Consolidated Financial Statements with Supplemental Information

West Tennessee Healthcare and Related Affiliates
Years Ended June 30, 2008 and 2007
With Report of Independent Auditors

0811-1007284

West Tennessee Healthcare and Related Affiliates

Audited Consolidated Financial Statements

Years Ended June 30, 2008 and 2007

Contents

Ernst & Young LLP
Suite 1400
One Nashville Place
`50 Fourth Avenue North
Nashville, Tennessee 37219

Tel: 615 252 2000
Fax: 615 242 9128
www.ey.com

Report of Independent Auditors

The Board of Trustees
West Tennessee Healthcare

We have audited the accompanying consolidated balance sheets of West Tennessee Healthcare and Related Affiliates (the Company) as of June 30, 2008 and 2007, and the related consolidated statements of revenues and expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of West Tennessee Healthcare and Related Affiliates at June 30, 2008 and 2007, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Management's Discussion and Analysis on pages 3 through 10 is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

0811-1007284

In accordance with *Government Auditing Standards,* we have also issued our report dated October 17, 2008 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedules of expenditures of federal awards and expenditures of state financial assistance are presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Ernst + Young LLP

October 17, 2008

West Tennessee Healthcare and Related Affiliates

Management's Discussion and Analysis

Years Ended June 30, 2008 and 2007

This section of the financial statements of West Tennessee Healthcare and Related Affiliates (the Company) presents management's analysis of the Company's financial performance during the fiscal year ended June 30, 2008.

Financial Highlights

2008

- With an operating margin of 2%, the Company experienced a downturn in financial results for 2008 as growth in operating expense, including interest costs, outpaced growth in revenue. Contributing to the increase in the operating expense was a $4 million dollar interest expense variance and two nonrecurring items: $1.4 million in losses related to the writedown of office buildings to allow for construction of a new Medical Office Building and $0.9 million in losses related to the extinguishment of the 2006A bond issue.

- The average length of stay for hospital inpatients at the flagship hospital was over budget by 2%, but improved from the prior year by 2%.

- Total operating revenues increased by 3% compared to the prior year with routine volume growth and improved reimbursement.

- Total operating expense, excluding interest costs, also increased by 3% compared to the prior year with market adjustments for employees, increases in depreciation expense, increases in cost for call pay to physicians and increases in maintenance contracts.

- During the last quarter of the calendar year 2007, turmoil in credit markets, downgrades to bond insurers and other financial institutions, as well as investor uncertainty resulted in the interruption of variable rate auction markets. This interruption negatively affected the Company and caused an interest expense variance from budget of $4 million.

- The Company has a history of sound bond ratings, with Moody's assigning a rating of "A1" to the Company's 2006 bond issue while Standard and Poor's assigned a rating of "A+" to the 2006 issue. It should also be noted that the Company's debt was comprised of fully-insured variable rate bonds.

- During April, May and June, in order to mitigate the high interest expense, the Company purchased and held up to $35,175,000 of its own bonds. This resulted in a reduced interest rate for the 2006A series of Bonds. As a result of this transaction, the Company posted a loss of $936,467 on the extinguishment of the debt and related unamortized asset costs. In addition, the Long Term Liability and corresponding Investment were written down by $33,175,000, the amount of bonds purchased.

- The increase in interest expense combined with negative results in investment income resulted in a significant downturn in net non-operating revenues and expenses compared with the prior year (down 163%).

2007

- Although operating margin remained strong at 4.4%, the Company experienced a slight downturn in financial results for 2007 as the growth of operating expenses exceeded the growth of operating revenue (9% vs. 7%).

- The Company continued its emphasis on improving patient satisfaction, given a year with major ongoing construction projects at several campuses and increased patient volume. Patient satisfaction results remained consistent throughout the year, with a slight decrease of 0.3 points from the annual average of the prior year.

- Total operating revenues increased by 7% compared to the prior year with routine volume growth and improved reimbursement.

- Total operating expense increased by 9% compared to the prior year with substantial increases in compensation, depreciation, and administrative costs.

- Net non-operating revenues and expenses increased significantly over the prior year with improved market conditions.

Overview of the Financial Statements

The Financial Statements consist of two parts: Management's Discussion and Analysis and the Basic Financial Statements. The Basic Financial Statements also include notes and required supplementary information that explain in more detail some of the information in the Financial Statements.

Required Basic Financial Statements

The Company reports financial information about the Company using accounting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information about its activities. The Consolidated Balance Sheets include all of the Company's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to Company creditors (liabilities). The assets and liabilities are presented in a classified format, which distinguishes between current and long-term assets and liabilities. These statements also provide the basis for computing rate of return, evaluating the capital structure of the Company and assessing the liquidity and financial flexibility of the Company.

All of the current year's revenues and expenses are accounted for in the Consolidated Statements of Revenues and Expenses and Changes in Net Assets. These statements measure the performance of the Company's operations over the past year and can be used to determine whether the Company has successfully recovered all of its costs through the services provided, as well as its profitability and credit worthiness.

The final required statement is the Consolidated Statement of Cash Flows. The primary purpose of this statement is to provide information about the Company's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, non-capital financing and financing activities, and provides information as to where cash came from, what cash was used for, and what the change in the cash balance was during the reporting period.

Financial Analysis

Our analysis of the Financial Statements of the Company begins below. One of the most important questions asked about the Company's finances is "Is the Company as a whole better off or worse off as a result of the year's activities?" The Consolidated Balance Sheet and the Consolidated Statement of Revenues, Expenses, and Changes in Net Assets report information about the Company's activities in a way that will help answer this question. These statements report the net assets of the Company and changes in them. You can think of the Company's net assets – the difference between assets and liabilities – as one way to measure financial health or financial position. Over time, increases or decreases in the Company's net assets are one indicator of whether its financial health is improving or deteriorating. However, you will need to consider other non-financial factors such as changes in interest rates, economic conditions, regulations and new or changed government legislation.

Net Assets

A summary of the Company's Consolidated Balance Sheets is presented in Table A-1.

Table A-1

Condensed Consolidated Balance Sheets (In millions of dollars)

	Fiscal Year 2008	Fiscal Year 2007	Fiscal Year 2006	Dollar Increase (Decrease) 2007-2008	Percentage Increase (Decrease) 2007-2008
Current Assets	**$ 114.8**	**$ 105.0**	$ 89.6	$ 9.8	9%
Capital Assets, Net	**399.2**	**363.8**	308.9	35.4	10%
Other Long-Term Assets	**275.0**	**356.6**	284.4	(81.6)	(23%)
Total Assets	**$ 789.0**	**$ 825.4**	$ 682.9	$ (36.4)	(4%)
Current Liabilities	**$ 66.4**	**$ 71.1**	$ 71.9	$ (4.7)	(7%)
Long-Term Liabilities	**229.3**	**265.8**	179.3	(36.5)	(14%)
Total Liabilities	**$ 295.6**	**336.9**	251.2	(41.2)	(12%)
Invested in Capital Assets, net of related financing	**$ 230.7**	**213.1**	149.6	17.6	8%
Restricted	**1.1**	**19.2**	10.0	(18.2)	(95%)
Unrestricted	**261.6**	**256.2**	272.1	5.4	2%
Total Net Assets	**493.4**	**488.5**	431.7	4.8	1%
Total Liabilities and Net Assets	**$ 789.0**	**$ 825.4**	$ 682.9	$ (36.4)	(4%)

As indicated in Table A-1, net assets increased from fiscal 2007 by $4.8 million or 1% with the Company's operating performance in fiscal year 2008.

- Total assets decreased by $36.4 million or 4% due primarily to substantial reductions in invested funds as a result of the organization's purchase of its own bonds in an effort to mitigate losses from the failed bond auctions as discussed above. Current and Capital assets were up from the prior year, offsetting the loss.

- Total liabilities decreased by $41.2 million or 12% due primarily to the extinguishment of $33.1 million of the 2006A auction rate bonds, as discussed above.

Table A-2

Condensed Consolidated Statements of Revenues, Expenses and Changes in Net Assets (In millions of dollars)

	Fiscal Year 2008	Fiscal Year 2007	Fiscal Year 2006	Dollar Increase (Decrease) 2007-2008	Percentage Increase (Decrease) 2007-2008
Net Patient Service Revenues	**$ 510.1**	**$ 496.1**	$ 462.0	$ 14.0	3%
Other Operating Revenues	**33.0**	**31.8**	30.9	1.2	4%
Total Operating Revenues	**543.1**	**527.9**	492.9	15.2	3%
Salaries and Benefits	**288.9**	**279.2**	253.6	9.7	3%
Supply Expenses	**110.5**	**108.2**	104.6	2.3	2%
Other Expenses	**118.1**	**105.7**	93.8	12.4	12%
Total Expenses	**517.5**	**493.1**	452.0	24.4	5%
Income from Operations	**25.6**	**34.8**	40.9	(9.2)	26%
Net Nonoperating Revenues and Expenses	**(15.4)**	**24.6**	7.8	(40.0)	(163%)
Change in Net Assets	**10.2**	**59.4**	48.7	(49.2)	(83%)
Beginning Net Assets	**488.5**	**431.8**	385.9	56.7	13%
Less Contributions	**(5.3)**	**(2.7)**	(2.8)	(2.6)	96%
Ending Net Assets	**$ 493.4**	**$ 488.5**	$ 431.8	$ 4.9	1%

While the Consolidated Balance Sheets show the change in financial position or net assets, the Consolidated Statements of Revenues and Expenses and Changes in Net Assets, as indicated above, provide answers as to the nature and source of these changes (i.e., the financial result of current year operations).

Operating revenues increased by 3% from the prior year. The increase was driven by routine factors—volume and reimbursement changes.

1. Volumes were up over the prior period with routine growth in mostly outpatient services. Emergency visits increased by 4% and inpatient and outpatient surgical cases increased by 2% each. Inpatient volumes were flat compared to the prior year with discharges down 0.1% and the average daily census was down 2% which was driven by a corresponding decrease in the average length of stay.

