

Annual Financial Report

Blount Memorial
Hospital, Inc.

*Years ended June 30, 2009 and 2008
with Report of Independent Auditors*

Blount Memorial Hospital, Inc.

Annual Financial Report

Years ended June 30, 2009 and 2008

Contents

Report of Independent Auditors	1
Management’s Discussion and Analysis	2
Audited Financial Statements	
Balance Sheets	6
Statements of Revenues, Expenses and Changes in Net Assets	8
Statements of Cash Flows	9
Notes to Financial Statements.....	11
List of Officials (Unaudited)	23
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	24



Report of Independent Auditors

Board of Directors
Blount Memorial Hospital, Inc.

We have audited the accompanying balance sheets of Blount Memorial Hospital, Inc., a component unit of the County of Blount, Tennessee, as of June 30, 2009 and 2008, and the statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital'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 *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Blount Memorial Hospital, Inc. as of June 30, 2009 and 2008, and the changes in its net assets 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 a report dated September 14, 2009 on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions, laws, regulations, contracts 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 conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis on pages 2 through 5 is not a required part of the financial statements but is 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 measurements and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

The List of Officials on page 23, which is of a nonaccounting nature, has not been subjected to the auditing procedures applied in the audit of the financial statements, and we express no opinion on it.

Coulter & Justus, P.C.

September 14, 2009

Blount Memorial Hospital, Inc.
Management's Discussion and Analysis

This section of Blount Memorial Hospital, Inc.'s annual financial report presents management's discussion and analysis of the Hospital's financial performance during the fiscal years ended June 30, 2009 and 2008. The information contained herein should be considered in conjunction with the Hospital's accompanying financial statements. Unless otherwise indicated, amounts are in thousands.

Overview of the Financial Statements

The Hospital is a component unit of Blount County, Tennessee, and the accompanying financial statements reflect the Hospital's financial position and activities. These financial statements consist of balance sheets, statements of revenues, expenses and changes in net assets and statements of cash flows. The accompanying notes to the financial statements are an integral part of the financial statements and are essential to understanding the data contained in the financial statements.

The balance sheets provide descriptions of the Hospital's assets and liabilities and an indication of the Hospital's financial position. The statements of revenue, expenses and changes in net assets report the revenues and expenses related to the Hospital's activities. The statements of cash flows report the cash provided and used by operating, investing, capital, financing and other activities.

Financial Highlights

Condensed financial information as of and for the years June 30, 2009, 2008, and 2007 is provided in the tables below.

	2009	2008	2007
Assets			
Current assets	\$ 28,290	\$ 25,344	\$ 24,668
Assets limited as to use	140,779	141,868	156,214
Capital assets	104,864	113,270	106,265
Other	5,943	3,505	3,616
Total assets	<u>\$ 279,876</u>	<u>\$283,987</u>	<u>\$ 290,763</u>
Liabilities			
Current liabilities	\$ 18,588	\$ 15,359	\$ 14,691
Long term liabilities	106,671	110,431	113,589
Total liabilities	<u>\$ 125,259</u>	<u>\$125,790</u>	<u>\$128,280</u>
Net assets (deficit)			
Invested in capital assets, net of related debt	\$ 202	\$ 6,280	\$ (3,807)
Restricted	679	764	848
Unrestricted	153,736	151,153	165,442
Total net assets	<u>\$ 154,617</u>	<u>\$158,197</u>	<u>\$162,483</u>

Blount Memorial Hospital, Inc.

Management's Discussion and Analysis (continued)

Financial Highlights (continued)

	2009	2008	2007
Changes in Net Assets			
Operating revenues	\$ 182,290	\$170,911	\$164,685
Operating expenses	182,469	173,936	161,193
Operating (loss) income	(179)	(3,025)	3,492
Nonoperating (expense) income	(3,401)	(1,261)	14,100
Excess of (expenses over revenues) revenues over expenses	\$ (3,580)	\$ (4,286)	\$ 17,592

Financial Position

Overall, the Hospital's net assets declined in 2009 as compared to 2008 and 2007. This decrease in net assets is primarily the result of investment losses in 2009 and 2008 (discussed further in the following section).

The investment losses in 2009 also resulted in a decrease in assets limited as to use in 2009. The 2008 decrease in assets limited as to use by Board corresponds to the increase in property and equipment in 2008 as the Hospital purchased several parcels of land and completed routine upgrades and improvements.

The effect of depreciation decreased the amounts classified as net assets invested in capital assets (net of related debt) in 2009. In 2008, the capital additions and repayments of bonds payable resulted in an increase in net assets invested in capital assets (net of related debt).

The statements of cash flows and Notes 6 and 7 to the financial statements provide additional information regarding the capital additions, bonds and related cash flows.

Blount Memorial Hospital, Inc.

Management's Discussion and Analysis (continued)

Results of Operations

Operating revenues and expenses are as follows for the years ended June 30, 2009, 2008 and 2007.

