CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System and Discretely Presented Component Units)

Audited Combined Financial Statements
(and Required Supplementary Information)

Years Ended June 30, 2008 and 2007

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Audited Combined Financial Statements (and Required Supplementary Information)

Years Ended June 30, 2008 and 2007

Independent Auditor's Report 1

Management's Discussion and Analysis 3

Audited Combined Financial Statements

Combined Balance Sheets 10
Combined Statements of Revenue, Expenses and Changes in Net Assets 12
Combined Statements of Cash Flows 14
Notes to Combined Financial Statements 16

Required Supplementary Information

Schedule of Expenditures of Federal Awards 47
Schedule of Expenditures of State and Other Financial Assistance 49
Notes to the Schedule of Expenditures of Federal Awards and State and Other Financial Assistance 50
Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133 51
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards* 53
Schedule of Findings and Questioned Costs 55

PYA
Pershing Yoakley & Associates
CERTIFIED PUBLIC ACCOUNTANTS

Pershing Yoakley & Associates, P.C.
One Perkins Place, 525 Portland Street
Knoxville, TN 37919

(p) (865) 673-0844 (f) (865) 673-0173
(w) www.pyapc.com

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of
Chattanooga-Hamilton County Hospital Authority
(d/b/a Erlanger Health System):

We have audited the accompanying financial statements of the business-type activities and the discretely presented component units of Chattanooga-Hamilton County Hospital Authority (d/b/a Erlanger Health System) as of and for the years ended June 30, 2008 and 2007, which collectively comprise the Chattanooga-Hamilton County Hospital Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Chattanooga-Hamilton County Hospital Authority'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 of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of ContinuCare HealthServices, Inc., a discretely presented component unit, were not audited in accordance with *Government Auditing Standards*. An audit includes 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 Chattanooga-Hamilton County Hospital Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the discretely presented component units of Chattanooga-Hamilton County Hospital Authority as of June 30, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2008 on our consideration of Chattanooga-Hamilton County Hospital Authority's internal control over financial reporting and 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.

The management's discussions and analysis on pages 3 through 9 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of the Chattanooga-Hamilton County Hospital Authority taken as a whole. The accompanying schedules of expenditures of federal and state and other awards 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 the State of Tennessee Comptroller of the Treasury, respectively, and are not a required part of the basic financial statements of the Chattanooga-Hamilton County Hospital Authority. 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.

Pershing Yoakley : Associates PC

Knoxville, Tennessee
December 19, 2008

Management's Discussion and Analysis

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Management's Discussion and Analysis

Years Ended June 30, 2008 and 2007

The discussion and analysis of Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System's financial performance provides an overview of the Primary Health System's financial activities for the fiscal year ended June 30, 2008

Erlanger Health System (the Primary Health System) is the largest health care provider in Southeast Tennessee. The Primary Health System maintains a number of very specialized clinical services such as Level I trauma, Level III neonatal, kidney transplantation, Regional Cancer Unit, a full service children's hospital, open heart surgery and primarily serviced by three "Life Force" helicopters; all supported by subspecialty physicians (residents, faculty and private attending physicians) located on its campuses. In the fiscal year 2002, the Primary Health System entered into a partnership agreement with TriState Partners, L.L.P. and Plaza Physicians, LLC to form Plaza Surgery, G.P. In the fiscal year 2007, the Primary Health System sold 4.63% interest in Plaza Surgery, G.P. to Spine Surgery, P.C. The Primary Health System owns a controlling 51% share of this partnership.

OVERVIEW OF THE COMBINED FINANCIAL STATEMENTS

The combined financial statements consist of two parts: Management's Discussion and Analysis and the combined financial statements. The combined financial statements also include notes that explain in more detail some of the information in the combined financial statements.

The combined financial statements of the Primary Health System offer short-term and long-term financial information about its activities. The combined balance sheets include all of the Primary Health System's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to the Primary Health System's creditors (liabilities). The assets and liabilities are presented in a classified format, which distinguishes between current and long-term assets and liabilities. It also provides the basis for computing rate of return, evaluating the capital structure of the Primary Health System and assessing the liquidity and financial flexibility of the Primary Health System.

All of the current fiscal year's revenues and expenses are accounted for in the combined statements of revenue, expenses, and changes in net assets. These statements measure the success of the Primary Health System's operations over the past fiscal year and can be used to determine whether the Primary Health System has successfully recovered all of its costs through the services provided, as well as its profitability and credit worthiness.

The final required financial statement is the combined statements of cash flows. The primary purpose of this statement is to provide information about the Primary Health System's cash receipts, cash payments and net changes in cash resulting from operating, investing, non-capital

OVERVIEW OF THE COMBINED FINANCIAL STATEMENTS - Continued

financing and financing activities. The statement also provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

The analyses of the combined financial statements of the Primary Health System begin on the next page. One of the most important questions asked about the Primary Health System's finances is "Is the financial condition of the Primary Health System as a whole better or worse as a result of the fiscal year's activities?" The combined balance sheets and the combined statements of revenue, expenses and changes in net assets report information about the Primary Health System's activities in a way that will help answer this question. These two statements report the net assets of the Primary Health System and changes in them. One can think of the Primary Health System'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 Primary Health System's net assets are one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, regulations and new or changed government legislation.

REPORTING ENTITY

The Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System (the Primary Health System) was created by a private act passed by the General Assembly of the State of Tennessee on March 11, 1976, and adopted by a majority of the qualified voters of Hamilton County, Tennessee on August 5, 1976. The Primary Health System is considered the primary governmental unit for financial reporting purposes. As required by generally accepted accounting principles, these financial statements present the Primary Health System and its component units. The component units discussed below are included in the Primary Health System's reporting entity because of the significance of their operational or financial relationships with the Primary Health System.

ContinuCare HealthServices, Inc., Plaza Surgery, GP, and Erlanger Health Plan Trust are legally separate organizations for which the Primary Health System is either financially accountable or owns a majority interest. Accordingly, these organizations represent component units of the Primary Health System. The financial statements of Erlanger Health Plan Trust are blended with the financial statements of the Primary Health System, as the Board of Erlanger Health Plan Trust is substantially the same as that of the Primary Health System.

KEY FINANCIAL INDICATORS

The following key financial indicators are for Erlanger Health System as a whole. They are inclusive of the Primary Health System, ContinuCare HealthServices, Inc., and the 51% controlling share of Plaza Surgery, GP.

- Operating income for Erlanger Health System for the fiscal year 2008 is a loss of $15.7 million compared to a profit of $15.4 million for the fiscal year 2007. Total excess revenues over expenses excluding the mark to market on swaps is a loss of $8.7 million.
- Total cash and temporary investment reserves are $69.1 million (excluding $96 million for Board restricted and $40 million of funds held by Trustees or restricted by donors or others).
- Net days in accounts receivable for Erlanger Health System (utilizing a three month rolling average of net revenue) are 67 days at June 30, 2008 compared to 63 days at June 30, 2007.
- For the fiscal year 2008, Erlanger Health System received $6.5 million essential access payment from the State of Tennessee compared to $6.8 million in fiscal year 2007.
- For the fiscal year 2008, Erlanger Health System received a one time disproportionate share payment of $520,822 from the State of Tennessee compared to $2.2 million in fiscal year 2007.
- Erlanger Health System did not receive any additional trauma funding in fiscal year 2008. The Health System received $1.3 million in fiscal year 2007.

The required bond covenants ratios for fiscal year 2008 compared to bond requirements are as follows:

		Bond Requirement				
	June 30, 2008	***93 Series***	***97 Series***	***98 Series***	***00 Series***	***04 Series***
Debt service coverage ratio	1.58	1.35	1.35	1.35	1.35	1.35
Cushion ratio	6.59	N/A	N/A	1.50	N/A	N/A
Current ratio	2.46	1.50	1.50	1.50	1.50	1.50
Days cash on hand	95 days	65 days			65 days	65 days
Indebtedness ratio	50.45%					65%

NET ASSETS

Erlanger Health System's net assets for the combined Primary Health System and ContinuCare increased by $2 million in the fiscal year 2008. Our analysis focuses on the net assets (Table 1) and changes in net assets (Table 2) of the Primary Health System's operating activities. Discussion focuses on the Primary Health System and its blended component unit.

Table 1 - Net Assets (in Millions)

	June 30, 2008			*June 30, 2007*		
	Primary Health System	*ContinuCare Health Services, Inc.*	*Plaza Surgery, G.P.*	*Primary Health System*	*ContinuCare Health Services, Inc.*	*Plaza Surgery, G.P.*
Current and other assets	$ 305	$ 13	$ 10	$ 298	$ 14	$ 10
Capital assets	190	2	-	202	2	-
Total assets	$ 495	$ 15	$ 10	$ 500	$ 16	$ 10
Long-term debt outstanding	$ 201	$ -	$ -	$ 212	$ -	$ -
Other liabilities	100	2	1	98	2	1
Total liabilities	$ 301	$ 2	$ 1	$ 310	$ 2	$ 1
Net assets						
Capital assets, net of debt	$ 13	$ 2	$ 7	$ 14	$ 2	$ 7
Restricted	8	-	-	9	-	-
Unrestricted	173	11	2	168	12	2
Total net assets	$ 194	$ 13	$ 9	$ 191	$ 14	$ 9

Net assets for the Primary Health System have increased from $191 million as of June 30, 2007 to $194 million as of June 30, 2008, a 1.6 percent increase. The current ratio (current assets divided by current liabilities) decreased from 2.79 in 2007 to 2.35 in 2008 for the Primary Health System.

Days in cash increased from 92 days as of June 30, 2007 to 94 days as of June 30, 2008 for the Primary Health System. Days in net accounts receivable were 65 days as of June 30, 2007 and June 30, 2008. The Primary Health System received $6.5 million essential access payment from the State of Tennessee in fiscal year 2008 compared to $6.8 million in fiscal year 2007, Additionally, the Primary Health System received a disproportionate share payment of $.5 million from the State of Tennessee in fiscal year 2008 compared to $2.2 million in fiscal year 2007. The Primary Health System did not receive any additional trauma funding in fiscal year 2008 compared to $1.3 million in fiscal year 2007.

Capital assets for the Primary Health System were $190 million. Additions for the fiscal year 2008 amounted to $23 million while $20 million of assets were retired. Depreciation expense was $32 million for the Primary Health System. Retirement of assets reduced accumulated

NET ASSETS - Continued

depreciation by $17 million in fiscal year 2008. Construction in progress was $8 million as of June 30, 2007 and $7 million as of June 30, 2008. Included in construction in progress at June 30, 2008 is the Erlanger East expansion of $3 million.

Property, plant and equipment at June 30 is as follows:

	Primary Health System	
	2008	*2007*
Land and improvements	$ 27	$ 27
Buildings	237	234
Equipment	334	333
Total	598	594
Less accumulated depreciation	(415)	(400)
Construction in progress	7	8
Net property, plant and equipment	$ 190	$ 202

Long-term debt outstanding amounted to $201 million as of June 30, 2008 compared to $212 million as of June 30, 2007. The decrease in long-term debt reflects normal scheduled principal payments.

Other liabilities for the Primary Health System increased 2% from the prior year. Current liabilities increased by $13 million. A change in the valuation of the FID swaps total resulted in an increase of $2 million. The post retirement benefit obligation decreased by $14 million resulting from the adoption of GASB 45.