2. Routine reimbursement changes from Medicare and contracted payers drove net revenues up by an estimated $5.5 million over the prior year.

Operating expense increased by 3% from the prior year.

1. Total salaries and benefits expense for the system increased by 3%. The Company's staffing levels as measured by total paid full-time-equivalent employees (FTEs) increased by 2% driving a portion of the increase. The remainder of the increase was driven by significant adjustments to salaries (merit and market-based salary adjustments in the first quarter of 2008) and routine growth of health plan claims cost. These increases were offset by the Company's efforts to control cost with reduced inpatient volumes. The most significant impact of these efforts was reduced usage of contract labor, for which expense was down 37% or $6.4 million from the prior year.

2. Total supply cost for the system increased by 2% from the prior year with the increase in surgical volume. Efforts to control growth of supply chain costs continued through the year.

3. Other expenses increased by 12% from the prior year with the following notable changes.

    a. Depreciation expense increased by 6% or $2.3 million. In addition to routine capital additions and improvements, the Company brought into service several minor construction projects.

    b. The Company incurred $1.4 million in nonrecurring losses for the de-valuation of office buildings to be vacated and demolished to allow construction of a new Medical Office Building.

    c. The Company incurred $0.9 million in nonrecurring losses with the extinguishment of the 2006A bond issue.

    d. Medical services fees increased by $3.6 million or 36% with increased cost primarily for physician call pay.

    e. Equipment Maintenance costs increased by $1.1 million or 12% with routine inflation of costs and new equipment. The Company's investment in the Cerner clinical information system represents a significant portion of these costs.

The significant decrease in net non-operating revenues was the result of significant increases in interest expense during the year with unfavorable changes in the auction rate bond market. Interest expense for the year was up 30% or $3.5 million over the prior year. In addition, income from investments was down due to the year-end valuation of investments.

Capital Assets and Long-Term Debt

Capital Assets

As of June 30, 2008, the Company had $399.2 million invested in a variety of capital assets, as reflected in Table A-3, which represents a net increase (additions, disposals and depreciation) of $35.4 million or 10% from the end of last year. Construction in progress includes costs to date of $121 million for a nine floor, 356,000 square foot bed tower opened in late September of 2008.

Table A-3

Capital Assets (In millions of dollars)

	Fiscal Year 2008	Fiscal Year 2007
Land and Land Improvements	43.0	43.5
Buildings	167.8	168.4
Equipment	440.0	421.5
Construction in Progress	128.5	82.5
Total Capital Assets	779.3	715.9
Accumulated Depreciation	(380.1)	(352.1)
Net Capital Assets	399.2	363.8

Long-Term Debt

As of June 30, 2008, the Company had $233 million in outstanding long-term debt and as of June 30, 2007, the Company had $270 million in outstanding long-term debt. This represents a net decrease of $36 million over the prior fiscal year which is attributable primarily to the extinguishment of $33.1 million of the 2006A auction rate bonds, as discussed above.

For more detailed information regarding the Company’s capital assets and long-term debt, please refer to the notes to the financial statements.

Future Outlook

The Board of Trustees and management have a positive outlook about the future of the Company. Increases in volume are expected to resume as the Company continues to add new services and expand existing services. Additional increases in volume are expected as the Company continues to experience an increase in the population of its service area along with an increase in the age of the population as a whole and a projected increase in medical staff.

In August of 2008, the Company issued fixed rate bonds and has eliminated its risk associated with variable rate debt. During this process Standard and Poor’s reaffirmed our bond rating of “A+,” while Moody’s assigned the Company an “A1” rating with a positive outlook.

On September 28, 2008, the Company opened the recently completed replacement bed tower. Major renovations to the replaced tower began immediately thereafter, with an approved budget of $27 million.

In addition, plans for the near future include construction of a Medical Office building complex across Forest Avenue from the main campus. This complex is to be constructed by an unrelated developer on property to be leased from the Company.

Requests for Information

This financial report is designed to provide a general overview of the Company's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Company.

West Tennessee Healthcare and Related Affiliates

Consolidated Balance Sheets

	June 30 2008	June 30 2007
Assets		
Current assets:		
Cash and cash equivalents	**$ 12,121,725**	$ 17,220,991
Accounts receivable:		
Patient accounts receivable	**85,642,117**	71,394,653
Other	**5,232,847**	6,551,128
Total accounts receivable	**90,874,964**	77,945,781
Inventories	**4,976,984**	4,383,124
Prepaid expenses	**5,771,386**	4,170,112
Assets limited as to use—current portion	**1,076,595**	1,310,470
Total current assets	**114,821,654**	105,030,478
Assets limited as to use:		
Funded depreciation—buildings	**34,197,922**	34,495,668
Funded depreciation—equipment	**18,387,406**	18,547,498
Project fund	**–**	17,841,567
Project building fund	**101,764,179**	164,470,960
Operating reserve fund	**91,876,306**	92,745,457
Contingency fund	**7,180,844**	7,243,365
High technology fund	**8,525,726**	8,599,959
	261,932,383	343,944,474
Other assets:		
Unamortized bond issue costs	**5,567,012**	6,510,915
Other	**7,449,212**	6,107,954
	13,016,224	12,618,869
Property, plant, and equipment:		
Land and land improvements	**42,965,154**	43,465,323
Buildings	**167,820,543**	168,380,577
Fixed equipment	**117,145,675**	117,849,608
Moveable equipment	**322,857,236**	303,780,978
Construction in progress	**128,538,305**	82,457,318
	779,326,913	715,933,804
Accumulated depreciation	**(380,093,335)**	(352,128,116)
	399,233,578	363,805,688
Total assets	**$ 789,003,839**	$ 825,399,509

	June 30	
	2008	**2007**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 19,784,889**	$ 18,370,215
Accrued compensation and related expenses	**18,337,515**	16,140,436
Accrued interest expense	**1,302,308**	892,601
Other accrued expenses	**22,874,594**	31,722,208
Long-term debt due within one year	**4,100,000**	3,925,000
Total current liabilities	**66,399,306**	71,050,460
Other liabilities:		
Long-term debt, less amounts due within one year	**229,251,283**	265,846,719
Net assets:		
Unrestricted net assets	**261,573,077**	256,233,038
Invested in capital assets, net of related financing	**230,703,578**	213,117,255
Restricted net assets	**1,076,595**	19,152,037
Total net assets	**493,353,250**	488,502,330
Total liabilities and net assets	**$ 789,003,839**	$ 825,399,509

See accompanying notes.

West Tennessee Healthcare and Related Affiliates

Consolidated Statements of Revenues
and Expenses and Changes in Net Assets

	Year Ended June 30	
	2008	**2007**
Operating revenues		
Net patient service revenues	**$ 510,105,046**	$ 496,124,087
Other revenues	**32,990,361**	31,831,551
Total operating revenues	**543,095,407**	527,955,638
Operating expenses		
Salaries and benefits	**288,898,960**	279,267,249
Supplies and other	**187,985,953**	175,587,878
Depreciation and amortization	**40,593,135**	38,257,874
Total operating expenses	**517,478,048**	493,113,001
Income from operations	**25,617,359**	34,842,637
Nonoperating revenues (expenses)		
Investment (loss) income	**(325,599)**	36,158,800
Interest expense	**(15,112,931)**	(11,590,345)
Total nonoperating (expenses) revenue, net	**(15,438,530)**	24,568,455
Income before capital contributions	**10,178,829**	59,411,092
Other changes in net assets:		
Contribution to City of Jackson & Madison County	**(5,327,909)**	(2,671,129)
Net assets at beginning of year	**488,502,330**	431,762,367
Net assets at end of year	**$ 493,353,250**	$ 488,502,330

See accompanying notes.

West Tennessee Healthcare and Related Affiliates

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2008	**2007**
Operating activities		
Receipts from third party payors and patients	**$ 530,166,225**	$ 510,285,935
Payments to suppliers	**(199,090,605)**	(172,308,711)
Payments to employees	**(286,701,881)**	(280,727,716)
Net cash provided by operating activities	**44,373,739**	57,249,508
Noncapital financing activities		
Contributions to City of Jackson and Madison County	**(5,327,909)**	(2,671,129)
Net cash used in noncapital financing activities	**(5,327,909)**	(2,671,129)
Investing activities		
Interest, dividends, and realized gain on investments	**7,449,165**	10,399,435
Investment in assets limited as to use	**74,471,202**	(41,708,785)
Net cash provided by (used in) investing activities	**81,920,367**	(31,309,350)
Capital and related financing activities		
Purchases of property, plant, and equipment	**(75,885,705)**	(93,007,267)
Proceeds from 2006 bond issuance	**–**	195,800,000
Repayment of long-term debt	**(36,420,438)**	(111,039,697)
Interest paid on long-term debt	**(13,759,321)**	(15,200,396)
Net cash used in capital and related financing activities	**(126,065,464)**	(23,447,360)
Decrease in cash and cash equivalents	**(5,099,266)**	(178,331)
Cash and cash equivalents at beginning of year	**17,220,991**	17,399,322
Cash and cash equivalents at end of year	**$ 12,121,725**	$ 17,220,991
Reconciliation of excess of revenues over expenses to net cash provided by operating activities		
Income from operations	**$ 25,617,359**	$ 34,842,637
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	**40,457,815**	38,126,449
Amortization	**135,320**	131,425
Changes in operating assets and liabilities:		
Accounts receivable	**(12,929,183)**	(17,669,702)
Inventory and prepaid expenses	**(2,195,134)**	501,161
Other assets	**(1,476,577)**	(384,550)
Accounts payable and accrued expenses	**(5,235,861)**	1,702,088
Net cash provided by operating activities	**$ 44,373,739**	$ 57,249,508
Supplemental schedule of noncash investing activities		
Change in fair value of investments	**$ (7,774,764)**	$ 25,759,365
Amortization of loss on bond refunding	**–**	14,446

See accompanying notes.

