Consolidated Financial Statements of

MEDICAL FACILITIES CORPORATION

December 31, 2012 and 2011
(In U.S. dollars)

TABLE OF CONTENTS

FINANCIAL STATEMENTS

NOTES TO THE FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Medical Facilities Corporation

We have audited the accompanying consolidated financial statements of Medical Facilities Corporation, which comprise the consolidated balance sheets as at December 31, 2012 and December 31, 2011, the consolidated statements of comprehensive income, changes in equity and cash flows for the years ended December 31, 2012 and December 31, 2011, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Medical Facilities Corporation as at December 31, 2012 and December 31, 2011, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2012 and December 31, 2011 in accordance with International Financial Reporting Standards**.**

KPMG LLP

Chartered Accountants, Licensed Public Accountants

March 20, 2013

Toronto, Canada

MEDICAL FACILITIES CORPORATION

Consolidated Balance Sheets
(In thousands of U.S. dollars)

	Note	December 31, 2012 $	2011 $
ASSETS			
Current assets			
Cash and cash equivalents		35,376	17,984
Short-term bank deposits		11,284	9,034
Accounts receivable	12.4.2	46,875	41,508
Supply inventory		5,654	3,774
Prepaid expenses and other		4,049	2,602
Income tax receivable	15	6,936	10,134
Total current assets		**110,174**	**85,036**
Non-current assets			
Long-term bank deposits		-	2,526
Restricted cash	12.1	-	4,483
Foreign exchange forward contracts	12.1	1,507	3,076
Deferred income tax assets	15	37,520	13,204
Investment in and loan receivable from an associate	5	289	356
Property and equipment	6	64,340	54,808
Goodwill	7.1	104,696	87,278
Other intangibles	7.2	121,265	83,574
Total non-current assets		**329,617**	**249,305**
TOTAL ASSETS		**439,791**	**334,341**
LIABILITIES AND EQUITY			
Current liabilities			
Accrued interest payable		607	526
Dividends payable		2,669	2,553
Accounts payables		14,744	7,299
Accrued liabilities		16,198	12,602
Current portion of long-term debt	8	13,959	11,889
7.5% debentures	10.1	45,729	-
Total current liabilities		**93,906**	**34,869**
Non-current liabilities			
Long-term debt	8	27,685	32,083
Foreign exchange forward contracts	12.1	-	424
7.5% debentures	10.1	-	43,110
5.9% debentures	10.2	42,434	-
Exchangeable interest liability	12.2	85,726	72,031
Total non-current liabilities		**155,845**	**147,648**
Total liabilities		**249,751**	**182,517**
Equity			
Share capital	11.3	361,936	361,935
Deficit		(227,014)	(228,352)
Equity attributable to owners of the Corporation		134,922	133,583
Non-controlling interest		55,118	18,241
Total equity		**190,040**	**151,824**
Commitments and contingencies	19		
TOTAL LIABILITIES AND EQUITY		**439,791**	**334,341**

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

On behalf of the Board:

Seymour Temkin

Alan J. Dilworth

MEDICAL FACILITIES CORPORATION

Consolidated Statements of Changes in Equity
(In thousands of U.S. dollars)

	Note	Attributable to Owners of the Corporation			Non-controlling Interest	Total Equity
		Share Capital $	Deficit $	Total $	$	$
2012						
Balance at December 31, 2011		361,935	(228,352)	133,583	18,241	151,824
Net income and comprehensive income		-	32,815	32,815	29,360	62,175
Dividends to owners of the Corporation		-	(31,507)	(31,507)	-	(31,507)
Distributions to non-controlling interest		-	-	-	(27,118)	(27,118)
Acquisition of Arkansas Surgical Hospital, L.L.C.	4.1	-	-	-	33,217	33,217
Acquisition of additional interest in Oklahoma Spine Hospital, LLC	4.2	722	-	722	-	722
Equity contribution by non-controlling interests to Black Hills Surgical Hospital, LLP		-	-	-	1,418	1,418
Conversion of 7.5% debentures into common shares	10.1	390	30	420	-	420
Purchase of common shares under normal course issuer bid	11.5	(1,111)	-	(1,111)	-	(1,111)
Balance at December 31, 2012		**361,936**	**(227,014)**	**134,922**	**55,118**	**190,040**
2011						
Balance at December 31, 2010		98,764	(76,937)	21,827	21,551	43,378
Net income (loss) and comprehensive income (loss)		-	(15,370)	(15,370)	27,506	12,136
Dividends to owners of the Corporation		-	(22,616)	(22,616)	-	(22,616)
Distributions to non-controlling interest		-	-	-	(30,816)	(30,816)
Acquisition of additional interest in Oklahoma Spine Hospital, LLC	4.2	1,458	-	1,458	-	1,458
Elimination of common share component of previously outstanding IPS units	11.3	(99,132)	-	(99,132)	-	(99,132)
Issue of new common shares on exchange of previously outstanding IPS units	11.3	362,403	(113,429)	248,974	-	248,974
Purchase of IPS units/common shares under normal course issuer bids	11.5	(1,558)	-	(1,558)	-	(1,558)
Balance at December 31, 2011		**361,935**	**(228,352)**	**133,583**	**18,241**	**151,824**

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

MEDICAL FACILITIES CORPORATION

Consolidated Statements of Comprehensive Income
(In thousands of U.S. dollars, except per share amounts)

	Note	Years Ended December 31, 2012 $	2011 $
Facility service revenue		**239,380**	**216,404**
Operating expenses			
Salaries and benefits		59,934	52,600
Drugs and supplies		60,623	53,534
General and administrative		33,016	27,890
Depreciation of property and equipment	6	7,121	6,885
		160,694	**140,909**
Income from operations		**78,686**	**75,495**
Amortization of other intangibles	7.2	**12,709**	**12,510**
Finance costs			
Interest expense, net of interest income	16	6,709	14,582
Interest expense on exchangeable interest liability	12.2	7,624	8,275
Increase in value of subordinated notes payable early redemption option	11.2	-	1,185
Loss (gain) on foreign currency	17	(2,662)	4,784
		11,671	**28,826**
Income before undernoted		**54,306**	**34,159**
Increase (decrease) in values of convertible debentures	10	3,431	(2,263)
Increase in value of exchangeable interest liability	12.2	10,818	14,874
Direct expenses attributable to restructuring		-	518
Income before income taxes		**40,057**	**21,030**
Income tax expense (recovery)	15	(22,118)	8,894
Net income and comprehensive income for the year		**62,175**	**12,136**
Attributable to:			
Owners of the Corporation		32,815	(15,370)
Non-controlling interest		29,360	27,506
		62,175	**12,136**
Basic and fully diluted earnings (loss) per share attributable to owners of the Corporation	11.4	**$ 1.158**	**$ (0.542)**

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

MEDICAL FACILITIES CORPORATION

Consolidated Statements of Cash Flows
(In thousands of U.S. dollars)

	Note	Years Ended December 31, 2012 $	2011 $
Cash flows from operating activities			
Net income and comprehensive income for the year		62,175	12,136
Adjustments for:			
Depreciation of property and equipment	6	7,121	6,885
Amortization of other intangibles	7.2	12,709	12,510
Share of equity loss in an associate	5	4	15
Increase (decrease) in values of convertible debentures	10	3,431	(2,263)
Increase in value of subordinated notes payable early redemption option	11.2	-	1,185
Increase in value of exchangeable interest liability	12.2	10,818	14,874
Interest expense, net of interest income	16	6,709	14,582
Loss (gain) on foreign currency	17	(2,662)	4,784
Deferred income tax expense (recovery)	15	(24,316)	6,793
Current income tax expense	15	2,198	2,100
Interest paid		(5,138)	(5,408)
Income and withholding taxes received	15	1,257	2,882
Change in non-cash operating working capital		2,839	(10,049)
Net cash provided by operating activities		**77,145**	**61,026**
Cash flows from investing activities			
Acquisition of Arkansas Surgical Hospital, L.L.C.	4.1	(36,706)	-
Acquisition of occupational medicine clinic by Black Hills Surgical Hospital, LLP	4.3	(550)	-
Purchase of property and equipment	6	(10,633)	(3,072)
Redemption of (investment in) short-term bank deposits		(2,250)	3,497
Redemption of (investment in) long-term bank deposits		2,526	(2,526)
Release of collateral on foreign exchange forward contracts	12.1	4,483	-
Cash interest received		522	250
Net cash used in investing activities		**(42,608)**	**(1,851)**
Cash flows from financing activities			
Repayments of revolving credit facilities at the Centers	8	(1,508)	(3,333)
Repayments of notes payable and obligations under lease arrangements at the Centers	8	(3,348)	(3,063)
Distributions, return of capital and loan receivable from an associate	5	63	33
Distributions to non-controlling interest		(27,118)	(30,816)
Dividends paid		(31,390)	(20,912)
Equity contribution by non-controlling interest to Black Hills Surgical Hospital, LLP		1,418	-
Proceeds from bought deal offering of 5.9% debentures	10.2	42,042	-
Purchase of 7.5% debentures under the terms of normal course issuer bid	10.1	-	(3)
Purchase of IPS units/common shares under the terms of normal course issuer bids	11.5	(1,111)	(1,634)
Costs related to the Conversion		-	(1,146)
Net cash used in financing activities		**(20,952)**	**(60,874)**
Increase (decrease) in cash and cash equivalents		**13,585**	**(1,699)**
Effect of exchange rate fluctuations on cash balances held		3,807	621
Cash and cash equivalents, beginning of the year		17,984	19,062
Cash and cash equivalents, end of the year		**35,376**	**17,984**
Non-cash transactions:			
Acquisition of additional interest in Oklahoma Spine Hospital, LLC	4.2	722	1,853
Conversion	11.3	-	362,403

