benefit liabilities	5,000	373
Accounts payable and accrued expenses	37,733	32,600
BAL LLC—liabilities held for sale	5,910	–
Advances from third-party payors	15,887	13,408
Accrued annual leave	7,135	6,764
Specific purpose funds	1,080	729
Total current liabilities	<u>75,910</u>	<u>56,847</u>
Long-term debt, net of current portion	80,895	84,019
Other liabilities:		
Accrued professional liabilities	23,673	23,216
Accrued employee benefit liabilities	26,497	39,144
Total other liabilities	<u>50,170</u>	<u>62,360</u>
Net (deficit) assets:		
Unrestricted	(17,555)	(15,589)
Restricted	–	1,000
	<u>(17,555)</u>	<u>(14,589)</u>
Total liabilities and net assets	<u><u>\$ 189,420</u></u>	<u><u>\$ 188,637</u></u>

See accompanying notes.

Dimensions Health Corporation and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

	Year ended June 30	
	2004	2003
	<i>(In Thousands)</i>	
Unrestricted revenue and other support:		
Net patient service revenue	\$ 308,563	\$ 300,360
Other income:		
Other	15,291	11,594
Total unrestricted revenue and other support	323,854	311,954
Operating expenses:		
Salaries and benefits	162,845	153,895
Supplies	45,566	43,384
Purchased services	49,190	52,390
Bad-debt expenses	42,747	41,394
Physician fees	9,598	8,843
Utilities	3,728	3,495
Total operating expenses	313,674	303,401
Operating earnings before interest, depreciation and amortization	10,180	8,553
Investment income	(504)	(734)
Interest expense	4,781	5,257
Depreciation and amortization	9,044	9,900
Net interest, depreciation and amortization	13,321	14,423
Deficit of unrestricted revenue and other support over expenses and investment income from continuing operations	(3,141)	(5,870)

Dimensions Health Corporation and Subsidiaries

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

	Year ended June 30	
	2004	2003
	<i>(In Thousands)</i>	
Deficit of unrestricted revenue and other support over expenses and investment income from continuing operations	\$ (3,141)	\$ (5,870)
Other changes in unrestricted net assets:		
Net change in appreciation of marketable investments	(751)	690
Minority interest in BAL, LLC	(324)	-
Change in minimum pension liability	2,250	(14,410)
Decrease in unrestricted net assets	<u>(1,966)</u>	<u>(19,590)</u>
Changes in restricted net assets:		
Restricted grant	<u>(1,000)</u>	1,000
Decrease in unrestricted and restricted net assets	<u>(2,966)</u>	<u>(18,590)</u>
Net (deficit) assets, beginning of year	<u>(14,589)</u>	4,001
Net (deficit) assets, end of year	<u><u>\$ (17,555)</u></u>	<u><u>\$ (14,589)</u></u>

See accompanying notes.

Dimensions Health Corporation and Subsidiaries

Consolidated Statements of Cash Flows

	Year ended June 30	
	2004	2003
	<i>(In Thousands)</i>	
Operating activities		
Change in net assets	\$ (2,966)	\$(18,590)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Bad-debt expense	42,747	41,394
Depreciation and amortization of property and equipment	9,044	9,900
Amortization of original issue discount and deferred financing costs	188	188
Amortization of intangible assets	488	487
Net unrealized gains on marketable investments	751	(690)
Losses on sale of assets on marketable investments	(209)	(341)
Restricted grant	1,000	(1,000)
(Decrease) increase in minimum pension liability	(2,250)	14,410
Other	34	(117)
Changes in operating assets and liabilities:		
(Increase) decrease:		
Accounts receivable, net	(38,217)	(38,925)
Inventories	(95)	(606)
Prepaid expenses and other assets	(1,165)	(875)
Other noncurrent assets	(91)	(20)
Increase (decrease):		
Accounts payable and accrued expenses	5,133	(6,336)
Accrued annual leave	371	(122)
Specific purpose funds	351	(155)
Accrued employee benefit liabilities	(5,770)	63
Accrued professional liabilities	457	2,764
Net cash provided by operating activities	9,801	1,429

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

	Year ended June 30	
	2004	2003
	<i>(In Thousands)</i>	
Investing activities		
Purchase of property and equipment	\$ (4,876)	\$ (4,524)
Proceeds from sale of assets	9	467
Issuance of note receivable	-	(838)
Payments on notes receivable	21	19
Net (purchases) sales of investments	(2,183)	3,203
Net cash used in investing activities	(7,029)	(1,673)
Financing activities		
Payments of long-term debt and capital lease obligations	(3,012)	(4,819)
Advances from third-party payors	2,479	2,690
Net cash used in financing activities	(533)	(2,129)
Increase (decrease) in cash and cash equivalents	2,239	(2,373)
Cash and cash equivalents at beginning of year	1,500	3,873
Cash and cash equivalents at end of year	\$ 3,739	\$ 1,500
Noncash transactions		
Acquisitions of property and equipment through capital leases	\$ -	\$ 15

See accompanying notes.