1. Significant Accounting Policies

Organization and Basis of Presentation

The accompanying consolidated financial statements include West Tennessee Healthcare and its related affiliates (hereinafter collectively referred to as the Company), all of which are under common control of the Jackson-Madison County General Hospital District (the District) and have been presented as blended component units of the Company. The Company presents its financial statements in accordance with generally accepted accounting principles and financial reporting standards. All significant intercompany balances and transactions have been eliminated in consolidation.

Proprietary Fund Accounting

The Company utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on an accrual basis. Substantially all revenues and expenses are subject to accrual.

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Company has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) issued before November 30, 1989.

Recently Issued Accounting Pronouncements

In June 2008, the GASB issued GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This statement intended to improve how state and local governments report information about derivative instruments—financial arrangements used by governments to manage specific risks or make investments—in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements and is effective for financial statements for reporting periods beginning after June 15, 2009 (July 1, 2009 for the Company).

1. Significant Accounting Policies (continued)

The new standard provides specific criteria that governments will use to determine whether a derivative instrument results in an effective hedge. Changes in fair value for effective hedges that are achieved with derivative instruments will be recognized in the reporting period to which they relate. The changes in fair value of these hedging derivative instruments do not affect current investment revenue, but are instead reported as deferrals in the statement of net assets or the balance sheet. Derivative instruments that either do not meet the criteria for an effective hedge or are associated with investments that are already reported at fair value are classified as investment derivative instruments for financial reporting purposes. Changes in fair value of those derivative instruments are reported as part of investment revenue in the current reporting period. The statement also improves disclosures, providing a summary of the government's derivative instrument activity, its objectives for entering into derivative instruments, and their significant terms and risks. The Company has not yet evaluated the impact this statement will have on its results of operations or financial position.

Cash and Cash Equivalents

The Company considers temporary cash investments with a maturity of three months or less when purchased to be cash and cash equivalents.

Investments

The Company's investments are reported at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.* The Company invests in government bonds, short-term money market investments, equity securities and alternative investments that are in accordance with the Company's investment policy.

Investments include the Company's ownership interest in various limited partnerships and investment funds (collectively referred to as Funds) that, in turn, invest the capital of the Funds in other funds. These Funds have no significant liabilities, and the equity of the Funds is based upon the fair value of the financial instruments held. One of the Company's seven Funds invests directly in other funds that, in turn, invest primarily in financial instruments that are readily marketable in various public markets. The remaining six Funds invest in real estate, hedge funds, and limited partnerships. The fair value of these investments is determined by the underlying asset's manager or independent appraisals (in the case of real estate). Due to inherent uncertainty of these estimates, these values may differ materially from the values that would have been used had a ready market for these investments existed.

1. Significant Accounting Policies (continued)

The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year were included as a change in the fair value of investments reported in the prior year and the current year. Realized and unrealized gains and losses are included in investment income in the accompanying consolidated statements of revenues and expenses and changes in net assets.

Inventories

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

Funded Depreciation

The Company reserves funds for future purchases of property, plant and equipment. Investment earnings on funded depreciation funds were $6,314,313 and $5,264,146 for the years ended June 30, 2008 and 2007, respectively, and are classified as investment income in the accompanying consolidated statements of revenues and expenses and changes in net assets.

Bond Issue Costs and Discounts

Bond issue costs and discounts are amortized over the life of the related bonds by the interest method. Such amortization is included in interest expense in the accompanying consolidated statements of revenues and expenses and changes in net assets.

Property, Plant, and Equipment

Property, plant, and equipment are recorded on the basis of cost. Provisions for depreciation are computed by the straight-line method based on the estimated useful lives of the assets.

Fair Value of Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term maturity of these instruments. The carrying amounts of the Company's long-term debt instruments approximate fair value, as they are subject to variable rates of interest.

1. Significant Accounting Policies (continued)

Compensated Absences

The Company allows employees to accumulate paid time off to be used for vacation, holiday and sick time. The Company allows employees to be paid for their vacation and holiday time not taken and accrues its liability for such time. Such liability is classified as accrued compensation and related expenses in the accompanying consolidated balance sheets.

Charity Care and Community Benefit

As a community provider, the Company's policy is to accept all patients regardless of their ability to pay. As a result, no distinction is made between bad debts and charity care for financial reporting purposes. However, management believes that substantially all of the uncollected amounts are due to patients' inability to pay. Therefore, all amounts which are not collected, other than third-party payor contractual adjustments, are recorded as charity care and excluded from net patient service revenues. The community benefit provided through charity care was $80,345,794 and $85,336,182, based on gross charges, for the years ended June 30, 2008 and 2007, respectively.

Net Patient Service Revenues

Net patient service revenues are reported at the net amounts billed to patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as changes in estimated provisions and final settlements are determined. Changes in estimated provisions and final settlements are included in net patient service revenues. For the fiscal year ended June 30, 2008, changes in estimated settlements resulted in an increase to revenues of approximately $1,195,615.

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

1. Significant Accounting Policies (continued)

- *Medicare.* Inpatient acute care services and skilled nursing services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. The Company receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid eligible and other low income patients. Effective August 1, 2000, the Center for Medicare and Medicaid Services (CMS) (formerly known as the Health Care Financing Administration) established an outpatient prospective payment system. The CMS established groups called ambulatory payment classifications for outpatient procedures. Payments are made based on the group assignment for the service rendered. Additionally, CMS established a prospective payment system for home health services.

- *TennCare.* Effective January 1, 1994, the State of Tennessee Medicaid program was replaced by the State of Tennessee TennCare (TennCare) program for hospital services. Under the TennCare program, patients traditionally covered by the State of Tennessee Medicaid program enroll in managed care organizations that have contracted with the State of Tennessee to ensure health care coverage to their enrollees. The Company contracts with the managed care organizations to receive reimbursement for providing hospital services to these patients. Payment arrangements with these managed care organizations consist primarily of prospectively determined rates per discharge, discounts from established charges or prospectively determined daily rates.

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

Charges at the Company’s established billing rates (gross patient service charges) related to patients covered by Medicare, Medicaid, and TennCare programs were 61% and 60% of gross patient service revenues in 2008 and 2007, respectively.

1. Significant Accounting Policies (continued)

Charges exceeding amounts reimbursed and not included in net patient service revenues were as follows:

	Year Ended June 30	
	2008	**2007**
Medicare	**$ 314,589,830**	$ 311,037,970
TennCare	**117,340,200**	118,725,193
Other	**235,007,606**	228,927,033
	$ 666,937,636	$ 658,690,196

Laws and regulations governing the Medicare and TennCare/Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The estimated reimbursement amounts are adjusted in subsequent periods as cost reports are prepared and filed and as final settlements are determined (in relation to certain government programs, primarily Medicare, this is generally referred to as the "cost report" filing and settlement process). Final determination of amounts earned under prospective payment and cost reimbursement activities is subject to review by appropriate governmental authorities or their agents. Management believes that adequate provisions have been made for adjustments that may result from final determination of amounts earned under Medicare and Medicaid programs.

Essential access and Medicaid Disproportionate Share payments of approximately $4,701,724 and $3,337,658 received from TennCare/Medicaid were included in net revenues during the years ended June 30, 2008 and 2007, respectively.

The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and TennCare/Medicaid programs.

1. Significant Accounting Policies (continued)

Operating Revenues

The Company's primary mission is to provide health care services to the citizens of West Tennessee through its acute care and specialty care facilities. Therefore, operating revenues include those generated from direct patient care and sundry revenues related to the operation of the Company's facilities.

Use of Estimates

The preparation of financial statements in conformity with governmental accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Federal Income Taxes

The Internal Revenue Service has determined that all material affiliates comprising the Company are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC). The District is also exempt from federal income taxes under Section 115 of the IRC. As qualified tax-exempt organizations, each of the tax-exempt affiliates comprising the Company must operate in conformity with the IRC to maintain its tax-exempt status.

Reclassifications

Certain reclassifications have been made in the 2007 financial statements to conform to the 2008 presentation. These reclassifications have no effect on the results of operations as previously reported.

2. Assets Limited as to Use

The Company, as authorized by the Board of Trustees, maintains checking accounts necessary for daily operations, deposits for the contingency fund, and deposits and investments for the funded depreciation funds. The bond funds are maintained in accordance with the bond indenture related to the Series 2003 $80,000,000, Series 2006A $50,100,000, and Series 2006B $145,700,000 Hospital Revenue Refunding and Improvement Bonds (see Note 6). The interest fund and bond sinking fund are maintained for the payment of bond principal and interest. The interest fund and bond sinking fund are included in assets limited as to use—current portion in the accompanying consolidated balance sheets.

The Company's investments and deposits, classified as assets limited as to use, are categorized to give an indication of the level of risk assumed by the Company as of year-end. All of the Company's investments presented below are included in Category 1. Category 1 includes investments that are insured or registered, or for which the securities are held by the Company or its agent in the Company's name.

The Company's investments are reported at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The Company invests in government and corporate bonds, equity securities, alternative investments and short-term money market investments that are in accordance with the Company's investment policy.