	2009	Relative %	2008	Relative %	2007	Relative %
Net patient service revenues	\$ 169,227	93%	\$157,175	92%	\$151,379	92%
Other revenues	13,064	7%	13,736	8%	13,306	8%
Total operating revenues	\$ 182,291	100%	\$170,911	100%	\$164,685	100%
Salaries and wages	\$ 79,570	44%	\$ 76,515	44%	\$ 70,605	44%
Employee benefits	22,412	12%	21,784	13%	19,910	12%
Contract salaries	1,709	1%	2,277	1%	2,720	2%
Professional fees	6,276	4%	4,202	2%	3,414	2%
Patient supplies	27,861	15%	24,757	14%	24,461	15%
Purchased maintenance	5,998	3%	5,011	3%	4,186	3%
Outside services	5,965	3%	5,563	3%	3,944	2%
Equipment rental	1,764	1%	1,915	1%	1,561	1%
Utilities	4,073	2%	3,755	2%	3,158	2%
Marketing	593	1%	602	1%	629	1%
Depreciation	12,950	7%	12,605	7%	12,157	7%
Interest	4,248	2%	6,160	4%	5,484	3%
Other expenses	9,050	5%	8,790	5%	8,964	6%
Total operating expenses	\$ 182,469	100%	\$ 173,936	100%	\$ 161,193	100%

Net patient service revenues increased 8% in 2009 and 4% in 2008 primarily due to volume increases. Hospital fees and rates have increased each year but a significant portion of the price increases are not reimbursed by the Hospital's largest third party payors such as Medicare and TennCare. Services related operating expenses in 2009 and 2008 increased due to the increased volume of services provided and inflationary costs which particularly affect the health care industry (primarily increases in staffing costs and costs of medical supplies). Overall, operating expenses have increased 5%, resulting in an operating loss for 2009 of \$179. In 2008, the Hospital incurred an operating loss of \$3,024 as operating expenses increased by 7%, which was a greater increase than the 4% increase in total operating revenues.

Interest costs in 2009 decreased due to lower variable bond interest rates as a result of the Hospital refunding existing bonds through the issuance of additional bonds (discussed further in the following section). Interest expense in 2008 reflects the increases in variable rates paid in connection with the bonds during this period.

Other Changes in Net Assets

The Hospital experienced net investment losses of \$4,290 in 2009 and \$2,033 in 2008 (including decreases in fair value of investments of \$9,298 in 2009 and \$9,426 in 2008). Losses in both years were due to the decline in the market value of investments.

Blount Memorial Hospital, Inc.

Management's Discussion and Analysis (continued)

Capital Acquisitions and Construction Activities

Note 6 to the financial statements summarizes property and equipment by class and changes for the years ended June 30, 2009 and 2008. Additional information regarding accounting policies for capital assets is provided in Note 1 to the financial statements.

Total additions to property and equipment were \$4,436 in 2009 and \$19,620 in 2008. Additions in 2009 included the purchase of new computer software and routine upgrades and improvements. In 2008, additions to building improvements and major moveable equipment totaled approximately \$14,762 and included the renovation of a nursing floor to add additional capacity and routine upgrades and improvements. Additions to land of \$4,858 in 2008 included purchases of several parcels of land for potential future expansion. Construction in progress at June 30, 2009 consists primarily of routine upgrades and improvements.

Long-Term Debt Activity

Principal payments on the 1998 bond issues were \$1,980 and \$1,890 for 2009 and 2008, respectively. The balances outstanding at June 30, 2009 and 2008 were \$16,390 and \$18,370, respectively. The outstanding 1998 bonds bear interest at fixed rates ranging from 4.30% to 5.15%.

There were no principal payments due on the Hospital's \$40,000 Local Government Public Improvement Bonds, Series A-3-A, and \$40,000 remained outstanding at June 30, 2008. During 2008, the Hospital made principal payments of \$1,200 on the C-2-A Bonds.

In August 2008, Blount County issued, on behalf of the Hospital, Local Government Public Improvement Bonds, Series E-5-A, totaling \$96,350. The Series E-5-A bonds provided the funds necessary to refund the previously issued Series A-3-A and C-2-A bonds. The Series E-5-A bonds bear interest at a variable rate. Bonds totaling \$25,000 are subject to an interest rate swap agreement which fixes the rate at 4.9%. An additional portion of the bonds totaling \$30,700 are subject to an interest rate swap agreement which fixes the rate at 4.33%. Principal payments totaled \$1,305,000 on the series E-5-A bonds during 2009.

The terms of the bond issues are included in Note 7 to the financial statements.

Requests for Information

The annual financial report is designed to provide an overview of the Hospital's financial position and activity. Questions concerning the information provided herein or requests for additional information should be directed to the Assistant Administrator/Chief Financial Officer of Blount Memorial Hospital, Inc.

Respectfully submitted,



David Avriett
Assistant Administrator/Chief Financial Officer
Blount Memorial Hospital, Inc.

Blount Memorial Hospital, Inc.

