

CONSOLIDATED FINANCIAL STATEMENTS
AND SCHEDULES

West Tennessee Healthcare and Related Affiliates
Years Ended June 30, 2012 and 2011
With Report of Independent Auditors

Ernst & Young LLP

 **ERNST & YOUNG**

West Tennessee Healthcare and Related Affiliates

Consolidated Financial Statements and Schedules

Years Ended June 30, 2012 and 2011

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Report of Independent Auditors

The Board of Trustees
West Tennessee Healthcare and Related Affiliates

We have audited the accompanying financial statements of the business-type activities of West Tennessee Healthcare and Related Affiliates (the Company), as of and for the years ended June 30, 2012 and 2011, which collectively comprise the Company's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Company's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and 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 the business-type activities of the Company as of June 30, 2012 and 2011, and the changes in financial position and cash flows thereof for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2012 on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States require that management's discussion and analysis on pages 4 through 11 and the required pension and post employment benefits disclosure information on pages 45 through 47 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was performed for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by US Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the financial statements as a whole.

Ernst + Young LLP

October 31, 2012, except for the
schedule of expenditures of federal awards,
for which the date is December 28, 2012

West Tennessee Healthcare and Related Affiliates

Management's Discussion and Analysis

Years Ended June 30, 2012 and 2011

This section of the financial statements of West Tennessee Healthcare and Related Affiliates (the Company) presents management's analysis of the Company's financial performance during the fiscal year ended June 30, 2012.

Financial Highlights

2012

- The Company's results from operations, including interest expense, fell below budgeted expectations in 2012 with an operating margin of 0.9%.
- Total operating revenues were 0.4% below the prior year, a decrease of approximately \$2 million. A decline in surgical and cardiology cases drove net patient service revenues down by 1.5%. The decline in patient revenue was offset by 17.7% increase in other operating revenue due to incentive payments for the meaningful use of electronic health records.
- Total operating expenses were up nearly 1%, led by employee salaries and benefits costs, which increased by 3% due to increased staffing and employee raises awarded during the year as well as increased utilization of the Company's medical benefit plan. In addition, administrative and other expenses were up 5.5%. These cost increases were offset by a decline in supply costs, which were down 7.5% with the decline in volumes.
- The Company's non-operating revenue was down significantly due to deteriorating market conditions for the Company's investments.

2011

- The Company's results from operations improved slightly in 2011 with an operating margin of 2.1%.
- Total operating revenues were nearly 5% over the prior year, an increase of nearly \$27 million. The increase was driven primarily by increased inpatient and surgical volume, along with a slight increase in reimbursement and less than \$5 million in nonrecurring funding.
- Total operating expenses were also up nearly 5%. Expense for employee salaries and benefits increased by 5% with increased staffing, employee raises and bonuses awarded during the year and increased utilization cost of the Company's medical benefit plan.

West Tennessee Healthcare and Related Affiliates

Management's Discussion and Analysis (continued)

Additionally, supply costs were up 9% for the year, driven by cardiology and surgical volume, and other expenses were up 1%.

- The Company's non-operating revenue continued to increase with an improvement in market value over the prior year.

Overview of the Consolidated Financial Statements

The financial statements consist of two parts: management's discussion and analysis and the basic financial statements. The basic financial statements also include notes and required supplementary information that explain in more detail some of the information in the financial statements.

Required Basic Consolidated Financial Statements

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

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

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

West Tennessee Healthcare and Related Affiliates

Management's Discussion and Analysis (continued)

Financial Analysis

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

Table A-1

Condensed Consolidated Balance Sheets (in millions of dollars)

	2012	June 30 2011	2010	Dollar Increase (Decrease) 2011–2012	Percentage Increase (Decrease) 2011–2012	Dollar Increase (Decrease) 2010–2011	Percentage Increase (Decrease) 2010–2011
Current assets	\$ 140.0	\$ 141.5	\$ 120.0	\$ (1.5)	(1)%	\$ 21.5	18%
Capital assets, net	386.6	403.5	421.7	(16.9)	(4)	(18.2)	(4)
Other long-term assets	334.5	314.8	284.1	19.7	6	30.7	11
Total assets	861.1	859.8	825.8	1.3	–	34.0	4
Current liabilities	67.9	68.2	70.5	(0.3)	–	(2.3)	(3)
Long-term liabilities	287.5	291.3	295.4	(3.8)	(1)	(4.1)	(1)
Total liabilities	355.4	359.5	365.9	(4.1)	(1)	(6.4)	(2)
Unrestricted	368.2	344.3	290.9	23.9	7	53.4	18
Invested in capital assets, net of related financing	115.5	128.9	141.8	(13.4)	(10)	(12.9)	(9)
Restricted	22.0	27.1	27.2	(5.1)	(19)	(0.1)	–
Total net assets	505.7	500.3	459.9	5.4	1	40.4	9
Total liabilities and net assets	\$ 861.1	\$ 859.8	\$ 825.8	\$ 1.3	–%	\$ 34.0	4%

As indicated in Table A-1, net assets increased from fiscal 2011 by \$5.4 million or 1% with the Company's financial performance in fiscal year 2012.

West Tennessee Healthcare and Related Affiliates

Management's Discussion and Analysis (continued)

1. Total assets remained relatively flat, increasing by \$1.3 million or 0%.
2. Total liabilities decreased by \$4.1 million or 1% due to the routine decrease in the balance of outstanding debt.

As indicated in Table A-1, net assets increased from fiscal 2010 by \$40.4 million or 9% with the Company's financial performance in fiscal year 2011.

1. Total assets increased by \$34 million or 4% due primarily to the turnaround in the value of the Company's investment portfolio.
2. Total liabilities decreased by \$6.4 million or 2% with the routine decrease in the balance of outstanding debt and a less significant decline in other accrued expenses.

Table A-2

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

	Year Ended June 30			Dollar Increase (Decrease)	Percentage Increase (Decrease)	Dollar Increase (Decrease)	Percentage Increase (Decrease)
	2012	2011	2010	2011-2012	2011-2012	2010-2011	2010-2011
Net patient service revenues	\$ 553.0	\$ 561.4	\$ 529.2	\$ (8.4)	(1)%	\$ 32.2	6%
Other operating revenues	40.9	34.7	40.0	6.2	18	(5.3)	(13)
Total operating revenues	593.9	596.1	569.2	(2.2)	-	26.9	5
Salaries and benefits	317.7	307.0	292.6	10.7	3	14.4	5
Supply expenses	116.6	126.1	115.9	(9.5)	(8)	10.2	9
Other expenses	136.4	132.7	131.0	3.7	3	1.7	1
Total expenses	570.7	565.8	539.5	4.9	1	26.3	5
Income from operations	23.2	30.3	29.7	(7.1)	(23)	0.6	2
Net nonoperating revenues and expenses	(14.9)	11.0	6.1	(25.9)	(235)	4.9	80
Change in net assets	8.3	41.3	35.8	(33.0)	(80)	5.5	15
Beginning net assets	500.3	459.9	425.2	40.4	9	34.7	8
Less contributions	(2.9)	(0.9)	(1.1)	(2.0)	222	0.2	(18)
Ending net assets	\$ 505.7	\$ 500.3	\$ 459.9	\$ 5.4	1%	\$ 40.4	9%

While the consolidated balance sheets show the change in financial position or net assets, the consolidated statements of revenues and expenses and changes in net assets, as indicated above, provide answers as to the nature and source of these changes (i.e., the financial result of current year operations).