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

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

1. REPORTING ENTITY

Medical Facilities Corporation (the "Company"), is a British Columbia corporation and a public company listed on the Toronto Stock Exchange under the ticker symbol DR. The Company owns indirect controlling interests in six (2011: five) limited liability entities (the "Centers" and collectively with the Company, the "Corporation"), each of which owns a specialty hospital or an ambulatory surgery center located in the United States. The Centers, their locations and the Corporation's ownership interest in each are as follows:

		Ownership Interest December 31,	
Centers	**Location**	**2012**	**2011**
Black Hills Surgical Hospital, LLP ("BHSH")	Rapid City, South Dakota	54.2%	54.2%
Sioux Falls Specialty Hospital, LLP ("SFSH")	Sioux Falls, South Dakota	51.0%	51.0%
Dakota Plains Surgical Center, LLP ("DPSC")	Aberdeen, South Dakota	64.6%	64.6%
Oklahoma Spine Hospital, LLC ("OSH")	Oklahoma City, Oklahoma	58.5%	57.8%
The Surgery Center of Newport Coast, LLC ("Newport Coast")	Newport Beach, California	51.0%	51.0%
Arkansas Surgical Hospital, L.L.C. ("ASH")	North Little Rock, Arkansas	51.0%	-

On November 30, 2012, the Corporation purchased an indirect 51% interest in Arkansas Surgical Hospital, L.L.C. ("ASH"), a surgical hospital located in North Little Rock, Arkansas (note 4.1). The Corporation's financial results for the year ended December 31, 2012 include the operating results of ASH for the month of December 2012.

The Corporation previously issued income participating securities ("IPS") units. Each IPS unit was comprised of Cdn$5.90 aggregate principal value of 12.5% subordinated notes payable and one common share of the Corporation. On May 31, 2011, the Corporation converted to a traditional common share structure (the "Conversion").

2. BASIS OF PREPARATION

2.1 Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee. The Corporation's accounting policies presented in note 3 have been applied in preparing these consolidated financial statements and the comparative information.

These consolidated financial statements were approved by the Corporation's board of directors on March 20, 2013.

2.2 Basis of measurement

These consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair value (as described in note 3.13(i)).

2. BASIS OF PREPARATION (Continued)

2.3 Functional and presentation currency

The Corporation's financial statements are reported in U.S. dollars which is its functional and presentation currency. All financial information presented in U.S. dollars has been rounded to the nearest thousand, unless otherwise indicated.

The Corporation translates monetary assets and liabilities denominated in Canadian dollars, principally its convertible debentures and certain of its cash balances, which are all denominated in Canadian dollars, at exchange rates in effect at the reporting date. Non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations were incurred. Revenue and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses, including translation adjustments, are included in the determination of net income and comprehensive income.

2.4 Use of judgments and estimates

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies, reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. On an ongoing basis, management evaluates its judgments and estimates in relation to assets, liabilities, facility service revenue and expenses. Management uses historical experience and various other factors it believes to be reasonable under the circumstances as the basis for its judgments and estimates. Actual results may differ from these estimates. Such differences in estimates are recognized when realized.

Management's judgment is required in respect of (i) consolidation (discussed in note 3.1), (ii) functional currency (discussed in note 2.3), (iii) recognition of deferred tax assets and liabilities (discussed in note 15) and (iv) classification of leases (discussed in note 3.9).

Management's estimates are required in respect of (i) facility service revenue (discussed in note 3.19) and accounts receivable (discussed in notes 3.6 and 12.4.2), (ii) supply inventory (discussed in note 3.7), (iii) valuation of financial instruments (discussed in note 12), (iv) acquired assets and liabilities, primarily goodwill and other intangibles (discussed in note 4), (v) impairment of goodwill and other intangibles (discussed in notes 3.12 and 7), (vi) provision for potential liabilities and contingencies (discussed in note 19) and (vii) income tax provisions (discussed in note 15).

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and have been applied consistently by the Centers.

3.1 Basis of consolidation

3.1.1 Subsidiaries

Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation has the power to govern financial and operating policies of an entity so as to obtain benefits from its activities. In assessing the degree of control, potential voting rights that are currently exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The non-controlling interest in the equity of the Corporation's subsidiaries is included in equity.

All intra-company balances and transactions have been eliminated in preparing these consolidated financial statements. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Corporation.

3.1.2 Associates

The Corporation has significant influence on the operating and financial decisions of an associate which does not amount to total or joint control and, therefore, the investment in the associate is accounted on an equity basis.

3.2 Business combinations

Acquisitions are accounted for using the acquisition method. The cost of each acquisition is measured at the fair values of liabilities incurred or assumed and the consideration paid by the Corporation in exchange for control of the acquired entity on the date when control is transferred to the Corporation. The acquired entity's identifiable assets, including previously unrecognized intangibles, liabilities and contingent liabilities, are recognized at their fair values at the acquisition date. Costs related to effecting the acquisition are expensed in the period they are incurred. At the date of the acquisition, the non-controlling interest is measured at the non-controlling interest's proportionate share of the fair value of identifiable assets of the acquiree. As part of the transition to IFRS, the Corporation has elected to not restate those business combinations that occurred prior to January 1, 2010. In respect of those acquisitions, goodwill represents the amount recognized under the Corporation's previous accounting framework. Contingent consideration in respect of those acquisitions prior to January 1, 2010, accounted for as exchangeable interest liability, is recorded on the balance sheet with periodic changes in fair value of that liability reflected in net income and comprehensive income.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.3 Segment information

Management of the Corporation reviews performance of the Corporation on a combined basis. As the Corporation's Centers operate in the same industry and in the same country, they are treated as one segment for financial reporting and disclosure purposes.

3.4 Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and all liquid investments purchased with a maturity of three months or less and which can be redeemed by the Corporation on short notice without any penalties.

3.5 Bank deposits

Bank deposits represent all liquid investments purchased with a maturity of three months or more. Bank deposits with maturities of more than three months but less than twelve months are classified as short-term and bank deposits with maturities of twelve months or more are classified as long-term.

3.6 Accounts receivable

Accounts receivable are recorded at the time services are rendered. Payments from third-party payors are generally received within 60 days of the billing date. Residual amounts due from patients are considered past due 30 days after receiving payment from third-party payors. Accounts receivable are recorded at the amounts estimated to be recoverable from the third-party payors and the patients, by applying the following policies:

(i) An allowance for third-party payor discounts is maintained at a level management believes reflects the estimated discounts that will be applied upon collection of accounts receivable balances. The allowance is established using the third-party payor contracts effective at period end and/or based on historical payment rates.

(ii) An allowance for non-collectible receivable balances is maintained at a level which management believes is adequate to absorb probable losses. Management determines the adequacy of the allowance based on historical data, current economic conditions and other pertinent factors for the respective Center. Patient receivables are written off as non-collectible when all reasonable collection efforts have been exhausted.

3.7 Supply inventory

Supply inventory consists of inventory of medical supplies, including implants and pharmaceuticals. It is stated at the lower of cost or net realizable value, using the first-in, first-out valuation method.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.8 Foreign exchange forward contracts

The Corporation holds a portfolio of foreign exchange forward contracts to manage its exposure to fluctuations in the exchange rate between U.S. and Canadian currencies. These foreign exchange forward contracts are treated as freestanding derivative financial instruments and are recorded at fair value. Unrealized gains or losses resulting from changes in fair value and gains or losses realized upon settlement of the foreign exchange forward contracts are included in "Loss (gain) on foreign currency" in the consolidated statements of comprehensive income (note 17).

3.9 Property and equipment

Property and equipment are stated at cost less accumulated depreciation. Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour and any other costs directly attributable to bringing the assets to a working condition for their intended use.

Depreciation of property and equipment is computed using the straight-line and declining balance methods over the estimated useful lives of the assets. Depreciation of self-constructed assets commences when they are available for use. Assets under finance leases are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Centers will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives of property and equipment are as follows:

Building and improvements	3-39 years
Equipment and furniture	3-20 years

Leases that substantially transfer the risk and benefits of ownership are capitalized with the cost included in property and equipment and the related liability recorded in long-term debt.

Depreciation methods, useful lives and residual values are reviewed on an annual basis.

3.10 Goodwill

Goodwill arises on the acquisition of subsidiaries and represents the excess of cost over the fair value of identifiable net assets acquired. For business acquisitions occurring after the date of transition to IFRS (January 1, 2010), goodwill is also recognized on non-controlling interest. Goodwill is stated at cost less accumulated impairment losses. Goodwill is not amortized but is reviewed at least annually for impairment, or when events or changes in circumstances indicate that the carrying amount may not be recoverable.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.11 Other intangibles

Other intangibles are recognized only when it is probable that the expected future economic benefits attributable to the assets will be realized by the Corporation and the cost can be reliably measured. Other intangibles represent the value of the hospital operating licenses, medical charts and records, referral sources and trade names. Other intangibles are stated at cost less accumulated amortization and accumulated impairment losses, when applicable.

Amortization is recognized on a straight-line basis over the estimated useful lives of other intangibles, other than trade names, from the date they are available for use. The estimated useful lives of other intangibles are as follows:

Hospital operating licenses	5 years
Medical charts and records	5-10 years
Referral sources	10-15 years

Trade names represent the value assigned to the reputation of the hospitals and their standing in the business and local community which allow them to earn higher than average returns. There is no foreseeable limit to the period over which trade names are expected to generate cash inflows for the Corporation.

3.12 Impairment of non-financial assets

Non-financial assets that have an indefinite useful life, for example goodwill and trade names, are not amortized and are tested annually for impairment and when events or changes in circumstances indicate that the carrying amount may not be recoverable. Non-financial assets that are subject to amortization are reviewed for impairment annually and when events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to sell and value in use.