Balance Sheets

	June 30	
	2009	2008
Assets		
Current assets:		
Cash and cash equivalents	\$ 5,557,182	\$ 574,440
Patient accounts receivable, less allowances for uncollectible accounts of \$6,591,113 in 2009 and \$6,720,893 in 2008	16,775,044	18,765,433
Inventories	2,088,772	2,339,186
Prepaid expenses	1,157,956	1,238,378
Funds held by trustee restricted to payment of current liabilities	2,711,114	2,426,684
Total current assets	<u>28,290,068</u>	<u>25,344,121</u>
Assets limited as to use:		
By Board	135,582,583	136,320,287
Foundation	1,070,889	1,296,932
Other investments--held by trustee	1,052,459	1,186,853
Under bond agreements--held by trustee	5,784,240	5,490,148
Less funds held by trustee restricted to payment of current liabilities	(2,711,114)	(2,426,684)
	<u>140,779,057</u>	<u>141,867,536</u>
Property and equipment, net	104,864,050	113,270,470
Deferred debt expense	989,429	1,464,722
Other assets	4,953,592	2,040,000
Total assets	<u><u>\$ 279,876,196</u></u>	<u><u>\$ 283,986,849</u></u>

	June 30	
	2009	2008
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 2,546,763	\$ 2,508,341
Accrued compensation, benefits and withholdings	7,485,661	5,751,979
Other accrued expenses	3,842,765	2,112,090
Estimated third party payor settlements	691,898	881,005
Accrued interest payable	571,059	875,684
Current portion of bonds payable	3,450,000	3,230,000
Total current liabilities	<u>18,588,146</u>	15,359,099
Long-term debt, net of current portion:		
Bonds payable, net of unamortized loss on refunding	<u>106,670,639</u>	110,430,469
Total liabilities	<u>125,258,785</u>	125,789,568
Net assets:		
Invested in capital assets, net of related debt	202,719	6,280,340
Restricted--nonexpendable	678,919	763,949
Unrestricted	<u>153,735,773</u>	151,152,992
Total net assets	<u>154,617,411</u>	158,197,281
Total liabilities and net assets	<u><u>\$ 279,876,196</u></u>	<u><u>\$ 283,986,849</u></u>

See accompanying Notes to Financial Statements.

Blount Memorial Hospital, Inc.

Statements of Revenues, Expenses and Changes in Net Assets

	Year ended June 30	
	2009	2008
Operative revenues:		
Net patient service revenue	\$ 169,227,060	\$ 157,174,644
Other revenue	13,063,380	13,736,605
Total operating revenues	182,290,440	170,911,249
Operating expenses:		
Salaries and wages	79,569,832	76,514,592
Employee benefits	22,411,868	21,783,993
Contract salaries	1,708,791	2,276,809
Professional fees	6,276,216	4,202,386
Patient supplies	27,861,173	24,757,416
Purchased maintenance	5,997,668	5,011,464
Outside services	5,964,723	5,563,371
Equipment rental	1,764,231	1,914,654
Utilities	4,073,122	3,754,622
Marketing	592,827	601,762
Depreciation	12,950,262	12,605,289
Interest	4,248,541	6,159,695
Other expenses	9,050,131	8,789,484
Total operating expenses	182,469,385	173,935,537
Operating loss	(178,945)	(3,024,288)
Nonoperating (expenses) revenues:		
Investment loss	(4,290,072)	(2,032,587)
Contributions and other	889,147	771,324
Total nonoperating (expenses) revenues	(3,400,925)	(1,261,263)
Excess of expenses over revenues	(3,579,870)	(4,285,551)
Net assets at beginning of year	158,197,281	162,482,832
Net assets at end of year	\$ 154,617,411	\$ 158,197,281

See accompanying Notes to Financial Statements.

Blount Memorial Hospital, Inc.

Statements of Cash Flows

	Year ended June 30	
	2009	2008
Cash flows from operating activities		
Receipts from and on behalf of patients	\$ 184,091,722	\$ 167,177,875
Payments to employees for services	(78,841,657)	(75,953,844)
Payments to suppliers and contractors	(82,526,539)	(78,046,615)
Net cash provided by operating activities	22,723,526	13,177,416
 Cash flows from noncapital financing activities		
Contributions and other	889,147	771,324
 Cash flows from capital and related financing activities		
Additions to property and equipment	(4,392,150)	(19,796,618)
Repayments of long-term debt	(98,860,000)	(3,090,000)
Proceeds from bond issuance	96,350,000	-
Deferred debt expense	(775,000)	-
Interest paid on long-term debt	(4,553,166)	(6,082,768)
Net cash used in capital and related financing activities	(12,230,316)	(28,969,386)
 Cash flows from investing activities		
Interest and dividends	5,008,403	8,244,917
Investment in affiliates	(2,913,592)	-
Net (purchases) proceeds of investment securities designated as assets limited as to use	(5,899,656)	5,221,209
Net cash (used in) provided by investing activities	(3,804,845)	13,466,126
 Net increase (decrease) in cash and cash equivalents	7,577,512	(1,554,520)
Cash and cash equivalents at beginning of year	8,919,912	10,474,432
Cash and cash equivalents at end of year	\$ 16,497,424	\$ 8,919,912
 Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents in current assets	\$ 5,557,182	\$ 574,440
Cash and cash equivalents included in assets limited as to use	10,940,242	8,345,472
Total cash and cash equivalents	\$ 16,497,424	\$ 8,919,912

Blount Memorial Hospital, Inc.
Statements of Cash Flows (continued)

	Year ended June 30	
	2009	2008
Reconciliation of operating loss to net cash provided by operating activities		
Operating loss	\$ (178,945)	\$ (3,024,288)
Adjustments to reconcile operating loss to net cash flows provided by operating activities:		
Depreciation and amortization	12,950,262	12,605,289
Amortization of loss of bond refunding	125,660	71,136
Interest payments	4,553,166	6,082,768
Changes in operating assets and liabilities:		
Net patient accounts receivable	1,990,389	(3,041,913)
Inventories and prepaid expenses	330,836	(340,518)
Accounts payable, other accrued expenses and accrued interest	1,407,583	1,003,777
Accrued compensation, benefits and withholdings	1,733,682	512,616
Estimated third party payor settlements	(189,107)	(691,451)
Net cash provided by operating activities	\$ 22,723,526	\$ 13,177,416

Noncash investing, capital and financing activities

At June 30, 2009 and 2008, accounts payable and accrued expenses include \$147,399 and \$90,510, respectively, for property and other capital additions.