2. Assets Limited as to Use (continued)

A summary of assets limited as to use follows:

	June 30	
	2008	**2007**
Externally restricted by bond indenture agreement – held by bond trustee:		
Cash and short-term investments	**$ 1,076,595**	$ 19,152,038
Internally designated for capital acquisitions:		
Cash and short-term investments	**847,674**	366,221
Corporate and US agency bond funds	**53,164,124**	65,596,743
Real estate mortgage fund	**16,981,387**	18,474,306
Equity securities	**91,882,050**	141,676,815
	162,875,235	226,114,085
Other internally designated funds:		
Cash and short-term investments	**22,940,970**	38,628,057
U.S. government agency obligations	**24,975,070**	17,829,920
Real estate mortgage fund	**7,977,396**	5,021,519
Equity securities	**43,163,712**	38,509,325
	99,057,148	99,988,821
Total assets limited as to use	**263,008,978**	345,254,944
Amounts required to meet current obligations	**(1,076,595)**	(1,310,470)
	$261,932,383	$343,944,474

3. Cash and Investments

At June 30, 2008 and 2007, the Company had cash on hand and deposits as follows:

	June 30 2008	June 30 2007
Cash on hand	**$ 17,605**	$ 17,380
Insured (FDIC) or collateralized with securities held by the Company	**$ 862,296**	$ 963,461
Collateralized by securities held by the pledging financial institution's trust department in the Company's name or in the State of Tennessee Collateral Pool	**11,241,824**	16,240,150
Total	**$ 12,121,725**	$ 17,220,991

The types of securities which are permitted investments for Company funds are established by the Company's Investment Policy in accordance with Tennessee Statutes. All funds of the Company may be invested in obligations of or guaranteed by the United States Government. In addition, certain funds of the Company may be invested in obligations of agencies of the U.S. government; obligations of or guaranteed by the State of Tennessee; collateralized certificates of deposit and repurchase agreements' commercial paper; and other asset classes including fixed income, domestic equities, international equities, and alternative investments.

Investments of the Company are comprised of the following:

	June 30 2008	June 30 2007
Cash and short-term investments	**$ 23,788,643**	$ 38,994,277
Trustee funds	**1,076,595**	19,152,038
Corporate and US agency bond funds	**78,139,197**	83,426,663
Real estate mortgage fund	**24,958,785**	23,495,826
Equity securities	**135,045,758**	180,186,140
Total investments	**263,008,978**	345,254,944
Amounts required to meet current obligations	**(1,076,595)**	(1,310,470)
Total	**$261,932,383**	$343,944,474

3. Cash and Investments (continued)

At June 30, 2008 and 2007, the Company had $23,788,643 and $38,994,277, respectively, invested in short-term investments, which include U.S. Agencies and a sweep account secured by Agency securities held by the Trustee. All investments are carried at fair value.

In accordance with Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures* (GASB 40), the Company has assessed the Custodial Credit Risk, the Concentration of Credit Risk, Credit Risk, and Interest Rate Risk of its Cash and Investments.

(a) Custodial Credit Risk – The Company's deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized or are collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name. The deposit risk is that, in the event of the failure of a depository financial institution, the Company will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Company's investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Company, and are held by either the counterparty or the counterparty's trust department or agent but not in the Company's name. The investment risk is that, in the event of the failure of the counterparty to a transaction, the Company will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

At June 30, 2008, the Company's bank balances were not exposed to custodial credit risk since the full amount was covered by FDIC insurance or collateralized by securities held by the pledging financial institution's Trust department in the Company's name or by the State of Tennessee Collateral Pool.

As of June 30, 2008 and 2007, the Company's investments were comprised of various short term investments, trustee funds, corporate and U.S. agency bond funds, real estate mortgage funds, equity securities and alternative investments. Since the investments are registered in the Company's name, they are not exposed to custodial credit risk. In addition, the Company's investment policy requires that specific qualifications be met in order to represent the Company as a custodian.

3. Cash and Investments (continued)

(b) Concentration of Credit Risk – This is the risk associated with the amount of investments the Company has with any one issuer that exceeds 5 percent or more of its total investments. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. The Company's investment policy states that no equity may represent more than 8% of any individual portfolio manager and that no single purchase shall represent more than 5% of the Company's total equity position.

(c) Credit Risk – GASB 40 requires that disclosure be made as to the credit rating of all debt security investments except for obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government. This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Company's investment policy provides guidelines for its fund managers and lists specific allowable investments. The policy provides for the utilization of varying styles of managers so that portfolio diversification is maximized and total portfolio efficiency is enhanced.

The credit risk profile of the Company's investments as of June 30, 2008, is as follows:

	Balance as of	Rating			
Investment Type	**June 30, 2008**	**AAA**	**AA**	**A+**	**N/A**
Short-term investments	$ 23,788,643	$ 23,788,643	$ -	$ -	$ -
Trustee funds	1,076,595	1,076,595	-	-	-
Corporate & US agency bond funds	78,139,197	-	63,697,875	14,441,322	-
Real estate mortgage fund	24,958,785	-	-	-	24,958,785
Equity securities	135,045,758	-	-	-	135,045,758
Total investments	263,008,978	24,865,238	63,697,875	14,441,322	160,004,543
Amounts required to meet current obligations	(1,076,595)	(1,076,595)	-	-	-
Total	$261,932,383	$23,788,643	$63,697,875	$14,441,322	$160,004,543

3. Cash and Investments (continued)

(d) Investment Rate Risk – This is the risk that changes in interest rates will adversely affect the fair value of an investment. The Company's Investment Policy authorizes a strategic asset allocation that is designed to provide an optimal return over the Company's investment horizon and within the Company's risk tolerance and cash requirements.

The distribution of the Company's investments by maturity as of June 30, 2008, is as follows:

		Remaining Maturity (In Months)				
Investment Type	**Balance as of June 30, 2008**	**12 Months or Less**	**13 Months to 24 Months**	**25 Months to 60 Months**	**Greater than 60 Months**	**N/A**
Short-term investments	$ 23,788,643	$23,788,643	$ -	$ -	$ -	$ -
Trustee funds	1,076,595	1,076,595	-	-	-	-
Corporate & US agency bond funds	78,139,197	9,763,565	-	68,375,632	-	-
Real estate mortgage fund	24,958,785	-	-	-	-	24,958,785
Equity securities	135,045,758	-	-	-	-	135,045,758
Total investments	263,008,978	34,628,803	-	68,375,632	-	160,004,543
Amounts required to meet current obligations	(1,076,595)	(1,076,595)	-	-	-	–
Total	$261,932,383	$33,552,208	$ -	$68,375,632	$ -	$160,004,543

For the years ended June 30, 2008 and 2007, investment income is comprised of the following:

	2008	**2007**
Interest earnings	**$ 7,449,165**	$ 10,399,435
Net (decrease) increase in fair value of investments	**(7,774,764)**	25,759,365
	$ (325,599)	$ 36,158,800

4. Disaggregation of Payable Balances

Accounts Payable and Accrued Expenses

Accounts payable for the years ended June 30, 2008 and 2007, consisted of the following:

	2008	**2007**
Due to vendors	**$ 18,494,489**	$ 15,615,775
Due to patients	**1,117,140**	2,632,586
Other	**173,260**	121,854
Total accounts payable	**$ 19,784,889**	$ 18,370,215

Other accrued expenses for the years ended June 30, 2008 and 2007, consisted of the following:

	2008	**2007**
Accruals for self insurance	**$ 7,443,311**	$ 7,966,780
Other	**15,431,283**	23,755,428
Total other accrued expenses	**$ 22,874,594**	$ 31,722,208

5. Net Property, Plant and Equipment

Net property, plant, and equipment activity for the years ended June 30, 2008 and 2007, consisted of the following:

	Balance at June 30, 2006	Additions	Reductions	Balance at June 30, 2007	Additions	Reductions	Balance at June 30, 2008
Land and improvements	$ 29,421,887	$ 127,826	$ (15,100)	**$ 29,534,613**	**$ 484,690**	**$ (42,000)**	**$ 29,977,302**
Land improvements	12,991,046	1,016,893	(77,229)	**13,930,710**	**114,323**	**(1,057,181)**	**12,987,852**
Less accumulated depreciation	6,595,387	610,214	(59,678)	**7,145,923**	**605,475**	**(895,787)**	**6,855,611**
Net land and improvements	6,395,659	406,680	(17,552)	**6,784,787**	**(491,152)**	**(161,394)**	**6,132,241**
Buildings	157,705,947	12,460,785	(1,786,155)	**168,380,577**	**4,207,288**	**(4,767,322)**	**167,820,543**
Less accumulated depreciation	79,013,470	7,150,858	(1,130,311)	**85,034,017**	**7,161,357**	**(3,037,647)**	**89,157,727**
Net buildings	78,692,477	5,309,927	(655,844)	**83,346,560**	**(2,954,069)**	**(1,729,675)**	**78,662,816**
Equipment	379,346,265	48,568,909	(6,284,588)	**421,630,586**	**27,272,160**	**(8,899,836)**	**440,002,910**
Less accumulated depreciation	231,828,797	31,879,718	(3,760,339)	**259,948,176**	**32,770,998**	**(8,639,177)**	**284,079,996**
Net equipment	147,517,468	16,689,191	(2,524,248)	**161,682,411**	**(5,498,838)**	**(260,659)**	**155,922,914**
Construction in progress	46,897,378	70,166,695	(34,606,756)	**82,457,318**	**53,844,904**	**(7,763,917)**	**128,538,305**
	$ 308,924,870	$ 9,270,0319	$ (37,819,500)	**$ 363,805,688**	**$ 45,385,535**	**$ (9,957,645)**	**$ 399,233,578**

Depreciation is computed by applying the straight-line method over the estimated remaining useful lives of buildings and improvements (10 to 40 years) and equipment (4 to 20 years). Assets under capital leases are amortized using the straight-line method over the shorter of the estimated useful life of the assets or life of the lease term, excluding any lease renewal, unless the lease renewals are reasonably assured. Amortization expense related to assets under capital leases is included in depreciation expense. The Company's capitalization threshold is $1,000 and a minimum useful life of 2 years. Depreciation expense totaled $40,457,815 and $38,126,449 during the years ended June 30, 2008 and 2007, respectively.

Construction in progress at June 30, 2008, consists of various projects for additions and renovations to the Company's facilities. The Company has outstanding contracts and other commitments related to the completion of these projects. The Company estimates $50,759,497 in costs to complete these projects.