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2004 and 2003

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 100% interest in Bowie Assisted Living, LLC (BAL LLC), the owner and operator of Woodward Estates, an 80-unit assisted-living facility also located on the Bowie campus. Prior to June of 2004, the Corporation only held a 50% interest in BAL LLC. The Corporation committed to a plan to dispose of certain assets and liabilities of BAL LLC in the year ended June 30, 2004. Based on this decision, the corresponding assets and liabilities of BAL LLC have been classified as held for sale in the consolidated balance sheet at June 30, 2004.

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

1. Summary of Significant Accounting Policies (continued)

Organization (continued)

Health Care Supporting Subsidiaries and Affiliates: (continued)

- Dimensions Assurance, Ltd. (DAL), a wholly owned, for-profit captive insurance company located in the Cayman Islands.

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. Additionally, the Corporation's investment in BAL LLC was accounted for under the equity method through May 31, 2004 and consolidated thereafter. 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 commercial banks under custody agreements 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.

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

1. Summary of Significant Accounting Policies (continued)

Marketable Investments and Investment Income (continued)

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 consolidated balance sheets as current assets.

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 were 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.

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

1. Summary of Significant Accounting Policies (continued)

Accounts Receivable and Contractual Allowances (continued)

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.

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, 2004 and 2003, approximately 18.8% and 20.2% of patient accounts receivable were due from commercial and Medicaid HMOs, 11.0% and 13.0% from the Medicare program, 9.6% and 9.0% from the Medicaid program, 19.4% and 23.1% from self pay, and 41.2% and 34.3% 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 30 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.

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Deferred Financing Costs

Financing costs incurred in issuing the Prince George's County, Maryland Project & Refunding Revenue Bonds (Dimensions Health Corporation Issue), 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.

The following table summarizes the annual deferred financing costs:

	June 30	
	2004	2003
	<i>(In Thousands)</i>	
Series 1994 revenue bonds	\$ 891	\$ 891
Flex term notes	216	216
Other	226	226
Accumulated amortization	(687)	(579)
Total	\$ 646	\$ 754

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 \$2,901,000 and \$2,413,000 at June 30, 2004 and 2003, 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)

Assets and Liabilities Held for Sale

During fiscal year 2004, sustained losses and continued unfavorable occupancy levels caused the Corporation to commit to a plan to sell certain operating assets and liabilities of BAL LLC. As of June 30, 2004, the operating assets and liabilities had carrying amounts of \$7,717,000 and \$5,910,000, respectively. The sale was completed on October 7, 2004. As of June 30, 2004, the Corporation determined that the held of sale criteria as described in SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, had been met.

Accordingly, the Corporation has reviewed the carrying value of the assets and liabilities of BAL LLC held for sale and determined that the carrying amounts were less than the estimate of fair value less cost to sell; therefore, no impairment has been recorded. The carrying value of the assets and liabilities that are held for sale are separately presented as the “held for sale” caption in the consolidated balance sheets.

Net Patient Service Revenue

During 2004 and 2003, respectively, approximately 28.4% and 28.6% of the net patient service revenue was recorded under the Medicare Program; 25.9% and 25.0% under the state Medicaid Program; 17.2% and 18.7% under commercial and Medicaid HMOs; and 28.5% and 27.7% 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:

	<u>2004</u>	<u>2003</u>
	<i>(In Thousands)</i>	
Gross patient service revenue	\$ 345,450	\$ 336,558
Revenue deductions:		
Charity care	631	849
Contractual allowances	36,256	35,349
Net patient service revenue	<u>\$ 308,563</u>	<u>\$ 300,360</u>

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

1. Summary of Significant Accounting Policies (continued)

Net Patient Service Revenue (continued)

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 rental income, parking garage and vending machine income.

The following one-time operating grants were recorded in other income as of June 30, 2004 and 2003:

	2004	2003
	<i>(In Thousands)</i>	
Prince George's County Government	\$ 5,000	\$ 3,000
State of Maryland	2,000	–
Magruder Memorial Hospital Trust	2,000	2,042

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, once the associated restrictions were satisfied, and is included with the \$2,000,000 listed above.