Investment income includes a decrease of \$9,298,475 in 2009 and \$9,425,718 in 2008, to reflect the net changes in fair value of investments during each year.

See accompanying Notes to Financial Statements.

Blount Memorial Hospital, Inc.

Notes to Financial Statements

June 30, 2009

1. Description of Reporting Entity and Significant Accounting Policies

Reporting Entity

Blount Memorial Hospital, Inc. (the Hospital) is an acute and general healthcare provider formed to provide services to Blount County and the surrounding communities. The Hospital is a component unit of the County of Blount, Tennessee (the County), which issues debt on the Hospital's behalf (*Note 7*). The Hospital's board members are appointed by the County Commission of Blount County, the Board of Commissioners of the City of Alcoa, the Board of Commissioners of the City of Maryville and by the Board of Directors of Maryville College. The Hospital is included as a discretely presented component unit in the financial statements of the County.

Basis of Presentation

The Hospital's financial statements are presented on the accrual basis of accounting in accordance with Governmental Accounting Standards Board (GASB) Statement No. 34 *Basic Financial Statements - and Management's Discussion and Analysis for State and Local Governments* (Statement 34). Statement 34 establishes standards for external financial reporting for all state and local governmental entities. Statement 34 requires the classification of net assets into three components which are defined as follows:

Invested in capital assets, net of related debt - This component of net assets consists of property and equipment, net of accumulated depreciation, and unamortized debt expense reduced by the outstanding balances of bonds and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

Restricted - This component of net assets consists of constraints placed on net assets use by external sources.

Unrestricted net assets - This component of net assets consists of net assets that do not meet the definition of restricted or invested in capital assets, net of related debt.

The Hospital uses enterprise fund accounting and follows the Financial Accounting Standards Board Statements and Interpretations issued before November 30, 1989 to the extent that those standards do not conflict with or contradict GASB guidance.

The Hospital is the sole corporate member of the Blount Memorial Foundation (the Foundation). The Hospital and the Foundation have common boards of directors. As a result, the financial activity of the Foundation is included (blended) in the Hospital's financial statements (*Note 9*).

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

1. Description of Reporting Entity and Significant Accounting Policies (continued)

Affiliate Entities

Other assets include the Hospital's \$2,040,000 investment in a general partnership which operates a medical facility in Blount County, as well as \$2,913,592 related to the Hospital's acquisition of a rehabilitation clinic during 2009. The Hospital also has ownership interests in other entities which are involved in activities related to the Hospital's mission of providing healthcare services. The Hospital has not included these entities or presented summarized disclosures in its financial statements due to the relative insignificance of the financial activities of these entities.

Cash and Cash Equivalents

The Hospital considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Inventories

Inventories are stated at the lower of cost or market and are valued principally by methods which approximate the first-in, first-out method.

Investments

Investments are recorded at fair value based on quoted market prices. Interest and dividends on investments, as well as realized and unrealized gains and losses, are included in nonoperating revenues when earned.

The Hospital diversifies its investments into a broad range of asset classes in order to reduce the concentration of credit risk and to maximize return with reasonable and prudent levels of risk. It is also the Hospital's policy to limit the maximum position for each type of investment at varying levels within these classifications. As of June 30, 2009 and 2008, the Hospital's fixed income investments all have quality ratings of A or better (by both Standard & Poor's and Moody's Investors Service).

To limit its exposure to fair value losses arising from changing interest rates, the Hospital's investment policy restricts the type and maturities of fixed income investments in order to increase the overall investment horizon. The current duration of the Hospital's fixed income investments ranges from 2.9 to 4.8 years, based on timing of interest payments, maturity dates, and expectations of minimal interest rate changes.

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

1. Description of Reporting Entity and Significant Accounting Policies (continued)

Assets Limited as to Use by Board and Foundation

Certain investments have been designated by the Board of Directors for the replacement of property and equipment or for other purposes. Cash and investments held by the Foundation in trust accounts are also classified as assets limited as to use (*Note 9*).

Property and Equipment

Land, buildings and equipment are stated on the basis of cost or fair value at date of donation. Although title to certain land and buildings rests with the County, these assets have been recorded by the Hospital as the County has authorized their use by the Hospital. Repairs and maintenance costs are expensed as incurred while significant asset purchases and improvements are capitalized. Depreciation of property and equipment is computed by the straight-line method over the estimated useful lives of the assets. The estimated useful lives are based on guidelines established for the healthcare industry, which are summarized as follows:

Land improvements	8 to 25 years
Buildings, improvements and fixed equipment	10 to 30 years
Equipment	3 to 15 years

Deferred Debt Expense

Deferred debt expense represents costs related to issuance of bonds (*Note 7*). These costs are being amortized by the straight-line method over the life of the related bond obligations.