6. Long-Term Debt

Long-term debt consists of the following:

	June 30	
	2008	**2007**
Hospital Revenue Refunding and Improvement Bonds, Series 1995, unamortized loss on bond refunding	**(933,907)**	(1,200,508)
	(933,907)	(1,200,508)
		–
Hospital Revenue Bonds, Series 1998, unamortized bond discount	**(2,780,807)**	(3,017,141)
	(2,780,807)	(3,017,141)
Auction Rate Hospital Revenue Bonds, Series 2003, through April 2026	**78,350,000**	78,800,000
Less unamortized bond discount	**(119,553)**	(128,995)
	78,230,447	78,671,005
Auction Rate Hospital Revenue Bonds, Series 2006A, through April 2041	**15,550,000**	50,100,000
Less unamortized bond discount	**(52,941)**	(211,943)
	15,497,059	49,888,057
Auction Rate Hospital Revenue Bonds, Series 2006B, through April 2041	**143,600,000**	145,700,000
Less unamortized bond discount	**(261,509)**	(269,694)
	143,338,491	145,430,306
	233,351,283	269,771,719
Amounts due within one year	**(4,100,000)**	(3,925,000)
	$ 229,251,283	$ 265,846,719

In September 1995, the District issued $68,200,000 of Series 1995 Hospital Revenue Refunding and Improvement Bonds. A portion of the proceeds of the Series 1995 Bonds were used to advance refund $39,370,000 of its Series 1986 Bonds. The remaining proceeds of the Series 1995 Bonds were used to fund capital improvements of certain facilities of the District.

6. Long-Term Debt (continued)

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of approximately $1,840,000. This difference, reported in the accompanying balance sheets as a reduction of long-term debt, is being amortized through the year 2013.

In September 1998, the District issued $70,000,000 of Series 1998 Hospital Revenue Bonds. A portion of the proceeds of the Series 1998 Bonds were used to advance refund $8,940,000 and $1,150,000 of Series 1992 and 1986 Bonds, respectively. The remaining proceeds of the Series 1998 Bonds were used to fund capital improvements of certain facilities of the District.

In October of 2003, the District issued $80,000,000 of Series 2003 Auction Rate Hospital Revenue Bonds. The proceeds of these bonds were used to fund capital improvements of certain facilities of the District.

In August of 2006, the District issued $50,100,000 of Series 2006A Auction Rate Hospital Revenue Refunding Bonds. A portion of the proceeds were used to refund $49,700,000 of its Series 1995 Bonds. The remaining proceeds of the Series 2006A Bonds were used to fund capital improvements of certain facilities of the District.

In August of 2006, the District issued $145,700,000 of Series 2006B Variable Rate Demand Hospital Revenue Refunding and Improvement Bonds. A portion of the proceeds were used to advance refund $57,570,000 of its Series 1998 Bonds. The remaining proceeds of the Series 2006B Bonds were used to fund capital improvements of certain facilities of the District.

The District's revenues are pledged as collateral to the Series 2003, 2006A and 2006B Bonds.

The Company paid interest of $13,759,321 and $15,200,396 for the years ended June 30, 2008 and 2007, respectively.

Long-term debt activity for the years ended June 30, 2008 and 2007, consisted of the following:

	Balance at June 30, 2006	Additions	Reductions	Balance at June 30, 2007	Additions	Reductions	Balance at June 30, 2008
Bonds payable	$186,495,000	**$195,800,000**	$107,695,000	$274,600,000	**$ -**	**$ 37,100,000**	**$ 237,500,000**
Other	-	-	-	–	-	-	-
Total long-term debt	$186,495,000	**$195,800,000**	$107,695,000	$274,600,000	**$ -**	**$ 37,100,000**	**$ 237,500,000**

6. Long-Term Debt (continued)

During fiscal year 2008, the District purchased $33,175,000, of the Series 2006A Auction Rate Hospital Revenue Refunding Bonds, prior to refinancing all of its outstanding long-term debt in August 2008. These purchases were accounted for as an extinguishment of debt.

See **Note 12 Subsequent Event** for a description of the Company's debt refinancing transaction resulting in revised borrowings and terms.

Interest Rate Swap – 2003 Bond Issue

Objective of the interest rate swap. As a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance in September 2003, the District entered into an interest rate swap in connection with its $80 million 2003 Series A variable-rate revenue bonds. The intention of the swap was to effectively change the District's interest rate on the bonds to a synthetic fixed rate of 3.5975 percent.

Terms. The bonds and related swap agreement mature on April 1, 2026, and the swap's original notional amount of $80 million matched the $80 million variable-rate bonds. The swap was entered at the same time the bonds were issued (September 2003). The notional value of the swap and the principal associated debt declined to a balance of $78,350,000 on April 1, 2008. Under the swap, the district pays the Swap Counterparty a fixed payment of 3.5975 percent and receives a variable payment computed as 67.74 percent of the London Interbank Offered Rate (LIBOR). Conversely, the bond's variable-rate coupons are based on the auction rate market which resets every 28 days.

Fair Value. The average life of this transaction is approximately 15.5 years. Swap rates on this part of the yield curve have declined since the execution of the swap resulting in a negative fair value of ($3,463,159), including accrued interest, as of June 30, 2008. This fair value was measured by a swap pricing system in which the future net settlement swap payments were calculated and discounted to the valuation date using future spot interest rates. The future spot rates are zero-coupon bonds due on the future settlement dates implied from the current yield curve. As of June 30, 2007, the swap had a positive fair value of $1,391,768.

6. Long-Term Debt (continued)

Credit Risk: Because the swap has a negative value of ($3,463,159) on June 30, 2008, the Company has no credit risk to the Swap Counterparty. However, if swap rates increased and the fair value of the swap moved in favor of the Counterparty, credit risk would be present. The current ratings of the Swap Counterparty are Aal/AA- by Moody's and Standard & Poor's, respectively. Because the swap had a positive value of $1,391,768 as of June 30, 2007, the Company had credit risk to the Swap Counterparty at the end of the prior year.

Basis Risk. As long as there is not a direct relationship between the floating rate received from the Swap Counterparty (67.74% of One Month Libor) and the rate at which the variable bonds reset, the Company is exposed to basis risk.

Termination Risk. The Company or the Swap Counterparty may terminate the swap if the other party fails to perform under the terms of the agreement. The swap may be terminated by the Company if the Swap Counterparty's credit rating falls below "A-" as issued by Standard & Poor's and "A3" as issued by Moody's Investor Services. If the swap is terminated, the variable-rate bond would no longer carry a synthetic interest rate. Also, if at the time of the termination the swap has a negative fair value, the Company would be liable to the counterparty for a payment equal to the swap's fair value. As of June 30, 2008, the swap had a negative fair value of ($3,463,159).

Interest Rate Risk: Currently, the Company has eliminated the majority of its interest rate risk because it is paying a fixed rate on the swap (see Basis Risk). However, if the swap is terminated prior to maturity, the Company will have interest rate risk associated with the outstanding variable rate bonds until maturity.

Interest Rate Swaps – 2006A and 2006B Bond Issue

Objective of the interest rate swap. As a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance in August 2006, the District entered into two interest rate swaps in connection with its $50.1 million 2006A variable-rate revenue bonds and $145.7 million 2006B variable-rate revenue bonds. The intention of the swap was to effectively change the District's interest rate on the bonds to a synthetic fixed rate of 3.684% and 3.848% for 2006A and 2006B bonds, respectively.

6. Long-Term Debt (continued)

Terms. The bonds and related swap agreements mature on April 1, 2041, and the swap's original notional amounts of $50.1 million and $145.7 million matched the $50.1 million and $145.7 million variable-rate bonds for 2006A and 2006B, respectively. The swap was entered at the same time the bonds were issued (August 2006). The notional value of the swaps and the principal associated debt balances were $48.725 million and $143.6 million on April 1, 2008 for 2006A and 2006B bonds, respectively.

Under the swap agreement for 2006A bonds, the district pays the Swap Counterparty a fixed payment of 3.684% and receives a variable payment computed as 61.65% of the London Interbank Offered Rate (LIBOR) plus 0.17%. Conversely, the 2006A bond variable-rate coupons are based on the auction rate market which resets every 7 days.

Under the swap agreement for 2006B bonds, the district pays the Swap Counterparty a fixed payment of 3.848% and receives a variable payment computed as 61.94% of the London Interbank Offered Rate (LIBOR) plus 0.31%. Conversely, the 2006B bonds variable-rate coupons are based on the variable rate demand market which resets every 7 days.

Fair Value. The average life of this transaction is approximately 24.5 years. Swap rates on this part of the yield curve have declined since the execution of the swap resulting in a negative fair value of ($3,101,627) and ($9,826,112), including accrued interest, as of June 30, 2008, respectively, for 2006A and 2006B Bonds. This fair value was measured by a swap pricing system in which the future net settlement swap payments were calculated and discounted to the valuation date using future spot interest rates. The future spot rates are zero-coupon bonds due on the future settlement dates implied from the current yield curve. The swap agreements became effective in August 2006 and had a positive value of $648,572 and $77,388 as of June 30, 2007, respectively for the 2006A and 2006B Bonds.

Credit Risk: Because the swaps have a negative value of ($3,101,627) and ($9,826,112), on June 30, 2008, for the 2006A and 2006B bonds, respectively, the Company does not have credit risk to the Swap Counterparty. However, if swap rates increased and the fair value of the swap moved in favor of the Counterparty, credit risk would be present. The current ratings of the Swap Counterparty are Aaa/AA+ by Moody's and Standard & Poor's, respectively. The swap agreements became effective in August 2006 and had a positive value of $648,572 and $77,388 as of June 30, 2007, respectively for the 2006A and 2006B Bonds.

6. Long-Term Debt (continued)

Basis Risk. As long as there is not a direct relationship between the floating rate received from the Swap Counterparty (61.65% of One Month Libor plus 0.17% and 61.94% on One Month Libor plus 0.31% for the 2006A and 2006B bonds, respectively) and the rate at which the variable bonds reset, the Company is exposed to basis risk.