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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. The accrued professional liabilities amounts included in the June 30, 2004 and 2003 consolidated balance sheets have not been discounted.

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.

Fair Value of Financial Instruments

The carrying amount reported in the consolidated 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. Management's Plans as to Continuing as a Going Concern

The Corporation has experienced operating losses and decreases in net assets each year for the past six fiscal years. At June 30, 2004, the Corporation had 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

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

2. Management's Plans as to Continuing as a Going Concern (continued)

continuing operations. These circumstances raise substantial doubt about the ability of the Corporation to continue as a going concern. 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. Management's plans to address this situation are described below.

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 ongoing support to the Corporation.

As part of this Memorandum of Understanding, the Corporation expects to receive other external sources of financing through grants from the State of Maryland and Prince George's County Government. Furthermore, the Corporation has engaged a management consultant to advise the Corporation on appropriate short- and long-term approaches to managing and financing the Corporation's health care delivery system.

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. 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 other external sources of funding are 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.

3. Investments

Marketable investments are included in the consolidated balance sheets in the captions investments held for strategic and capital projects (\$1,174,000 and \$4,403,000 at June 30, 2004 and 2003, respectively) and assets limited as to use, including restricted cash, (\$37,185,000 and \$33,311,000 at June 30, 2004 and 2003, 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 June 30 fair values are as follows:

	2004	2003
	<i>(In Thousands)</i>	
Cash and cash equivalents	\$ 13,365	\$ 10,491
Cash equivalent fixed maturities	2,998	186
Government and agency	10,612	16,120
Corporate bonds	7,062	7,133
Common stock	4,056	3,425
Asset-backed securities	3	71
Other	263	288
Total marketable investments	38,359	37,714
Less:		
Amount needed for current debt service	(4,149)	(4,103)
Restricted cash—current	(4,352)	(3,274)
Long-term investments	\$ 29,858	\$ 30,337

Gross unrealized gains at June 30, 2004 and 2003 were approximately \$136,000 and \$1,439,000, respectively. Gross unrealized losses at June 30, 2004 and 2003 were approximately \$(207,000) and \$(754,000), respectively.

4. Property and Equipment

A summary of property and equipment at June 30, 2004 and 2003 is as follows:

	2004	2003
	<i>(In Thousands)</i>	
Buildings and improvements	\$ 61,354	\$ 60,988
Leasehold improvements	30,452	29,485
Equipment	100,548	96,791
Equipment under capital lease obligation	539	523
	192,893	187,787
Less: accumulated depreciation and amortization	(129,447)	(120,650)
Construction in progress	857	1,188
Property and equipment, net	\$ 64,303	\$ 68,325

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

4. Property and Equipment (continued)

Accumulated amortization for equipment under capital leases was \$332,800 and \$196,000 at June 30, 2004 and 2003, respectively. The Corporation recognized amortization expense for assets under capital lease obligations of approximately \$137,000 and \$282,000 for the periods ended June 30, 2004 and 2003, respectively. These amounts are included in depreciation and amortization expense within the consolidated statements of operations and changes in net assets.

At June 30, 2004, the Corporation has outstanding construction contracts aggregating approximately \$151,716 for the remodeling and construction of certain facilities.

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, 2004 and 2003 are summarized as follows:

	2004	2003
	<i>(In Thousands)</i>	
Series 1994 Bonds:		
4.50%—Serial bonds payable July 1, 2003	\$ —	\$ 1,990
4.50%—5.35%—Serial bonds payable in periodic installments through 2008	11,530	11,530
5.38%—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
	76,610	78,600
Less: Original issue discount	(1,571)	(1,651)
Total bonds	75,039	76,949
Magruder Trust Mortgage, three-year adjustable rate (4.0% at June 30, 2004), repayable in periodic installments through 2025	4,274	4,365
Series 1996 Flexible Term Notes, variable rate (1.06% at June 30, 2004), repayable in periodic installments through 2007, net of sinking fund balance	2,158	2,821
Pooled Loan Program—Series D, Maryland Health and Higher Educational Facilities Authority (MHHEFA) variable rate (1.28% at June 30, 2004), repayable in periodic installments through 2016	2,310	2,450
BAL LLC—liability held for sale—Series 1997 demand bonds, variable rate (1.40% at June 30, 2004), repayable in periodic installments through 2023	5,910	—
Capital lease obligations, payable in monthly installments through 2006 collateralized by leased equipment	279	407
	89,970	86,992
Current portion of long-term debt, capital lease obligations and liabilities held for sale	(9,075)	(2,973)
Long-term debt	\$ 80,895	\$ 84,019