Accrual for Compensated Absences

The Hospital recognizes an expense and accrues a liability for compensated future employee absences in the period in which employees' rights to such compensated absences are earned.

Operating Revenues and Expenses

Revenue and expenses associated with the Hospital's mission of providing healthcare services are considered to be operating activities. Nonoperating revenues consists primarily of investment income and general contributions to the Hospital.

Income Taxes

The Hospital is classified as a governmental organization exempt from income tax. The Foundation is a not-for-profit organization defined by Section 501(c)(3) of the Internal Revenue Code as other than a private foundation. Accordingly, no provision for income taxes has been included in the accompanying financial statements.

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

1. Description of Reporting Entity and Significant Accounting Policies (continued)

Charity Care

The Hospital accepts patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the Hospital. Charges at established rates related to charity care are not included in net patient service revenue.

Patient Service Revenue

Patient service revenue is reported 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 payors under provisions of reimbursement formulas in effect and is net of the provision for bad debts.

Risk Management

The Hospital is self-insured for medical malpractice and employee (including dependent) group health expenses and claims (*Note 5*). Commercial insurance is purchased for significant exposure to various other risks typical to the Hospital's operating environment and industry such as loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; and natural disasters. There were no significant losses in excess of insurance coverage during the last three years.

Reclassifications

Operating expense classifications for 2008 were reclassified from functional to natural classifications for consistency with 2009. In addition, certain other 2008 amounts were reclassified for consistency with 2009 presentation.

Use of Estimates

The preparation of 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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. Cash, Cash Equivalents and Assets Limited as to Use

The Hospital's cash and cash equivalent balances are on hand with financial institutions participating in the Bank Collateral Pool, which is administered by the Collateral Pool Board and monitored by the Treasury Department of the State of Tennessee.

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

2. Cash, Cash Equivalents and Assets Limited as to Use (continued)

The assets limited as to use by Board and those held by trustees include U.S. Government instruments and other securities held at financial institutions in the Hospital's name (uninsured credit risk category) and are categorized by investment type as follows:

	June 30 2009	%	June 30 2008	%
U.S. Treasury Portfolio (cash equivalents)	\$ 10,672,106	8%	\$ 8,018,400	6%
U.S. Government Agency Securities	10,352,731	7%	48,575,658	34%
Municipal bonds	4,632,991	3%	-	0%
Corporate bonds	23,542,583	17%	47,945,290	33%
Bond mutual funds	81,126,746	57%	-	0%
Equity mutual funds	12,092,125	8%	38,457,940	27%
	\$142,419,282	100%	\$142,997,288	100%

The Foundation's cash balances at financial institutions are covered by Federal Deposit Insurance Corporation insurance (risk category insured) subject to certain limits. Foundation assets limited as to use are comprised of the following:

	June 30 2009	June 30 2008
Cash	\$ 96,365	\$ 193,710
U.S. Treasury Portfolio (cash equivalents)	171,771	133,362
Bond mutual funds	437,697	464,265
Equity mutual funds	365,056	505,595
	\$1,070,889	\$1,296,932

3. Net Patient Service Revenue

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the statements of revenues, expenses and changes in net assets is as follows:

	Year ended June 30	
	2009	2008
Gross patient service charges	\$549,891,305	\$474,595,523
Contractual adjustments and discounts	(346,386,024)	(290,014,935)
Charity care charges foregone	(26,874,149)	(20,249,540)
Provision for bad debts	(7,404,072)	(7,156,404)
Net patient service revenue	\$169,227,060	\$157,174,644

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

4. Third Party Payor Agreements

The Hospital renders services to patients under contractual arrangements with the Medicare and TennCare programs. Laws, regulations and contracts governing third party payor programs can be extremely complex and subject to interpretation. Amounts earned under these contractual arrangements are subject to regulatory review and final determination by the various program intermediaries and other appropriate governmental authorities or their agents. In the opinion of management, adequate provision has been made in the financial statements for any adjustments which may result from such reviews.

The Medicare program pays for inpatient services on a prospective basis primarily based upon diagnostic related group assignments as determined by the patient's clinical diagnosis and medical procedures utilized. The Hospital receives additional payments from Medicare based on the provision of services to a disproportionate share of low income patients (as defined by the Medicare program). Medicare also pays for outpatient services on a prospective basis based upon ambulatory payment classifications and fee schedules. TennCare reimbursement for both inpatient and outpatient services is based upon prospectively determined rates and per diem amounts.

Contractual adjustments for Medicare, TennCare and other third party discount arrangements are recognized when the related revenues are reported in the financial statements. The percentage of gross patient charges from the Medicare and TennCare programs was approximately 36% and 11%, respectively, for 2009 and 38% and 11%, respectively, in 2008.

The Hospital has also entered into reimbursement agreements with 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.

5. Malpractice Trust Fund and Employee Group Health Claims

The Hospital is covered under the "Tennessee Governmental Tort Liability Act" (T.C.A. 29-20-101, et seq). In addition to requiring claims be made in conformance with this Act, special provisions include, but are not limited to, special notice of requirements imposed upon the claimant, a one year statute of limitations, and a requirement that the governmental entity purchase insurance or be self-insured with certain limits. This Act also prohibits a judgment or award exceeding the minimum amounts of insurance coverage set out in the Act or the amount of insurance purchased by the governmental entity.