For the purposes of assessing impairment, assets are grouped at the cash generating unit level which is the lowest level for which there are separately identifiable cash flows. Management considers each Center as a cash generating unit. Impairment losses recognized in respect of the Centers are allocated first to reduce the carrying amount of any goodwill allocated to the respective Center and, then, to reduce the carrying amount of the other assets of the respective Center on a *pro rata* basis.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.13 Financial assets and liabilities

The Corporation initially recognizes financial assets on the date that they originate or on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument. The Corporation derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. The Corporation assesses financial assets for impairment at each reporting date.

The Corporation initially recognizes financial liabilities on the date that they originate or on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument. The Corporation derecognizes a financial liability when its contractual obligations are discharged, cancelled or expire.

All financial assets and liabilities are initially recorded at fair value and designated into one of the following categories:

(i) Fair value through profit or loss (“FVTPL”)

Foreign exchange forward contracts, embedded derivatives requiring bifurcation from their host contracts, convertible debentures and exchangeable interest liability are classified as FVTPL and are carried at fair value with unrealized gains or losses recognized through net income and comprehensive income.

(ii) Loans and receivables

Cash and cash equivalents, short-term and long-term bank deposits, restricted cash, accounts receivable and loan receivable from an associate are classified as loans and receivables and are carried at amortized cost using the effective interest rate method.

(iii) Other liabilities

Accrued interest payable, dividends payable, accounts payable, accrued liabilities and long-term debt are classified as other assets and liabilities and are carried at amortized cost using the effective interest rate method.

3.14 Common shares

Common shares are classified as equity. The recorded amount is reduced by the incremental costs directly attributable to the issuance of new shares.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.15 Dividends

Dividend payments to the Corporation's owners are recognized in the Corporation's financial statements in the period in which the dividends are declared by the Corporation's board of directors.

3.16 Provisions

A provision is recognized if, as a result of a past event, the Corporation has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are measured at the estimated expenditures required to settle the present obligation, based on the most reliable evidence available at the reporting date, including the risks and uncertainties associated with the present obligation. Provisions are discounted to their present values, where the time value of money is material. All provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

3.17 Convertible debentures

The Corporation's 7.5% convertible secured debentures and 5.9% convertible unsecured subordinated debentures (hereinafter collectively referred to as "convertible debentures" and individually referred to as "7.5% debentures" and "5.9% debentures") are convertible into a fixed number of common shares at the option of the holder. The number of common shares to be issued does not vary with changes in the market values of these convertible debentures.

The convertible debentures are denominated in Canadian dollars while the Corporation's functional currency is U.S. dollars, which requires the Corporation to deliver a variable amount of cash to settle the obligation. Because the conversion option requires the Corporation to deliver a fixed number of common shares to settle a variable liability, the convertible debentures are considered hybrid financial instruments. The Corporation elected to account for the convertible debentures as financial liabilities measured at FVTPL. The changes in the recorded amounts of the liability due to the changes in the fair values of the convertible debentures and fluctuations in foreign exchange rates between the periods are reflected in net income and comprehensive income.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.18 Exchangeable interest liability

Exchangeable interest liability represents an estimated liability for the remaining portion of the interest in the Centers held by the non-controlling interests which can be exchanged, subject to certain restrictions, for common shares of the Corporation. The exchangeable interest liability has been designated at FVTPL and accordingly is re-measured at the end of each reporting period taking into account (i) the calculated amount of common shares potentially issuable for the remaining portion of the exchangeable interest in the Centers held by the non-controlling interests, (ii) the market value of common shares and (iii) the exchange rate between Canadian and U.S. dollars at the end of the reporting period. The change in value of the exchangeable interest liability is included in net income and comprehensive income for the respective periods.

3.19 Facility service revenue

Facility service revenue consists of the actual amounts received and the estimated net realizable amounts receivable from patients, third-party payors and others for services rendered.

Each Center has agreements with third-party payors that provide for payments at amounts different from the Center's established rates. Payment arrangements include prospectively determined rates per diagnosis, reimbursed costs, discounted charges and per diem payments. Settlements under reimbursement arrangements are accrued on an estimated basis in the period the services are rendered, and are adjusted in future periods, as final settlements are determined. Differences between the estimated amounts accrued and interim and final settlements are reported in operations in the period of settlement.

3.20 Income taxes

Income tax expense consists of current and deferred taxes. Income tax expense is recognized in the statement of comprehensive income except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted on the reporting date, and any adjustment to tax payable in respect of previous years.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Corporation calculates deferred income taxes using the liability method on temporary differences between the carrying amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are calculated, without discounting, at tax rates that are expected to apply to their respective period of realization, provided they are enacted or substantively enacted by the end of the reporting period. The effect on tax assets and liabilities of a change in tax rates is recognized in income tax expense in net income and comprehensive income in the period that includes the date of enactment or substantive enactment.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized. Deferred tax liabilities are always recognized in full.

3.21 Earnings per share

The Corporation presents basic and fully diluted earnings per share (“EPS”) data for its common shares. Basic EPS is calculated by dividing net income and comprehensive income attributable to owners of the Corporation by the weighted average number of common shares outstanding during the period. Fully diluted EPS is determined by adjusting the net income and comprehensive income attributable to owners of the Corporation and the weighted average number of common shares outstanding for the effects of all potentially dilutive events, which comprise the conversion of convertible debentures and the exercise of exchange rights by the non-controlling interest.

3.22 IFRS standards not yet adopted

3.22.1 Financial instruments

IFRS 9, *Financial Instruments* (“IFRS 9 (2009)”), was issued by the IASB on November 12, 2009 and will replace IAS 39, *Financial Instruments: Recognition and Measurement* (“IAS 39”). In October 2010, the IASB published amendments to IFRS 9 (“IFRS 9 (2010)”). IFRS 9 (2010) uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 (2010) is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of its financial assets. The new standard requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 (2010) also provides for new measurement guidance for financial liabilities designated at FVTPL. In December 2011, the IASB deferred the mandatory effective date of IFRS 9 (2010) to annual periods beginning on or after January 1, 2015 and will be effective for the year ending December 31, 2015. The Corporation has not yet determined the impact of these standards on its financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.22.2 Disclosure of interests in other entities

On May 12, 2011, the IASB issued IFRS 12, *Disclosure of Interests in Other Entities* ("IFRS 12") which requires extensive disclosures relating to an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. Concurrent with the issuance of IFRS 12, the IASB also issued:

(i) IFRS 10, *Consolidated Financial Statements* ("IFRS 10");

(ii) IFRS 11, *Joint Arrangements* ("IFRS 11");

(iii) IAS 27, *Separate Financial Statements* (revised 2011), which has been amended for the issuance of IFRS 10 but retains the current guidance for separate financial statements; and

(iv) IAS 28, *Investments in Associates and Joint Ventures* (revised 2011), which has been amended for conforming changes based on the issuance of IFRS 10 and IFRS 11.

Each of the above-mentioned standards has an effective date for annual periods beginning on or after January 1, 2013. Early adoption is permitted provided all five standards are adopted at the same time. In June 2012, the amendments to IFRS 10, IFRS 11 and IFRS 12 were issued to clarify certain transitional guidance on the application of these standards for the first time. The Corporation does not expect the above-mentioned standards to have a material impact on its financial statements.

3.22.3 Fair value measurement

In May 2011, the IASB issued IFRS 13, *Fair Value Measurement* ("IFRS 13"), which provides a revised definition of fair value, establishes a framework for measuring fair value and sets out disclosure requirements for when fair value measurement is required or permitted under IFRS. IFRS 13 is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted and will be effective for the year ending December 31, 2013. The Corporation does not expect IFRS 13 to have a material impact on its financial statements.

3.22.4 Other comprehensive income ("OCI")

In June 2011, the IASB amended IAS 1, *Presentation of Financial Statements* ("IAS 1") to require the grouping together of OCI items that may be reclassified to the Statement of Earnings within OCI. The amendment is effective for annual periods beginning on or after July 1, 2012, and will be effective for the Corporation's financial year ending December 31, 2013. The Corporation has determined that this amendment will have no impact on its financial statements.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.22.5 Employee benefits

The amendments to IAS 19, *Employee Benefits* (“IAS 19”) change the accounting for defined benefit plans and termination benefits. The amendments require the recognition of changes in defined benefit obligations and in fair value of plan assets when they occur and accelerate the recognition of past service costs. The amendments require all actuarial gains and losses to be recognized immediately through OCI. The interest cost and expected return on plan assets are replaced with a ‘net-interest’ amount, which is calculated by applying the discount rate to the net defined benefit liability or asset. The amendments are effective for annual periods beginning on or after January 1, 2013 and require retrospective application. The Corporation does not expect IAS 19 to have a material impact on its financial statements.

4. BUSINESS ACQUISITIONS

4.1 Acquisition of Arkansas Surgical Hospital (ASH)

On November 30, 2012, Medical Facilities (USA) Holdings, Inc., a wholly-owned indirect subsidiary of the Corporation, completed its acquisition of a 51% interest in ASH. The current physician-owners of ASH retained 49% interest. A portion of that retained interest, representing a 5% interest in ASH, is exchangeable for common shares of the Corporation, subject to certain restrictions. The acquisition of ASH added another surgical hospital to the Corporation’s group of hospitals and is consistent with the Corporation’s strategy to grow distributable cash by identifying and executing accretive acquisitions.