West Tennessee Healthcare and Related Affiliates

Management's Discussion and Analysis (continued)

Operating revenues decreased by \$2.2 million or 0.4% from 2011 to 2012. The decrease was driven primarily by declining cardiology and surgical volumes, offset by non-recurring income.

1. Inpatient discharges were up 2%. However, although inpatient volumes were up, patient revenue declined with the decline in surgical and cardiology cases. Surgical volumes were down 1% compared to the prior year.
2. The Company received \$7.4 million in incentive payments for the meaningful use of electronic health records.

Operating revenues increased by 5% from 2010 to 2011. The increase was driven primarily by increases in outpatient revenue and other operating revenue, as follows:

1. Inpatient discharges were up 3% for the system. Inpatient volumes for the flagship hospital increased by 6% while others declined. Surgical cases increased by 1.6% over the prior year. Charges for outpatient services increased by approximately 3% over the prior year with routine growth and the addition of a few new services including the Skyline Endoscopy Center, Medical Specialty Clinic, and Milan Physical Therapy.
2. Reimbursement increased slightly with routine escalation of commercial payment and a shift in the mix of volume toward more highly reimbursed services such as cardiology and surgery.
3. The Company received \$4.2 million in non-recurring extraordinary funding during the year. The funding was the result of two factors: a) the extension of the enhanced Federal Medical Assistance Percentage, which was introduced with the American Recovery and Reinvestment Act (ARRA); and b) the increased Federal match of State funds because of the provider enhanced coverage fee. The combination of these two resulted in an additional distribution of funds in the 2011 fiscal year that is not expected to recur in the future.

West Tennessee Healthcare and Related Affiliates

Management's Discussion and Analysis (continued)

Operating expense increased by \$4.9 million or 1% when comparing 2012 to 2011.

1. Total salaries and benefits expense increased by \$10.7 million or 3% due to several factors. Routine employee rate adjustments were given in September 2011, while costs for the employee's health plan increased with increased utilization and cost of employee medical claims. In addition, the 403b match was reinstated in July 2011.
2. Total supply expenses for the Company decreased by \$9.5 million or 8% due to declining volumes particularly for surgery and cardiology services, where supply costs per case are generally higher.
3. Other expenses increased by \$3.7 million or 3% due to changes to co-management arrangements, enhanced case management services and routine inflation of equipment and software maintenance costs.

Operating expense increased by \$26.3 million or 5% when comparing 2011 to 2010.

1. Total salaries and benefits expense increased by \$14.4 million or 5% due to several significant factors. Total FTEs increased by 1.6% with routine staff increases and the addition or expansion of services during the year. In addition, employee rate adjustments were given in September 2010 and an employee bonus was given in June 2011. The Company also incurred \$0.6 million in non-recurring costs during the 2011 year for a voluntary retirement program implemented during the year. Finally, costs for the employee's health plan increased with staffing and increases in utilization and cost of employee medical claims.
2. Total supply expenses for the Company increased by \$10.2 million or 9% due to increases in volume at the flagship hospital, particularly for surgery and cardiology services, where supply costs per case are generally higher.
3. Other expenses increased by \$1.7 million or 1% due to a full year of cost related to the cardiology co-management program introduced in the prior year as well as routine inflation of utilities and equipment and software maintenance costs.

West Tennessee Healthcare and Related Affiliates

Management's Discussion and Analysis (continued)

Capital Assets and Long-Term Debt

Capital Assets

As of June 30, 2012, the Company had \$386.6 million invested in a variety of capital assets, as reflected in Table A-3, which represents a net decrease (additions, disposals and depreciation) of \$16.9 million or 4% from the end of last year.

Table A-3

Capital Assets (in millions of dollars)

	June 30	
	2012	2011
Land and land improvements	\$ 46.6	\$ 44.3
Buildings	285.6	283.4
Equipment	554.8	542.6
Construction in progress	3.8	5.9
Total capital assets	890.8	876.2
Accumulated depreciation	(504.2)	(472.7)
Capital assets, net	\$ 386.6	\$ 403.5

Long-Term Debt

As of June 30, 2012, the Company had \$287.5 million in outstanding long-term debt and as of June 30, 2011, the Company had \$291.3 million in outstanding long-term debt. This represents a net decrease of \$3.8 million over the prior fiscal year.

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

West Tennessee Healthcare and Related Affiliates

Management's Discussion and Analysis (continued)

Future Outlook

The Board of Trustees and management continue to have a positive outlook for the Company. The Company has committed to a renewed focus on improving reliability and quality, while pursuing business strategies that will strengthen its financial position and ensure its ability to continue to provide high quality healthcare to the citizens of West Tennessee in the future. The Company continues to develop and evaluate alignment and business strategies to accomplish these objectives.

Of particular note in the short-term, the Company will open two new facilities in the upcoming year to improve the health and well-being of the citizens of West Tennessee.

- In January 2013, the Company will open the LIFT Wellness Center as part of a new development in downtown Jackson. The new center will combine a clinic with medically-based fitness, land and water-based physical therapy, and disease management services in a single site focused on improving the wellness of individuals as well as the community as a whole.
- In the Fall of 2013, the Company will open the Kirkland Cancer Center, relocating medical and radiation oncology services to a new comprehensive cancer facility adjacent to the flagship hospital in Jackson. The new facility will offer expanded services to cancer patients in a single site.

Requests for Information

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

Roster of Governance and Management Officials

Governance Officials – Board of Trustees

Name	Title	Principal Occupation
Phil Bryant	Chairman	Financial Services
Earl Anderson	Vice-Chairman	Retired Director of Information Systems, Pictsweet
Greg Milam	Secretary	Insurance Services
Curtis Mansfield		President, First Bank
Sammie Arnold		Retired Pharmacist and Entrepreneur

Management Officials

Name	Title
Bobby Arnold	Chief Executive Officer
James Ross	Vice-President, Chief Operating Officer
Jeff Blankenship	Vice-President, Chief Financial Officer
Currie Higgs	Vice-President, General Counsel
Dr. David Roberts	Vice-President, Medical Affairs
Tina Prescott	Vice-President, Chief Nursing Officer
Amy Griffin	Vice-President, Compliance Officer
Jeff Frieling	Vice-President, Chief Information Officer
Wendie Carlson	Vice-President of Human Resources
Catherine Kwasigroh	Vice-President of Hospital Services
Deann Montchal	Vice-President of Hospital Services
Dr. Lisa Piercey	Vice-President of Hospital Services
Karen Utley	Vice-President of Hospital Services