The Hospital provides professional liability coverage through a self-insurance malpractice trust fund. Under the trust agreement, the trust assets can only be used for payment of malpractice losses, related expenses, and the cost of administering the trust. The assets of, and contributions to, the trust are reported in the balance sheets; income from the trust assets, claims and administrative costs are reported in the statements of revenues, expenses and changes in net assets.

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

5. Malpractice Trust Fund and Employee Group Health Claims (continued)

Claims and expenses of \$185,470 and \$263,304 were paid from the fund during the years ended June 30, 2009 and 2008, respectively. At June 30, 2009, the Hospital is involved in medical malpractice litigation in which management of the Hospital, after consultation with legal counsel, is of the opinion that liability, if any, related to these claims would not be material to the financial statements. No amounts are accrued for potential losses related to unreported incidents or reported incidents which have not yet resulted in asserted claims as the Hospital is not able to estimate such amounts.

The Hospital is self-insured for employee (and dependent) group health claims and records a liability for claims known but unpaid and estimated claims incurred but not reported. The liability for employee group health claims was \$1,047,796 and \$1,126,068 at June 30, 2009 and 2008, respectively. The total expense related to employee group health claims (net of employee paid premiums) was approximately \$11,118,000 and \$10,516,000 for 2009 and 2008, respectively.

6. Property and Equipment

A summary of changes in property and equipment is as follows:

	Balance July 1, 2008	Additions	Retirements and Transfers	Balance June 30, 2009
Cost:				
Land	\$ 8,560,804	\$ 111,822	\$ (3,514)	\$ 8,669,112
Land improvements	2,403,837	-	3,514	2,407,351
Buildings, improvements, and fixed equipment	132,978,308	377,838	328,713	133,684,859
Equipment	86,698,111	2,075,439	1,698,163	90,471,713
Construction in progress	619,450	1,870,459	(2,072,591)	417,318
Total cost	231,260,510	4,435,558	(45,715)	235,650,353
Allowances for depreciation:				
Land improvements	(2,028,959)	(89,049)	-	(2,118,008)
Buildings, improvements, and fixed equipment	(51,819,403)	(6,045,546)	-	(57,864,949)
Equipment	(64,141,678)	(6,700,064)	38,396	(70,803,346)
Total allowances for depreciation	(117,990,040)	(12,834,659)	38,396	(130,786,303)
Net property and equipment	\$ 113,270,470	\$ (8,399,101)	\$ (7,319)	\$ 104,864,050

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

6. Property and Equipment (continued)

	Balance July 1, 2007	Additions	Retirements and Transfers	Balance June 30, 2008
Cost:				
Land	\$ 3,708,169	\$ 4,858,256	\$ (5,621)	\$ 8,560,804
Land improvements	2,403,527	-	310	2,403,837
Buildings, improvements, and fixed equipment	127,764,002	462,346	4,751,960	132,978,308
Equipment	77,140,755	9,706,340	(148,984)	86,698,111
Construction in progress	871,317	4,593,062	(4,844,929)	619,450
Total cost	211,887,770	19,620,004	(247,264)	231,260,510
Allowances for depreciation:				
Land improvements	(1,897,164)	(135,607)	3,812	(2,028,959)
Buildings, improvements, and fixed equipment	(46,009,353)	(5,933,209)	123,159	(51,819,403)
Equipment	(57,716,128)	(6,425,550)	-	(64,141,678)
Total allowances for depreciation	(105,622,645)	(12,494,366)	126,971	(117,990,040)
Net property and equipment	\$ 106,265,125	\$ 7,125,638	\$ (120,293)	\$ 113,270,470

7. Long-term Debt

Changes in long-term debt are summarized as follows:

	Balance July 1, 2008	Additions	Principal Payments	Balance June 30, 2009
Series 1998A Bonds	\$ 6,935,000	\$ -	\$ (1,270,000)	\$ 5,665,000
Series 1998B Bonds	11,435,000	-	(710,000)	10,725,000
Series A-3-A Bonds	40,000,000	-	(40,000,000)	-
Series C-2-A Bonds	55,575,000	-	(55,575,000)	-
Series E-5-A Bonds	-	96,350,000	(1,305,000)	95,045,000
Total outstanding	113,945,000	<u>\$96,350,000</u>	<u>\$(98,860,000)</u>	\$111,435,000
Less current portion	(3,230,000)			(3,450,000)
Less unamortized loss on bond refunding	(284,531)			(1,314,361)
Long-term portion	<u>\$110,430,469</u>			<u>\$106,670,639</u>

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

7. Long-term Debt (continued)

	Balance July 1, 2007	Additions	Principal Payments	Balance June 30, 2008
Series 1998A Bonds	\$ 8,155,000	\$ –	\$(1,220,000)	\$ 6,935,000
Series 1998B Bonds	12,105,000	–	(670,000)	11,435,000
Series A-3-A Bonds	40,000,000	–	–	40,000,000
Series C-2-A Bonds	56,775,000	–	(1,200,000)	55,575,000
Total outstanding	117,035,000	\$ –	\$(3,090,000)	113,945,000
Less current portion	(3,090,000)			(3,230,000)
Less unamortized loss on bond refunding	(355,667)			(284,531)
Long-term portion	<u>\$113,589,333</u>			<u>\$110,430,469</u>

In December 1998, Blount County issued, on behalf of the Hospital, \$15,420,000 of Hospital Revenue Refunding Bonds, Series 1998A and \$16,000,000 of Hospital Revenue Improvement Bonds, Series 1998B. The Series 1998A Bonds provided the funds necessary to refund the previously issued Blount County Hospital Revenue Bonds. The Hospital computed a loss on the refunding in 1999 of \$959,455 which has been deferred and is being amortized over the life of the refunded debt (\$71,312 in 2009 and \$71,136 in 2008). The proceeds of the Series 1998B Bonds provided funds for the Hospital's facilities and equipment.