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

5. Long-Term Debt (continued)

Scheduled principal repayments on long-term debt (excluding debt of BAL LLC of \$5,910,000, which is classified as held for sale) and capital leases are as follows:

	Long-Term Debt	Obligations Under Capital Leases
<i>(In Thousands)</i>		
Year ending:		
2005	\$ 3,014	\$ 151
2006	3,438	128
2007	3,659	–
2008	3,307	–
2009 and thereafter	71,934	–
	\$ 85,352	\$ 279

The 1994 Bonds, the Series 1996 Flexible Term notes and the MHHEFA note 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 MHHEFA note 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, 2004, the Corporation was in compliance with this covenant. Management believes, but can provide no assurance, that it will be in compliance at the next annual measurement date of June 30, 2005. The maximum annual debt service is currently estimated to be \$7,182,000 for the year ending June 30, 2005.

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, 2005, 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 \$2,460,365 supporting the Series 1996 Flexible Term Notes, which expires on January 26, 2006. 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 \$2,434,226 that supports the outstanding borrowings under the MHHEFA Pooled Loan program, which expires on July 15, 2006. 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, 2004 and 2003, net of interest income, were \$4,277,000 and \$4,522,000, respectively.

The assets held in trust under the Series 1994 Bonds as of June 30, 2004 and 2003 are as follows:

	June 30	
	2004	2003
	<i>(In Thousands)</i>	
Construction fund	\$ 4	\$ 4
Interest reserve fund (Series 1996 Flexible Term Notes)	35	50
Debt-service reserve fund	7,652	7,614
Debt-service fund	4,128	4,079
Total trust fund investments	\$ 11,819	\$ 11,747

The fair value of the Corporation's Series 1994 Bond indentures, based on the quoted market prices at June 30, 2004 and 2003, was \$61,390,000 and \$53,702,000, respectively. The fair value of all other outstanding debt approximates its carrying value.

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, 2004 and 2003 are as follows:

	2004	2003
	<i>(In Thousands)</i>	
Health care services	\$ 302,831	\$ 301,352
Management & general	24,668	17,206
	\$ 327,499	\$ 318,558

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. As of June 30, 2004 and 2003, the limits were \$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 actuarial 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 \$1,000,000 and \$3,000,000 in the annual aggregate.

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

	June 30	
	2004	2003
	<i>(In Thousands)</i>	
Balance at beginning of year	\$ 16,535	\$ 19,296
Deposits	9,400	900
Investment income	562	1,521
Claims and expenses paid	(5,848)	(5,182)
Balance at end of year	\$ 20,649	\$ 16,535

In calendar years 2004 and 2003, the captive insurance company provided umbrella excess liability coverage to the Corporation for general and professional liability exposures, with coverage limits totaling \$15,000,000 and \$10,000,000, respectively. This coverage is 100% reinsured through other commercial insurance companies.

As of June 30, 2004 and 2003, the Corporation had payables to the captive insurance company of \$4,193,000 and \$8,357,000, respectively.

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 \$1,864,000 and \$1,778,000 at June 30, 2004 and 2003, 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 the District 1199E-DC, SEIU (District 1199) union, 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 Professional Staff Nurses Association (PSNA) union, benefits are based on years of service and average, final 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). By September 15, 2004, the Corporation will be required to have funded \$15,769,000. Additional funding of \$12,237,000 is due by September 15, 2005 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. On March 15, 2004, the Corporation submitted an application to the Internal Revenue Service (IRS) requesting a waiver of the minimum funding requirements due September 15, 2004. Subsequently, on September 9, 2004, the Corporation completed the required funding, and the application was withdrawn. As of June 30, 2004 and 2003, the Plan had unfunded accumulated benefit obligations and, therefore, recorded (decreases) increases to additional minimum pension liabilities as direct charges to net assets of \$(2,250,000) and \$14,410,000, respectively. The Corporation also sponsors two defined postretirement benefit 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 District 1199 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	
	2004	2003	2004	2003
	<i>(In Thousands)</i>			
Change in benefit obligation				
Benefit obligation at beginning of year	\$ 100,544	\$ 84,320	\$ 6,795	\$ 6,302
Service cost	3,759	3,002	–	–
Interest cost	6,413	5,985	421	513
Plan participants contribution	–	–	402	389
Actuarial (gain) loss	458	10,987	(296)	742
Benefits paid	(3,772)	(3,750)	(1,152)	(1,151)
Benefit obligation at end of year	\$ 107,402	\$ 100,544	\$ 6,170	\$ 6,795