West Tennessee Healthcare and Related Affiliates

Consolidated Balance Sheets

	June 30	
	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 36,988,257	\$ 36,237,568
Accounts receivable:		
Patient accounts receivable, less allowances for doubtful accounts and contractual adjustments of approximately \$153,506,000 and \$147,389,000	80,927,852	83,041,868
Other	7,304,235	3,407,078
Total accounts receivable	88,232,087	86,448,946
Inventories	5,840,953	6,227,753
Prepaid expenses	8,249,049	7,222,567
Assets limited as to use – current portion – restricted	685,584	5,415,489
Total current assets	139,995,930	141,552,323
Assets limited as to use:		
Funded depreciation – buildings	57,184,551	43,790,181
Funded depreciation – equipment	30,746,768	23,544,936
Debt service reserve fund – restricted	21,374,418	21,703,519
Project building fund	73,394,787	89,405,105
Operating reserve fund	100,925,440	100,088,056
Contingency fund	7,889,929	7,814,762
High technology fund	9,367,614	9,278,370
	300,883,507	295,624,929
Other assets:		
Unamortized bond issue costs	2,096,574	2,164,154
Other	31,554,592	16,992,280
	33,651,166	19,156,434
Property, plant, and equipment:		
Land and land improvements	46,576,018	44,354,416
Buildings	285,630,836	283,425,657
Fixed equipment	194,388,623	188,074,313
Moveable equipment	360,374,025	354,507,313
Construction in progress	3,808,513	5,860,845
	890,778,015	876,222,544
Accumulated depreciation	(504,181,605)	(472,720,169)
	386,596,410	403,502,375
Total assets	\$ 861,127,013	\$ 859,836,061

	June 30	
	2012	2011
Liabilities and net assets		
Current liabilities:		
Accounts payable	\$ 11,983,670	\$ 14,945,958
Accrued compensation and related expenses	17,455,214	21,545,131
Accrued interest expense	4,154,098	4,211,621
Other accrued expenses	29,528,781	22,892,305
Long-term debt due within one year	4,760,135	4,562,437
Total current liabilities	<u>67,881,898</u>	<u>68,157,452</u>
Other liabilities:		
Long-term debt, less amounts due within one year	287,514,481	291,331,021
Net assets:		
Unrestricted	368,215,041	344,325,596
Invested in capital assets, net of related financing	115,455,591	128,902,983
Restricted for debt service	22,060,002	27,119,009
Total net assets	<u>505,730,634</u>	<u>500,347,588</u>
Total liabilities and net assets	<u>\$ 861,127,013</u>	<u>\$ 859,836,061</u>

See accompanying notes.

West Tennessee Healthcare and Related Affiliates

Consolidated Statements of Revenues and Expenses and Changes in Net Assets

	Year Ended June 30	
	2012	2011
Operating revenues		
Net patient service revenues	\$ 552,972,210	\$ 561,402,313
Other revenues	40,921,017	34,753,356
Total operating revenues	593,893,227	596,155,669
Operating expenses		
Salaries and benefits	317,708,787	307,027,798
Supplies and other	203,420,790	208,310,729
Depreciation and amortization	49,609,821	50,472,724
Total operating expenses	570,739,398	565,811,251
Income from operations	23,153,829	30,344,418
Nonoperating revenues (expenses)		
Investment income	3,036,285	29,103,735
Interest expense	(17,853,610)	(18,114,097)
Nonoperating revenue	(14,817,325)	10,989,638
Income before capital contributions	8,336,504	41,334,056
Other changes in net assets		
Contribution to City of Jackson and Madison County	(2,400,254)	(406,784)
Contribution to City of Jackson: Sportsplex	(150,000)	(150,000)
Contribution to West Tennessee Healthcare Foundation	(403,205)	(374,515)
Net assets at beginning of year	500,347,589	459,944,832
Net assets at end of year	\$ 505,730,634	\$ 500,347,589

See accompanying notes.

West Tennessee Healthcare and Related Affiliates

Consolidated Statements of Cash Flows

	Year Ended June 30	
	2012	2011
Operating activities		
Receipts from third-party payors and patients	\$ 592,110,086	\$ 588,082,986
Payments to suppliers	(215,338,567)	(215,178,473)
Payments to employees	(321,798,704)	(306,207,508)
Net cash provided by operating activities	54,972,815	66,697,005
Noncapital financing activity		
Contributions to City of Jackson, Madison County, and West Tennessee Healthcare Foundation	(2,953,459)	(931,299)
Net cash used in noncapital financing activity	(2,953,459)	(931,299)
Investing activities		
Interest, dividends, and realized gains on investments	5,156,587	4,406,756
Net change in assets limited as to use	(2,648,973)	(3,687,874)
Net cash provided by investing activities	2,507,614	718,882
Capital and related financing activities		
Purchases of property, plant, and equipment	(32,313,886)	(31,875,142)
Repayment of long-term debt	(3,618,843)	(5,483,418)
Interest paid on long-term debt	(17,843,553)	(18,056,608)
Net cash used in capital and related financing activities	(53,776,282)	(55,415,168)
Increase in cash and cash equivalents	750,689	11,069,420
Cash and cash equivalents at beginning of year	36,237,568	25,168,148
Cash and cash equivalents at end of year	\$ 36,988,257	\$ 36,237,568
Reconciliation of income from operations to net cash provided by operating activities		
Income from operations	\$ 23,153,829	\$ 30,344,418
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation	49,219,850	50,112,152
Amortization	389,971	360,572
Changes in operating assets and liabilities:		
Accounts receivable	(1,783,141)	(8,072,683)
Inventory and prepaid expenses	(639,682)	(2,666,292)
Other assets	(14,952,283)	(2,580,342)
Accounts payable and accrued expenses	(415,729)	(800,820)
Net cash provided by operating activities	\$ 54,972,815	\$ 66,697,005
Supplemental schedule of noncash investing activities		
Change in fair value of investments	\$ (2,120,302)	\$ 24,696,979

See accompanying notes.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements

June 30, 2012

1. Significant Accounting Policies

Organization and Basis of Presentation

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

Proprietary Fund Accounting

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

Accounting Standards

Government Accounting Standard Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, offers the option of following all Financial Accounting Standards Board (FASB) standards issued after November 30, 1989, unless the latter conflict with or contradict GASB pronouncements, or not following FASB standards issued after such date. The Company elected the option not to follow FASB pronouncements issued after November 30, 1989.

Recent Accounting Pronouncements

In December 2009, the GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. The objective of this Statement is to address issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans (that is, agent employers). The provisions of this Statement related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. The adoption of this statement on July 1, 2011 did not have a significant impact on the Company's results of operations or financial position.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

The GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus and amendment of GASB Statements No. 14 and No. 34*, in November 2010. The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012, although earlier application is encouraged. The adoption of this statement on July 1, 2012 is not anticipated to have a significant impact on the Company’s results of operations or financial position.

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to incorporate into the GASB’s authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants’ (AICPA) Committee on Accounting Procedure.

This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. However, those entities can continue to apply, as other accounting literature, post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements, including this Statement. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. The adoption of this statement on July 1, 2012 is not anticipated to have a significant impact on the Company’s results of operations or financial position.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

The GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, in June 2011. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities. Concepts Statement 4 also identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011. The adoption of this statement on July 1, 2012 is not anticipated to have a significant impact on the Company's results of operations or financial position.