CHANGES IN NET ASSETS

The focus for Erlanger Health System's management team during fiscal year 2008 was to increase the Primary Health System's volumes in a number of key product lines as the Chattanooga market remained flat in total volumes, improve relationships with stakeholders, and improve operating efficiencies. Staffing was benchmarked by department against best practices. Bi-weekly sessions were held to monitor the flexing of staff as volumes fluctuated. Multidisciplinary teams formed in direct response to high cost physician preference items combined with renegotiated contracts continued to result in supply savings for the Primary Health System.

CHANGES IN NET ASSETS - Continued

Table 2 - Changes in Net Assets (in Millions)

	June 30, 2008			*June 30, 2007*		
	Primary Health System	*ContinuCare Health Services, Inc.*	*Plaza Surgery, G.P.*	*Primary Health System*	*ContinuCare Health Services, Inc.*	*Plaza Surgery, G.P.*
Net patient revenue	$ 456	$ 9	$ 7	$ 456	$ 8	$ 7
Other revenue	17	17	-	16	18	-
Total revenue	473	26	7	472	26	7
Expenses:						
Salaries	267	11	2	249	10	2
Supplies and expenses	105	17	3	103	17	3
Purchased services	79	-	1	69	-	1
Insurance and taxes	5	-	-	3	-	-
Depreciation and amortization	32	-	-	32	1	-
Total expenses	488	28	6	456	28	6
Revenues in excess of (less than) expenses	(15)	(2)	1	16	(2)	1
Gain on disposal of assets	9	-	-	-	-	-
Nonoperating gains	9	1	-	9	1	-
Interest expense	(16)	-	-	(11)	-	-
Income tax provision	-	-	-	-	-	
Operating/capital contributions	1	-	(1)	1	-	(1)
Cumulative effect of change in accounting principle	15	-	-	-	-	-
Change in net assets	$ 3	$ (1)	$ -	$ 15	$ (1)	$ -

Net patient service revenue for the Primary Health System was $456 million in both fiscal year 2008 and fiscal year 2007. Admissions were less than 1 % under fiscal year 2007.

Salaries for the Primary Health System increased from $249 million in fiscal year 2007 to $267 million in fiscal year 2008. A three percent cost of living adjustment was made for all employees July 1, 2007. Paid FTE's per adjusted occupied bed were 5.92 in fiscal year 2007 and 6.02 in fiscal year 2007, a 1.7% increase.

Supplies and expenses increased from $103 million in fiscal year 2007 to $105 million in fiscal year 2008. Supplies and expenses increased from 21.8% of net operating revenue in fiscal year 2007 to 22.1% in fiscal year 2008.

Purchased services increased from $69 million in fiscal year 2007 to $79 million in fiscal year 2008. This increase resulted from increased legal fees due to a vacancy in Legal Officer Position, outsourcing of physician billing and supplemental contracted labor for the Technology Management Department.

CHANGES IN NET ASSETS - Continued

Insurance and taxes increased from $3 million in fiscal year 2007 to $5 million in fiscal year 2008. This resulted from an increase in the self insurance liability.

Depreciation and amortization expense was $32 million in fiscal year 2007 and fiscal year 2008.

Interest expense increased from $11 million in fiscal year 2007 to $16 million in fiscal year 2008. This resulted primarily from a change in the market valuation of the FID swaps total and increased interest rates associated with the auction rate bonds.

The Primary Health System entered into an arrangement with Med Trans Corporation transferring the ownership of three helicopters. A $9 million gain from sale of asset was recognized as a result of this transaction.

The Primary Health System adopted GASB 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, in fiscal year 2008. As permitted by GASB 45, the Primary Health System elected to reset to $0 the transition obligation as previously accrued through June 30, 2007 under FAS 106. The adjustment of $15 million was booked as an increase in net assets as of July 1, 2007.

OUTLOOK

The State of Tennessee continues to significantly modify the TennCare program (the State's Medicaid program). These changes could have an adverse effect on TennCare reimbursement and the number of participants in the TennCare program. Changes have also been made to the Medicaid program in the State of Georgia. These changes have directly affected the Primary Health System's bottom line with TennCare and Medicaid patients representing approximately 26% of the payor mix. Self Pay patients have increased by 5.5% from fiscal year 2007. Any changes in Medicare regulations could also have an adverse effect on the Primary Health System's future operations since Medicare represents approximately 29% of the payor mix.

The State of Tennessee approved a disproportionate share payment of $2.4 million to the Primary Health System for fiscal year 2008 subsequent to June 30, 2008. This payment was recorded as income in July 2008 as the amount has not been determined at June 30, 2008. Additional disproportionate share payments for fiscal year 2009 as well as trauma fund payments are expected to be approved and paid by the State of Tennessee during fiscal year 2009.

Audited Combined Financial Statements

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Combined Balance Sheets

	June 30, 2008		
		Component Units	
	Primary Health System	*ContinuCare Health Services, Inc.*	*Plaza Surgery, G.P.*
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	$ 60,490,481	$ 1,697,118	$ 796,890
Temporary investments	797,323	6,138,518	-
Assets limited as to use available for current liabilities	123,626	-	-
Patient accounts receivable, net	80,715,756	2,414,598	1,322,520
Estimated amounts due from third party payors, net	1,669,288	-	-
Due from other governments, net	85,218	232,025	-
Inventories	9,723,459	1,844,721	468,725
Other current assets	9,465,668	492,243	14,924
TOTAL CURRENT ASSETS	163,070,819	12,819,223	2,603,059
NET PROPERTY, PLANT AND EQUIPMENT	189,820,471	1,957,770	27,273
ASSETS LIMITED AS TO USE	134,819,938	-	-
OTHER ASSETS:			
Deferred financing costs	6,945,469	-	-
Other assets	31,340	703,961	7,419,442
TOTAL OTHER ASSETS	6,976,809	703,961	7,419,442
TOTAL ASSETS	$ 494,688,037	$ 15,480,954	$ 10,049,774
LIABILITIES AND NET ASSETS			
CURRENT LIABILITIES:			
Accounts payable and accrued expenses	$ 34,472,982	$ 844,992	$ 171,829
Accrued salaries and related liabilities	22,208,251	1,015,989	280,819
Estimated amounts due to third party payors	-	93,625	-
Due to other governments	232,025	85,218	-
Current portion of long-term debt and capital lease obligations	11,590,867	21,427	168,815
Other current liabilities	980,190	-	14,420
TOTAL CURRENT LIABILITIES	69,484,315	2,061,251	635,883
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS	200,750,273	-	-
OTHER LONG-TERM LIABILITIES	30,295,328	-	-
NET ASSETS:			
Unrestricted	173,355,386	11,483,360	2,135,991
Invested in capital assets, net of related debt	13,019,219	1,936,343	7,277,900
Restricted	7,783,516	-	-
TOTAL NET ASSETS	194,158,121	13,419,703	9,413,891
TOTAL LIABILITIES AND NET ASSETS	$ 494,688,037	$ 15,480,954	$ 10,049,774

	June 30, 2007		
		Component Units	
	Primary Health System	*ContinuCare Health Services, Inc.*	*Plaza Surgery, G.P.*
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	$ 54,459,292	$ 1,952,178	$ 494,510
Temporary investments	780,000	5,368,412	-
Assets limited as to use available for current liabilities	115,522	-	-
Patient accounts receivable, net	81,154,743	3,087,094	1,392,416
Estimated amounts due from third party payors, net	751,627	-	-
Due from other governments, net	240,736	350,163	-
Inventories	9,287,590	1,860,468	476,179
Other current assets	10,755,549	946,088	33,785
TOTAL CURRENT ASSETS	157,545,059	13,564,403	2,396,890
NET PROPERTY, PLANT AND EQUIPMENT	202,149,145	2,163,151	47,483
ASSETS LIMITED AS TO USE	130,951,157	-	-
OTHER ASSETS:			
Deferred financing costs	7,494,266	-	-
Other assets	2,404,591	372,963	7,419,442
TOTAL OTHER ASSETS	9,898,857	372,963	7,419,442
TOTAL ASSETS	$ 500,544,218	$ 16,100,517	$ 9,863,815
LIABILITIES AND NET ASSETS			
CURRENT LIABILITIES:			
Accounts payable and accrued expenses	$ 28,044,966	$ 455,006	$ 113,992
Accrued salaries and related liabilities	16,160,149	873,045	252,742
Estimated amounts due to third party payors	-	100,000	-
Due to other governments	350,163	240,736	-
Current portion of long-term debt and capital lease obligations	10,942,398	91,121	312,144
Other current liabilities	1,052,830	-	28,634
TOTAL CURRENT LIABILITIES	56,550,506	1,759,908	707,512
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS	212,043,321	21,427	207,989
OTHER LONG-TERM LIABILITIES	41,057,782	-	-
NET ASSETS:			
Unrestricted	167,610,876	12,268,579	2,001,522
Invested in capital assets, net of related debt	14,087,930	2,050,603	6,946,792
Restricted	9,193,803	-	-
TOTAL NET ASSETS	190,892,609	14,319,182	8,948,314
TOTAL LIABILITIES AND NET ASSETS	$ 500,544,218	$ 16,100,517	$ 9,863,815

See notes to combined financial statements.

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Combined Statements of Revenue, Expenses and Changes in Net Assets

	Year Ended June 30, 2008		
		Component Units	
	Primary Health System	*ContinuCare Health Services, Inc.*	*Plaza Surgery, G.P.*
OPERATING REVENUE:			
Charges for services:			
Net patient service revenue	$ 456,485,848	$ 8,969,599	$ 7,248,628
Other revenue	17,315,596	16,975,555	14,209
TOTAL OPERATING REVENUE	473,801,444	25,945,154	7,262,837
OPERATING EXPENSES:			
Salaries, wages and benefits	266,974,749	10,558,092	2,359,626
Supplies and expenses	104,606,783	16,839,455	2,788,919
Purchased services	79,122,561	-	545,868
Insurance and taxes	5,312,089	-	101,974
Depreciation	32,387,419	363,862	21,510
TOTAL OPERATING EXPENSES	488,403,601	27,761,409	5,817,897
OPERATING INCOME (LOSS)	(14,602,157)	(1,816,255)	1,444,940
NONOPERATING REVENUE (EXPENSES):			
Gain on disposal of assets	9,058,113	-	-
Interest and investment income	9,116,982	569,236	-
Interest expense	(12,136,217)	(557)	(29,363)
Provision for income taxes	-	423,325	-
Loss on mark-to-market of interest rate swaps	(4,443,904)	-	-
NET NONOPERATING REVENUE (EXPENSES)	1,594,974	992,004	(29,363)
Income (loss) before contributions	(13,007,183)	(824,251)	1,415,577
Operating contributions (distributions)	279,040	-	(950,000)
Capital contributions/other, net	624,493	(75,228)	-
Cumulative effect of Change in Accounting Principle - Note J	15,369,162	-	-
CHANGE IN NET ASSETS	3,265,512	(899,479)	465,577
NET ASSETS AT BEGINNING OF YEAR	190,892,609	14,319,182	8,948,314
NET ASSETS AT END OF YEAR	$ 194,158,121	$ 13,419,703	$ 9,413,891

	Year Ended June 30, 2007		
		Component Units	
	Primary Health System	*ContinuCare Health Services, Inc.*	*Plaza Surgery, G.P.*
OPERATING REVENUE:			
Charges for services:			
Net patient service revenue	$ 455,501,100	$ 8,301,865	$ 7,122,409
Other revenue	16,765,089	17,572,100	37,401
Program-specific operating contributions	302,769	-	-
TOTAL OPERATING REVENUE	472,568,958	25,873,965	7,159,810
OPERATING EXPENSES:			
Salaries, wages and benefits	249,059,493	10,532,746	2,145,237
Supplies and expenses	102,805,280	16,780,894	3,025,152
Purchased services	68,859,206	-	575,631
Insurance and taxes	3,542,287	-	88,584
Depreciation	31,858,158	509,779	224,197
TOTAL OPERATING EXPENSES	456,124,424	27,823,419	6,058,801
OPERATING INCOME (LOSS)	16,444,534	(1,949,454)	1,101,009
NONOPERATING REVENUE (EXPENSES):			
Loss on disposal of assets	(233,148)	-	-
Interest and investment income	9,052,810	563,176	-
Interest expense	(10,789,929)	(10,980)	(66,023)
Provision for income taxes	-	344,785	-
Loss on mark-to-market of interest rate swaps	(350,479)	-	-
NET NONOPERATING REVENUE (EXPENSES)	(2,320,746)	896,981	(66,023)
Income (loss) before contributions	14,123,788	(1,052,473)	1,034,986
Operating contributions (distributions)	488,763	-	(600,000)
Capital contributions/other, net	534,723	68,614	-
CHANGE IN NET ASSETS	15,147,274	(983,859)	434,986
NET ASSETS AT BEGINNING OF YEAR	175,745,335	15,303,041	8,513,328
NET ASSETS AT END OF YEAR	$ 190,892,609	$ 14,319,182	$ 8,948,314

See notes to combined financial statements.