	Pension Benefits		Postretirement Benefits	
	2004	2003	2004	2003
	<i>(In Thousands)</i>			
Change in plan assets				
Fair value of plan assets at beginning of year	\$ 57,504	\$ 56,016	\$ –	\$ –
Actual return on plan assets	5,714	2,138	–	–
Employer contribution	11,200	3,100	749	762
Plan participants contributions	–	–	402	389
Benefits paid	(3,772)	(3,750)	(1,151)	(1,151)
Fair value of plan assets at end of year	\$ 70,646	\$ 57,504	\$ –	\$ –

	Pension Benefits		Postretirement Benefits	
	2004	2003	2004	2003
	<i>(In Thousands)</i>			
Funded status	\$ (36,756)	\$ (43,040)	\$ (6,170)	\$ (6,795)
Unrecognized actuarial loss	37,322	38,931	2,311	2,756
Unrecognized prior service cost	(510)	(782)	(1,456)	(1,591)
Unrecognized obligation	–	–	2,518	2,770
Accrued benefit cost	56	(4,891)	(2,797)	(2,860)
Additional minimum pension liability	(28,756)	(31,007)	–	–
	(28,700)	(35,898)	(2,797)	(2,860)
Additional accrual	–	–	–	(759)
Total accrued employee benefit liabilities	\$ (28,700)	\$ (35,898)	\$ (2,797)	\$ (3,619)

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Pension and Postretirement Benefits (continued)

The unrecognized obligation for the postretirement benefits represents the remaining unamortized transition obligation.

Significant assumptions used in the accounting for the benefit plans on the measurement dates are as follows. For measurement purposes, certain rate assumptions are adjusted based upon periodic changes in market indicators:

	Pension Benefits		Postretirement Benefits	
	2004	2003	2004	2003
Weighted-average assumptions				
Discount rate	6.5%	6.5%	6.5%	6.5%
Expected return on plan assets	9.0%	9.0%	–	–
Rate of compensation increase	3.0%	3.0%	–	–
Health care trend rate	–	–	3.0%	3.0%

The overall rate of expected return on assets assumption was based on historical returns, with adjustments made to reflect expectations of future returns. The extent to which the future expectations were recognized included the target rates of return for the future which has historically not changed.

	Pension Benefits		Postretirement Benefits	
	2004	2003	2004	2003
	<i>(In Thousands)</i>			

Components of net periodic benefit cost

Service cost	\$ 3,759	\$ 3,002	\$ –	\$ –
Interest cost	6,413	5,984	421	513
Expected return on plan assets	(5,816)	(6,160)	–	–
Amortization of prior service cost	(271)	(272)	(135)	(135)
Amortization of net actuarial loss (gain)	2,169	236	–	–
Recognized actuarial loss	–	–	150	176
Amortization of transition obligation	–	–	252	252
Net periodic benefit cost	\$ 6,254	\$ 2,790	\$ 688	\$ 806

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 projected accumulated obligations in excess of fair value of plan assets for the pension plan were as follows:

	June 30	
	2004	2003
	<i>(In Thousands)</i>	
Projected benefit obligation	\$ 107,402	\$ 100,544
Accumulated benefit obligation	99,346	93,401
Projected accumulated obligations in excess of fair value of plan assets	(36,756)	(43,040)
(Decrease) increase in minimum liability included in net assets	(2,250)	14,410

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:

	One Percentage- Point Increase	One Percentage- Point Decrease
	<i>(In Thousands)</i>	
Effect on interest cost component	\$ 28	\$ (26)
Effect on postretirement benefit obligation	460	(413)

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Pension and Postretirement Benefits (continued)

Plan Assets

Dimensions Heath Corporation Pension Plan weighted-average asset allocations at June 30, 2004 and 2003, by asset category, are as follows:

Asset Category	2004	2003
	<i>(In Thousands)</i>	
Equity securities	57%	57%
Debt securities	33%	41%
Real estate	—	—
Other (cash)	10%	2%
Total	100%	100%

The plan assets may be invested in publicly traded equity mutual funds, including equity index funds and unit investment trusts mirroring a major market equity index, and publicly traded bond mutual funds, including bond index funds, with allowable ranges of 50% to 80% of the total asset value for equities and 20% to 50% of the total asset value for fixed income investments. In addition, fixed income investments that are not publicly traded may be used with specific approval by the plan trustees. Investment results are evaluated against applicable major market indexes.

Cash Flows

The Corporation has contributed \$15,769,000 as of September 15, 2004 (\$11,200,000 as of June 30, 2004 and \$4,569,000 on September 15, 2004) and expects to contribute an additional \$12,237,000 by September 15, 2005.