The Series 1998A Bonds mature in increasing annual amounts ranging from \$1,325,000 in 2010 to \$1,515,000 in 2013 at interest rates ranging from 4.30% to 4.60%. The Series 1998B Bonds mature in increasing annual amounts ranging from \$745,000 in 2010 to \$4,610,000 in 2020 at interest rates ranging from 5% to 5.15%. The Series 1998A Bonds are subject to redemption at the option of the County, in whole or in part, at the redemption price of par, without premium, plus accrued interest to the redemption date. The Series 1998B Bonds maturing on or after July 1, 2010 shall be subject to redemption at the option of the County, in whole or in part, at the redemption price of par, without premium, plus accrued interest to the redemption date. The Series 1998B Bonds maturing on July 1, 2019 are subject to mandatory sinking fund redemptions prior to maturity beginning on July 1, 2016.

In November 2001, Blount County issued on behalf of the Hospital, \$40,000,000 of Local Government Public Improvement Bonds, Series A-3-A. The proceeds of these bonds were used to provide funds for the Hospital's facilities and equipment. The Series A-3-A Bonds were subject to redemption at the option of the Hospital, in whole or in part, at the redemption price of par plus accrued interest to the redemption date. The Hospital exercised its redemption option in August 2008 as described below.

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

7. Long-term Debt (continued)

In October 2003, Blount County issued on behalf of the Hospital, \$60,000,000 of Local Government Public Improvement Bonds, Series C-2-A. The proceeds of these bonds were used to provide funds for capital equipment and additions to the Hospital's facilities. The Series C-2-A Bonds were subject to redemption at the option of the Hospital, in whole or in part, at the redemption price of par plus accrued interest to the redemption date. The Hospital also exercised its option to redeem these bonds in August 2008 as described below.

Interest on the Series A-3-A and C-2-A Bonds was based on variable rates. The Hospital utilizes two separate interest rate swap agreements to effectively fix the interest rates on a portion of the amounts. One interest rate swap agreement establishes interest at an effective rate of 4.90% on \$25,000,000. The second interest rate swap agreement establishes interest at an effective rate of 4.33% on \$30,700,000. The counterparties to these agreements owe the Hospital interest based on a variable rate that is calculated based on a published index rate. The bond principal subject to the swap agreements is not exchanged; only the net difference in interest payments is actually exchanged with the counterparties and recorded by the Hospital as interest expense. The Hospital, through the trustee, continued to pay interest to the bondholders at the variable rate provided by the bonds. During the term of each swap agreement, the Hospital effectively pays a fixed rate on the debt plus or minus the difference between the variable rate due the bondholders and the variable rate received from the counterparty.

The Hospital is exposed to variable rates if the counterparties to the swap default, if the variable rate received from the counterparties is less than that due to bondholders or if the swaps are terminated. The termination of the swap agreements could also result in the Hospital making or receiving a termination payment. The fair value liabilities of the swap agreements were approximately \$7,334,000 and \$4,698,000 as of June 30, 2009 and 2008, respectively. These amounts, which were estimated by obtaining quotes from the financial institution, are not recorded in the accompanying financial statements. The net interest expenditures resulting from the swap agreements are recorded in the financial statements. Pursuant to GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, the fair value of the swap agreements will be recorded in the financial statements, effective for the year ending June 30, 2010.

In August 2008, Blount County issued, on behalf of the Hospital, \$96,350,000 of Local Government Public Improvement Bonds, Series E-5-A. The Series E-5-A Bonds provided the funds necessary to refund the previously issued Series A-3-A and C-2-A bonds and to reimburse issuance costs of \$775,000. The Hospital computed a loss on the refunding of \$1,155,490 which will be deferred and amortized over the life of the refunded debt (\$54,348 amortized in 2009).

The Series E-5-A Bonds bear interest at variable rates; however, the interest rate swap agreements described above remain in place to effectively fix the interest rate on the portion of the E-5-A Bonds totaling \$55,700,000. Scheduled principal reductions on the Series E-5-A Bonds increase in annual amounts ranging from \$1,380,000 in 2010 to 8,425,000 in 2029. The Series E-5-A Bonds are subject to redemption at the option of the Hospital, in whole or in part, at the redemption price of par plus accrued interest to the redemption date.