The GASB recently issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, which was approved in June 2012. The standard applies to government employers that offer pension benefits through a pension trust or an equivalent arrangement. It replaces GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and GASB Statement No. 50, *Pension Disclosures*, for these employers. The standard is intended to improve the usefulness of financial statements in assessing accountability and inter-period equity by requiring recognition of the entire net pension liability and a more comprehensive of pension expense, as well as explanatory disclosures in the notes to the financial statements and required supplemental information.

Among other requirements, under the standard, government employers will have to record a net pension liability in their financial statements for defined benefit plans that is based on fiduciary plan net position rather than plan funding. This portion of the standard will require the largest amount of time to adopt. The new standard is effective for fiscal years beginning after June 15, 2014, but the GASB is encouraging governments to implement sooner. The Company is working with their actuarial firm to determine the impact that this standard will have on the Company's financial statements.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

Cash and Cash Equivalents

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

Investments

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

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

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

Inventories

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

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

Funded Depreciation

The Company reserves funds for future purchases of property, plant and equipment. Investment earnings on funded depreciation funds were \$1,093,222 and \$940,411 for the years ended June 30, 2012 and 2011, respectively, and are included in investment income in the accompanying consolidated statements of revenues and expenses and changes in net assets.

Bond Issue Costs and Discounts

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

Property, Plant, and Equipment

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

Fair Value of Financial Instruments

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

Compensated Absences

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

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

Charity Care and Community Benefit

As a community provider, the Company's policy is to accept all patients regardless of their ability to pay. As a result, no distinction is made between bad debts and charity care for financial reporting purposes. However, management believes that substantially all of the uncollected amounts are due to patients' inability to pay. Therefore, all amounts which are not collected, other than third-party payor contractual adjustments, are recorded as charity care and excluded from net patient service revenues. The community benefit provided through charity care was \$101,258,639 and \$96,130,097, based on gross charges, for the years ended June 30, 2012 and 2011, respectively.

EHR Incentive Payments

The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicare and Medicaid incentive payment program beginning in 2011 for eligible providers that adopt and meaningfully use certified EHR technology. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. Initial Medicaid incentive payments are available to providers that adopt, implement or upgrade certified EHR technology. Providers must demonstrate meaningful use of such technology in subsequent years to qualify for additional Medicaid incentive payments.

The Company accounts for HITECH incentive payments under a grant accounting model. Income from Medicare and Medicaid incentive payments is recognized ratably as revenue as the Company has demonstrated that it complied with the meaningful use criteria over the applicable compliance period. The Company recognized revenue from Medicare and Medicaid incentive payments after it adopted certified EHR technology. Incentive payments totaling \$7,418,688 for the year ended June 30, 2012, are included in other revenues in the accompanying consolidated statements of revenues and expenses and changes in net assets. Income from incentive payments is subject to retrospective adjustment as the incentive payments are calculated using cost report data that is subject to audit. Additionally, the Company's compliance with the meaningful use criteria is subject to audit by the federal government.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

Net Patient Service Revenues

Net patient service revenues are reported at the net amounts billed to patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as changes in estimated provisions and final settlements are determined. Changes in estimated provisions and final settlements are included in net patient service revenues. For the fiscal year ended June 30, 2012, changes in estimated settlements resulted in an increase to revenues of approximately \$3,477,521 compared to an increase of \$1,190,976 for the fiscal year ended June 30, 2011.

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

- *Medicare.* Inpatient acute care services and skilled nursing services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. The Company receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid eligible and other low income patients. The Center for Medicare and Medicaid Services (CMS) (formerly known as the Health Care Financing Administration) established an outpatient prospective payment system. CMS established groups called ambulatory payment classifications for outpatient procedures. Payments are made based on the group assignment for the service rendered. Additionally, CMS established a prospective payment system for home health services.
- *TennCare.* The Company contracts with managed care organizations to receive reimbursement for providing hospital services to patients covered under the TennCare program. Payment arrangements with these managed care organizations consist primarily of prospectively determined rates per discharge, discounts from established charges or prospectively determined daily rates.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

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

Charges at the Company's established billing rates (gross patient service charges) related to patients covered by Medicare, Medicaid, and TennCare programs were 60% and 59% of gross patient service revenues for the fiscal years ended 2012 and 2011, respectively.

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

	Year Ended June 30	
	2012	2011
Medicare	\$ 430,880,302	\$ 433,904,265
TennCare	89,763,180	78,138,934
Other	376,791,432	367,116,871
	<u>\$ 897,434,914</u>	<u>\$ 879,160,070</u>

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

Essential access, critical access, Federal Medical Percentage Assistance and Medicaid Disproportionate Share payments of approximately \$6,883,094 and \$11,203,418 received from TennCare/Medicaid were included in net revenues during the years ended June 30, 2012 and 2011, respectively.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

The Company believes that it is in compliance with all applicable laws and regulations. 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.

Operating Revenues

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

Use of Estimates

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

2. Assets Limited as to Use

Federal Income Taxes

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

The Company, as authorized by the Board of Trustees, maintains checking accounts necessary for daily operations, deposits for the contingency fund, and deposits and investments for the funded depreciation funds. The bond funds are maintained in accordance with the bond indenture related to the Series 2008 \$318,980,000 Hospital Revenue Refunding and Improvement Bonds (see Note 6). The interest fund and bond sinking fund are maintained for the payment of bond principal and interest. A debt service reserve fund is maintained to make up any deficiencies in the interest fund and bond sinking fund. Certain amounts comprising the interest fund, bond sinking fund and debt service reserve fund are included in assets limited as to use-current portion in the accompanying consolidated balance sheets based on debt service requirements during the following fiscal year.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

2. Assets Limited as to Use (continued)

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

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

A summary of assets limited as to use follows:

	June 30	
	2012	2011
Externally restricted by bond indenture agreement – held by bond trustee:		
Cash and short-term investments	\$ 22,060,002	\$ 27,119,009
Internally designated for capital acquisitions:		
Cash and short-term investments	198,980	2,817,891
Corporate and U.S. agency bond funds	85,461,132	80,026,949
Real estate mortgage fund	14,097,846	12,739,220
Equity securities	70,935,763	70,434,532
	170,693,721	166,018,592
Other internally designated funds for operations:		
Cash and short-term investments	44,677,201	42,281,274
U.S. government agency obligations	32,149,498	32,178,121
Real estate mortgage fund	5,303,449	5,122,326
Equity securities	26,685,220	28,321,096
	108,815,368	107,902,817
Total assets limited as to use	301,569,091	301,040,418
Amounts required to meet current obligations	(685,584)	(5,415,489)
	\$ 300,883,507	\$ 295,624,929

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

3. Cash and Investments

At June 30, 2012 and 2011, the Company had cash on hand and deposits as follows:

	June 30	
	2012	2011
Cash on hand	\$ 13,247	\$ 13,667
Cash insured (FDIC) or collateralized with securities held by the Company	2,250,000	2,006,351
Cash collateralized by securities held by the pledging financial institution's trust department in the Company's name or in the State of Tennessee		
Collateral Pool	34,725,010	34,217,550
Total	\$ 36,988,257	\$ 36,237,568

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

At June 30, 2012 and 2011, the Company had \$44,876,181 and \$45,099,166, respectively, invested in short-term investments, which include U.S. Agencies and a sweep account secured by Agency securities held by the Trustee. All investments are carried at fair value.