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Combined Statements of Cash Flows

	Primary Health System Year Ended June 30,	
	2008	***2007***
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from third-party payors and patients	**$ 459,260,708**	$ 434,170,539
Receipts from grantors and donors	**-**	302,769
Payments to vendors and others for supplies, purchased services, and other expenses	**(183,405,234)**	(170,768,090)
Payments to employees	**(259,513,393)**	(244,871,019)
Other receipts	**16,397,304**	17,789,337
NET CASH PROVIDED BY OPERATING ACTIVITIES	**32,739,385**	36,623,536
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Contributions	**279,040**	488,763
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition and construction of capital assets, net	**(23,129,544)**	(29,333,131)
Principal paid on bonds, capital lease obligations and other	**(10,950,695)**	(9,632,139)
Proceeds from sale of assets	**12,128,912**	-
Interest payments on long-term debt	**(10,883,176)**	(10,143,685)
Capital contributions/other, net	**624,493**	534,723
NET CASH USED IN CAPITAL AND RELATED FINANCING ACTIVITIES	**(32,210,010)**	(48,574,232)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest, dividends, and gains on investments	**9,116,982**	9,052,810
(Purchases) sales of temporary investments, net	**(17,323)**	10,281,942
Cash provided by (used by) assets limited as to use	**(3,876,885)**	(2,048,642)
NET CASH PROVIDED BY INVESTING ACTIVITIES	**5,222,774**	17,286,110
INCREASE IN CASH AND CASH EQUIVALENTS	**6,031,189**	5,824,177
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**54,459,292**	48,635,115
CASH AND CASH EQUIVALENTS AT END OF YEAR	**$ 60,490,481**	$ 54,459,292

	Primary Health System Year Ended June 30,	
	2008	***2007***
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income (loss)	**$ (14,602,157)**	$ 16,444,534
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	**32,387,419**	31,858,158
Provision for self-insurance	**1,277,921**	1,048,329
Changes in assets and liabilities:		
Patient accounts receivable, net	**438,987**	(18,394,169)
Estimated amounts due from third party payors	**(917,661)**	356,331
Inventories and other current assets	**1,009,530**	(3,316,404)
Other long-term assets	**17,273**	54,103
Accounts payable and accrued expenses	**4,340,090**	6,079,199
Accrued salaries and related liabilities	**6,048,102**	3,367,615
Other current and long-term liabilities	**2,739,881**	(874,160)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**$ 32,739,385**	$ 36,623,536

SUPPLEMENTAL DISCLOSURE:

During 2007, through a non-cash transaction, the Primary Health System acquired medical equipment and assumed associated capital lease obligations totaling approximately $2,920,000.

NOTE A--SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity: The Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System (the Primary Health System) was created by a private act passed by the General Assembly of the State of Tennessee on March 11, 1976, and adopted by a majority of the qualified voters of Hamilton County, Tennessee on August 5, 1976. The Chattanooga-Hamilton County Hospital Authority consists of the Primary Health System and its discretely presented component units as disclosed below.

The Primary Health System provides comprehensive healthcare services throughout Hamilton and Bledsoe counties, as well as outlying areas in southeastern Tennessee and north Georgia. These services are provided primarily through the hospital and other facilities located on the Baroness campus of Erlanger Medical Center. The Primary Health System also operates other hospitals and clinics throughout the area. The Primary Health System is considered the primary governmental unit for financial reporting purposes. As required by accounting principles generally accepted in the United States of America, these combined financial statements present the Primary Health System and its component units. The component units discussed below are included in the Primary Health System's reporting entity because of the significance of their operational or financial relationships with the Primary Health System.

The primary mission of the Primary Health System and its component units is to provide healthcare services to the citizens of Chattanooga, Hamilton County and the surrounding area. Only those activities directly associated with this purpose are considered to be operating activities. Other activities that result in gains or losses unrelated to the Primary Health System's primary mission are considered to be nonoperating.

ContinuCare HealthServices, Inc., Plaza Surgery, G.P., and Erlanger Health Plan Trust are legally separate organizations for which the Primary Health System is financially accountable. Accordingly, these organizations represent component units of the Primary Health System.

Blended Component Unit: The financial statements of Erlanger Health Plan Trust are blended with the combined financial statements of the Primary Health System as the board of Erlanger Health Plan Trust is substantially the same as that of the Primary Health System.

Discretely Presented Component Units: The component unit columns in the basic combined financial statements include the financial data of the Primary Health System's other component units. They are reported in separate columns to emphasize that they are legally separate from the Primary Health System.

1. ContinuCare HealthServices, Inc. and subsidiary (ContinuCare) provide health and supportive services to individuals in their homes in the Hamilton County and north

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

Georgia areas. ContinuCare also provides retail pharmacy goods and services at four locations in Hamilton County. The Primary Health System owns 100% of the stock of ContinuCare. Separately audited financial statements for ContinuCare HealthServices, Inc. may be obtained by mailing a request to 1501 Riverside Drive, Suite 140, Chattanooga, Tennessee 37406.

As a for-profit entity, ContinuCare is subject to state and federal income taxes. ContinuCare HealthServices, Inc. and its subsidiary file consolidated federal income tax returns separately from the Primary Health System.

ContinuCare owes the Primary Health System for various services, supplies, and rents provided to, or expenses paid on its behalf. Actual expenses incurred were $777,024 and $1,968,428 in 2008 and 2007, respectively. In addition, ContinuCare provides staffing, contract nurse visits, and administrative services to the Primary Health System. Such revenues were $604,396 and $798,686 in 2008 and 2007, respectively. Amounts due at June 30, 2008 and 2007 are included in amounts due to/from other governments in the accompanying combined financial statements.

The Primary Health System charged approximately $32,900 in management services to ContinuCare for each of the fiscal years ending June 30, 2008 and 2007.

2. Plaza Surgery, G.P. (the Partnership) operates an ambulatory surgery center on the Primary Health System's campus. At June 30, 2006, the Primary Health System owned approximately 56% of the general partnership interest in the Partnership further described below. In the fiscal year 2007, the Primary Health System sold a portion of its investment in Plaza Surgery, GP to a third party for approximately $222,000. At June 30, 2008 and 2007, the Primary Health System continues to own a controlling 51% of the Partnership. As a general partnership, general partners are jointly and separately liable for the debts of the Partnership. Accordingly, the Partnership is fiscally dependent on the Primary Health System.

   Effective September 1, 2001, Plaza Surgery, G.P. was capitalized by the contribution by the Primary Health System of cash of $566,000 and the going concern value (i.e., goodwill) of Plaza Ambulatory Surgery Center (valued at $7,402,000 by an appraisal agreed to by all of the general partners) and the contribution of cash from certain minority partners of $3,369,000. Concurrent with the capitalization of the Partnership, and execution of an Asset Transfer Agreement, the Partnership distributed cash of $2,935,000 to the Primary Health System such that the partners' capital of the Primary Health System (56%) and the minority partners (44%) after the distribution were in

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

accordance with the Amended and Restated Partnership Agreement. The distribution of cash from the Partnership has been reflected in other long-term liabilities of the Primary Health System in the accompanying combined financial statements as a result of certain put and call rights that the minority partners had with respect to the Partnership. Upon the expiration of the put and call rights at August 31, 2003, the Primary Health System began amortizing this amount to income over the remaining term of the lease agreement associated with the Asset Transfer Agreement. Such amortization totaled $163,034 in both 2008 and 2007, and is reflected within other revenue in the accompanying combined statements of revenue, expenses and changes in net assets.

The total value of assets contributed by all general partners was approximately $8,402,000 and is included as capital contributions to Plaza Surgery, G.P. in the accompanying financial statements.

Income from the Partnership is allocated to general partners based on ownership percentages and taxed at the partner level based upon the tax status of the partner. The portion of income allocated to the Primary Health System is exempt from income taxes based on the Primary Health System's tax-exempt status.

Use of Estimates: The preparation of the combined financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the combined financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements: In November 2006, the Governmental Accounting Standards Board (GASB) issued Statement No. 49, *Accounting and Financial Reporting of Pollution Remediation Obligations*. This statement provides guidance with respect to evaluating the obligations related to the participation in pollution remediation activities, such as site cleanup, related to existing pollution. The statement is effective for periods beginning after December 15, 2007 and management is currently evaluating the impact of the statement on the Primary Health System.

In May, 2007, the GASB issued Statement No. 50, *Pension Disclosures*. This statement is effective for years beginning after June 15, 2007 and expands disclosure related to defined benefit pension plans. The adoption of this statement did not have a material impact on the Primary Health System.

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

In June 2007 the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets.* This statement is effective for years beginning after June 15, 2009 and provides guidance on amortization of intangible assets and provides guidance on financial statement recognition of intangible assets, including internally developed software. Management of the Primary Health System is evaluating the impact of this statement on the combined financial statements.

In June 2008, the GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* This statement is effective for years beginning after June 15, 2009 and provides guidance on how governmental entities report information about derivative instruments and new accounting requirements for hedge funds. 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. Management of the Primary Health System is evaluating the impact of this statement on the combined financial statements.

Enterprise Fund Accounting: The Primary Health System and its blended component unit utilize the enterprise fund method of accounting whereby revenue and expenses are recognized on the accrual basis using the economic resources measurement focus. Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* the Primary Health System has elected to apply the provisions of all relevant pronouncements of FASB, including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Net Patient Service Revenue/Receivables: Net patient service revenue is reported on the accrual basis in the period in which services are provided at rates which reflect the amount expected to be collected. Net patient service revenue includes amounts estimated by management to be reimbursable by third-party payor programs under payment formulas in effect. Net patient revenue also includes an estimated provision for bad debts based upon management's evaluation of collectability based upon the age of the receivables and other criteria, such as payor classification and management's assumptions about conditions it expects to exist and courses of action it expects to take. The Primary Health System's policies do not require collateral, or other security for accounts receivable, although the Primary Health System routinely accepts assignment or is otherwise entitled to receive patient benefits payable under health insurance programs, plans or policies. Supplemental payments from the State of Tennessee are recognized when determinable (Note B).