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

7. Long-term Debt (continued)

Maturities and mandatory sinking fund payments related to the balances outstanding as of June 30, 2009, are summarized as follows:

	Series E-5-A	Series 1998A and B	Total
2010	\$ 1,380,000	\$ 2,070,000	\$ 3,450,000
2011	1,455,000	2,165,000	3,620,000
2012	1,505,000	2,270,000	3,775,000
2013	1,580,000	2,385,000	3,965,000
2014	3,200,000	915,000	4,115,000
2015 – 2019	18,550,000	5,340,000	23,890,000
2020 – 2024	29,025,000	1,245,000	30,270,000
2025 – 2029	38,350,000	–	38,350,000
	<u>\$95,045,000</u>	<u>\$16,390,000</u>	<u>\$111,435,000</u>

Future interest payments related to the bonds are as follows (interest for variable portion of the Series E-5-A Bond is determined using the rate in effect at June 30, 2009, which was 1.8%).

	Series E-5-A	Series 1998A and B	Total
2010	\$ 3,261,448	\$ 752,074	\$4,013,522
2011	3,236,495	654,045	3,890,540
2012	3,210,230	550,923	3,761,153
2013	3,183,028	440,973	3,624,001
2014	3,152,158	360,828	3,512,986
2015 – 2019	14,832,664	1,031,411	15,864,075
2020 – 2024	12,174,172	31,903	12,206,075
2025 – 2029	5,085,158	–	5,085,158
	<u>\$48,135,353</u>	<u>\$3,822,157</u>	<u>\$51,957,510</u>

The revenues of the Hospital are pledged as collateral for the bonds outstanding. Payment of principal and interest for the Series 1998A, are insured by municipal bond insurance policies and the Series E-5-A Bonds are insured by a letter of credit. In addition, the bond agreements contain certain covenants which include deposits to trustee funds and maintenance of rates.

Blount Memorial Hospital, Inc.
Notes to Financial Statements (continued)

7. Long-term Debt (continued)

Funds held by trustees for the outstanding bond issues consisted of the following:

	June 30	
	2009	2008
Debt service reserve funds	\$3,073,126	\$3,063,464
Bond funds	2,711,114	2,426,684
	\$5,784,240	\$5,490,148

The Hospital is required to make periodic payments to the bond funds to pay principal and interest on the bonds. The debt service reserve funds may be used to make principal and interest payments if the Hospital is unable to make such payments and a deficiency exists in the bond funds. Funds held by the trustees are invested primarily in obligations of the United States government or its agencies as allowed by the trust agreements.

8. Pension Plan

The Blount Memorial Hospital Retirement Plan (the Plan) is a defined contribution plan available to all employees who are age 21 or older and have completed one year of service. Participants are 100% vested after five years of service. The Plan provides for the Hospital to contribute an amount equal to 4% of each eligible employee's compensation plus a matching contribution (limited to 2% of compensation) based upon voluntary employee contributions to the Plan. Pension contributions are made biweekly. Hospital contributions to the Plan totaled \$3,477,796 and \$3,426,003 in 2009 and 2008, respectively. Employee contributions were \$3,388,916 and \$3,792,244 in 2009 and 2008, respectively.

9. Foundation

At June 30, 2009 and 2008, the Foundation's assets and net assets total \$1,070,889 and \$1,296,932, respectively, and consist of cash and investments (*Note 2*). A portion of the investments at June 30, 2009 and 2008 totaling \$678,919 and \$763,949, respectively, is restricted in perpetuity (nonexpendable) under an irrevocable endowment trust. Endowment trust net income is available for various Foundation activities. The 2009 statement of revenues, expenses and changes in net assets includes Foundation contribution revenue of \$293,759, net investment loss of \$108,011 and distributions and other expenses of \$411,791. The 2008 statement of revenues, expenses and changes in net assets includes Foundation contribution revenue of \$336,319, net investment loss of \$34,063 and distributions and other expenses of \$321,910. Separate financial statements of the Foundation are maintained by Foundation and Hospital management. Except for certain expenses paid directly by the Foundation, the Hospital provides administrative services and pays for operating expenses to support the Foundation's activities.

Blount Memorial Hospital, Inc.

List of Officials (Unaudited)

June 30, 2009

Board of Directors

Robert P. Redwine, President

Ted L. Flickinger, M.D., Vice President

Jim C. Fiegle

Susan Hitch Keller

Robin R. Haynes

Francis M. Gross, Ed.D

Clarence B. Williams

David E. Pesterfield

David L. Cockrill

Executive Administration

Joseph M. Dawson

I. Donald Heinemann, II

Jane T. Nelson

David E. Avriett

Richard Hall

John Hanks

Connie W. Huffman



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*

Board of Directors
Blount Memorial Hospital, Inc.

We have audited the financial statements of Blount Memorial Hospital, Inc. as of and for the year ended June 30, 2009, and have issued our report thereon dated September 14, 2009. 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 of America.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Blount Memorial Hospital, Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Blount Memorial Hospital, Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Blount Memorial Hospital, Inc.'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 a combination of control deficiencies, that adversely affects Blount Memorial Hospital, Inc.'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 Blount Memorial Hospital, Inc.'s financial statements that is more than inconsequential will not be prevented or detected by Blount Memorial Hospital, Inc.'s internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Blount Memorial Hospital, Inc.

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

Board of Directors
Blount Memorial Hospital, Inc.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Blount Memorial Hospital, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 directors, management, and the State of Tennessee Comptroller of the Treasury and is not intended to be and should not be used by anyone other than these specified parties.

Coulter & Justus, P.C.

September 14, 2009