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

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

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

3. Cash and Investments (continued)

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

At June 30, 2012 and 2011, the Company's bank balances were not exposed to custodial credit risk since the full amount was covered by FDIC insurance or collateralized by securities held by the pledging financial institution's Trust department in the Company's name or by the State of Tennessee Collateral Pool.

As of June 30, 2012 and 2011, the Company's investments were comprised of various short-term investments, trustee funds, corporate and U.S. agency bond funds, real estate mortgage funds, equity securities and alternative investments. Since the investments are registered in the Company's name, they are not exposed to custodial credit risk. In addition, the Company's investment policy requires that specific qualifications be met in order to represent the Company as a custodian.

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

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

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

3. Cash and Investments (continued)

The credit risk profile of the Company's investments as of June 30, 2012, is as follows:

Investment Type	Balance as of June 30, 2012	Rating				
		AAA	AA	A-	AA-	NA
Cash and short-term investments	\$ 66,936,183	\$ 273,833	\$ -	\$ -	\$ -	\$ 66,662,350
Corporate and U.S. agency bond funds	117,610,631	-	43,093,663	16,767,169	57,749,799	-
Real estate mortgage fund	19,401,294	-	-	-	-	19,401,294
Equity securities	97,620,983	-	-	-	-	97,620,983
Total investments	\$ 301,569,091	\$ 273,833	\$ 43,093,663	\$ 16,767,169	\$ 57,749,799	\$ 183,684,627

The credit risk profile of the Company's investments as of June 30, 2011 is as follows:

Investment Type	Balance as of June 30, 2011	Rating				
		AAA	A+	A	A-	NA
Cash and short-term investments	\$ 72,218,175	\$ 3,950,940	\$ -	\$ -	\$ -	\$ 68,267,235
Corporate and U.S. agency bond funds	112,205,070	-	53,993,233	41,936,368	16,275,469	-
Real estate mortgage fund	17,861,546	-	-	-	-	17,861,546
Equity securities	98,755,627	-	-	-	-	98,755,627
Total investments	\$ 301,040,418	\$ 3,950,940	\$ 53,993,233	\$ 41,936,368	\$ 16,275,469	\$ 184,884,408

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

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

3. Cash and Investments (continued)

The distribution of the Company's investments by maturity as of June 30, 2012, is as follows:

Investment Type	Balance as of June 30, 2012	Remaining Maturity (In Months)				N/A
		12 Months or Less	13 Months to 24 Months	25 Months to 60 Months	Greater Than 60 Months	
Cash and short-term investments	\$ 66,936,183	\$ 66,936,183	\$ -	\$ -	\$ -	\$ -
Corporate and U.S. agency bond funds	117,610,631	-	-	117,610,631	-	-
Real estate mortgage fund	19,401,294	-	-	-	-	19,401,294
Equity securities	97,620,983	-	-	-	-	97,620,983
Total investments	301,569,091	66,936,183	-	117,610,631	-	117,022,277
Amounts required to meet current obligations	(685,584)	(685,584)	-	-	-	-
Total	\$ 300,883,507	\$ 66,250,599	\$ -	\$ 117,610,631	\$ -	\$ 117,022,277

The distribution of the Company's investments by maturity as of June 30, 2011, is as follows:

Investment Type	Balance as of June 30, 2011	Remaining Maturity (In Months)				N/A
		12 Months or Less	13 Months to 24 Months	25 Months to 60 Months	Greater Than 60 Months	
Cash and short-term investments	\$ 72,218,175	\$ 72,218,175	\$ -	\$ -	\$ -	\$ -
Corporate and U.S. agency bond funds	112,205,070	-	-	112,205,070	-	-
Real estate mortgage fund	17,861,546	-	-	-	-	17,861,546
Equity securities	98,755,627	-	-	-	-	98,755,627
Total investments	301,040,418	72,218,175	-	112,205,070	-	116,617,173
Amounts required to meet current obligations	(5,415,489)	(5,415,489)	-	-	-	-
Total	\$ 295,624,929	\$ 66,802,686	\$ -	\$ 112,205,070	\$ -	\$ 116,617,173

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

3. Cash and Investments (continued)

For the years ended June 30, 2012 and 2011, investment income is comprised of the following:

	2012	2011
Interest, dividends, and realized gains on investments	\$ 5,156,587	\$ 4,406,756
Change in fair value of investments	(2,120,302)	24,696,979
	\$ 3,036,285	\$ 29,103,735

4. Disaggregation of Payable Balances

Accounts Payable and Accrued Expenses

Accounts payable at June 30, 2012 and 2011, consisted of the following:

	2012	2011
Due to vendors	\$ 10,104,951	\$ 11,305,304
Due to patients	1,433,780	3,213,037
Other	444,939	427,617
Total accounts payable	\$ 11,983,670	\$ 14,945,958

Other accrued expenses at June 30, 2012 and 2011, consisted of the following:

	2012	2011
Accruals for self insurance	\$ 10,445,233	\$ 9,630,758
Other	19,083,548	13,261,547
Total other accrued expenses	\$ 29,528,781	\$ 22,892,305

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

5. Net Property, Plant and Equipment

Net property, plant, and equipment activity for the years ended June 30, 2012 and 2011, consisted of the following:

	Balance at June 30, 2010	Additions	Reductions	Balance at June 30, 2011	Additions	Reductions	Balance at June 30, 2012
Land	\$ 29,713,728	\$ 1,246,812	\$ (1,275,044)	\$ 29,685,496	\$ 2,204,741	\$ –	\$ 31,890,237
Land improvements	14,517,779	157,983	(6,842)	14,668,920	16,861	–	14,685,781
Less accumulated depreciation	7,676,580	652,722	(24,949)	8,304,353	1,231,478	(617,763)	8,918,068
Net land improvements	6,841,199	(494,739)	18,107	6,364,567	(1,214,617)	617,763	5,767,713
Buildings	257,803,414	8,256,004	(633,761)	283,425,657	2,249,546	(44,367)	28,630,836
Less accumulated depreciation	106,661,479	14,458,880	(3,966,031)	117,154,328	14,037,403	(3,529,066)	127,662,665
Net buildings	169,141,935	(6,202,876)	3,332,270	166,271,329	(11,787,857)	3,484,699	157,968,171
Equipment	529,739,223	22,329,817	(9,487,415)	542,581,625	31,683,104	(19,502,081)	554,762,648
Less accumulated depreciation	317,943,960	39,982,092	(10,664,564)	347,261,488	46,414,395	(26,075,011)	367,600,872
Net equipment	211,795,263	(17,652,275)	1,177,149	195,320,137	(14,731,291)	6,572,930	187,161,776
Construction in progress	4,247,262	7,263,403	(5,649,820)	5,860,845	6,308,693	(8,361,025)	3,808,513
	<u>\$ 421,739,387</u>	<u>\$ (15,839,675)</u>	<u>\$ (2,397,338)</u>	<u>\$ 403,502,374</u>	<u>\$ (19,220,331)</u>	<u>\$ 2,314,367</u>	<u>\$ 386,596,410</u>

Depreciation is computed by applying the straight-line method over the estimated remaining useful lives of buildings and improvements (10 to 40 years) and equipment (4 to 20 years). Assets under capital leases are amortized using the straight-line method over the shorter of the estimated useful life of the assets or life of the lease term, excluding any lease renewal, unless the lease renewals are reasonably assured. Amortization expense related to assets under capital leases is included in depreciation expense. The Company's capitalization threshold is \$1,000 and a minimum useful life of 2 years. Depreciation expense totaled \$49,219,850 and \$50,112,153 during the years ended June 30, 2012 and 2011, respectively.