Charity Care: The Primary Health System accepts patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain policies established by the County

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

Auditor with regard to the Hamilton County indigent program or by the Primary Health System for other patients. Essentially, these policies define charity services as those services for which minimal payment is anticipated. In assessing a patient's inability to pay, the County and the Primary Health System utilizes the generally recognized poverty income levels, but also includes certain cases where incurred charges are significant when compared to the income of the patient. These charges are not included in net patient service revenue.

Inventories: Inventories consist principally of medical and surgical supplies, general store supplies, and pharmacy items and are stated at lower of cost (first-in, first-out) or fair market value.

Investments: The Primary Health System's investments (including Assets Limited as to Use) are reported at fair market value based on quoted market prices in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.* The Primary Health System invests in governmental bonds, corporate debt, equity securities and short-term investments.

Derivative Instruments: The Primary Health System records all derivatives as assets or liabilities on the balance sheet at estimated fair value. The Primary Health System's derivative holdings consist of interest rate swap agreements. Since these derivatives are not designated as hedging instruments, mark-to-market accounting applies, and the gain or loss resulting from changes in the fair value of the derivatives is recognized in the accompanying combined statements of revenue, expenses and changes in net assets. The Primary Health System's objectives in using derivatives are to take advantage of the differences between taxable and tax-exempt debt, the timing of long-term versus short-term rates, and to manage the mix of fixed versus variable rate debt.

Net Property, Plant and Equipment: Property, plant and equipment are recorded on the basis of cost. Donated assets are recorded at their fair market value at the date of donation. Leases that are substantially installment purchases of property are recorded as assets and amortized over their estimated useful lives ranging from three to forty years; related amortization is included in depreciation expense. Depreciation expense is computed over estimated service lives of the respective classes of assets using the straight-line method. The Primary Health System has established a capitalization threshold for property, plant and equipment of $2,500 except for computer equipment, which has a threshold of $1,000. Interest expense and interest income on borrowed funds related to construction projects are capitalized during the construction period, if material. Costs of maintenance and repairs are charged to expense as incurred.

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

Assets Limited as to Use: Assets limited as to use include funds designated by the Board for capital improvements, funds held by trustees under trust indentures, and funds restricted by donors or grantors for specific purposes.

Compensated Absences: The Primary Health System recognizes an expense and accrues a liability for employees' paid annual leave and extended illness benefits in the period in which the employees' right to such compensated absences are earned. Liabilities expected to be paid within one year are included as accrued salaries and related liabilities in the accompanying combined financial statements.

Deferred Financing Costs: Deferred financing costs consist principally of costs associated with bond issues and are being amortized over the terms of the respective debt issues by the effective interest method.

Income Taxes: The Primary Health System is exempt from income taxes under Section 501(a) as an organization described in Section 501(c)(3) of the Internal Revenue Code (IRC). In addition, it qualifies for exemption from federal income taxes pursuant to IRC Section 115 as an instrumentality of the State of Tennessee. Therefore, no provision for income taxes has been recognized in the accompanying combined financial statements for the Primary Health System.

Contributed Resources: Resources restricted by donors for specific operating purposes are held as restricted funds until expended for the intended purpose, at which time they are reported as other revenue. Restricted resources consist principally of amounts restricted by donors for specific operating or capital purposes.

Cash Equivalents: The Primary Health System considers all highly liquid investments with maturities of three months or less when purchased, excluding amounts whose use is limited by board designation, held by trustees under indenture agreement, or otherwise restricted as to use, to be cash equivalents.

Temporary Investments: The Primary Health System considers all highly liquid investments with maturities of three or more months when purchased and maturing in less than one year excluding amounts whose use is limited by board designation, held by trustees under indenture agreement, or otherwise restricted as to use, to be temporary investments. Temporary investments consist of bank certificates of deposit and commercial paper.

Net Assets: Net assets of the Primary Health System are classified in three components. *Net assets invested in capital assets, net of related debt* consist of capital and other assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

used to finance the purchase or construction of those assets. *Restricted net assets* are net assets that must be used for a particular purpose. *Unrestricted* net assets are remaining net assets that do not meet the definition of *invested in capital assets, net of related debt* or *restricted.*

Fair Value of Financial Instruments: The carrying amounts reported in the combined balance sheets for cash, accounts receivable, investments and accounts payable approximate fair value.

The carrying value of long-term debt and capital lease obligations (including current portion) was $212,341,140 as of June 30, 2008 and $222,985,719 as of June 30, 2007. The estimated fair value of long-term debt and capital lease obligations (including current portion) was $215,124,440 as of June 30, 2008 and $232,026,801 as of June 30, 2007. The fair values of long-term debt are estimated using discounted cash flows, based on the Primary Health System's incremental borrowing rates or quotes obtained from independent third parties.

Reclassifications: Certain reclassifications have been made to the 2007 combined financial statements to conform with the 2008 financial statement presentation.

NOTE B--NET PATIENT SERVICE REVENUE

A reconciliation of the amount of services provided to patients at established rates by the Primary Health System to net patient service revenue as presented in the combined statements of revenue, expenses and changes in net assets for the years ended June 30, 2008 and 2007 is as follows:

	Primary Health System	
	2008	***2007***
Inpatient service charges	$ 919,422,792	$ 902,576,914
Outpatient service charges	464,322,699	433,679,595
Gross patient service charges	1,383,745,491	1,336,256,509
Less: Contractual adjustments and other discounts	781,421,781	734,388,085
Charity care	62,223,523	43,007,072
Provision for bad debts	83,614,339	103,360,252
	927,259,643	880,755,409
Net patient service revenue	$ 456,485,848	$ 455,501,100

NOTE B--NET PATIENT SERVICE REVENUE - Continued

Charity Care and Community Benefit: The Private Act of the State of Tennessee establishing the Primary Health System obligates the Primary Health System to make its facilities and patient care programs available to the indigent residents of Hamilton County to the extent of funds appropriated by Hamilton County and adjusted operating profits, as defined. The annual appropriation from Hamilton County is not to be less than $3,000,000 in each fiscal year without approval of the Primary Health System, so long as the 1966 Hamilton County Sales Tax Agreement remains in effect. Total charity care charges provided to the certified indigent residents of Hamilton County (net of the appropriation of $3,000,000 each year) were approximately $14,020,944 and $16,919,604 for the years ended June 30, 2008 and 2007 for the Primary Health System.

During 2006, the State of Tennessee TennCare program disenrolled a substantial number of participants and, as a result, the Primary Health System experienced an increase in uninsured patients which continued in 2007 and 2008.

In addition to charity care provided to specific patients within the hospital setting, the Primary Health System also provides unreimbursed services to the community which includes free and low cost health screenings. The Primary Health System also hosts health fairs and helps sponsor many other events that are free to the public and are spread throughout the year in various community locations. The Primary Health System also publishes *Erlanger Magazine* five times per year, with each issue distributed to more than 162,000 households throughout the region. The Primary Health System also places advertisements entitled "Health News" in the *Chattanooga Times Free Press* and sometimes in other newspapers throughout the region (the number of times per year varies). Both these ads and *Erlanger Magazine* are designed to educate and inform the public of health, wellness, illness and accident prevention issues.

The Primary Health System's Community Relations department, which conducts health, wellness and safety education classes and health screenings, includes Erlanger HealthLink Plus, a free adult membership program with over 23,000 members in the Chattanooga Statistical Metropolitan Service Area. The program provides over 15 classes and/or screenings and fitness opportunities per month that are free or at a low cost to members and to the community. These classes and screenings are held in two primary locations with additional classes at satellite locations in the region. As part of Community Relations, Safe & Sound, an injury prevention service of T.C. Thompson Children's Hospital, offers free educational events regarding childhood injury prevention, including at least four free car seat inspection and installation workshops per month. The Community Relations program utilizes the services of physicians, nurses, volunteers, educators, registered dietitians, social workers, secretaries and management personnel of the Primary Health System.

NOTE B--NET PATIENT SERVICE REVENUE - Continued

The Primary Health System's consumer call center, Erlanger HealthLink (423-778-LINK) is a free call center staffed by RN's to answer health questions, offer free physician referrals and to register participants in the programs offered by Community Relations, Women's & Infant Services and other departments and divisions of the Primary Health System.

Uncompensated Care Costs (Unaudited): The following table summarizes the total uncompensated care costs provided by Erlanger Medical Center as defined by the State of Tennessee for the years ended June 30, 2008 and 2007:

	2008	*2007*
Uncompensated cost of TennCare/Medicaid	$ 28,671,342	$ 24,284,198
Traditional charity uncompensated costs	23,130,509	15,611,933
Bad debt cost	29,791,235	35,215,834
Total uncompensated care costs	$ 81,593,086	$ 75,111,965

The uncompensated cost of TennCare/Medicaid is estimated by taking the estimated cost of providing care to the TennCare/Medicaid patients less payments from the TennCare and Medicaid programs. The payments exclude revenues from essential access and other, one-time supplemental payments from TennCare of approximately $7,044,000 and $9,550,000 for the years ended June 30, 2008 and 2007, respectively, as such payments are not guaranteed for future periods. Traditional charity uncompensated costs exclude $3,000,000 of local government support for each of the years ended June 30, 2008 and 2007.

Revenue from Significant Payors: Gross patient service charges related to the Medicare program accounted for approximately 29.4% and 28.9% of the Primary Health System's patient service charges for the years ended June 30, 2008 and 2007, respectively. Gross patient service charges related to the TennCare/Medicaid program accounted for approximately 24.8% and 25.6% of the Primary Health System's patient service charges for the years ending June 30, 2008 and 2007, respectively. TennCare typically reimburses providers at an amount less than their cost of providing services to TennCare patients. At June 30, 2008 and 2007, the Primary Health System has a credit concentration related to the Medicare and TennCare programs.

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. Final determination of amounts earned under prospective payment

NOTE B--NET PATIENT SERVICE REVENUE - Continued

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. Prior year cost report settlements increased the 2008 and 2007 net patient service revenue by approximately $1,000,000 and $7,000,000 respectively.

The Primary Health System believes that it is substantially in compliance with all applicable laws and regulations and is not aware of any on-going 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.

The Primary Health System has also entered into reimbursement agreements with certain commercial insurance companies, health maintenance organizations and preferred provider organizations. The basis for reimbursement under these agreements includes prospectively determined rates, per diems and discounts from established charges.

NOTE C--CASH AND CASH EQUIVALENTS

Cash and cash equivalents reported on the balance sheets include cash on hand and deposits with financial institutions including demand deposits and certificates of deposit.

The carrying amount of cash and cash equivalents consists of the following at June 30:

	Primary Health System	
	2008	*2007*
General Fund:		
Demand deposits	$ 4,966,869	$ 7,812,184
Cash on hand	6,074	5,874
Cash equivalents	55,517,538	46,641,234
	$ 60,490,481	$ 54,459,292

Cash equivalents include certificates of deposit, money market accounts, repurchase agreements and U.S. Government agency investments and commercial paper whose maturity, when purchased, was three months or less.

NOTE C--CASH AND CASH EQUIVALENTS - Continued

Bank balances consist of the following at June 30:

	Primary Health System	
	2008	*2007*
Insured (FDIC)	$ 530,828	$ 522,319
Uncollateralized	-	355,381
Collateralized with securities held by the pledging financial institution's agent in the entity's name	48,779,379	42,741,225
	$ 49,310,207	$ 43,618,925

In addition to the above bank balances, the Primary Health System held investments which met the definition of a cash equivalent and are included in cash and cash equivalents At June 30, 2008 and June 30, 2007 amounts totaling $18,472,334 and $16,793,762, respectively, were invested in U.S. Government agency investments and commercial paper.