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

9. Pension and Postretirement Benefits (continued)

Estimated Future Benefit Payments

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

	Pension Benefits	Other Benefits
	<i>(In Thousands)</i>	
2005	\$ 4,188	\$ 713
2006	4,333	693
2007	4,539	671
2008	4,834	644
2009 and thereafter	31,793	3,289

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 \$6,679,000 and \$6,553,000 for the years ended June 30, 2004 and 2003, respectively.

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

10. Commitments and Contingencies (continued)

Operating Leases (continued)

The following is a schedule of future minimum lease payments under operating leases as of June 30, 2004 that have initial or remaining lease terms in excess of one year.

	Amount
	<i>(In Thousands)</i>
Year ending June 30:	
2005	\$ 1,386
2006	1,847
2007	1,682
2008	1,296
2009 and thereafter	786

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:

	Amount
	<i>(In Thousands)</i>
Year ending June 30:	
2005	\$ 6,335
2006	4,091
2007	1,754

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 \$23,673,000. 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 approximately \$9,847,000 and \$14,111,000 for the years ended June 30, 2004 and 2003, respectively.

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

10. Commitments and Contingencies (continued)

Other

Letters of credit in the amounts of \$2,500,000, \$1,352,000, and \$500,000 expiring September 30, 2004, September 30, 2005, and January 1, 2005, respectively, are maintained in support of various insurance arrangements and require the payment of annual commitment fees ranging from 0.5% to 0.75%. The Corporation has pledged \$4,352,000 as cash collateral for these letters of credit. The cash pledged is classified within restricted cash in the consolidated balance sheets. The September 30, 2004 and 2005, letters of credit were renewed in amounts of \$2,500,000 through September 30, 2005, and \$1,305,000 through September 30, 2006, respectively.

As of June 30, 2004, the Corporation was self-insured against workers' compensation claims up to \$300,000 per claim with no annual aggregate limit. The Corporation maintains a commercial insurance policy for claims liabilities exceeding these limits. A liability of \$1,707,000 and \$1,776,000, as of June 30, 2004 and 2003, respectively, has been established for known claims and an estimate for claims incurred but not reported. Effective July 1, 2004, the Corporation's self insured limit was raised to \$400,000 per claim with no annual aggregate. Effective October 1, 2004, the Corporation's self-insurance privileges were revoked and the Corporation purchased a commercial policy to cover all prospective workers' compensation claims.

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, 2005.

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Maryland Health Services Cost Review Commission (continued)

Effective April 1, 1999, the Commission 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, 2004, PGHC and LRH were in compliance, defined as within 1% overcharge or 2% undercharge, with their average charge per case targets.

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 2005.

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

11. Maryland Health Services Cost Review Commission (continued)

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 also approved an additional \$2,800,000 of direct funding through its Uncompensated Care Pool Program. The additional uncompensated care monthly funding began in September 2004 and continues through February of 2005.

12. Bowie Assisted Living (BAL LLC) and Other Related Party Transactions

Subsequent to June 30, 2003, the Corporation entered into litigation with Parkside Senior Services (PSS). At that time, PSS and the Corporation each held a 50% interest in the BAL LLC partnership. On February 13, 2004, the Corporation and PSS reached a settlement. Under the terms of the settlement, PSS executed documents transferring its interest in BAL LLC to the Corporation upon receiving a cash payment in the amount of \$150,000. Prior to June 2004, the Corporation accounted for its 50% interest in BAL LLC under the equity method of accounting. In May 2004, the Corporation completed the acquisition of the remaining 50% interest in BAL LLC and began consolidation of BAL LLC's financial results with BAL LLC's parent corporation, AEI.

During fiscal year 2004, sustained losses and continued unfavorable occupancy levels caused the Corporation to commit to a plan to sell certain operating assets and liabilities of BAL LLC. As of June 30, 2004, the operating assets and liabilities had carrying amounts of \$7,717,000 and \$5,910,000, respectively. The sale was completed on October 7, 2004. The carrying value of the assets and liabilities is classified as held for sale and reported separately in the consolidated balance sheets.

During the year ended June 30, 2004, the Corporation recorded revenues of approximately \$201,000 and expenses of approximately \$253,000 from BAL LLC representing BAL LLC's results of operations as a wholly owned subsidiary of the Corporation. During the years ended June 30, 2004 and 2003, the Corporation recorded \$(185,000) and \$(136,000) as investment income in the consolidated statement of operations representing its share of the losses of BAL LLC under the equity method of accounting.