Construction in progress at June 30, 2012, consists of various projects for additions and renovations to the Company's facilities. The Company has outstanding contracts and other commitments related to the completion of these projects. The Company estimates \$50,408,298 in costs to complete these projects.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Capital Lease Obligations

Long-term debt consists of the following:

	June 30	
	2012	2011
Hospital Revenue Bonds, Series 2008	\$ 303,630,000	\$ 308,110,000
Less unamortized bond discount	(4,851,886)	(5,125,103)
	298,778,114	302,984,897
Hospital Revenue Refunding and Improvement Bonds, Series 1995, unamortized loss on bond refunding	(185,057)	(321,120)
Hospital Revenue Bonds, Series 1998, unamortized loss on defeasance	(1,852,730)	(2,081,959)
Auction Rate Hospital Revenue Bonds, Series 2003, unamortized loss on defeasance	(1,418,423)	(1,577,129)
Auction Rate Hospital Revenue Bonds, Series 2006A, unamortized loss on defeasance	(291,241)	(307,422)
Auction Rate Hospital Revenue Bonds, Series 2006B, unamortized loss on defeasance	(2,881,046)	(3,021,500)
Capital lease obligation	124,999	217,691
	292,274,616	295,893,458
Amounts due within one year	(4,760,135)	(4,562,437)
	\$ 287,514,481	\$ 291,331,021

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

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

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Capital Lease Obligations (continued)

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

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

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

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

The 2008 Bond Issue also provided for the termination of the District's 2003A, 2006A, and 2006B interest rate swaps. The District made termination payments to the counterparties of \$4,073,687, \$3,493,889, and \$11,344,647, respectively for the 2003A, 2006A, and 2006B interest rate swaps. Subsequent to such termination payments, the District has no risk associated with any interest rate swaps at June 30, 2012.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

6. Long-Term Debt and Capital Lease Obligations (continued)

The District's revenues are pledged as collateral to the Series 2008 Bond Issue.

The Company paid interest of \$17,843,553 and \$18,056,608 for the years ended June 30, 2012 and 2011, respectively.

Long-term debt activity (excluding unamortized bond discount and losses on refunding) for the years ended June 30, 2012 and 2011, consisted of the following:

	Balance at June 30, 2010	Additions	Reductions	Balance at June 30, 2011	Additions	Reductions	Balance at June 30, 2012
Bonds payable	\$ 312,415,000	\$ -	\$ 4,305,000	\$ 308,110,000	\$ -	\$ 4,480,000	\$ 303,630,000
Other	2,394,750	-	2,177,059	217,691	-	92,692	124,999
Total long-term debt	<u>\$ 314,809,750</u>	<u>\$ -</u>	<u>\$ 6,482,059</u>	<u>\$ 308,327,691</u>	<u>\$ -</u>	<u>\$ 4,572,692</u>	<u>\$ 303,754,999</u>

Scheduled principal and interest payments, including capital lease obligations and bonds payable, are as follows:

	Principal	Interest	Total
Fiscal Years Ending June 30:			
2013	\$ 4,760,135	\$ 16,615,913	\$ 21,376,048
2014–2018	27,035,000	79,453,538	106,488,538
2019–2023	34,685,000	71,800,531	106,485,531
2024–2028	44,905,000	61,576,869	106,481,869
2029–2033	58,490,000	47,993,713	106,483,713
2034–2038	76,640,000	29,847,375	106,487,375
2039–2041	57,195,000	6,699,900	63,894,900
Unamortized bond discount, net	(4,851,886)	-	(4,851,886)
Unamortized loss on bond refunding, net	(6,628,498)	-	(6,628,498)
Total	<u>\$ 292,229,751</u>	<u>\$ 313,987,839</u>	<u>\$ 606,217,590</u>

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

7. Leases

The Company leases equipment under various operating leases. Rent expense for all operating leases was approximately \$4,295,535 and \$4,736,428 for the years ended June 30, 2012 and 2011, respectively. Approximate minimum future rental payments, by year and in the aggregate, under noncancelable operating leases with initial terms of one year or more are as follows at June 30, 2012.

2013	\$ 4,099,102
2014	4,427,552
2015	4,205,791
2016	3,121,237
2017	3,485,732
Thereafter	21,809,078
	\$ 41,148,492

8. Concentrations of Credit Risk

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

	June 30	
	2012	2011
Medicare	34%	31%
Medicaid and TennCare	15	14
Blue Cross	9	11
Private pay	24	25
Other	18	19
	100%	100%

The allowance for doubtful accounts represents amounts, which, in the Company's judgment will be adequate to absorb write-offs of existing patient receivable balances, which may become uncollectible. Estimation of the allowance for doubtful accounts is based on several factors which include, but are not limited to, analytical review of loss experience of the various payor classes in relation to outstanding receivables and judgments with respect to the impact of current economic conditions.

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

9. Retirement Plans

Defined Benefit Plan

The Company maintains and administers a noncontributory, defined benefit pension plan (the Plan). The Plan was discontinued for employees hired after June 30, 2010. The West Tennessee Pension Plan is a single-employer defined benefit pension plan. All employees hired after October 1, 2005 and prior to June 30, 2010, are covered on the fifth anniversary of their date of hire after they have completed at least 1,800 hours of employment per year. The Plan provides retirement, termination, disability, and death benefits to plan members and beneficiaries. The operation of the Plan is consistent with the laws of Tennessee and the United States federal government. The Plan issues a publicly available financial report as required by GASB Statement No. 25 that includes a financial statement and required supplementary information for the Plan. That report may be obtained by writing to West Tennessee Healthcare, attention: Human Resources, Manager of Benefits, 620 Skyline Drive, Jackson, Tennessee 38301-3956 or by calling 731-541-5000.

Funding Policy

The Company has no legal or plan requirements to fund the Plan. The Company has established a policy of funding the end of the Plan year normal cost plus amortization of the unfunded actuarial accrued liability in level dollar amounts over a 30-year period beginning January 1, 2009, up to fully funding the accrued liability using the Projected Unit Credit Cost Method.

Annual Pension Cost and Net Pension Obligation

Current year contributions made to the Plan equaled 99% of the annual pension cost. Contributions made to the Plan in 2005 equaled the annual pension cost plus an additional onetime discretionary contribution of \$6,300,006. Therefore, the net pension obligation had an ending credit balance of \$5,295,698 at June 30, 2012, and \$5,362,145 at June 30, 2011.