The Primary Health System'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 risk is that, in the event of the failure of a depository financial institution, the Primary Health System 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.

NOTE D--DISAGGREGATION OF RECEIVABLE AND PAYABLE BALANCES

Patient Accounts Receivable, Net: Patient accounts receivable and related allowances are as follows at June 30:

	Primary Health System	
	2008	*2007*
Gross patient accounts receivable	$ 282,106,548	$ 307,760,811
Estimated allowances for contractual adjustments and uncollectible accounts	(201,390,792)	(226,606,068)
	$ 80,715,756	$ 81,154,743

NOTE D--DISAGGREGATION OF RECEIVABLE AND PAYABLE BALANCES - Continued

Other Current Assets: Other current assets consist of the following at June 30:

	Primary Health System 2008	2007
Prepaid expenses	$ 3,932,721	$ 2,889,413
Other receivables	5,532,947	7,866,136
Total other current assets	$ 9,465,668	$ 10,755,549

Accounts Payable and Accrued Expenses: Accounts payable and accrued expenses consist of the following at June 30:

	Primary Health System 2008	2007
Due to vendors	$ 30,997,238	$ 25,097,519
Other	3,475,744	2,947,447
Total accounts payable and accrued expenses	$ 34,472,982	$ 28,044,966

Other Long-Term Liabilities: Other long-term liabilities consist of the following at June 30:

	Primary Health System 2008	2007
Pension obligation	$ 9,990,917	$ 9,273,532
Postretirement benefits other than pensions - Note J	746,701	9,989,951
Compensated absences	7,959,680	13,389,723
Medical malpractice and general liabilities	5,000,000	5,000,000
Other	6,598,030	3,404,576
Total other long-term liabilities	$ 30,295,328	$ 41,057,782

NOTE E--NET PROPERTY, PLANT AND EQUIPMENT

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

NOTE E--NET PROPERTY, PLANT AND EQUIPMENT - Continued

	Balance at June 30, 2006	*Additions*	*Reductions/ Transfers*	*Balance at June 30, 2007*	*Additions*	*Reductions/ Transfers*	*Balance at June 30, 2008*
Capital assets:							
Land and improvements	$ 26,692,650	$ 660,857	$ -	$ 27,353,507	$ -	$ -	$ 27,353,507
Buildings	229,331,149	5,107,246	-	234,438,395	2,302,997	-	236,741,392
Equipment	309,108,424	26,364,720	2,745,624	332,727,520	21,489,282	20,112,349	334,104,453
	565,132,223	32,132,823	2,745,624	594,519,422	23,792,279	20,112,349	598,199,352
Accumulated depreciation :							
Land and improvements	10,768,168	455,932	-	11,224,100	387,269	-	11,611,369
Buildings	134,156,440	8,762,118	-	142,918,558	8,683,825	-	151,602,383
Equipment	225,735,587	22,640,108	2,489,816	245,885,879	23,316,325	17,041,550	252,160,654
	370,660,195	31,858,158	2,489,816	400,028,537	32,387,419	17,041,550	415,374,406
	194,472,028	274,665	255,808	194,490,885	(8,595,140)	3,070,799	182,824,946
Construction in progress ($9,138,957 estimated cost to complete at June 30, 2008)	7,514,830	143,430	-	7,658,260	15,470,577	16,133,312	6,995,525
	$ 201,986,858	$ 418,095	$ 255,808	$ 202,149,145	$ 6,875,437	$ 19,204,111	$ 189,820,471

Depreciation expense totaled $32,387,419 and $31,858,158 for 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 Primary Health System's facilities. The Primary Health System has outstanding contracts and other commitments related to the completion of these projects.

The Primary Health System has included in net property, plant, and equipment, certain property subject to a capital lease arrangement. At the end of the twenty-year lease term, the Primary Health System will receive one-half interest in the property.

NOTE F--INVESTMENTS AND ASSETS LIMTED AS TO USE

The Primary Health System's investments (including assets limited as to use) are reported at estimated fair value based on quoted market prices in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools.* The Primary Health System invests in government and corporate debt, certificates of deposit, equities and short-term money market investments that are in accordance with the Primary Health System's investment policy. Temporary investments at June 30, 2008 and 2007 consist primarily of certificates of deposit, government agency securities and commercial paper.

The carrying and estimated fair values for assets whose use is limited, by type, at June 30 are as follows:

NOTE F--INVESTMENTS AND ASSETS LIMTED AS TO USE - Continued

	Primary Health System	
	2008	*2007*
Government and municipal bonds	$ 111,118,233	$ 109,323,215
Corporate bonds and commercial paper	7,762,980	11,255,361
Short-term investments and cash equivalents	16,062,351	10,488,103
Total investments	$ 134,943,564	$ 131,066,679

Assets limited as to use are classified as follows:

	Primary Health System	
	2008	*2007*
By board of trustees for capital improvements	$ 96,537,759	$ 92,153,670
Under bond indentures - held by trustees	29,490,651	28,793,025
Self-insurance trust	5,480,675	6,476,198
Restricted by donors	3,434,479	3,643,786
	134,943,564	131,066,679
Less current portion	(123,626)	(115,522)
	$ 134,819,938	$ 130,951,157

Assets limited as to use by the board of trustees for capital improvements consist primarily of United States government and government agency obligations or other liquid assets, which are to be used for the replacement of property and equipment or for any other purposes so designated.

Funds held by trustees under bond indenture at June 30 are as follows:

	Primary Health System	
	2008	*2007*
Construction fund	$ 619,196	$ 1,094,598
Debt service reserve fund	28,594,419	27,430,238
Principal and interest fund	123,626	115,522
Other funds	153,410	152,667
Total funds held by trustees under bond indenture	$ 29,490,651	$ 28,793,025

NOTE F--INVESTMENTS AND ASSETS LIMTED AS TO USE - Continued

These funds held by trustees consist primarily of United States government and government agency obligations, municipal obligations and corporate debt. The debt service reserve fund at June 30, 2008 and 2007 is to be used only to make up any deficiencies in other funds related to the Hospital Revenue and Refunding Bonds Series 1993, Series 1997A, Series 1998A, Series 2000, and Series 2004. The interest funds are to be used only to pay interest on the Series 1993, Series 1997A, Series 1998A, Series 2000 and Series 2004 bonds.

The Primary Health System has implemented the disclosure requirements of GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (GASB No. 40) and, accordingly, the Primary Health System has assessed the custodial credit risk, the concentration of credit risk, credit risk, and interest rate risk of its cash and investments. The Primary Health System's investment policy specifies the types of investments which can be included in board-designated assets limited as to use, as well as collateral or other security requirements. The investment policy also specifies the maximum maturity of the portfolio of board-designated assets. Assets limited as to use and held by trustees are invested as permitted by the bond indenture.

Custodial Credit Risk: The Primary Health System's investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Primary Health System, and are held by either the counterparty or the counterparty's trust department or agent but not in the Primary Health System's name. The investment risk is that, in the event of the failure of the counterparty to a transaction, the Primary Health System will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

As of June 30, 2008 and 2007, the Primary Health System's assets limited as to use were comprised of various short-term investments, government bonds, corporate bonds, commercial paper, and U.S. Treasury Notes. All of the Primary Health System's investments presented are uninsured or unregistered. Securities are held by the counterparty, or by its trust department or agent, but not in the Primary Health System's name.

Concentration of Credit Risk: This is the risk associated with the amount of investments the Primary Health System has with any one issuer that exceeds 5% 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 Primary Health System's investment policy does not restrict the amount that may be held for any single issuer. At June 30, 2008, none of the Primary Health System's investments with any one issuer exceed 5% of its total investments.

NOTE F--INVESTMENTS AND ASSETS LIMTED AS TO USE - Continued

Credit Risk: GASB No. 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 Primary Health System's investment policy provides guidelines for its fund managers and lists specific allowable investments.

The credit risk profile of the Primary Health System's assets limited as to use as of June 30, 2008, is as follows:

		Rating					
Investment Type	*Balance as of June 30, 2008*	*AAA*	*AA*	*A*	*BBB*	*BB*	*N/A*
U.S. Government bonds	$ 112,220,318	$ 111,781,451	$ -	$ -	$ -	$ -	$ 438,867
Municipal bonds	1,498,528	-	1,498,528	-	-	-	-
Corporate bonds and commercial paper	14,329,311	481,906	497,689	13,349,716	-	-	-
Equity securities	-	-	-	-	-	-	-
Cash equivalents	6,895,407	-	-	-	-	-	6,895,407
Total investments	$ 134,943,564	$ 112,263,357	$ 1,996,217	$ 13,349,716	$ -	$ -	$ 7,334,274

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

The distribution of the Primary Health System's assets limited as to use by maturity as of June 30, 2008, is as follows:

		Remaining Maturity				
Investment Type	*Balance as of June 30, 2008*	*12 months or less*	*13-24 Months*	*25-60 Months*	*Over 60 Months*	*N/A*
U.S. Government bonds	$ 112,220,318	$ 43,153,262	$ 17,824,061	$ 8,076,669	$ 43,166,326	$ -
Municipal bonds	1,498,528	1,498,528	-	-	-	-
Corporate bonds and commercial paper	14,329,311	14,329,311	-	-	-	-
Equity securities	-	-	-	-	-	-
Cash equivalents	6,895,407	6,895,407	-	-	-	-
Total investments	$ 134,943,564	$ 65,876,508	$ 17,824,061	$ 8,076,669	$ 43,166,326	$ -

NOTE G-- LONG-TERM DEBT

Long-term debt at June 30 consists of:

	Primary Health System	
	2008	*2007*
Revenue and Refunding Bonds, Series 2004	$ 85,000,000	$ 85,000,000
Hospital Revenue Refunding Bonds, Series 2000	43,100,000	44,500,000
Hospital Revenue Bonds, Series 1998A, net of bond discount of $354,461 in 2008 and $369,230 in 2007	20,120,539	20,520,770
Hospital Revenue Bonds, Taxable Series 1997A	41,000,000	41,000,000
Revenue and Refunding Bonds, Series 1993, net of bond discount of $1,301,773 in 2008 and $1,466,682 in 2007	15,763,837	23,373,428
Total bonds payable	204,984,376	214,394,198
Less: unamortized premium paid on advance refunding	(1,238,941)	(1,324,879)
Total bonds payable, net	203,745,435	213,069,319
Capital leases - Note M	8,595,705	9,916,400
	212,341,140	222,985,719
Less: current portion	(11,590,867)	(10,942,398)
	$ 200,750,273	$ 212,043,321

On January 1, 2004, the Primary Health System issued $85,000,000 insured Series 2004 Hospital Revenue Refunding Bonds (Series 2004) for the purpose of refunding $80,925,000 of the outstanding Series 1993 bonds (described below). The Series 1993 bonds were refunded at 102% of par value and the premium paid is presented as a deduction from the face value of the bonds. The premium is being amortized over the remaining term of the 1993 bonds. The refunded 1993 term bonds were scheduled to mature on October 1, 2013, 2018 and 2023. The Primary Health System also contributed a portion of the 2004 bond proceeds in the amount of $1,633,658 to establish a debt service fund. Amounts in the debt service fund are to be used for any deficiencies in the interest and principal amounts of the bond fund, but are not to be used to pay the principal or interest on the bonds.