The aggregate purchase price for the acquisition was $36,706 paid in cash. The Corporation has not finalized its purchase price allocation as at December 31, 2012, but the preliminary allocation is as follows:

	$
Current assets, less current liabilities (including cash of $2,723)	2,762
Property and equipment	5,955
Goodwill	16,933
Other intangibles	50,400
Long-term debt	(2,528)
Exchangeable interest liability	(3,599)
Non-controlling interest	(33,217)
Fair value of net assets acquired	**36,706**

The purchase price was funded through borrowing under the Corporation’s Amended and Restated Credit Agreement (“Line of Credit”) with a Canadian chartered bank of $27,110 and cash on hand of $9,596. The borrowing under the Line of Credit was subsequently repaid with the funds from the bought deal offering of 5.9% debentures (note 10.2).

4. BUSINESS ACQUISITIONS (Continued)

Other intangibles principally represent the values of referral sources of the physician-owners and non-owners of ASH that will be amortized over estimated useful lives of 12 and 15 years, respectively. Approximately $641 of acquisition-related costs have been recognized as an expense in the consolidated statement of comprehensive income. The goodwill attributable to this acquisition includes the value of the workforce acquired, the benefit of future revenue growth, opportunities to expand within the marketplace and other key competitive advantages. The total amount of goodwill related to this acquisition and deductible for tax purposes is $34,598.

Concurrent with the acquisition of its interest in ASH, the Corporation entered into an exchange agreement with the holders of the non-controlling interest in ASH. Pursuant to the terms of this exchange agreement, the non-controlling interest holders are entitled to exchange up to 5% of their original membership interest in ASH for common shares of the Corporation. The Corporation has recognized an estimated liability for the portion of the interest in ASH that can be exchanged pursuant to the exchange agreement (note 12.2).

The non-controlling interest recognized at the acquisition date was measured by reference to the fair value of the non-controlling interest and amounted to $33,217. This fair value was determined with reference to the estimated future cash flows using the assumed discount rate of 11% and assumed long-term sustainable growth rate of 4% to 8%.

Earnings from the acquisition are included in the Corporation’s results of operations from the date of acquisition: facility service revenue of $4,361 and net income of $611.

Had the ASH acquisition occurred as of January 1, 2012, the Corporation’s facility service revenue for the year would have been $292,845 and net income and comprehensive income for the year would have been $66,256. *Pro forma* adjustments only include the adjustment for amortization of other intangibles and interest expense related to financing of the acquisition and the estimated tax effect of such adjustments. The *pro forma* financial information is not necessarily indicative of operating results that would have occurred had the ASH acquisition been effected at January 1, 2012 nor is it indicative of future operating results.

4.2 Acquisition of additional interest in Oklahoma Spine Hospital (OSH)

In April 2011, pursuant to the terms of the exchange agreement with the Corporation, the holders of the non-controlling interest in OSH (“non-controlling owners”) exchanged 0.75% of the ownership in the Center for IPS units of the Corporation which were valued at $845 (Cdn$813) based on the market value of the IPS units on the date of the transaction. This consideration was allocated between subordinated notes payable and share capital as presented in notes 11 and 11.3, respectively.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

4. BUSINESS ACQUISITIONS (Continued)

In June 2011, the non-controlling owners of OSH exchanged 0.88% of the ownership in the Center for common shares of the Corporation which were valued at $1,008 (Cdn$980) based on the market value of the common shares on the date of the transaction. This consideration was recorded in share capital of the Corporation as presented in note 11.3.

In April 2012, the non-controlling owners of OSH exchanged 0.75% of the ownership in the Center for common shares of the Corporation which were valued at $722 (Cdn$716) based on the market value of the common shares on the date of the transaction. This consideration was recorded in the share capital of the Corporation as presented in note 11.3.

4.3 Acquisition of occupational medicine clinic by Black Hills Surgical Hospital (BHSH)

During 2012, BHSH's wholly-owned subsidiary purchased the assets of an occupational medicine clinic for a total purchase price of $550, of which $65 was allocated to property and equipment and the balance of $485 to goodwill.

5. INVESTMENT IN AND LOAN RECEIVABLE FROM AN ASSOCIATE

The investment in and loan receivable from an associate for the years ended 2012 and 2011 consists of:

	Equity Investment $	Loan Receivable $	Total Investment and Loan Receivable $
2011			
Balance at December 31, 2010	204	200	404
Share of equity loss	(15)	-	(15)
Return of capital	(5)	-	(5)
Distributions received	(22)	-	(22)
Repayments	-	(6)	(6)
Balance at December 31, 2011	**162**	**194**	**356**
2012			
Balance at December 31, 2011	162	194	356
Share of equity loss	(4)	-	(4)
Return of capital	(3)	-	(3)
Distributions received	(40)	-	(40)
Repayments	-	(20)	(20)
Balance at December 31, 2012	**115**	**174**	**289**

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

6. PROPERTY AND EQUIPMENT

	Land and Improvements $	Construction in Progress $	Building and Improvements $	Equipment and Furniture $	Total $
Cost					
Balance at December 31, 2010	4,185	-	54,876	27,737	86,798
Additions	14	-	745	2,408	3,167
Disposals	-	-	(56)	(957)	(1,013)
Balance at December 31, 2011	**4,199**	**-**	**55,565**	**29,188**	**88,952**
Balance at December 31, 2011	4,199	-	55,565	29,188	88,952
Additions	66	2,586	2,870	5,126	10,648
Disposals	-	-	-	(68)	(68)
Acquisitions through business combinations	143	-	1,344	4,533	6,020
Balance at December 31, 2012	**4,408**	**2,586**	**59,779**	**38,779**	**105,552**
Accumulated Depreciation					
Balance at December 31, 2010	-	-	(10,153)	(18,024)	(28,177)
Charged for the year	-	-	(3,259)	(3,626)	(6,885)
Disposals	-	-	14	904	918
Balance at December 31, 2010	**-**	**-**	**(13,398)**	**(20,746)**	**(34,144)**
Balance at December 31, 2011	-	-	(13,398)	(20,746)	(34,144)
Charged for the year	(17)	-	(3,373)	(3,731)	(7,121)
Disposals	-	-	1	52	53
Balance at December 31, 2012	**(17)**	**-**	**(16,770)**	**(24,425)**	**(41,212)**
Carrying Amounts					
At December 31, 2011	4,199	-	42,167	8,442	54,808
At December 31, 2012	4,391	2,586	43,009	14,354	64,340

Included in the equipment and furniture for the years 2012 and 2011 is certain equipment under long-term lease agreements as follows:

	2012 $	2011 $
Equipment	6,491	2,094
Less accumulated depreciation	(2,461)	(986)
Total	**4,030**	**1,108**

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

7. GOODWILL AND OTHER INTANGIBLES

7.1 Goodwill

The Corporation performed its annual impairment test for goodwill and other intangibles with indefinite lives as at December 31, 2012 and December 31, 2011 and determined that there was no impairment of goodwill and other intangibles with indefinite lives.

The Corporation identified six cash-generating-units ("CGUs") for which impairment testing was performed. Management used the business enterprise fair value ("EV") approach and estimated the recoverable amounts of the CGUs. IAS 36 defines the recoverable amount as the greater of Value in Use and Fair Value less Costs to Sell. Management has estimated costs to sell to be 1%, based on recent acquisitions. Management determined the EV of the Corporation as at December 31, 2012 based on (i) its market capitalization of the outstanding common shares taking into account a 20% equity control premium attributable to the common shares, (ii) the market value of convertible debentures outstanding and (iii) the Corporation's portion of the Centers' long-term debt, less (iv) cash on hand. Management then determined the multiple of EV to consolidated earnings before income taxes, depreciation and amortization ("EBITDA"), which was allocated to the CGUs based on their relative contribution to the consolidated EBITDA and risk and return.

The following table represents the changes in the carrying amount of goodwill for the years 2012 and 2011:

	$
Balance at December 31, 2010	87,278
Balance at December 31, 2011	**87,278**
Balance at December 31, 2011	87,278
Goodwill related to business acquisitions (notes 4.1 and 4.3)	17,418
Balance at December 31, 2012	**104,696**

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

7.2 Other intangibles

	Hospital Operating Licenses	Medical Charts and Records	Referral Sources	Trade Names	Total
	$	$	$	$	$
Cost					
Balance at December 31, 2010	714	6,981	157,242	9,826	174,763
Balance at December 31, 2011	**714**	**6,981**	**157,242**	**9,826**	**174,763**
Balance at December 31, 2011	714	6,981	157,242	9,826	174,763
Business acquisitions	1,000	1,000	48,400	-	50,400
Balance at December 31, 2012	**1,714**	**7,981**	**205,642**	**9,826**	**225,163**
Accumulated Amortization					
Balance at December 31, 2010	(714)	(6,816)	(71,149)	-	(78,679)
Amortization charges	-	(165)	(12,345)	-	(12,510)
Balance at December 31, 2011	**(714)**	**(6,981)**	**(83,494)**	**-**	**(91,189)**
Balance at December 31, 2011	(714)	(6,981)	(83,494)	-	(91,189)
Amortization charges	(17)	(17)	(12,675)	-	(12,709)
Balance at December 31, 2012	**(731)**	**(6,998)**	**(96,169)**	**-**	**(103,898)**
Carrying Amounts					
At December 31, 2011	-	-	73,748	9,826	83,574
At December 31, 2012	983	983	109,473	9,826	121,265
Amortization period (years)	5	5-10	10-15	N/A (indefinite life)	

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

8. LONG-TERM DEBT

	December 31,				
	2012			2011	
	Authorized	Balance	Effective Interest Rate	Balance	Effective Interest Rate
	$	$	%	$	%
Revolving credit facilities					
SFSH	3,500	-	2.25	5,188	2.31
DPSC	2,000	-	4.00	26	4.50
BHSH	6,000	1,425	3.00	750	3.25
OSH	5,000	4,008	3.00	3,508	3.00
Newport Coast	2,500	-	3.55	-	3.55
ASH	3,000	-	3.00	-	N/A
	22,000	**5,433**		**9,472**	
Notes payable					
SFSH	17,345	17,345	4.83	18,597	4.85
DPSC	3,369	3,369	4.50	3,487	4.50
BHSH	9,850	9,850	5.37	10,688	5.36
OSH	1,101	1,101	2.99	914	2.99
Newport Coast	-	-	N/A	-	N/A
ASH	1,898	1,898	5.50	-	N/A
	33,563	**33,563**		**33,686**	
Capital leases (note 9)					
SFSH	-	2,146	N/A	814	N/A
ASH	-	502	N/A	-	N/A
		2,648		**814**	
		41,644		**43,972**	
Less current portion		(13,959)		(11,889)	
		27,685		**32,083**	

The revolving credit facility for SFSH bears interest at an annual rate of 2.0% plus the one month London Interbank Offered Rate and notes payable bear fixed interest rates. The credit facility for DPSC bears interest at a rate that varies with prime but has a minimum of 4.0% and note payable bears interest at a rate that varies with prime but has a minimum of 4.5%. The credit facilities for BHSH vary with prime and notes payable bear fixed interest rates. The OSH credit facility and notes payable bear fixed interest rates. The credit facility for Newport Coast bears interest at a rate that varies with prime. The ASH credit facility bears interest at a rate 0.25% below prime but has a minimum of 3.0% and notes payable bear fixed interest rates.