Dimensions Health Corporation and Subsidiaries

Notes to Consolidated Financial Statements (continued)

12. Bowie Assisted Living (BAL LLC) and Other Related Party Transactions (continued)

At June 30, 2004, assets held for sale consisted of the property, plant and equipment of BAL LLC. Liabilities held for sale consisted of debt secured by the assets held for sale which is required to be paid from the proceeds of the assets to be sold. The Corporation expects to retain all other assets and liabilities of BAL LLC after the sale of the property, plant and equipment and repayment of related debt.

Prior to June 30, 2004, the Corporation solicited and received bids for the sale of the operating assets and liabilities of BAL LLC. On that basis, certain intercompany receivables and payables, in the amount of \$1,770,000, between DHC and AEI (BAL LLC's parent corporation), were forgiven. The extinguishment of these intercompany receivables and payables had no impact on the consolidated financial results of the Corporation.

On June 28, 2001, the Corporation loaned 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 LLC bonds. At June 30, 2004, this rate was 2.40%. 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. The Corporation believes that this note will be recovered in full from the sale of BAL LLC.

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, 2004, this rate was 4.7%. 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's wholly owned subsidiary, Madison Manor, Inc. 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. Subsequent Events (dated as of October 7, 2004)

On September 10, 2004, as part of the Memorandum of Understanding between the Prince George's County Government and the State of Maryland, the Prince George's County Government appropriated and paid a \$5,000,000 restricted operating grant to the Corporation to support the cost of providing continued health care services to county residents.

As part of the operational and financial restructuring of the Corporation supported by the management consultant, key management staff separated from the Corporation effective October 1, 2004. Corresponding severance expenses will be incurred in applicable future periods. The amounts of severance payments are currently under negotiation. Management does not believe that these severance payments will have a material effect on the Corporation's financial position.

On October 7, 2004, BAL LLC sold certain operating assets and liabilities designated in the accompanying financial statements as assets and liabilities held for sale for \$8,700,000, less costs to sell, in an Asset Purchase Agreement between BAL LLC and an unrelated party. The sale transaction and distribution of sale proceeds included the early redemption and payoff of certain BAL LLC liabilities including the Series 1997 Demand Bonds and the intercompany promissory note payable to DHC with principal amounts of \$5,910,000 and \$2,000,000 at June 30, 2004, respectively.

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, 2004 and 2003 presented herein and have issued our unqualified opinion thereon dated September 9, 2004 (except for Note 13, as to which the date is October 7, 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, 2004 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

September 9, 2004, except for Note 13,
as to which the date is October 7, 2004

Dimensions Health Corporation and Subsidiaries

Consolidating Balance Sheets—Obligated Group

June 30, 2004

	PGHC	LRH	GSSNHC	BHC	Corporate	Total Obligated Group	Other Entities	Eliminations	Consolidated Total
<i>(In Thousands)</i>									
Assets									
Current assets:									
Cash and cash equivalents	\$ —	\$ —	\$ 1	\$ —	\$ 3,393	\$ 3,394	\$ 345	\$ —	\$ 3,739
Assets limited as to use	—	—	—	—	4,149	4,149	—	—	4,149
Restricted cash	—	—	—	—	3,852	3,852	500	—	4,352
Patient accounts receivable, net of allowance	29,357	16,447	3,568	3,820	—	53,192	4,455	—	57,647
Inventories	2,144	1,492	72	400	—	4,108	—	—	4,108
BAL LLC—assets held for sale	—	—	—	—	—	—	7,717	—	7,717
Prepaid expenses and other assets	413	50	—	17	2,988	3,468	5,861	—	9,329
Total current assets	31,914	17,989	3,641	4,237	14,382	72,163	18,878	—	91,041
Investments held for strategic and capital projects	—	—	—	—	1,174	1,174	—	—	1,174
Due from affiliates	—	—	16,446	9,105	72,870	98,421	—	(98,421)	—
Assets limited as to use:	—	—	—	—	—	—	—	—	—
Held in trust under bond and note indentures	—	—	—	—	7,670	7,670	109	—	7,779
Restricted investments—strategic	—	—	—	—	100	100	156	—	256
Investments held for self insurance	—	—	—	—	—	—	20,649	—	20,649
Total assets limited as to use	—	—	—	—	7,770	7,770	20,914	—	28,684
Property and equipment, net	30,922	17,598	1,461	3,234	4,372	57,587	6,716	—	64,303
Intangible assets, net	—	—	—	—	415	415	—	—	415
Notes receivable from related party	—	—	—	—	819	819	—	—	819
Other noncurrent assets	1,372	—	—	—	—	1,372	966	—	2,338
Deferred financing costs	—	—	—	—	558	558	88	—	646
Total assets	\$ 64,208	\$ 35,587	\$ 21,548	\$ 16,576	\$ 102,360	\$ 240,279	\$ 47,562	\$ (98,421)	\$ 189,420