The Series 2004 bonds were issued on parity, with respect to collateral, with the other outstanding bonds, described below. The Series 2004 bonds are also secured by a mortgage on a

NOTE G--LONG-TERM DEBT - Continued

portion of the Primary Health System's main campus. The Series 2004 bonds are subject to optional redemption at the end of any variable rate auction period at 100% plus accrued interest. Interest on the Series 2004 bonds is payable at a variable auction rate for a 7-day period, which was 4.31% at June 30, 2008 and 3.75% at June 30, 2007. The bonds mature through October 1, 2023.

The Primary Health System issued $47,300,000 insured Series 2000 Hospital Revenue Refunding Bonds (Series 2000) for the purpose of refunding $40,000,000 of then-outstanding Series 1987 bonds and funding a debt service reserve fund in an original amount of $4,407,377 in August 2000. Interest is payable at a variable auction rate for a 7-day period, which was 3.70% at June 30, 2008 and 3.75% at June 30, 2007. The Series 2000 bonds mature annually beginning October 1, 2005 through October 1, 2025 and may be redeemed by the Primary Health System at the end of any variable rate auction period at 100% of par value plus accrued interest. The Series 2000 bonds were issued on parity with other outstanding bond issues. The refunded 1987 bonds were subject to a variable rate and were scheduled to mature on September 1, 2017.

The Primary Health System's 1997A and 1998A Hospital Revenue Bonds (Series 1997A and Series 1998A, respectively) were issued to fund capital improvements for Erlanger Medical Center and establish a debt service reserve fund (1998A only) in an original amount of $2,174,125. The Series 1997A bonds are taxable and are secured on a parity under a Master Trust Indenture with other outstanding bond issues. The bonds mature beginning in fiscal year 2015 through fiscal year 2028. The 1997A bonds are subject to optional redemption at 100% plus accrued interest. Interest is payable at a variable auction rate for a 35-day period, which was 4.90% at June 30, 2008.

The Series 1998A insured bonds are tax-exempt and consist of $6,080,000 serial bonds maturing annually on October 1 of each year through 2013 in varying amounts; and term bonds maturing on October 1, 2018 and 2028 ($5,825,000 and $17,095,000, respectively). Such bonds are secured on parity with other outstanding bonds. The bonds maturing after October 1, 2008 may be redeemed by the Primary Health System after April 1, 2008 at amounts ranging from 100% to 101% of par value plus accrued interest.

Interest rates for the Series 1998A bonds are as follows:

$ 6,080,000 Series Bonds	-	4.50% to 5.00%
$ 5,825,000 Term Bonds	-	5.0%
$17,095,000 Term Bonds	-	5.0%

NOTE G--LONG-TERM DEBT - Continued

During fiscal year 2002, the Primary Health System defeased $5,320,000 of the 1998A bond issuance because IRS regulations do not permit tax-exempt debenture proceeds to be used to fund for-profit endeavors. These funds were used in the construction of the Plaza Ambulatory Surgery Center that was contributed to Plaza Surgery, G.P. on September 1, 2001, as discussed in the Discretely Presented Component Units section of Note A. The Primary Health System contributed to an escrow account funds generated from its operations sufficient to fund all principal and interest payments for approximately $5,320,000 of debentures until maturity. The Primary Health System was released from being the primary obligor and cannot be held liable for the defeased obligation, of which approximately $4,951,586 remains outstanding at June 30, 2008.

The Primary Health System Hospital Revenue and Refunding Bonds Series 1993 (Series 1993) were issued to advance refund the previously outstanding $84,000,000 Revenue and Refunding Bonds Series 1986A and $40,000,000 Hospital Revenue Bonds Series 1991A, 1991B, and 1991C and provide additional capital for expansion. The Series 1993 bonds are secured on parity with other outstanding bonds and consisted of $96,245,000 Serial Bonds with interest rates from 5.5% to 5.625%. The serial bonds mature annually on October 1 of each year through 2009 in increasing annual amounts ranging from $7,775,000 in 2007 to $8,920,000 in 2009. The Series 1993 bonds represent general unsecured obligations of the Primary Health System. All remaining Series 1993 serial bonds are insured.

The trust indentures and related documents underlying the bonds contain certain covenants and restrictions. Management believes the Primary Health System was in compliance with all such covenants at June 30, 2008.

The Primary Health System's scheduled principal and interest payments (estimated for variable rate debt based on rates at June 30, 2008) on bonds payable are as follows for the years ending June 30:

	Principal	*Interest*	*Total*
2009	$ 10,185,000	$ 8,971,143	$ 19,156,143
2010	10,830,000	8,415,765	19,245,765
2011	12,880,000	7,855,558	20,735,558
2012	13,090,000	7,306,240	20,396,240
2013	13,695,000	6,738,929	20,433,929
2014-2018	52,405,000	26,321,274	78,726,274

NOTE G--LONG-TERM DEBT - Continued

	Principal	*Interest*	*Total*
2019-2023	51,595,000	15,307,008	66,902,008
2024-2028	39,840,000	4,735,983	44,575,983
2029-2033	2,120,610	53,000	2,173,610
TOTAL	$ 206,640,610	$ 85,704,900	$ 292,345,510

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

	Balance at June 30, 2006	*Additions/ Amortizations*	*Reductions*	*Balance at June 30, 2007*	*Additions/ Amortizations*	*Reductions*	*Balance at June 30, 2008*
Bonds Payable							
Series 2004	$ 85,000,000	$ -	$ -	$ 85,000,000	$ -	$ -	$ 85,000,000
Series 2000	46,000,000	-	1,500,000	44,500,000	-	1,400,000	43,100,000
Series 1998A	20,751,001	14,769	245,000	20,520,770	54,769	455,000	20,120,539
Series 1997A	41,000,000	-	-	41,000,000	-	-	41,000,000
Series 1993	30,611,030	172,398	7,410,000	23,373,428	165,409	7,775,000	15,763,837
Premium paid on advance refunding	(1,410,817)	85,938		(1,324,879)	85,938		(1,238,941)
Total bonds payable	221,951,214	273,105	9,155,000	213,069,319	306,116	9,630,000	203,745,435
Capital leases	7,468,822	2,920,462	472,884	9,916,400		1,320,695	8,595,705
Other	4,255	-	4,255	-	-		-
Total long-term debt	$ 229,424,291	$ 3,193,567	$ 9,632,139	$ 222,985,719	$ 306,116	$ 10,950,695	$ 212,341,140

NOTE H--PENSION PLAN

The Primary Health System sponsors a single-employer defined benefit pension plan covering substantially all employees meeting certain age and service requirements. In addition to normal retirement benefits, the plan also provides for early retirement, delayed retirement, disability and death benefits. The Primary Health System funds the plan as contributions are approved by the Board of Trustees. During the years June 30, 2008 and 2007, the Primary Health System made contributions of $6,060,563 and $8,261,320, respectively to the plan. The Primary Health System has the right to amend, in whole or in part, any or all of the provisions of the plan. The plan issues a publicly available financial report that includes a financial statement and required supplementary information for the plan. That report may be obtained by writing to Erlanger Medical Center, Attention: Human Resources Department, 975 East Third Street, Chattanooga, Tennessee 37403 or by calling 423-778-7000.

NOTE H--PENSION PLAN - Continued

The annual pension cost and net pension obligation for the years ended June 30, 2008 and 2007 are as follows:

	Primary Health System	
	2008	*2007*
Annual expected contribution	$ 6,731,386	$ 8,261,320
Interest on net pension obligation	695,515	692,040
Adjustment to annual expected contribution	(648,953)	(645,710)
Annual pension cost	6,777,948	8,307,650
Contributions made	(6,060,563)	(8,261,320)
Change in net pension obligation	717,385	46,330
Net pension obligation at beginning of year	9,273,532	9,227,202
Net pension obligation at end of year	$ 9,990,917	$ 9,273,532

The annual expected contribution for the years ended June 30, 2008 and 2007, was determined as part of the January 1, 2008 and 2007 actuarial valuations, respectively, using the projected unit credit method. The following actuarial assumptions were utilized:

	Primary Health System	
	2008	*2007*
Investment rate of return	7.5%	7.5%
Projected salary increases	4.5%	4.5%
Inflation	2.5%	2.5%
Increase in Social Security taxable wage base	3.5%	3.5%

The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments using an average of cost and market value. The plan reset the amortization period to 20 years beginning January 1, 2004 and used a level percentage of payrolls as the amortization factor. During 2007, the Primary Health System in consultation with it actuaries, updated the estimated retirement and withdrawal decrements and changed the formula for determining the average monthly compensation from the last fifteen years to the last ten years. The impact of the assumption change and change in the formula for determining average monthly compensation decreased the 2007 normal pension cost by $404,836 and the unfunded actuarial accrued liability as of June 30, 2007 by $4,468,458.

NOTE H--PENSION PLAN - Continued

Three-Year Trend Information

Fiscal Year Ending	*Annual Pension Cost (APC)*	*Percentage of APC Contributed*	*Net Pension Obligation*
June 30, 2006	$ 7,518,236	116%	$ 9,227,202
June 30, 2007	8,307,650	99%	9,273,532
June 30, 2008	6,777,948	89%	9,990,917

Schedule of Funding Progress

Actuarial Valuation Date	*Actuarial Value of Assets*	*Actuarial Accrued Liability (AAL)*	*Total Unfunded AAL (UAAL)*	*Funded Ratio %*	*Annual Covered Payroll*	*UAAL as a Percentage of Covered Payroll*
1/1/06	$ 91,138,935	$ 106,308,433	$15,169,498	85.7	$ 134,278,637	11.3
1/1/07	105,525,982	108,686,447	3,160,465	97.1	127,662,997	2.5
1/1/08	118,955,710	119,927,714	972,004	99.2	138,478,848	0.7

NOTE I--403(b) RETIREMENT PLAN

On July 1, 1997, the Primary Health System implemented a defined contribution plan under Section 403(b) and 401(a) of the IRC which provides for voluntary contributions by employees upon employment and matching contributions by the Primary Health System after 12 months of service. The plan is for the benefit of generally all employees 25 years of age or older.

The Primary Health System matches 50% of the participant's contribution up to 4% of the employee's earnings. Employer contributions to the plan were $1,590,441 and $1,502,752 for the years ended June 30, 2008 and 2007, respectively. Employee contributions to the plan were $8,057,124 and $5,778,375 for the years ended June 30, 2008 and 2007, respectively.

NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

The Primary Health System sponsors three defined benefit postretirement plans other than pensions for full-time employees who have reached retirement age, as defined. The respective plans provide medical, dental and life insurance benefits, along with a lump-sum cash payment for one-half of the hours in the participant's extended illness benefit bank at retirement. The

NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued

postretirement health and dental plan is contributory and contains other cost-sharing features, such as deductibles and coinsurance. The life insurance plan and the extended illness bank are noncontributory.

In June 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. This statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. The statement is effective in three phases based on a government's total annual revenues and was adopted by the Primary Health System for the year ended June 30, 2008. The Primary Health System had previously implemented Statement of Financial Accounting Standards Statement No. 106, *Employers' Accounting for Postemployment Benefits Other Than Pensions* (FAS No. 106).

As permitted by GASB Statement No. 45, the Primary Health System has reset the transition obligation to $0 through an adjustment of the opening net assets as of July 1, 2007. The financial statements for the year ended June 30, 2007 have not been restated to conform with GASB Statement No. 45, but present the pension obligation and expense as computed under FAS No. 106.