SFSH's credit facility and notes payable mature between 2013 and 2016. DPSC's credit facility matures on July 15, 2013 and note payable matures on December 1, 2020. BHSH's credit facilities and notes payable mature during 2014 and 2015. The credit facility related to OSH is due on August 11, 2013 and the notes payable mature between 2014 and 2017. Newport Coast's credit facility matures on May 1, 2013. ASH's credit facility renews automatically at the end of its annual term and notes payable mature in 2014.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

8. LONG-TERM DEBT (Continued)

Each credit facility is secured by a security interest in all property and a mortgage on real property owned by the respective Center. These credit facilities contain certain restrictive financial and non-financial covenants. As of the reporting date, there were no breaches of these covenants.

The following are the future maturities of long-term debt, including capital leases (note 9), for the years ending December 31:

	$
2013	13,959
2014	16,101
2015	7,908
2016	730
2017 and thereafter	2,946
Future maturities of long-term debt	**41,644**

9. CAPITAL LEASES

SFSH and ASH lease certain equipment under long-term lease agreements which have been capitalized. Minimum future lease payments for the capital leases are as follows:

	$
2013	1,611
2014	524
2015	408
2016	188
Total minimum lease payments	2,731
Less interest	(83)
Present value of minimum lease payments	**2,648**

10. CONVERTIBLE DEBENTURES

10.1 7.5% debentures

On April 14, 2008, the Corporation issued, in a public offering, Cdn$43,000 (US$42,124) aggregate principal amount of 7.5% debentures. The 7.5% debentures pay interest semi-annually in arrears on April 30 and October 30 of each year. The 7.5% debentures mature on April 30, 2013 and are convertible into 76.3359 common shares per Cdn$1,000 principal amount of 7.5% debentures. Under the terms of the Trust Indenture, the holders of the 7.5% debentures have the right to convert their holdings into common shares at a conversion price of C$13.10 per common share. If the holders of the 7.5% debentures do not exercise their right to convert their holdings into the Corporation’s common shares prior to and including the maturity date, the principal amount is due and payable in full on maturity. The Corporation intends to utilize cash on hand and, if necessary, to draw funds from its Line of Credit to repay the 7.5% debentures not yet converted at the time the conversion privilege expires.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

10. CONVERTIBLE DEBENTURES (Continued)

The following table represents changes in the 7.5% debentures for the years 2012 and 2011:

	$
Balance at December 31, 2010	45,376
7.5% debentures purchased and cancelled under the terms of normal course issuer bid	(3)
Decrease in fair value of 7.5% debentures at market price	(2,263)
Balance at December 31, 2011	**43,110**
Balance at December 31, 2011	43,110
Increase in fair value of 7.5% debentures at market price	3,039
Conversion of 7.5% debentures into common shares	(420)
Balance at December 31, 2012	**45,729**

In 2011, under the normal course issuer bid in effect from November 24, 2010 to November 23, 2011, the Corporation purchased Cdn$3 aggregate principal amount of its outstanding 7.5% debentures for a total consideration of $3.

In 2012, certain holders of the 7.5% debentures exercised their conversion rights and converted Cdn$388 of the face value of the 7.5% debentures into 29,613 common shares of the Corporation (note 11.3).

10.2 5.9% debentures

On December 21, 2012, the Corporation issued, in a public offering, Cdn$41,800 (US$42,042) aggregate principal amount of 5.9% debentures. The 5.9% debentures pay interest semi-annually in arrears on June 30 and December 31 of each year, mature on December 31, 2019 and are convertible into 52.3286 common shares per Cdn$1,000 principal amount of 5.9% debentures at the option of the holder, representing a conversion price of Cdn$19.11 per common share. The 5.9% debentures are subordinate to all other existing and future senior unsecured indebtedness of the Corporation, including, without limitation, the 7.5% debentures.

The 5.9% debentures contain a provision whereby holders of the 5.9% debentures would be entitled to convert their debentures within a specified time period and would receive, in addition to the number of shares on conversion, additional shares calculated as a function of the change of control offer price and time remaining to maturity.

The following table represents changes in the 5.9% debentures since the offering on December 21, 2012:

	$
Proceeds of offering	42,042
Increase in fair value of 5.9% debentures at market price	392
Balance at December 31, 2012	**42,434**

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

11. SUBORDINATED NOTES PAYABLE AND SHARE CAPITAL

11.1 Subordinated notes payable

The Conversion that occurred on May 31, 2011 resulted in the extinguishment of $166,073 of principal value of subordinated notes payable calculated on an amortized cost basis. Costs related to the Conversion of $1,146 were recorded as a reduction of shareholders' equity.

	$
Balance at December 31, 2010	167,976
Subordinated notes payable issued for acquisition of additional interest in OSH (note 4.2)	395
IPS units purchased and cancelled under normal course issuer bid (note 11.5)	(76)
Unrealized loss on foreign currency translation (note 17)	4,506
Balance at May 31, 2011 before financing costs	172,801
Less financing costs related to subordinated notes payable	(6,728)
Net balance at May 31, 2011	166,073
Extinguishment of subordinated notes payable as a result of the Conversion	(166,073)
Balance at December 31, 2011	**-**

11.2 Embedded derivatives in the subordinated notes payable

Prior to the Conversion, the Corporation identified two embedded derivatives in the subordinated notes payable that required separate presentation at fair value in the consolidated financial statements:

(i) An early redemption option ("Early Redemption Option") which permitted the Corporation to call its outstanding subordinated notes payable after the fifth anniversary date for a premium over the principal amount; and

(ii) An extension option under which the Corporation could extend the maturity of its subordinated notes payable for two additional successive five-year terms subject to the consent of debtholders and other conditions. No value was assigned to this option previously.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

11. SUBORDINATED NOTES PAYABLE AND SHARE CAPITAL (Continued)

The extinguishment of the Corporation's subordinated notes payable resulted in the transfer of the value of the subordinated notes payable Early Redemption Option accrued through the date of the Conversion to the share capital section of the shareholders' equity.

	$
Balance at December 31, 2010	28,539
Increase in value of subordinated notes payable early redemption option	(1,185)
Balance at May 31, 2011	27,354
Transfer to share capital	(27,354)
Balance at December 31, 2011	**-**

11.3 Share capital

The following table represents changes in the number and value of common shares issued and outstanding for the reporting periods:

	Number of Common Shares	$
Opening balance at December 31, 2010	28,316,749	98,764
Common shares issued for acquisition of additional interest in OSH in April 2011 (note 4.2)	64,501	450
Common shares purchased and cancelled under the terms of normal course issuer bid (note 11.5)	(12,600)	(82)
Balance at May 31, 2011	28,368,650	99,132
Retirement of common shares on Conversion	(28,368,650)	(99,132)
New common shares issued on Conversion	28,368,650	362,403
Common shares issued for acquisition of additional interest in OSH in June 2011 (note 4.2)	77,692	1,008
Common shares purchased and cancelled under the terms of normal course issuer bid (note 11.5)	(136,300)	(1,476)
Balance at December 31, 2011	**28,310,042**	**361,935**
Opening balance at December 31, 2011	28,310,042	361,935
Common shares issued for acquisition of additional interest in OSH in April 2012 (note 4.2)	56,836	722
Common shares issued on exchange of 7.5% debentures (note 10.1)	29,613	390
Common shares purchased and cancelled under the terms of normal course issuer bid (note 11.5)	(81,774)	(1,111)
Balance at December 31, 2012	**28,314,717**	**361,936**

11.4 Earnings (loss) per share

Basic earnings (loss) per share attributable to owners of the Corporation are calculated as follows:

	2012 $	2011 $
Net income (loss) and comprehensive income (loss) for the year attributable to owners of the Corporation	32,815	(15,370)
Divided by weighted average number of common shares outstanding for the period	28,336,905	28,353,578
Basic earnings (loss) per share attributable to owners of the Corporation	**1.158**	**(0.542)**

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

11. SUBORDINATED NOTES PAYABLE AND SHARE CAPITAL (Continued)

For 2012 and 2011, issuance of common shares upon exchange of the outstanding exchangeable interest liability and conversion of the outstanding convertible debentures would have been anti-dilutive and, therefore, the calculation of fully diluted earnings (loss) per share is not presented.

11.5 Normal course issuer bids

Pursuant to the terms of the Corporation's normal course issuer bids in 2011, the Corporation purchased 12,600 of its IPS units, consisting of subordinated notes payable and common shares, for a total consideration of $158. The consideration paid was $76 for the subordinated notes payable and $82 for the share capital (notes 11 and 11.3, respectively). The Corporation also purchased 136,300 of its common shares for a total consideration of $1,476, recorded in share capital (note 11.3).