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>								
Liabilities and net assets									
Current liabilities:									
Current portion of long-term debt	\$ 147	\$ —	\$ —	\$ —	\$ 2,890	\$ 3,037	\$ 128	\$ —	\$ 3,165
Current portion of accrued benefit liabilities	—	—	—	—	5,000	5,000	—	—	5,000
Accounts payable and accrued expenses	8,430	3,180	656	1,052	18,090	31,408	6,325	—	37,733
BAL LLC—liabilities held for sale	—	—	—	—	—	—	5,910	—	5,910
Advances from third-party payors	13,448	2,219	220	—	—	15,887	—	—	15,887
Accrued annual leave	3,755	1,527	328	204	584	6,398	737	—	7,135
Specific purpose funds	910	170	—	—	—	1,080	—	—	1,080
Total current liabilities	26,690	7,096	1,204	1,256	26,564	62,810	13,100	—	75,910
Long-term debt, net of current portion	132	—	—	—	76,617	76,749	4,146	—	80,895
Due to affiliates	53,086	22,977	—	—	—	76,063	22,358	(98,421)	—
Other liabilities:									
Accrued professional liability costs	—	—	—	—	—	—	23,673	—	23,673
Accrued employee benefit liabilities	—	—	—	—	26,497	26,497	—	—	26,497
Total other liabilities	—	—	—	—	26,497	26,497	23,673	—	50,170
Net assets (deficit)	(15,700)	5,514	20,344	15,320	(27,318)	(1,840)	(15,715)	—	(17,555)
Total liabilities and net assets	\$ 64,208	\$ 35,587	\$ 21,548	\$ 16,576	\$ 102,360	\$ 240,279	\$ 47,562	\$ (98,421)	\$ 189,420

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

For the year ended June 30, 2004

	PGHC	LRH	GSSHNC	BHC	Corporate	Total Obligated Group	Other Entities	Total
	<i>(In Thousands)</i>							
Unrestricted revenue and other support:								
Net patient service revenue	\$ 193,277	\$ 71,367	\$ 17,566	\$ 15,261	\$ —	\$ 297,471	\$ 11,092	\$ 308,563
Other income	11,064	243	114	9	697	12,127	2,261	14,388
Investment income	—	—	—	—	—	—	903	903
Other	—	—	—	—	—	—	—	—
Total unrestricted revenue and other support	204,341	71,610	17,680	15,270	697	309,598	14,256	323,854
Operating expenses:								
Salaries and benefits	97,363	40,751	9,249	4,451	(14)	151,800	11,045	162,845
Supplies	30,717	10,767	2,328	1,482	8	45,302	264	45,566
Purchased services	37,495	10,879	1,946	2,888	(5)	53,203	(4,013)	49,190
Bad-debt expenses	26,291	7,088	1,176	3,003	—	37,558	5,189	42,747
Physician fees	4,711	2,384	101	1,364	6	8,566	1,032	9,598
Utilities	2,236	1,070	254	140	—	3,700	28	3,728
Total operating expenses	198,813	72,939	15,054	13,328	(5)	300,129	13,545	313,674
Operating earnings before interest, depreciation and amortization	5,528	(1,329)	2,626	1,942	702	9,469	711	10,180
Investment income	(313)	(155)	(20)	(21)	—	(509)	5	(504)
Interest expense	2,483	1,490	142	230	—	4,345	436	4,781
Forgiveness of Due To (From)	—	—	—	—	1,770	1,770	(1,770)	—
Depreciation and amortization	4,908	2,803	374	566	35	8,686	358	9,044
Net interest, depreciation, amortization and other	7,078	4,138	496	775	1,805	14,292	(971)	13,321
(Deficit) excess of unrestricted revenue and other support over expenses from continuing operations	(1,550)	(5,467)	2,130	1,167	(1,103)	(4,823)	1,682	(3,141)
Other changes in unrestricted net assets:								
Net change in appreciation of marketable investments	—	—	—	—	(751)	(751)	—	(751)
Minority interest in BAL LLC	—	—	—	—	—	—	(324)	(324)
Change minimum pension liability (Note 9)	—	—	—	—	2,250	2,250	—	2,250
Restricted grant	—	—	—	—	(1,000)	(1,000)	—	(1,000)
(Decrease) increase in unrestricted and restricted net assets	\$ (1,550)	\$ (5,467)	\$ 2,130	\$ 1,167	\$ (604)	\$ (4,324)	\$ 1,358	\$ (2,966)