Termination Risk. The Company or the Swap Counterparty may terminate the swap agreements if the other party fails to perform under the terms of the agreement. The swap may be terminated by the Company if the Swap Counterparty's credit rating falls below "BBB" as issued by Standard & Poor's and "Baa2" as issued by Moody's Investor Services. If the swap is terminated, the variable-rate bond would no longer carry a synthetic interest rate. Also, if at the time of the termination the swap agreements have a negative fair value, the Company would be liable to the counterparty for a payment equal to the swap's fair value.

Interest Rate Risk: Currently, the Company has eliminated the majority of its interest rate risk because it is paying a fixed rate on the swaps (see Basis Risk). However, if the swaps are terminated prior to maturity, the Company will have interest rate risk associated with the outstanding variable rate bonds until maturity.

Swap Payments and Associated Debt for 2003, 2006A and 2006B Bond Issues

The 2008 Bond Issue which closed in August 2008 provided for the termination of the District's 2003A, 2006A, and 2006B interest rate swaps. The District made termination payments to the counterparties of $4,145,700, $3,529,000, and $11,449,000, respectively for the 2003A, 2006A, and 2006B interest rate swaps. Subsequent to such termination payments, the District has no risk associated with any interest rate swaps.

See **Note 12 Subsequent Event** for a description of the Company's debt refinancing transaction resulting in revised borrowings and terms.

7. Leases

The Company leases equipment under various operating leases. Rent expense for all operating leases was approximately $3,047,191 and $2,521,073 for the years ended June 30, 2008 and 2007, respectively. Approximate minimum future rental payments, by year and in the aggregate, under noncancelable operating leases with initial terms of one year or more are as follows at June 30, 2008.

2009	$ 1,449,528
2010	807,436
2011	440,308
2012	2
2013	1
Thereafter	15
	$ 2,697,290

8. Concentrations of Credit Risk

The Company grants credit without collateral to its patients, most of whom are individuals and are insured under third-party payor agreements. Accounts receivable from patients and third-party payors are as follows:

	June 30	
	2008	**2007**
Medicare	**35%**	33%
Medicaid and TennCare	**14**	12
Blue Cross	**15**	17
Private pay	**22**	23
Other	**14**	15
	100%	100%

9. Retirement Plans

Defined Benefit Plan

The Company has a noncontributory, defined benefit pension plan (the Plan) covering substantially all of its employees. The Plan is a single-employer defined benefit pension plan which covers all employees on the first anniversary of their date of hire who have completed at least 1,000 hours of employment in any anniversary year following their date of hire. All employees hired after October 1, 2005, are covered on the fifth anniversary of their date of hire after they have completed at least 1,800 hours of employment per year. The Plan provides retirement, termination, disability, and death benefits to plan members and beneficiaries. The operation of the Plan is consistent with the laws of Tennessee and the United States federal government. The Plan issues a publicly available financial report as required by GASB Statement No. 25 that includes a financial statement and required supplementary information for the Plan. That report may be obtained by writing to West Tennessee Healthcare, attention: Human Resources, Manager of Benefits, 620 Skyline Drive, Jackson, Tennessee 38301-3956 or by calling 731-541-5000.

Funding Policy

The Company has no legal or plan requirements to fund the Plan.The Company has established a policy of funding the end of the Plan year normal cost plus 20-year amortization of the unfunded actuarial accrued liability up to fully funding the accrued liability of the Actuarial Cost Method.

Annual Pension Cost and Net Pension Obligation

Current year contributions made to the Plan equaled 98% of the annual pension cost. Contributions made to the Plan in 2005 equaled the annual pension cost plus an additional one-time discretionary contribution of $6,300,006. Therefore, the net pension obligation had an ending credit balance of $5,686,173 at June 30, 2008, and $5,951,140 at June 30, 2007.

The annual required contribution for the fiscal year ending June 30, 2008, was determined as part of the actuarial valuation for the Plan year beginning January 1, 2008, and is the December 31, 2007, recommended contribution using the Actuarial Cost Method with amortization of the unfunded actuarial liability over 20 years. The actuarial assumptions included (a) 7.0% post-retirement and 7.0% pre-retirement investment rate of return and (b) a projected salary increase of 5.0% per year. Both (a) and (b) include an inflation component of 2.5%. The actuarial value of assets is equal to the market value of assets reported by First Tennessee Bank and CNA Insurance Company.

9. Retirement Plans (continued)

Defined Benefit Plan Three-Year Trend Information

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Credit)
June 30, 2006	11,019,771	98%	(6,131,475)
June 30, 2007	11,108,459	98%	(5,951,140)
June 30, 2008	11,447,418	98%	(5,686,173)

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Total Unfunded AAL (Funding Deficit) (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
01/01/06	114,794,581	143,944,223	29,149,642	80%	174,101,093	17%
01/01/07	133,859,871	160,535,174	26,675,303	83%	178,576,648	15%
01/01/08	152,712,499	175,027,485	22,314,986	87%	173,007,888	13%

The Company also maintains a defined contribution plan under Section 403(b) of the IRC which provides for voluntary contributions by employees upon employment and matching contributions by the District after two years of service. Substantially all employees of the District are eligible and may contribute up to 20% of their compensation, subject to certain IRC limitations. Upon January 1 after the completion of two years of credited service, the District matches 100% of the first 3% of compensation contributed and 50% of the next 3% contributed. The District recognized expense related to the 403(b) Plan of $4,612,918 and $4,961,333 in 2008 and 2007, respectively.

9. Retirement Plans (continued)

Supplemental 415(m) Retirement Plan

In 2005 the Company established a supplemental 415(m) retirement plan (the 415 Plan). The 415 Plan will provide monthly benefits equal to the benefit that cannot be paid from the Defined Benefit Plan due to the application of the Code Section 415 limits. The operation of the Plan is consistent with the laws of Tennessee and the United States federal government.

Because the 415 Plan is unfunded, no contributions will be officially made until benefits come due, which is expected to occur in fiscal year 2009. These benefit payments will be deemed contributions when paid.

Supplemental 415(m) Plan Three-Year Trend Information

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Credit)
June 30, 2006	70,070	0%	70,070
June 30, 2007	74,274	0%	144,344
June 30, 2008	78,744	0%	223,088

Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Total Unfunded AAL (Funding Deficit) (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
01/01/06	-	803,695	803,695	0%	N/A	0%
01/01/07	-	851,917	851,917	0%	N/A	0%
01/01/08	-	903,176	903,176	0%	N/A	0%

9. Retirement Plans (continued)

Other Post-Employment Benefits

Governmental Accounting Standards Board (GASB) Statement No. 45: *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* was issued in June 2004. The requirements apply to any state or local government employer that provides Other Post-Employment Benefits (OPEB). The primary types of OPEB covered by the statement are postretirement health benefits and life insurance benefits. The effective date of this requirement for the Company was the fiscal year beginning July 1, 2007.

Any of six actuarial cost methods can be used to determine the OPEB expense. The Company calculated its OPEB expense using the projected unit credit method.

The unfunded actuarial accrued liability must be amortized over a period of not greater than 30 years. The amortization amount may be computed as a level dollar amount or as a level percentage of pay. The Company used a level percentage of pay with a 30 year closed amortization period for purposes of computing the minimum accrual under GASB 45.

The Annual Required Contribution (ARC) calculated in accordance with GASB 45 for the fiscal years ending June 30, 2008 and 2009, is summarized below.

ARC Based on a Level Percent of Pay Amortization for Fiscal Year Ending

Level Percent of Pay Amortization	**6/30/2008**	**6/30/2009**
Medical Benefits – Projected Unit Credit	$ 628,065	$ 647,040

GASB 45 does not require funding of OPEB expense, but any differences between the annual expense and the amount funded in a year are recorded in the Company's financial statement as an increase (or decrease) in the net OPEB obligation. The Company elected to fund its OPEB expense and as of June 30, 2008, the fund had net assets in the amount of $547,951. This balance represents the ARC of $628,065 less the net claims cost of $80,114 incurred during fiscal year 2008.

10. Commitments and Contingencies

The Company is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters.

Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Professional Liability

The Company established the contingency fund as a professional liability self-insurance fund in accordance with the Government Tort Liability Act, which restricts the District's exposure to professional liability risks to a pre-determined amount per occurrence.

The District is a "governmental entity" within the meaning of the Tennessee Governmental Tort Liability Act (the Tort Act). As such, its maximum liability for state law tort causes of action is $250,000 for bodily injury or death of any one person in accident, occurrence, or act, and $600,000 for bodily injury or death of all persons in any one accident, occurrence, or act. These limits are subject to change by the Tennessee Legislature. Prior to July 1, 2002, the Tennessee Governmental Tort Liability limited local government tort liability to $130,000 for individual injury or death in any one occurrence and $350,000 for injury or death of all persons in any one occurrence.

Investment earnings on contingency fund assets were $875,597 and $732,191 for the years ended June 30, 2008 and 2007, respectively, and are classified as investment income in the accompanying consolidated statements of revenues and expenses and changes in net assets.

The Company's accrual for self-insured professional liability risks was $3,700,000 at June 30, 2008 and 2007, and was based on asserted claims for occurrences prior to that date. The Company does not accrue for unasserted claims or occurrences. In the opinion of management, any liability for such unasserted claims or occurrences would not materially affect the financial position of the Company.

10. Commitments and Contingencies (continued)

Workers' Compensation

Under the Tennessee Workers' Compensation Law, governmental entities such as the District need not accept the workers' compensation system, thereby remaining subject to common law liability for work-related injuries and retaining all common law defenses to such claims. The limits of liability under the Tort Act are applicable to such claims. The District has not accepted the workers' compensation system. The Tennessee Supreme Court has ruled this exemption applicable to the District's affiliate nonprofit corporations as well.