The following table shows the plan's funded status as of the actuarial valuation date June 30, 2008:

Actuarial accrued liability	$	17,176,864
Market value of assets		-
Unfunded actuarial accrued liability	$	17,176,864

The following is a summary of the components of the annual OPEB cost recognized by the Primary Health System for the year ended June 30, 2008:

NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued

Annual required contribution	$	1,945,436
Interest on the net obligation		-
Amortization of net obligation		-
OPEB cost recognized	$	1,945,436

Reconciliation of the net OPEB obligation for the fiscal year ended June 30, 2008:

Net OPEB obligation beginning of the year (transition)	$	-
OPEB cost recognized		1,945,436
Actual contributions		(758,312)
Net OPEB obligation end of the year	$	1,187,124

Trend Information

Fiscal Year Ending	*Annual OPEB Cost*	*Percentage of Annual OPEB Cost Contributed*	*Net OPEB Obligation at the End of Year*
June 30, 2008	$ 1,945,436	38.98%	$ 1,187,124

Schedule of Funding Progress

Actuarial Valuation Date	*Actuarial Value of Assets*	*Actuarial Accrued Liability*	*Unfunded Actuarial Accrued Liability*	*Annual Covered Payroll*	*Unfunded Actuarial Accrued Liability as a Percent of Covered Payroll*	*Funded Ratio*
June 30, 2008	$ -	$ 17,176,864	$ 17,176,864	$138,478,848	12.4%	0%

The actuarial calculations reflect a long term perspective. Accordingly, the actuarial valuation involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The schedule of funding progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability. The calculations are based on the benefits currently provided under the terms of the plan as of the date of each valuation and on the sharing of cost between employer and plan members at that point.

NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued

The actuarial cost method utilized is the projected unit credit method. The 2008 postretirement benefit cost assumed an average weighted annual rate increase in per capita cost of pre-Medicare covered health benefits of 8%, decreasing gradually to 5% in 2017 and subsequent years and a weighted average annual rate increase in per capita cost of post-Medicare covered health care benefits of 9.5%, decreasing gradually to 5% in 2017 and subsequent years. The amortization method used is the level percent of payroll method over a thirty year amortization. Other assumptions include a 4% discount rate, and assumed salary increases of 4.5% annually until age 65. The plan is currently open.

June 30, 2007 Status: The following table shows the plan's funded status reconciled with the amount recognized in the Primary Health System's combined financial statements at June 30, 2007 as determined under FAS No. 106:

Accumulated postretirement benefit obligation	$	14,409,273
Plan assets at fair value		-
Accumulated postretirement benefit obligation in excess of Plan assets		14,409,273
Unrecognized prior service cost		257,870
Unrecognized net gain (loss)		702,012
Accrued postretirement benefit cost	$	15,369,155

The reconciliation of the accumulated postretirement benefit obligation for the year ended June 30, 2007 is as follows:

Accumulated postretirement benefit obligation, at beginning of year	$	16,869,128
Service cost		1,416,338
Interest cost		986,005
Estimated benefits paid		(1,235,368)
Actuarial (gain)/loss		(3,626,830)
Accumulated postretirement benefit obligation, at end of year	$	14,409,273

NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued

The components of the net periodic postretirement benefit cost for the years ended June 30, 2007 is as follows:

Service cost	$	1,416,338
Interest cost		986,005
Amortization of prior service costs		(53,169)
Actuarial (gain)/loss		120,939
Net periodic postretirement benefit cost	$	2,470,113

Primary Health System expenses for postretirement benefits that are recognized as claims are reported and totaled $1,235,368 for the year ended June 30, 2007.

The 2007 postretirement benefit cost assumed a weighted average annual rate increase in per capita cost of pre-Medicare covered health benefits of 8%, decreasing gradually to 5.0% in 2013 and subsequent years, and a weighted average annual rate increase in per capita cost of post-Medicare covered healthcare benefits of 10%, decreasing gradually to 5.0% in 2017 and subsequent years.

The healthcare cost trend rate assumption has a significant effect on the amounts reported. Increasing the assumed healthcare cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of June 30, 2007 by approximately $905,000, and the aggregate net periodic retirement benefit cost for fiscal year 2007 by approximately $143,000. Decreasing the assumed healthcare cost trend rates by one percentage point in each year would decrease the accumulated postretirement benefit obligation as of June 30, 2007 by approximately $804,000, and the aggregate net periodic retirement benefit cost for fiscal year 2007 by approximately $125,000. During 2007, the assumed per capita medical cost was increased from $7,800 to $8,700.

The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 6.0% for June 30, 2007. The rate of compensation increase assumption for the extended illness benefit is 4.5% for 2007. At July 1, 2008, the number of active participants is as follows:

Medical coverage	3,365
Dental coverage	3,365
Life insurance	68
Extended illness bank	3,300

NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued

The Primary Health System also has a job injury program to provide benefits to workers injured in employment-related accidents. This program provides medical and indemnity benefits to employees injured in the course of employment for a period up to 24 months from the date of injury. The Primary Health System has recorded a projected liability of approximately $1,255,000 and $900,000 at June 30, 2008 and 2007, respectively. The projected liability was discounted using a 5% rate of return.

NOTE K--MEDICAL MALPRACTICE AND GENERAL LIABILITY CLAIMS

As of January 1, 1976, the Primary Health System adopted a self-insurance plan to provide for malpractice and general liability claims and expenses arising from services rendered subsequent to that date. In 1980, the Primary Health System's Self-Insurance Trust Agreement (the Agreement) was amended to include all coverage's that a general public liability insurance policy would cover. In 1988, the Agreement was amended and restated to comply with amendments to the Tennessee Governmental Tort Liability Act and to formally include any claims and expenses related to acts of employees of the Primary Health System. The Primary Health System is funding actuarial estimated liabilities through a revocable trust fund with a bank included as a part of Assets Limited as to Use in the accompanying combined balance sheets. Such amounts in the trust can be withdrawn by the Primary Health System only to the extent there is an actuarially determined excess. The annual deposit to the self-insurance trust fund is determined by management based on known and threatened claims, consultation with legal counsel, and a report of an independent casualty actuary. Losses against the Primary Health System are generally limited by the Tennessee Governmental Tort Liability Act to $300,000 ($250,000 in 2007) for injury or death to any one person in any one occurrence or $700,000 ($600,000 in 2007) in the aggregate. However, claims against healthcare practitioners are not subject to the foregoing limits applicable to the Primary Health System. Any such individuals employed by the Primary Health System are covered by the Trust to the limits set forth therein. Employed physicians are not subject to the Tort Liability Act and are not covered by the Trust as the Primary Health System has purchased insurance coverage for such individuals.

In the opinion of management, the revocable trust fund assets are adequate at June 30, 2008, to cover potential liability and malpractice claims and expenses that may have been incurred to that date.

The Primary Health System provides for claims and expenses in the period in which the incidence related to such claims occur based on historical experience and consultation with legal counsel. It is the opinion of management that the reserve for estimated losses and loss

NOTE K--MEDICAL MALPRACTICE AND GENERAL LIABILITY CLAIMS - Continued

adjustment expense (LAE) at June 30, 2008 and 2007, respectively, is adequate to cover potential liability and malpractice claims which may have been incurred but not reported (IBNR) to the Primary Health System. Such reserve for IBNR claims reflect a discount rate of 5.5% based on the Primary Health System's expected investment return during the payout period.

The following is a reconciliation of changes in the estimated losses and LAE that have been recognized in the combined financial statements for the years ended June 30, 2008 and 2007:

	Primary Health System	
	2008	*2007*
Reserve for losses and LAE at beginning of year	$ 5,000,000	$ 5,000,000
Provision for claims	1,277,921	1,048,329
Payments on claims	(1,277,921)	(1,048,329)
Reserve for losses and LAE at end of year	$ 5,000,000	$ 5,000,000

NOTE L--COMMITMENTS AND CONTINGENCIES

Litigation: The Primary Health System 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 provided for in its combined financial statements, and will not have a material effect on the Primary Health System's results of operations or financial position.

Government Investigation: The Primary Health System resolved an investigation, without any admission of wrongdoing by the Primary Health System, in October 2005 by entering into a civil settlement agreement with the U.S. Department of Justice and the Office of Inspector General of HHS. At that time the Primary Health System also entered into a five year Corporate Integrity Agreement. The Primary Health System was not suspended, sanctioned or otherwise restricted from participating in any federal, state or private health insurance program.

Asset Retirement Obligations: Management of the Primary Health System is not aware of any significant asset retirement obligations.

NOTE M--LEASES

During 1998, the Primary Health System entered into a twenty-year capital lease with Sports Barn Inc., for the operation of the Lifestyle Center. At the end of the lease term, the Primary Health System will receive a one-half interest in the land and building. Additionally during

NOTE M--LEASES - Continued

2007, the Primary Health System acquired certain equipment and assumed the associated capital leases totaling approximately $2,920,000.

Capital: The following is an analysis of the property under capital leases by major classes at June 30:

	Primary Health System	
	2008	*2007*
Land and improvements	$ 500,000	$ 500,000
Buildings	9,620,457	9,620,457
Equipment	2,920,462	2,955,227
	13,040,919	13,075,684
Less: accumulated amortization	(5,803,507)	(4,417,795)
	$ 7,237,412	$ 8,657,889

The following is a schedule of future minimum lease payments under capital leases:

Year Ending June 30,	
2009	$ 1,997,026
2010	1,997,025
2011	1,370,737
2012	976,905
2013	908,231
2014-2018	4,120,806
Total minimum lease payments	11,370,730
Less: amount representing interest	(2,775,025)
Present value of minimum lease payments (including current portion of $1,405,867)	$ 8,595,705

Operating: The Primary Health System rents office space and office equipment under non-cancelable operating leases through 2010. The original lease terms are generally ten years. The leases have other various provisions, including sharing of certain executory costs. Rent expense under operating leases was approximately $5,852,914 and $4,741,293 in 2008 and 2007, respectively. Future minimum lease commitments at June 30, 2008 for all non-cancelable leases are as follows:

NOTE M--LEASES - Continued

Year Ending June 30,	
2009	$ 1,754,825
2010	1,458,905
2011	1,447,679
2012	1,051,003
2013	654,405
Thereafter	1,238,890
	$ 7,605,707

NOTE N--DERIVATIVE FINANCIAL INSTRUMENTS

Simultaneous with the issuance of the $85,000,000 Series 2004 bonds discussed in Note G, the Primary Health System entered into interest rate swap agreements. In an effort to balance its exposure to market fluctuations with respect to interest rates as well as to balance its mix of fixed and variable rate debt instruments, the Primary Health System executed three distinct interest rate swap agreements with Lehman Brothers Special Financing, Inc.

With respect to the Series 2004 bonds, the Primary Health System executed a swap where the Primary Health System receives a variable rate equal to 67% of the one-month LIBOR-BBA rate and pays a fixed rate of 3% on a notional amount of $40,100,000. Unless terminated at an earlier date (at the Primary Health System's option), this agreement terminates on October 1, 2013.

With respect to the 1997A Series bonds, the Primary Health System executed a swap agreement whereby the Primary Health System receives a variable rate equal to the one-month LIBOR-BBA rate and pays a fixed rate equal to 5.087% on a notional amount of $41,000,000. Unless terminated at an earlier date (at the Primary Health System's option), this agreement terminates on October 1, 2027.