The annual required contribution for the fiscal year ending June 30, 2012, was determined as part of the actuarial valuation for the Plan year beginning January 1, 2011, and was determined using the Projected Unit Credit Cost Method with amortization of the unfunded actuarial liability over 29 years. The actuarial assumptions included (a) 7% post-retirement and 7% pre-retirement investment rate of return and (b) a projected salary increase of 5% per year. Both (a) and (b) include an inflation component of 2.5%. Prior to January 1, 2009, the actuarial value of assets

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

9. Retirement Plans (continued)

was equal to the market value of assets reported by First Tennessee Bank and CNA Insurance Company. Effective January 1, 2009, a 5-year smoothing method was adopted prospectively. Investment experience different from expected is recognized on a pro rata basis over a 5-year period. The actuarial value of assets at January 1, 2012 reflects three years of smoothing.

The annual pension cost for the fiscal year ending June 30, 2012, was calculated as follows:

Annual Required Contribution (ARC)	\$ 12,555,768
Interest on Beginning of Year Net Pension Credit	(375,350)
Adjustment to ARC	441,797
Annual Pension Cost (APC)	\$ 12,622,215

The funded status of the defined benefit plan, including three year trend information, was as follows:

Defined Benefit Plan Three-Year Trend Information			
Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Credit)
June 30, 2010	\$ 11,126,262	99%	\$ (5,424,246)
June 30, 2011	11,279,178	99%	(5,362,145)
June 30, 2012	12,622,215	99%	(5,295,698)

Schedule of Funding Progress						
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Total Unfunded AAL (Funding Deficit) (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
January 1, 2010	\$ 168,453,833	\$ 205,375,259	\$ 36,921,426	82%	\$ 159,404,388	23%
January 1, 2011	178,927,625	228,607,365	49,679,740	78%	158,948,315	31%
January 1, 2012	179,550,974	239,688,164	60,137,190	75%	156,334,613	39%

The Company also maintains a defined contribution plan under Section 403(b) of the IRC which provides for voluntary contributions by employees upon employment and matching contributions by the Company after 90 days of service. Substantially all employees of the Company are

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

9. Retirement Plans (continued)

eligible and may contribute up to 100% of their compensation, subject to certain IRC limitations. The Company placed a temporary freeze on the match to the 403(b) plan during the fiscal year ended June 30, 2011 and reinstated the match during the fiscal year ended June 30, 2012. Upon January 1 or July 1 after the completion of 90 days of credited service, for every 1% the employee invests up to 6%, the Company matches 25% of the employee's contribution. The Company recognized expense related to the 403(b) Plan of \$1,626,767 in 2012 and \$0 in 2011.

Supplemental 415(m) Retirement Plan

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

Because the 415 Plan is unfunded, these benefit payments are deemed contributions when paid.

The funded status of the 415 Plan, including three year trend information, was as follows:

Supplemental 415(m) Plan Three-Year Trend Information			
Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2010	\$ 82,180	85%	\$ 254,652
June 30, 2011	84,159	83%	268,854
June 30, 2012	85,842	82%	284,739

Schedule of Funding Progress						
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Total Unfunded AAL (Funding Deficit) (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
July 1, 2010	\$ —	\$ 923,632	\$ 923,632	—%	N/A	—%
July 1, 2011	—	916,816	916,816	—%	N/A	—%
July 1, 2012	—	901,427	901,427	—%	N/A	—%

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

9. Retirement Plans (continued)

Other Post-Employment Benefits

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

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

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

The Annual Required Contribution (ARC) calculated in accordance with GASB 45 for the fiscal years ending June 30, 2012 and 2013, is summarized below.

	ARC Based on a Level Percent of Pay Amortization for Fiscal Year Ending	
	June 30	
	2012	2013
Level Percent of Pay Amortization:		
Medical benefits – projected unit credit	\$ 937,560	\$ 908,366

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

9. Retirement Plans (continued)

GASB 45 does not require funding of OPEB expense, but any differences between the annual expense and the amount funded in a year are recorded in the Company's financial statement as an increase (or decrease) in the net OPEB obligation. The Company elected to fund its OPEB expense and as of June 30, 2012, the fund had net assets in the amount of \$3,034,173 which was comprised primarily of ARC payments, as follows:

ARC for OPEB for Fiscal Year Ending:	
2008	\$ 547,951
2009	337,343
2010	643,116
2011	687,056
2012	589,985
Cumulative earnings on fund	228,722
	<u>\$ 3,034,173</u>

The balance funded by the Company for the fiscal year ended June 30, 2012 was \$589,985, which represents the 2012 ARC of \$937,560 less actual benefit payments of \$347,575.

10. Commitments and Contingencies

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

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

Professional Liability

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

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

10. Commitments and Contingencies (continued)

The District is a “governmental entity” within the meaning of the Tennessee Governmental Tort Liability Act (the Tort Act). As such, its maximum liability for state law tort causes of action is \$300,000 for bodily injury or death of any one person in accident, occurrence, or act, and \$700,000 for bodily injury or death of all persons in any one accident, occurrence, or act. These limits are subject to change by the Tennessee Legislature. Prior to July 1, 2002, the Tennessee Governmental Tort Liability limited local government tort liability to \$130,000 for individual injury or death in any one occurrence and \$350,000 for injury or death of all persons in any one occurrence.

Investment earnings on contingency fund assets were \$143,037 and \$115,516 for the years ended June 30, 2012 and 2011, respectively, and are included in investment income in the accompanying consolidated statements of revenues and expenses and changes in net assets.

The Company’s accrual for self-insured professional liability risks was \$4,000,000 at June 30, 2012 and 2011, and was based on asserted claims for occurrences prior to that date. The Company does not accrue for unasserted claims or occurrences. In the opinion of management, any liability for such unasserted claims or occurrences would not materially affect the financial position of the Company.

Workers’ Compensation

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

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

10. Commitments and Contingencies (continued)

Employee Health

The Company is self-insured with respect to employee health insurance. Estimates of health insurance claims incurred but unpaid as of June 30, 2012 and 2011, are accrued based on estimates that incorporate the Company's past experience, as well as other considerations including the nature of claims and relevant trends. The Company had accrued a liability for incurred but unpaid claims of approximately \$10,445,233, and \$9,630,758, as of June 30, 2012 and 2011, respectively, which is included in other accrued expenses in the accompanying consolidated balance sheets. The expenses related to claims paid during the years ended June 30, 2012 and 2011, are \$32,557,260 and \$30,362,379, respectively, and are included in salaries and benefits expense.