Employee Health

The Company is self-insured with respect to employee health insurance. Estimates of health insurance claims incurred but unpaid as of June 30, 2008 and 2007, are accrued based on estimates that incorporate the Company's past experience, as well as other considerations including the nature of claims and relevant trends. The Company had accrued a liability for incurred but unpaid claims of approximately $7,443,311 and $7,966,780, as of June 30, 2008 and 2007, respectively, which is included in accrued compensation and related expenses in the accompanying consolidated financial statements. The expenses related to claims paid during the years ended June 30, 2008 and 2007, are $27,878,482 and $27,503,639, respectively, and are included in salary and benefits expense.

Litigation

The Company is subject to claims and suits which arise in the ordinary course of business. In the opinion of management, the ultimate resolution of such pending legal proceedings has been adequately recorded in its consolidated financial statements, and will not have a material effect on the Company's results of operations or financial position.

11. Segment Information

As disclosed in footnote 6, the Company has revenue bonds outstanding that are payable from the operating revenues of certain affiliates of the District (the Obligated Group). Summary financial information for the Obligated Group is as follows:

	June 30	
	2008	**2007**
Assets		
Current assets	**$115,788,075**	$ 101,253,610
Property, plant, and equipment, net	**372,381,426**	338,570,848
Other assets	**249,086,295**	330,475,904
	$ 737,255,796	$ 770,300,362
Liabilities and net assets		
Current liabilities	**$ 54,017,852**	$ 53,840,019
Long-term debt	**229,251,283**	265,846,719
Net assets:		
Unrestricted net assets	**249,058,640**	243,579,172
Invested in capital assets, net of related financing	**203,851,426**	187,882,415
Restricted net assets	**1,076,595**	19,152,037
	453,986,661	450,613,624
	$ 737,255,796	$ 770,300,362

11. Segment Information (continued)

	Year Ended June 30 2008	2007
Net patient service revenues	**$451,643,882**	$440,968,284
Other operating revenues	**19,997,840**	19,334,837
Total revenues	**471,641,722**	460,303,121
Operating expenses	**407,539,973**	391,645,860
Depreciation	**36,791,045**	34,761,106
Total expenses	**444,331,018**	426,406,966
Income from operations	**27,310,704**	33,896,155
Net nonoperating gains	**(438,185)**	32,719,797
Interest expense	**15,112,931**	11,590,345
Income before capital contributions and transfers	**14,060,657**	55,025,607
Transfers (to) from other affiliates	**(5,327,909)**	(2,147,085)
Contributions	**(3,058,642)**	(2,671,129)
Increase in net assets	**3,373,037**	50,207,393
Net assets, beginning of year	**450,613,624**	400,406,231
Net assets, end of year	**$453,986,661**	$450,613,624
Net cash provided by (used in):		
Operating activities	**$ 45,607,759**	$ 49,578,433
Noncapital financing activities	**(8,386,551)**	(4,818,215)
Capital and related financing activities	**(120,646,061)**	(17,516,339)
Investing activities	**81,582,652**	(31,800,662)
Net decrease in cash and cash equivalents	**(1,842,201)**	(4,556,783)
Cash and cash equivalents, beginning of year	**4,034,855**	8,591,638
Cash and cash equivalents, end of year	**$ 2,192,654**	$ 4,034,855

12. Subsequent Event

In August 2008, the District issued $318,980,000 of Series 2008 Hospital Revenue Refunding and Improvement Bonds. With the 2008 fixed rate bond issue, the District has eliminated all auction rate and variable rate debt. A portion of the proceeds were used to refund $78,350,000 of its Series 2003 Auction Rate Hospital Revenue Bonds; $48,725,000 of its Series 2006A Auction Rate Hospital Revenue Bonds; and $143,600,000 of its Series 2006B Variable Demand Rate Hospital Revenue Refunding and Improvement Bonds. A Debt Service Reserve Fund was created under the 2008 indenture. On the date of issuance of the 2008 bonds, $21,299,713 of the proceeds of the 2008 bonds were deposited in the Debt Service Reserve Fund. The remaining proceeds of the Series 2008 Bonds will be used to fund capital improvements of certain facilities of the District.

In connection with the issuance of the 2003, 2006A and 2006B bonds, the Company entered into interest rate swap agreements. In connection with the issuance of the 2008 bonds the interest rate swap agreements have been terminated. The District made termination payments to the counterparties of $4,145,700, $3,529,000, and $11,449,000, respectively for the 2003A, 2006A, and 2006B interest rate swaps. Subsequent to such termination payments, the District has no risk associated with any interest rate swaps.

Scheduled principal and interest payments, excluding capital lease payments, commencing October 1, 2008, are as follows:

Fiscal Years Ending June 30	Principal	Interest	Total
2009-2010	$ 6,565,000	$ 27,453,213	$ 34,018,213
2011-2015	23,505,000	82,979,580	106,484,580
2016-2020	29,815,000	76,673,869	106,488,869
2021-2025	38,430,000	68,052,975	106,482,975
2026-2030	49,875,000	56,606,675	106,481,675
2031-2035	65,125,000	41,365,588	106,490,588
2036-2041	105,665,000	22,118,475	127,783,475
Unamortized bond discount, net	(5,919,066)	–	(5,919,066)
Unamortized loss on bond refunding, net	(5,819,164)	–	(5,819,164)
Total	$ 307,241,770	$ 375,250,375	$ 682,492,145

Supplemental Information

West Tennessee Healthcare and Related Affiliates

Schedule of Expenditures of Federal Awards and State Financial Assistance

Year Ended June 30, 2008

Federal Grantor/Pass-Through Grantor	CFDA #	Contract Number	Beginning (Accrued) Deferred	Cash Receipts	Expenditures	Ending (Accrued) Deferred
<u>Federal Awards</u>						
US Dept of Education						
Tennessee Dept of Education						
Special Education Grants for Infants and Families With Disabilities	84.181A	GG-07-12423-01	$ (90,361)	$ 90,361	$ –	$ –
	84.181A	GG-08-21963-00	–	234,947	267,982	(33,035)
Total US Dept of Education			$ (90,361)	$ 325,308	$ 267,982	$ (33,035)
US Department of Health and Human Services						
Tennessee Department of Human Services						
Child Care and Development Block Grant	93.575	N/A	(85,567)	85,567	–	–
	93.575	N/A	–	213,791	334,008	(120,217)
		N/A	(3,866)	3,866	–	–
		N/A	–	495	4,123	(3,628)
		N/A	(22,065)	22,065	–	–
		N/A	–	29,968	56,999	(27,031)
Block Grant for Community Mental Health Services	93.958	GG-07-12561-02	(69,584)	69,584	–	–
	93.958	GG-07-12544-00	(59,284)	59,284	–	–
Block Grant for Community Mental Health Services	93.958	GG-08-21460-00	–	205,500	205,500	–
	93.958	GG-08-21846-00	–	88,963	120,047	(31,084)
Block Grant for Prevention and Treatment	93.958	Z-07-034149-00	(138,551)	138,551	–	–
of Substance Abuse	93.958	Z-07-034149-00	(18,853)	18,853	–	–
	93.958	GG-07-12674-00	(43,712)	43,712	–	–

West Tennessee Healthcare and Related Affiliates

Schedule of Expenditures of Federal Awards and State Financial Assistance (continued)

Year Ended June 30, 2008

Federal Grantor/Pass-Through Grantor	CFDA #	Contract Number	Beginning (Accrued) Deferred	Cash Receipts	Expenditures	Ending (Accrued) Deferred
<u>Federal Awards (continued)</u>						
<u>US Department of Health and Human Services (continued)</u>						
Tennessee Department of Mental Health and Developmental Disabilities						
Division of Aochol and Drug Abuse Services						
Block Grant for Prevention and Treatment	93.959	Z-08-033634-00	$ -	$ 253,797	$ 303,993	$ (50,196)
of Substance Abuse	93.959	Z-08-033634-00	–	65,303	72,513	(7,210)
	N/A	GG-08-22588-00	–	90,124	124,742	(34,618)
Tennessee Department of Health						
Block Grant for Maternal and Child Health Services	93.994	GG-07-12609-00	(51,687)	51,687	–	–
	93.994	GG-08-20858-00	–	7,765	10,460	(2,695)
	93.301	Z-07-038124-00	(42,500)	42,500	–	–
	93.301	Z-08-022660-00	–	–	42,500	(42,500)
Rural Health Outreach & Rural Network Development Prgm						
	93.912C	GG-06-12661-00	(50,641)	50,641	–	–
Cooperative Agreements for State-Based Comprehensive	93.919	GG-07-12339-00	(11,457)	11,457	–	–
Breast and Cervical Cancer Early Detection Programs	93.919	GG-08-21163-00	–	23,385	41,997	(18,612)
National Bioterrorism Hospital Preparedness Program	93.889	Z-08-200412-00	–	275,300	–	275,300
	93.889	Z-08-200438-00	–	15,000	–	15,000
	93.889	Z-08-200399-00	–	15,000	–	15,000
	93.889	Z-08-200376-00	–	15,000	5,704	9,296
	93.889	Z-08-200378-00	–	15,000	10,772	4,228
	93.889	Z-08-200410-00	–	15,000	–	15,000
	93.889	Z-07-036207-00	15,000	–	10,556	4,444
	93.889	Z-07-036209-00	273,000	–	116,830	156,170

West Tennessee Healthcare and Related Affiliates

Schedule of Expenditures of Federal Awards and State Financial Assistance (continued)