Pursuant to the terms of the Corporation's normal course issuer bid in 2012, the Corporation purchased 81,774 of its common shares for a total consideration of $1,111, recorded in share capital (note 11.3).

All IPS units and common shares acquired under these bids were cancelled.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

12.1 Foreign exchange forward contracts

At December 31, 2012, the Corporation held foreign exchange forward contracts with two financial institutions under which the Corporation sells U.S. dollars each month for a fixed amount of Canadian dollars on the following terms:

Contract Dates	US$ to be Delivered	Cdn$ to be Received	Cdn$ per US$ (weighted average)
Jan 2013 – Dec 2013	37,467	38,613	1.0306
Jan 2014 – Dec 2014	38,447	39,118	1.0175
Jan 2015 – Feb 2015	6,000	6,112	1.0186
	81,914	**83,843**	

As of December 31, 2012, the fair value of the outstanding contracts was an asset of $1,507 (December 31, 2011: a net asset of $2,652), which has been recognized in the Corporation's consolidated financial statements for the year ended December 31, 2012.

At December 31, 2011, the Corporation had in place collateral of $4,483 to ensure its performance under the foreign exchange forward contracts, which was released in 2012. The deposit was classified as "Restricted cash" on the consolidated balance sheet.

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

12.2 Exchangeable interest liability

Concurrent with the acquisition of its interests in five (2011: four) of the Centers, the Corporation entered into exchange agreements with the vendors who originally retained a 49% non-controlling interest in these Centers. Pursuant to the terms of these exchange agreements, the non-controlling interest holders in each of the Centers received the right to exchange a portion of their interest in their respective Centers (“Exchangeable Interest”) for common shares of the Corporation. Such exchanges may only take place quarterly and are based on the exchange formulae stipulated in the exchange agreements and are subject to certain limitations.

The number of common shares issuable under the Exchangeable Interest is determined by application of a formula which takes into account the number of partnership units being tendered for exchange and an exchange ratio based upon the distributions from the Centers over the prior twelve months. The exchange agreements between the Corporation and the non-controlling interest holders in each of the Centers contain the details of the exchange rights.

The Corporation uses the liability method of accounting for the Exchangeable Interest. Under this method, the Exchangeable Interest is reflected in the financial statements as follows:

(i) The exchange right is considered to have been fully exchanged at the original dates of acquisition of each of the five (2011: four) Centers in which Exchangeable Interests are held, resulting in the purchase of a further 14% interest in each such Center, except for ASH where 5% can be purchased, for an amount (the “imputed purchase price”) proportionate to the price paid for the original 51% interest in such Centers. The imputed purchase price was allocated to the fair value of the assets acquired, including goodwill and other intangibles, consistent with the acquisition of the initial 51% interest.

(ii) The corresponding amount of the imputed purchase price relating to the 14% interest (5% in the case of ASH) is reflected as exchangeable interest liability. The exchangeable interest liability is carried at fair value, as determined at each reporting date by applying the closing common share price on the last trading day of the period, converted into U.S. dollars at the closing exchange rate, to the total number of common shares issuable under the outstanding Exchangeable Interest. Changes in the fair value of the exchangeable interest liability, including their effect on the deferred tax position, are included in net income and comprehensive income.

(iii) Amortization of other intangibles and fair market value of property and equipment in excess of underlying book values are consistent with the amortization of the assets that arose on acquisition of the initial 51% interest in each Center.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

(iv) The distributions made by each Center, that relate to the ownership interest therein that is the subject of the outstanding Exchangeable Interest, are treated as interest expense in the Corporation's consolidated statement of comprehensive income. The non-controlling interest in the results of operations of the Centers is correspondingly reduced.

(v) The calculation of basic and diluted earnings (loss) per share involves certain modifications, if applicable, to net income and comprehensive income as reported and the number of issued and outstanding common shares as set out in note 11.4.

The number of common shares to be potentially issued for the exchangeable interest liability and the fair value of the exchangeable interest liability as at December 31, 2012 and December 31, 2011 are as follows:

	2012	2011
Number of common shares to be potentially issued for exchangeable interest liability	6,162,453	6,288,026
Fair value of the exchangeable interest liability	$ 85,726	$ 72,031

12.3 Fair values and classification of financial instruments

The Corporation obtains the fair value of foreign exchange forward contracts from the counterparties to such contracts. The fair values of the convertible debentures are determined based on the closing trading price of the securities at each reporting period. The fair values of notes payable and term loans at the Centers' level approximate their book values as the interest rates are similar to prevailing market rates. The fair values of all other financial instruments of the Corporation, due to the short-term nature of these instruments, approximate their book values.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

The following table presents the carrying value and classification of the Corporation's financial instruments as of December 31, 2012 and December 31, 2011:

	2012 $	2011 $
Financial assets		
FVTPL		
Foreign exchange forward contracts	1,507	3,076
Loans and receivable (carried at amortized cost)		
Cash and cash equivalents	35,376	17,984
Short-term bank deposits	11,284	9,034
Accounts receivable	46,875	41,508
Long-term bank deposits	-	2,526
Restricted cash	-	4,483
Investment in and loan receivable from an associate	289	356
Financial liabilities		
FVTPL		
Foreign exchange forward contracts	-	424
7.5% debentures	45,729	43,110
5.9% debentures	42,434	-
Exchangeable interest liability	85,726	72,031
Other liabilities (carried at amortized cost)		-
Accrued interest payable	607	526
Dividends payable	2,669	2,553
Accounts payable	14,744	7,299
Accrued liabilities	16,198	12,602
Long-term debt	41,644	43,972

The financial instruments of the Corporation that are recorded at fair value have been classified into levels using a fair value hierarchy. The three levels of the fair value hierarchy are defined below:

Level 1 – unadjusted quoted prices available in active markets for identical assets or liabilities;

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs).

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

The following tables represent the fair value hierarchy of the Corporation's financial assets and liabilities that were recognized at fair value as of December 31, 2012 and December 31, 2011.

	2012			
	Level 1 $	Level 2 $	Level 3 $	Total $
Financial assets				
Foreign exchange forward contracts	-	1,507	-	1,507
Financial liabilities				
7.5% debentures	45,729	-	-	45,729
5.9% debentures	42,434	-	-	42,434
Exchangeable interest liability	-	85,726	-	85,726
Total	**88,163**	**87,233**	**-**	**175,396**

	2011			
	Level 1 $	Level 2 $	Level 3 $	Total $
Financial assets				
Foreign exchange forward contracts	-	3,076	-	3,076
Financial liabilities				
Foreign exchange forward contracts	-	424	-	424
7.5% debentures	43,110	-	-	43,110
Exchangeable interest liability	-	72,031	-	72,031
Total	**43,110**	**75,531**	**-**	**118,641**

12.4 Financial risk management

In the normal course of its operations, the Corporation faces a number of risks that might have an impact on results of its operations and values of the financial instruments presented in the financial statements. Financial risks are outlined below as well as policies and procedures established by the Corporation for monitoring and controlling these risks.

12.4.1 Foreign Exchange Risk

Dividends to common shareholders of the Corporation, interest on convertible debentures and a portion of the Corporation's expenses are paid in Canadian dollars while all of its revenues are in U.S. dollars. To mitigate this risk, the Corporation enters into foreign exchange forward contracts to economically hedge its exposure to the fluctuation of the exchange rate between U.S. and Canadian currencies. The Corporation has foreign exchange hedging policies in place and the execution of these policies is monitored by a designated hedging committee of the board of directors.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

The values of foreign exchange forward contracts and convertible debentures as reported in the Corporation's financial statements are dependent on the movement of the exchange rate between U.S. and Canadian dollars. Except for the impact on the value of the foreign exchange forward contracts (not readily available), a 1% change in the value of the Canadian dollar against the U.S. dollar, compared to the actual fluctuations in the exchange rate that occurred in the current period, would have had the following impact on net income and comprehensive income for the years reported:

Exchange rate change	**2012 $**	**2011 $**
1% strengthening of the Canadian dollar	(1,716)	(2,194)
1% weakening of the Canadian dollar	1,716	2,151

12.4.2 Credit Risk

The Corporation faces the following credit risks.

Accounts Receivable

The Centers receive payment for services rendered from U.S. federal and state agencies, private insurance carriers, employers, managed care programs and patients. In 2012, two of these payors contributed 25.9% (2011: 25.3%) and 18.1% (2011: 19.2%), respectively, to the facility service revenue. A portion of the facility service revenue is received directly from the patients (either in the form of co-payments and/or deductibles under insurance policies or full payment if a patient does not have insurance coverage). Amounts considered non-collectible are provided for and monitored on an on-going basis. The Corporation reviews reimbursement rates and aging of the accounts receivable to monitor its credit risk exposure.

The table below summarizes the patient accounts receivable and allowance for non-collectible amounts as at December 31, 2012 and December 31, 2011:

	2012 $	**2011 $**
Accounts receivable (net of allowance for contractual adjustments)	56,908	46,992
Allowance for non-collectible receivable balances	(10,033)	(5,484)
Net accounts receivable	**46,875**	**41,508**

Concentration of Financial Institutions

The Corporation regularly enters into foreign exchange forward contracts and places excess funds for investment with certain financial institutions. The counterparties to the foreign exchange forward contracts are two banking institutions and the Corporation considers the risk of their default on the contracts to be minimal. Investment of excess funds is guided by the investment policy of the Corporation that (i) prescribes the eligible types of investments and (ii) establishes limits on the amounts that can be invested with any one financial institution.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

12.4.3 Interest Rate Risk

The Corporation and the individual Centers enter into certain long-term credit facilities that expose them to the risk of interest rate fluctuations. The Corporation uses floating rate debt facilities for operating lines of credit that fund short-term working capital needs and uses fixed rate debt facilities to fund investments and capital expenditures.