With respect to the 1998A Series bonds, the Primary Health System executed a swap agreement whereby the Primary Health System receives a fixed rate of 3.932% and pays a variable rate equal to the BMA Municipal Swap Index on a notional amount of $16,305,000. Unless terminated at an earlier date (at the Primary Health System's option), this agreement terminates on October 1, 2027.

Although these swap instruments are intended to manage exposure to interest rate risks associated with the various debt instruments referred to above, none of these swap agreements

NOTE N--DERIVATIVE FINANCIAL INSTRUMENTS - Continued

have been designated as a hedge for accounting purposes. Accordingly, the interest rate swaps are reflected in the accompanying combined balance sheets at their aggregate fair value (a liability of $2,087,926 at June 30, 2008 and an asset of $2,355,978 at June 30, 2007) and the changes in the value of the swaps are reflected as a component of nonoperating revenues in the combined statements of revenue, expenses and changes in net assets.

Required Supplementary Information

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2008

Grantor	*Pass-Through Grantor Agency*	*Program Name*	*CFDA Number*	*Grant Number (Grant Period)*	*Grant Expenditures*
U.S. Department of Agriculture	Chattanooga-Hamilton County Health Department	Special Supplemental Nutrition Program for Women, Infants, and Children	10.557	CC-07-12994-00 (10/1/06 - 9/30/07)	$ 17,935
				CC-08-22504-00 (10/1/07 - 9/30/08)	54,745
				Total U.S. Department of Agriculture	72,680
U.S. Department of Health and Human Services	University of Tennessee	Environmental Justice	93.113	5 R25 ES014317-03 (8/1/07 - 7/31/08)	49,704
U.S. Department of Health and Human Services	n/a	Community Health Centers	93.224	H80CS00091 (12/1/06 - 11/30/07) (12/1/07 - 11/30/08)	1,909,641
U.S. Department of Health and Human Services	State of Tennessee Department of Health	Public Health Emergency Endowment	93.283	Z-07-038357-00 (6/1/07 - 8/31/07)	7,300
U.S. Department of Health and Human Services	State of Tennessee Department of Health	Small Hospital Improvement Program	93.301	Z-07-038146-00 (1/1/07 - 8/31/07)	8,500
				Z-08-022644-00 (9/1/07 - 8/31/08)	8,500
					17,000
U.S. Department of Health and Human Services	MeHarry Medical College	Community Health Centers Network	93.399	040805JEM101S103 (5/1/07 - 4/30/08)	80,885
U.S. Department of Health and Human Services	State of Tennessee Department of Health, Bureau of TennCare	Medical Assistance Program	93.778*	GG-08-21474-00 (7/1/07 - 6/30/10)	383,150
U.S. Department of Health and Human Services	State of Tennessee Department of Health	Bioterrorism Hospital Preparedness	93.889*	Z-06-029095-00 (9/1/05 - 8/31/07)	212,025
				Z-06-029041-00 (9/1/05 - 8/31/07)	81,660
				Z-06-029094-00 (9/1/05 - 8/31/07)	15,000
				Z-06-029093-00 (9/1/05 - 8/31/07)	15,000
				Z-07-036189-00 (9/1/06 - 8/31/08)	205,574
				Z-07-036264-00 (9/1/06 - 8/31/08)	74,144

See Notes to Schedule of Expenditures of Federal Awards and State and Other Financial Assistance.

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2008

Grantor	*Pass-Through Grantor Agency*	*Program Name*	*CFDA Number*	*Grant Number (Grant Period)*	*Grant Expenditures*
U.S. Department of Health and Human Services	State of Tennessee Department of Health	Bioterrorism Hospital Preparedness	93.889*	Z-07-036190-00 (9/1/06 - 8/31/08)	9,034
				Z-07-036188-00 (9/1/06 - 8/31/08)	15,000
					627,437
U.S. Department of Health and Human Services	State of Tennessee Department of Health	Maternal and Child Health Services Block Grant to the States	93.994	GG-08-20665-00 (7/1/07 - 6/30/08)	116,130
				GG-08-21866-00 (7/1/07 - 6/30/08)	20,400
					136,530
				Total U.S. Department of Health and Human Services	3,211,647
				Total Expenditures of Federal Awards	$ 3,284,327

* Denotes major program

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Schedule of Expenditures of State and Other Financial Assistance

Year Ended June 30, 2008

Grantor	*Program Name*	*Contract Number (Contract Period)*	*Beginning Balance*	*Cash Received*	*Grant Expenditures*	*Ending Balance*
State of Tennessee Department of Health, Bureau of TennCare	Medical Assistance Program	GG-06-11818-00 (7/1/05 - 6/30/07)	$ 95,787	$ 95,787	$ -	$ -
		GG-08-21474-00 (7/1/07 - 6/30/10)	-	191,575	383,150	191,575
State of Tennessee Department of Health	Maternal and Child Health Services Block Grant to the States	GG-07-12710-00 (7/1/06 - 6/30/07)	12,964	12,964	-	-
		GG-07-12409-00 (7/1/06 - 6/30/07)	4,849	4,849	-	-
		GG-08-20665-00 (7/1/07 - 6/30/08)	-	37,975	50,470	12,495
		GG-08-21866-00 (7/1/07 - 6/30/08)	-	6,909	16,000	9,091
		GG-08-22062-00 (7/1/07 - 6/30/08)	-	31,300	31,300	-
	TOTAL STATE AND OTHER FINANCIAL ASSISTANCE		$ 113,600	$ 381,359	$ 480,920	$ 213,161

See Notes to Schedule of Expenditures of Federal Awards and State and Other Financial Assistance.

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Notes to Schedule of Expenditures of Federal Awards and State and Other Financial Assistance

Year Ended June 30, 2008

NOTE A--BASIS OF PRESENTATION

The accompanying schedules of expenditures of federal and state awards includes the grant activity of Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System (the Primary Health System) and is presented on the accrual basis of accounting. The information in these schedules is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the Tennessee Comptroller of the Treasury, respectively. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B--CONTINGENCIES

The Primary Health System'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 Primary Health System'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 Primary Health System expects such amounts, if any, to be immaterial.

NOTE C--BIOTERRORISM HOSPITAL PREPAREDNESS AWARDS

The following is a reconciliation of the Bioterrorism Hospital Preparedness Awards by Primary Health System award:

Grant	*Unexpended Balance at June 30, 2007*	*Receipts*	*Awards Earned by Expenditures*	*Unexpended Balance at June 30, 2008*
Z-06-029095-00	$ (212,025)	$ -	$ 212,025	$ -
Z-06-029041-00	(81,660)	-	81,660	-
Z-06-029094-00	(15,000)	-	15,000	-
Z-06-029093-00	(15,000)	-	15,000	-
Z-07-036189-00	-	(215,100)	205,574	(9,526)
Z-07-036264-00	-	(82,400)	74,144	(8,256)
Z-07-036190-00	-	(15,000)	9,034	(5,966)
Z-07-036188-00	-	(15,000)	15,000	-
Z-08-200392-00	-	(217,700)	-	(217,700)
Z-08-200457-00	-	(82,400)	-	(82,400)
Z-08-200393-00	-	(15,000)	-	(15,000)
Z-08-200394-00	-	(15,000)	-	(15,000)
Total	$ (323,685)	$ (657,600)	$ 627,437	$ (353,848)

PYA
Pershing Yoakley & Associates
CERTIFIED PUBLIC ACCOUNTANTS

Pershing Yoakley & Associates, P.C.
One Perkins Place, 525 Portland Street
Knoxville, TN 37919
(p) (865) 673-0844 (f) (865) 673-0173
(w) www.pyapc.com

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Trustees of
Chattanooga-Hamilton County Hospital Authority
(d/b/a Erlanger Health System):

Compliance

We have audited the compliance of Chattanooga-Hamilton County Hospital Authority (d/b/a Erlanger Health System) 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. Chattanooga-Hamilton County Hospital Authority'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 Chattanooga-Hamilton County Hospital Authority's management. Our responsibility is to express an opinion on Chattanooga-Hamilton County Hospital Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Chattanooga-Hamilton County Hospital Authority'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 Chattanooga-Hamilton County Hospital Authority's compliance with those requirements.

In our opinion, Chattanooga-Hamilton County Hospital Authority 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 Chattanooga-Hamilton County Hospital Authority is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Chattanooga-Hamilton County Hospital Authority'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 Chattanooga-Hamilton County Hospital Authority'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 the 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 the Board of Trustees, management, federal awarding agencies, pass-through entities and state awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Pershing Yoakley & Associates PC

Knoxville, Tennessee
December 19, 2008

PYA
Pershing Yoakley & Associates
CERTIFIED PUBLIC ACCOUNTANTS

Pershing Yoakley & Associates, P.C.
One Perkins Place, 525 Portland Street
Knoxville, TN 37919
(p) (865) 673-0844 (f) (865) 673-0173
(w) www.pyapc.com

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Trustees of
Chattanooga-Hamilton County Hospital Authority
(d/b/a Erlanger Health System):

We have audited the financial statements of the business-type activities and the discretely presented component units of Chattanooga-Hamilton County Hospital Authority (d/b/a Erlanger Health System) as of and for the year ended June 30, 2008, which collectively comprise the Chattanooga-Hamilton County Hospital Authority's basic financial statements and have issued our report thereon dated December 19, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of ContinuCare HealthServices, Inc., a discretely presented component unit, were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Chattanooga-Hamilton County Hospital Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Chattanooga-Hamilton County Hospital Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Chattanooga-Hamilton County Hospital Authority'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 material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the 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 Chattanooga-Hamilton County Hospital Authority'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 the Board of Trustees, management, federal awarding agencies, pass-through entities and state awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Pershing Yoakley & Associates P.C.

Knoxville, Tennessee
December 19, 2008

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Schedule of Findings and Questioned Costs

Year Ended June 30, 2008

Section I - Summary of Auditor's Results

FINANCIAL STATEMENTS

The auditor's report expressed an unqualified opinion on the financial statements of Chattanooga-Hamilton County Hospital Authority.

Internal control over financial reporting:

Material weakness identified?	Yes [ ] No [X]
Significant deficiency identified not considered to be material weaknesses?	Yes [ ] No [X]
Noncompliance material to financial statements noted?	Yes [ ] No [X]

FEDERAL AWARDS

Internal control over major programs:

Material weakness identified?	Yes [ ] No [X]
Significant deficiency identified not considered to be material weaknesses?	Yes [ ] No [X]

The auditor's report expressed an unqualified opinion on compliance for major programs.

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133? Yes [ ] No [X]

Identification of Major Programs:

CFDA Number(s)	*Name of Federal Program or Cluster*
93.778	U.S. Department of Health and Human Services – Medical Assistance Program
93.889	U.S. Department of Health and Human Services – Bioterrorism Hospital Preparedness

Dollar threshold used to distinguish between Type A and Type B programs: $ 300,000

Auditee qualified as low-risk auditee? Yes [X] No [ ]

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
(d/b/a Erlanger Health System)

Schedule of Findings and Questioned Costs – Continued

Year Ended June 30, 2008

Section II - Financial Statement Findings

This section identifies the control deficiencies, material weaknesses, and instances of noncompliance related to the financial statements for which *Government Auditing Standards* require reporting in a Circular A-133 audit.

Not Applicable, no financial statement findings.

Section III - Federal Award Findings and Questioned Costs

This section identifies the audit findings required to be reported by Circular A-133 Section 510(a) (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. Where practical, findings should be organized by federal agency or pass-through entity.

Not Applicable, no financial statement findings or questioned costs.