Year Ended June 30, 2008

Federal Grantor/Pass-Through Grantor	CFDA #	Contract Number	Beginning (Accrued) Deferred	Cash Receipts	Expenditures	Ending (Accrued) Deferred
Federal Awards (continued)						
US Department of Health and Human Services (continued)						
National Bioterrorism Hospital Preparedness	93.889	Z-07-0362385-00	$ 15,000	$ –	$ 13,295	$ 1,705
Program (continued)	93.889	Z-07-036196-00	5,484	–	4,095	1,389
	93.889	Z-07-036170-00	15,000	–	15,000	–
	93.889	Z-07-036172-00	9,177	–	9,177	–
	93.889	Z-06-029121-00	15,000	–	15,000	–
	93.889	Z-06-029123-00	203,462	–	203,462	–
	93.889	Z-06-029122-00	14,584	–	14,584	–
	93.889	Z-06-029124-00	8,336	–	8,336	–
	93.889	Z-06-029126-00	2,020	–	2,020	–
	93.889	Z-06-029127-00	418	–	418	–
	93.889	GG-07-12964-01	(99,822)	105,562	5,740	–
Centers for Disease Control						
and Prevention Investigations and Technical Assistance	93.283	Z-07-038376-00	(633)	7,300	6,667	–
	93.283	Z-07-038337-00	–	7,300	7,300	–
	93.283	Z-07-038339-00	–	7,300	7,300	–
	93.283	Z-07-038363-00	–	7,300	7,300	–
	93.283	Z-07-038374-00	–	7,300	7,300	–
	93.283	Z-07-038402-00	–	7,300	7,300	–
Tennessee Department of Children's Services						
Foster Care Title IV-E						–
						–
	93.658	2008H3C0000530000	–	8,484	9,920	(1,436)

West Tennessee Healthcare and Related Affiliates

Schedule of Expenditures of Federal Awards and State Financial Assistance (continued)

Year Ended June 30, 2008

Federal Grantor/Pass-Through Grantor	CFDA #	Contract Number	Beginning (Accrued) Deferred	Cash Receipts	Expenditures	Ending (Accrued) Deferred
Tennessee Department Mental Health Development Disabilities						
Substance Abuse and Mental Health Services						
Projects of Regional and National Significance	93.243	033433-00	$ –	$ 7,650	$ 10,330	$ (2,680)
Projects for Assistance in Transition from Homelessness	93.150	GG-08-22103-00	–	44,229	49,460	(5,231)
Total US Department of Health and Human Services			$ (121,741)	$ 2,153,848	$ 1,864,748	$ 150,394
Total Federal Awards			$ (212,102)	$ 2,479,156	$ 2,132,730	$ 117,359
<u>State Financial Assistance</u>						
US Dept of Education						
Tennessee Dept of Education						
Special Education Grants for Infants and Families With Disabilities	84.181A	GG-07-12423-00	$ (19,835)	$ 19,835	$ –	$ –
	84.181A	GG-08-21963-00	–	234,947	267,982	(33,035)
Total US Dept of Education			$ (19,835)	$ 254,781	$ 267,982	$ (33,035)

West Tennessee Healthcare and Related Affiliates

Schedule of Expenditures of Federal Awards and State Financial Assistance (continued)

Year Ended June 30, 2008

Federal Grantor/Pass-Through Grantor	CFDA #	Contract Number	Beginning (Accrued) Deferred	Cash Receipts	Expenditures	Ending (Accrued) Deferred
US Department of Health and Human Services						
Tennessee Department of Mental health and Developmental Disabilities						
Division of Alcohol and Drug Abuse Services						
Block Grant for Prevention and Treatment	93.959	Z-07-034149-00	$ (37,387)	$ 37,387	$ –	$ –
	93.959	Z-07-034149-00	(5,087)	5,087	–	–
	93.959	Z-08-033634-00	–	434,936	520,957	(86,021)
	93.959	Z-08-033634-00	–	111,912	124,267	(12,355)
	N/A	GG-0822552-00	–	93,300	117,000	(23,700)
Tennessee Department of Health						
Block Grant for Maternal and Child Health Services	93.994	GG-07-12609-00	(17,229)	17,229	–	–
	93.994	GG-08-20858-00	–	205,560	276,898	(71,338)
	N/A	GG-07-12950-00	(5,272)	5,272	–	–
	N/A	GG-08-23167-00	–	10,528	17,446	(6,918)
	N/A	GG-07-12343-00	(19,306)	19,306	–	–
	N/A	GG-08-20896-00	–	45,468	55,671	(10,203)
	93.958	Z-07-033267-00	(36,810)	36,810	–	–
	N/A	Z-07-033267-01&02	–	357,296	368,643	(11,347)
	N/A	GR-07-20785-00	(36,575)	–	–	(36,575)
	N/A	GG-08-23436-00	–	–	55,000	(55,000)

West Tennessee Healthcare and Related Affiliates

Schedule of Expenditures of Federal Awards and State Financial Assistance (continued)

Year Ended June 30, 2008

Federal Grantor/Pass-Through Grantor	CFDA #	Contract Number		Beginning (Accrued) Deferred		Cash Receipts		Expenditures		Ending (Accrued) Deferred
State Financial Assistance (continued)										
US Department of Health and Human Services (continued)										
Tennessee Department of Children's Services										
	93.658	2008H3C0000530000	$	–	$	161,188	$	188,476	$	(27,288)
Tennessee Department of Mental Health Development										
Disabilities										
Block Grant for Community Mental Health Services	93.958	GG-07-12561-00		(167,403)		167,403		–		–
	93.958	GG-07-12544-00		(16,826)		16,826		–		–
	93.958	GG-07-12501-00		(33,645)		33,645		–		–
	93.958	GG-08-21460-00		–		61,536		132,322		(70,786)
	N/A	GR-08-21905-00		–		80,236		87,199		(6,963)
	N/A	GG-08-21765-00		–		68,983		80,000		(11,017)
Substance Abuse and Mental Health Services										
Projects for Assistance in Transition from Homelessness	93.150	GG-08-22103-00		–		64,676		81,952		(17,276)
	N/A	GG-07-12502-01		(14,700)		14,700				–
	N/A	GG-08-21267-00		–		58,200		74,200		(16,000)
	N/A	GG-08-21518-01		–		37,660		50,949		(13,289)
Tennessee Department of Finance and Administration										
Division of Mental Retardation	N/A	Z-05-022106-02 & 03		(78,991)		78,991		–		–
Total US Department of Health and Human Services				(469,231)		2,224,135		2,230,981		(476,077)
Total State Awards			$	(489,066)	$	2,478,916	$	2,498,963	$	(509,113)
Total Federal and State Awards			**$**	**(489,066)**	**$**	**4,958,073**	**$**	**4,631,693**	**$**	**(509,113)**

Notes to Schedules of Expenditures of Federal Awards and State Financial Assistance

June 30, 2008

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards and state financial assistance includes the federal grant activity of West Tennessee Healthcare and Related Affiliates and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. Contingencies

The Company's federal programs are subject to financial and compliance audits by grantor agencies which, if instances of material noncompliance are found, may result in disallowed expenditures and affect the Company's continued participation in specific programs. The amount, if any, of expenditures which may be disallowed by the grantor agencies cannot be determined at this time, although the Company expects such amounts, if any, to be immaterial.

West Tennessee Healthcare and Related Affiliates

Schedule of Findings and Questioned Costs

Year Ended June 30, 2008

Part I—Summary of Auditor's Results

Financial Statement Section

Type of auditor's report issued:	Unqualified	
	Yes	**No**
Internal control over financial reporting:		
Material weakness(es) identified?		√
Significant deficiencies identified not considered to be material weaknesses?		√
Noncompliance material to financial statements noted?		√

Federal Awards Section

	Yes	**No**
Internal control over major programs:		
Material weakness(es) identified?		√
Significant deficiencies identified not considered to be material weaknesses?		√
Type of auditor's report on compliance for major programs:	Unqualified	
	Yes	**No**
Any audit findings disclosed that are required to be reported in accordance with Circular A-133 (section_.510(a))?		√

Part I—Summary of Auditor's Results (continued)

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
93.889	US Department of Health and Services – National Bioterrorism Hospital Preparedness Program
93.958	US Department of Health and Human Services – Block Grants for Community Mental Health
93.959	US Department of Health and Human Services – Block Grants for Prevention and Treatment of Substance Abuse
93.575	US Department of Health and Human Services – Child Care and Development Block Grant

Dollar threshold used to determine Type A programs:	$ 300,000	
	Yes	**No**
Auditee qualified as low-risk auditee?	√	

Part II—Financial Statement Findings Section

This section identifies the significant deficiencies, material weaknesses, fraud, illegal acts, violations of provisions of contracts and grant agreements, and abuse related to the financial statements for which *Government Auditing Standards* require reporting in a Circular A-133 audit.

No findings required to be reported.

Part III—Federal Award Findings and Questioned Costs Section

This section identifies the audit findings required to be reported by Circular A-133 section .510 (for example, significant deficiencies, material weaknesses, and material instances of noncompliance, including questioned costs), as well as any abuse findings involving federal awards that are material to a major program.

No findings required to be reported.

Ernst & Young LLP
Suite 1400
One Nashville Place
`50 Fourth Avenue North
Nashville, Tennessee 37219

Tel: 615 252 2000
Fax: 615 242 9128
www.ey.com

Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

The Board of Trustees
West Tennessee Healthcare and Related Affiliates

Compliance

We have audited the compliance of West Tennessee Healthcare and Related Affiliates (the Company) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. The Company's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's compliance based on our audit.

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

In our opinion, the Company complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2008.

Internal Control Over Compliance

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

A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

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

This report is intended solely for the information and use of management, the Board of Trustees, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

December 15, 2008

Ernst & Young LLP
Suite 1400
One Nashville Place
`50 Fourth Avenue North
Nashville, Tennessee 37219
Tel: 615 252 2000
Fax: 615 242 9128
www.ey.com

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

The Board of Trustees
West Tennessee Healthcare and Related Affiliates

We have audited the consolidated financial statements of West Tennessee Healthcare and Related Affiliates (the Company) as of and for the year ended June 30, 2008, and have issued our report thereon dated October 17, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Board of Trustees, others within the entity, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties

Ernst & Young LLP

October 17, 2008