At the reporting dates, the interest rate profile of the Corporation's interest-bearing financial liabilities was:

	2012 $	2011 $
Facilities with fixed interest rates	128,382	77,631
Facilities with variable interest rates	1,425	9,451
Total	**129,807**	**87,082**

A change of 100 basis points in the interest rates in the reporting period would have led to an increase or a decrease in interest expense of $16 (2011: $41).

12.4.4 Price Risk

The Centers routinely purchase materials and supplies for use in surgical and other procedures performed at the Centers. Certain materials and supplies are billed to payors based on cost, which serves to mitigate the risk associated with price changes. The Centers also enter into purchase agreements which include negotiated pricing that reduces pricing risk.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

12. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (Continued)

12.4.5 Liquidity Risk

The mandatory repayments under the credit facilities, notes payable and other contractual obligations and commitments including expected interest payments, on a non-discounted basis, as of December 31, 2012, are as follows:

		Future payments (including principal and interest)				
Contractual Obligations	**Carrying values at Dec. 31, 2012**	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
	$	**$**	**$**	**$**	**$**	**$**
Accrued interest payable	607	607	607	-	-	-
Dividends payable	2,669	2,669	2,669	-	-	-
Accounts payable	14,744	14,744	14,744	-	-	-
Accrued liabilities	16,198	16,198	16,198	-	-	-
Revolving credit facilities	5,433	5,535	4,110	1,425	-	-
Notes payable and term loans	33,563	36,556	9,826	22,914	1,077	2,739
Finance lease obligation	2,648	2,760	1,622	559	382	197
Operating leases and other commitments (not recorded in the financial statements)	-	10,401	3,290	4,289	2,371	451
7.5% debentures	45,729	46,872	46,872	-	-	-
5.9% debentures	42,434	59,960	2,504	5,007	5,007	47,442
Total contractual obligations	**164,025**	**196,302**	**102,442**	**34,194**	**8,837**	**50,829**

The Corporation's Line of Credit of Cdn$50.0 million expiring on July 4, 2015 was undrawn as at December 31, 2012.

The Corporation anticipates renewing, extending or replacing its revolving credit facilities which fall due during 2013 and expects that cash flows from operations and working capital will be adequate to meet future payments on other contractual obligations during 2013.

13. CAPITAL

The Corporation's objective when managing capital is to:

(i) safeguard the Corporation's ability to continue as a going concern and make acquisitions;

(ii) ensure sufficient liquidity to fund current operations and its growth strategy; and

(iii) maximize the return to common shareholders.

The capital of the Corporation is defined to include common shares (note 11.3), convertible debentures (note 10) and other debt facilities at the corporate level.

The Corporation manages its liquidity and capital structure by monitoring its cash and cash equivalents, its current indebtedness and future financing and funding needs.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

13. CAPITAL (Continued)

In addition, the Corporation regularly monitors current and forecasted debt levels to ensure compliance with debt covenants. As of the reporting date, the Corporation is in compliance with the covenants. The Corporation's long-term debt and revolving lines of credit require the maintenance of various financial ratios. Under the terms of the Line of Credit, the Corporation must meet two *pro forma* financial ratios at the time of incurring new debt.

In order to maintain or adjust the capital structure, the Corporation may enter into or repay credit facilities, adjust the amount of dividends paid to common shareholders, repurchase its publicly traded securities or issue new shares or convertible debt. During the twelve-month period ended December 31, 2012, the Corporation has returned capital to shareholders through the repurchase and cancellation of 81,774 common shares under the normal course issuer bid (note 11.5).

14. EMPLOYEE FUTURE BENEFITS

Benefits programs at the Centers include qualified 401(k) retirement plans which cover all employees who meet eligibility requirements. Each participating Center makes matching contributions subject to certain limits. In 2012, contributions made by the six (2011: five) Centers to such plans were $1,170 (in 2011: $1,083).

15. INCOME TAXES

Prior to the Conversion, the U.S. tax returns for the Corporation were prepared on a consolidated basis and included balances and amounts attributable to both Canadian and U.S. entities. Subsequent to the Conversion, the U.S. tax return for the Corporation is prepared on a consolidated basis for U.S. entities and includes balances and amounts attributable to these entities. The Canadian income tax return for the Corporation is prepared on a stand-alone basis and includes non-consolidated balances attributable to the Canadian entity only. Income taxes reported in these consolidated financial statements are as follows:

Provision for Income Taxes	**2012 $**	**2011 $**
U.S. income tax expense (recovery)		
Current	2,198	2,100
Deferred	(2,541)	11,519
	(343)	**13,619**
Canadian income tax expense (recovery)		
Current	-	-
Deferred	(21,775)	(4,725)
	(21,775)	**(4,725)**
Total income tax expense (recovery)	**(22,118)**	**8,894**

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

15. INCOME TAXES (Continued)

Prior to the Conversion, the Centers were required to withhold and deposit with the U.S. government the tax on the portion of their income allocable to the Corporation (reduced by the annual amount of goodwill amortized for tax purposes and interest incurred at the corporate level) at a rate of 35%. Such withholdings are treated as instalments for the income tax owing by the Corporation, and after deducting taxes exigible, are refunded by the U.S. government after the Corporation files its tax return. The amount of the withholding tax deposited by the Centers is reduced by the estimated provision for the current income taxes as follows:

	2012 $	2011 $
Income Tax		
Withholding tax and instalments deposited	10,261	12,234
Provision for current income taxes	(3,325)	(2,100)
Income tax receivable	**6,936**	**10,134**

The following table reconciles income taxes, calculated at the U.S. combined federal and state tax rate and the Canadian combined federal and provincial income tax rate, to the income tax expense reported in the consolidated statement of income and deficit:

	2012		2011	
	$	%	$	%
U.S. Income Taxes				
Consolidated pre-tax comprehensive income (loss)	10,700	100.0	(6,476)	100.0
Expected tax expense (recovery) at the combined U.S. federal and state rate	3,852	36.0	(2,331)	36.0
Impact of Conversion	-	-	19,767	(305.2)
Items attributable to exchangeable interest liability	838	7.8	1,489	(23.0)
Expenses attributable to Canadian entity that cannot be claimed on U.S. tax return	2,656	24.8	(585)	9.0
Non-deductible expenses	2	0.0	226	(3.5)
Inter-company loan interest expense	(8,604)	(80.4)	(5,029)	77.7
Adjustments to current taxes considered to be recoverable	(356)	(3.3)	-	-
Other	1,269	11.9	82	(1.3)
Income tax expense (recovery)	**(343)**	**(3.2)**	**13,619**	**(210.3)**
Canadian Income Taxes				
Non-consolidated pre-tax income (loss) of Canadian entity	16,644	100.0	(3,679)	100.0
Expected tax expense (recovery) at the combined Canadian federal and provincial rate[1]	4,411	26.5	(1,039)	28.2
Non-taxable foreign exchange loss (gain)	(986)	(5.9)	1,078	(29.3)
Change in value of convertible debentures	909	5.5	(367)	10.0
Change in previously unrecognized deferred tax assets	(26,105)	(156.8)	(4,725)	128.4
Difference between current and deferred enacted tax rate	-	-	(80)	2.2
Other	(4)	0.0	408	(11.1)
Income tax expense (recovery)	**(21,775)**	**(130.8)**	**(4,725)**	**128.4**

[1] The Canadian federal and provincial statutory income tax rates were reduced by 1.5% and 0.2%, respectively, in 2012.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

15. INCOME TAXES (Continued)

As of December 31, 2012, the Corporation had net operating loss carry forwards for Canadian tax purposes totalling $156,839 that are scheduled to expire in the following years:

	$
2015	20,977
2026	24,350
2027	24,710
2028	29,959
2029	28,518
2030	26,919
2031	1,406
Net operating loss carry forwards	**156,839**

Losses related to the Canadian entity may be used to offset the future income of the Canadian entity for Canadian income tax purposes. As of December 31, 2012, the Corporation has recognized deferred income tax assets of $26,500 in respect of net operating loss carry forwards that will be offset against future taxable income in the Canadian entity.

The components of deferred income tax balances are as follows:

	2012 **$**	**2011** **$**
U.S. Income Taxes		
Deferred income tax assets		
Allowance for doubtful accounts	1,745	1,400
Accrued liabilities and other	852	512
Goodwill and other intangibles	5,796	5,669
Cumulative change in the value of exchangeable interest liability	12,413	8,520
Net operating losses and deductions carry forwards	274	1,299
Total deferred income tax assets	**21,080**	**17,400**
Deferred income tax liabilities		
Property and equipment	(1,953)	(1,476)
Prepaid expenses and other	(77)	(83)
Goodwill and other intangibles	(7,845)	(6,255)
Unrealized foreign exchange loss	(185)	(1,107)
Total deferred income tax liabilities	**(10,060)**	**(8,921)**
Net deferred income tax assets	**11,020**	**8,479**
Canadian Income Taxes		
Deferred income tax assets		
Net operating loss carry forwards	41,562	42,765
Deferred financing costs	543	168
Deferred income tax assets	42,105	42,933
Unrecognized deferred income tax assets	(15,605)	(38,208)
Deferred income tax assets	**26,500**	**4,725**

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

16. INTEREST EXPENSE, NET OF INTEREST INCOME

Interest expense, net of interest income, included in the statement of comprehensive income consists of the following:

	2012 **$**	**2011** **$**
Interest expense at Centers' level	1,866	2,177
Interest expense on subordinated notes payable	-	9,137
Interest expense on convertible debentures	3,299	3,260
Financing costs related to 5.9% debentures	1,683	-
Miscellaneous interest expense at corporate level	40	2
Amortization of available Line of Credit stand-by fees	342	256
Interest income at Centers' level	(16)	(17)
Interest income at corporate level	(505)	(233)
Interest expense, net of interest income	**6,709**	**14,582**

17. LOSS (GAIN) ON FOREIGN CURRENCY

Loss (gain) on foreign currency included in the statement of comprehensive income consists of the following:

	2012 **$**	**2011** **$**
Unrealized loss (gain) on subordinated notes payable	-	4,506
Unrealized loss (gain) on foreign exchange forward contracts	1,145	899
Unrealized loss (gain) on foreign currency	1,145	5,405
Realized loss (gain) on foreign exchange forward contracts which matured in the current period	(3,522)	(797)
Translation loss (gain) on cash balances denominated in Cdn$	(285)	176
Loss (gain) on foreign currency	**(2,662)**	**4,784**

The unrealized loss on subordinated notes payable for 2011 represents the loss accrued on subordinated notes payable up to the date of Conversion, May 31, 2011.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

18. RELATED PARTY TRANSACTIONS AND BALANCES

The Corporation and the Centers routinely enter into transactions with certain related parties. These parties are considered related through ownership in them by the holders of non-controlling interests in the respective Centers. Such transactions are in the normal course of operations and are at the exchange amounts agreed upon by the parties involved.

18.1 Management services and other contracts and real estate lease contracts

The Corporation and the Centers entered into transactions with the following related parties during the years ended December 31, 2012 and December 31, 2011:

Entity	Related Party	Nature of Relationships	Nature of Transactions
SFSH	Center Inn	Certain indirect non-controlling owners of SFSH are also owners of Center Inn.	Provision of laundry services to SFSH.
	Surgical Management Professionals, LLC (“SMP”) and Sioux Falls Surgical Physicians, LLC (“Surgical Physicians”)	Surgical Physicians own 49% of SFSH. SMP is owned by certain indirect non-controlling owners of SFSH.	SFSH pays to and receives reimbursements from SMP for various shared services, such as utilities, computer software, travel, etc. SMP provides billing and coding services to SFSH and management services to DPSC.
	South Dakota Interventional Pain Institute, LLC (“SDIPI”)	Surgical Physicians and the Corporation own equity interest in SDIPI.	Use of a facility and related equipment by SFSH.
	Orthopedic Institute	Certain indirect non-controlling owners of SFSH are also owners of Orthopedic Institute.	Provision of physical and occupational therapy services.
	Medical Management Partners (“MMP”)	The President of MMP became an employee of SFSH in November 2011.	Provision of hospitalist coverage and medical director services. This relationship was terminated in 2012.
	Ludoc Enterprises	The President of Ludoc Enterprises became an employee of SFSH in November 2011.	Provision of contracted services for SFSH primary care and provision of drug screening. This relationship was terminated in 2012.
	Indirect non-controlling physician-owner		Provision of certain medical products.
	Anesthesiology Associates	Certain indirect non-controlling owner of SFSH is also owner of Anesthesiology Associates.	Provision of anaesthesia services to SFSH. Anesthesiology Associates lease office space from SFSH.
	Various entities	Certain indirect non-controlling owners of SFSH are also owners of various entities.	Physician professional fees in relation to an agreement with South Dakota Bureau of Personnel to provide outpatient surgeries.
DPSC	Orthopedic Surgery Specialists (“OSS”)	Certain indirect non-controlling owners of DPSC are also owners of OSS.	Provision of certain physician services to DPSC.
	Orthopedic Center of the Dakotas (“OCD”)	Certain indirect non-controlling owners of DPSC are also owners of OCD.	Reimbursement by DPSC of salaries and benefits expenses incurred on behalf of DPSC.
BHSH	Black Hills Orthopedic and Spine Center (“BHOSC”)	Certain indirect non-controlling owners of BHSH are also owners of BHOSC.	Provision of physical therapy services to BHSH.
	Neurosurgical & Spinal Surgery Associates (“NSSA”)	Certain indirect non-controlling owners of BHSH are also owners of NSSA.	Provision of physical therapy services and intra-operative monitoring services to BHSH.

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

18. RELATED PARTY TRANSACTIONS AND BALANCES (Continued)

Entity	Related Party	Nature of Relationships	Nature of Transactions
OSH	Integrated Medical Delivery, LLC (“IMD”)	Certain indirect non-controlling owners of OSH are also owners of IMD.	Provision of office and management services to OSH.
	Indirect non-controlling physician owner		Lease of anaesthesiology equipment by OSH.
	Memorial Property Holdings, LLC (“MPH”)	The majority of owners of MPH are also indirect non-controlling owners of OSH.	Lease of hospital building by OSH.
	MM Property Holdings, LLC (“MM Property”)	MM Property is owned by two physicians who are indirect non-controlling owners in OSH.	Lease of additional office space by OSH.
	Synergistic Implant Providers (“SIP”)	Certain indirect non-controlling owners of OSH are also owners of SIP.	Purchase of implants, implantable devices and medical supplies by OSH.
Newport Coast	Indirect non-controlling physician owner		Payment of pain management directorship fees by Newport Coast. This relationship was terminated in 2012.
ASH	A.S.H. Imaging Partners, LLC (“ASH Imaging”)	Certain indirect non-controlling owners of ASH are also owners of ASH Imaging.	Sub-lease of MRI equipment by ASH.
	A.S.H. Land & Development, LLC (“ASH L&D”)	Certain indirect non-controlling owners of ASH are also owners of ASH L&D.	Lease of facility building by ASH.
Corporation	SC Meridian, LLC	SC Meridian, LLC is an entity controlled by an officer of the Corporation.	Aircraft charter by the Corporation.

The expenses resulting from the Corporation’s and Centers’ transactions with related parties are as follows:

	2012 $	2011 $
SFSH	3,933	3,217
DPSC	2,807	2,658
BHSH	447	443
OSH	5,303	6,577
Newport Coast	5	34
ASH	337	-
Corporation	3	3
Total related party expenses	**12,835**	**12,932**

The amounts payable to (receivable from) the related parties are as follows:

	At December 31,	
	2012 $	2011 $
SFSH	496	883
DPSC	(18)	(10)
BHSH	30	19
OSH	197	449
ASH	1,262	-
Total payable to related parties	**1,967**	**1,341**

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

18. RELATED PARTY TRANSACTIONS AND BALANCES (Continued)

18.2 Other transactions

Certain of the physicians, who indirectly own the non-controlling interest in each of the Centers, routinely provide professional services directly to patients utilizing the facilities of the Centers and reimburse the Centers for the space and staff utilized. Also, certain of the physicians serve on the boards of management of the Centers and four such individuals perform the duties of Medical Director at the respective Centers and are compensated in recognition of their contribution to the Centers.

18.3 Key management compensation

Key management personnel are comprised of three executive officers, namely the President, the Chief Executive Officer and Chief Financial Officer, and the directors of the Corporation. Key management compensation for the years ended December 31, 2012 and December 31, 2011 was as follows:

	2012 $	2011 $
Salaries and other short-term employee benefits for executive officers	1,672	1,053
Director compensation	738	709
Total key management compensation	**2,410**	**1,762**

Salaries and other short-term employee benefits for executive officers include cash payments to executive officers for their base salaries, bonuses, social security payments, medical insurance payments and payments under the Corporation’s long-term incentive plan. Director compensation consists of retainers, meeting fees and fees for special projects where a director is asked to undertake such special projects.

19. COMMITMENTS AND CONTINGENCIES

19.1 Commitments

In the normal course of operations, the Centers lease certain equipment under non-cancellable long-term leases and enter into various commitments with third parties. In addition, certain of the Centers lease their facility space from related (note 18) and non-related parties. Minimum payments for these leases are detailed in “Liquidity risk” section in note 12.4.5.

19.2 Contingencies

In the normal course of business, the Centers are, from time to time, subject to allegations that may result in litigation. Certain allegations may not be covered by the Centers’ commercial and liability insurance. The Centers evaluate such allegations by conducting investigations to determine the validity of each potential claim. Based on the advice of the legal counsel, management records an estimate of the amount of the ultimate expected loss for each of these matters. Events could occur that would cause the estimate of the ultimate loss to differ materially from the amounts recorded.

19. COMMITMENTS AND CONTINGENCIES (Continued)

ASH recorded an accrued liability of approximately $780 for the estimated cost of surgeries to replace a recalled hip implant product (“revision surgeries”). ASH has received denials from third-party payors for the revision surgeries performed and anticipates having to perform additional revision surgeries that will result in no reimbursement.

20. COMPARATIVE INFORMATION

The Corporation made the following reclassifications to the previously reported IFRS consolidated statements of comprehensive income for the year ended December 31, 2011:

(i) Bad debt expense of $4,371 was reclassified from line item “General and administrative” to line item “Facility service revenue”;

(ii) Depreciation of property and equipment of $6,885 was reclassified from line item “Depreciation and amortization” and included in “Operating expenses”. The line item “Depreciation and amortization” was renamed “Amortization of other intangibles”; and

(iii) Unrealized (loss) gain on convertible debentures of $964 was reclassified from line item “Loss (gain) on foreign currency” to line item “Increase (decrease) in value of convertible debentures”.

As a result of these reclassifications, for the year ended December 31, 2011, (i) facility service revenue and general and administrative expenses decreased by $4,371; (ii) operating expenses increased by $2,514; (iii) income from operations decreased by $6,885 and (iv) loss (gain) on foreign currency increased by $964 and change in value of convertible debentures correspondingly decreased by $964. No change was recorded to net income and comprehensive income for the year ended December 31, 2011 as a result of the above-noted reclassifications.