Litigation

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

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

11. Obligated Group

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

	June 30	
	2012	2011
Assets		
Current assets	\$ 119,658,927	\$ 127,660,747
Property, plant, and equipment, net	367,364,503	373,479,937
Other assets	306,124,351	286,641,705
	\$ 793,147,781	\$ 787,782,389
Liabilities and net assets		
Current liabilities	\$ 28,182,267	\$ 33,282,074
Long-term debt	287,514,481	291,331,021
Net assets:		
Unrestricted net assets	359,167,348	337,169,739
Invested in capital assets, net of related financing	96,223,683	98,880,546
Restricted net assets	22,060,002	27,119,009
	477,451,033	463,169,294
	\$ 793,147,781	\$ 787,782,389

West Tennessee Healthcare and Related Affiliates

Notes to Consolidated Financial Statements (continued)

11. Obligated Group (continued)

	Year Ended June 30	
	2012	2011
Net patient service revenues	\$ 475,965,470	\$ 488,142,439
Other operating revenues	24,770,813	19,808,234
Total revenues	500,736,283	507,950,673
Operating expenses	423,324,204	431,108,794
Depreciation	45,788,373	45,903,606
Total expenses	469,112,577	477,012,400
Income from operations	31,623,706	30,938,273
Net nonoperating gains	2,719,959	25,585,451
Interest expense	(17,853,610)	(18,114,097)
Income before capital contributions and transfers	16,490,055	38,409,627
Contributions	(2,208,316)	(931,300)
Increase in net assets	14,281,739	37,478,327
Net assets, beginning of year	463,169,294	425,690,968
Net assets, end of year	\$ 477,451,033	\$ 463,169,295
Net cash provided by (used in):		
Operating activities	\$ 60,423,547	\$ 64,512,877
Noncapital financing activities	(2,208,316)	(931,300)
Capital and related financing activities	(60,745,363)	(52,838,720)
Investing activities	2,461,950	594,323
Net (decrease) increase in cash and cash equivalents	(68,182)	11,337,180
Cash and cash equivalents, beginning of year	24,393,728	13,056,548
Cash and cash equivalents, end of year	\$ 24,325,546	\$ 24,393,728

Required Supplemental Information

West Tennessee Healthcare and Related Affiliates

Defined Benefit Retirement Plan
Schedule of Employer Contributions (Unaudited)

(a)

Year Ended December 31	Fiscal Year Ending	Annual Required Contribution	Actual Contribution	Percentage Contributed
2004	June 30, 2005	\$ 7,024,158	\$ 13,324,164	190%
2005	June 30, 2006	10,851,226	10,851,240	100%
2006	June 30, 2007	10,928,116	10,928,124	100%
2007	June 30, 2008	11,254,451	11,182,451	99%
2008	June 30, 2009	10,937,013	10,937,016	100%
2009	June 30, 2010	11,068,225	11,068,225	100%
2010	June 30, 2011	11,217,077	11,217,077	100%
2011	June 30, 2012	12,555,768	12,555,768	100%

(a) The actuarially determined contribution requirements for the Company's fiscal year ended June 30, 2012, are based on actuarial valuations as of January 1, 2011.

West Tennessee Healthcare and Related Affiliates

Defined Benefit Retirement Plan
 Schedule of Funding Progress (Unaudited)

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Total Unfunded AAL (Funding Deficit) (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as % of Covered Payroll
January 1, 2010	\$ 168,453,833	\$ 205,375,259	\$ 36,921,426	82%	\$ 159,404,388	23%
January 1, 2011	178,927,625	228,607,365	49,679,740	78%	158,948,315	31%
January 1, 2012	179,550,974	239,688,164	60,137,190	75%	156,334,613	39%

West Tennessee Healthcare and Related Affiliates

Postemployment Benefits Other Than
Pensions Schedule of Funding Progress (Unaudited)

Supplemental 415(m) Plan – Schedule of Funding Progress							
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Total Unfunded AAL (Funding Deficit) (UAAL)	Funded Ratio	Annual Covered Payroll	UAAL as % of Covered Payroll	
July 1, 2010	\$ –	\$ 923,632	\$ 923,632	–%	NA	–%	
July 1, 2011	–	916,816	916,816	–%	NA	–%	
July 1, 2012	–	901,427	901,427	–%	NA	–%	

Grant Compliance

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

The Board of Trustees
Bobby Arnold, Chief Executive Officer
Jeff Blankenship, Chief Financial Officer
West Tennessee Healthcare and Related Affiliates

We have audited the financial statements of West Tennessee Healthcare and Related Affiliates (the Company) as of and for the year ended June 30, 2012, and have issued our report thereon dated October 31, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal control over financial reporting

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

A deficiency in internal control 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and other matters

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

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

Ernst + Young LLP

October 31, 2012

Report of Independent Auditors on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

The Board of Trustees
Bobby Arnold, Chief Executive Officer
Jeff Blankenship, Chief Financial Officer
West Tennessee Healthcare and Related Affiliates

Compliance

We have audited West Tennessee Healthcare and Related Affiliates' (the Company)'s compliance with the types of compliance requirements described in the US Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on the Company's major federal program for the year ended June 30, 2012. The Company's major federal program is 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 its major federal program is the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's compliance based on our audit.

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

In our opinion, the Company complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended June 30, 2012.

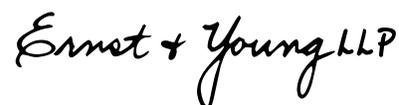
Internal control over compliance

The management of the Company is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Company's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

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

A handwritten signature in black ink that reads 'Ernst & Young LLP'.

December 28, 2012

West Tennessee Healthcare and Related Affiliates

Schedule of Expenditures of Federal Awards and
State Financial Assistance

For the Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program Name	CFDA #	Contract Number	Expenditures
Federal Awards			
US Department of Education			
Tennessee Dept of Education			
Special Education – Grants for Infants and Families	84.181	DG12-C000007	\$ 76,180
Total US Department of Education			<u>76,180</u>
US Department of Health and Human Services			
Tennessee Department of Human Services			
Pass-through from Signal Centers, Inc.			
Child Care and Development Block Grant	93.575	N/A	266,416
Tennessee Department of Mental Health			
Division of Alcohol and Drug Abuse Services			
Block Grants for Prevention and Treatment of Substance Abuse	93.959	GG1236250	578,092
	93.959	GG1236248	199,686
	93.959	GG1236593	79,308
	93.959	GG1235746	248,160
			<u>1,105,246</u>
Block Grants for Community Mental Health Services	93.958	GG1236265	119,956
	93.958	GG1236264	35,405
	93.958	GG1236392	26,400
			<u>181,761</u>
Substance Abuse and Mental Health Services			
Projects of Regional and National Significance	93.243	GG1236269	2,300
Substance Abuse and Mental Health Services			
Projects for Assistance in Transition from Homelessness (PATH)	93.150	GG1236266	58,500
Tennessee Department of Health			
Maternal and Child Health Services Block Grant to the States	93.994	GG1235555	10,700
Small Rural Hospital Improvement Grant Program	93.301	GG1236494	44,500
The Affordable Care Act: Center for Disease Contraol and Prevention			
Investigations and Technical Assistance	93.283	GG1236492	35,748
National Bioterrorism Hospital Preparedness Program	93.889	GG1236304	212,788
	93.889	GG1236569	20,000
	93.889	GG1236570	20,000
	93.889	GG1236498	20,079
	93.889	GG1236499	20,050
	93.889	GG1236568	20,000
			<u>312,917</u>
Total US Department of Health and Human Services			<u>2,018,088</u>
Total Federal Awards			<u>\$ 2,094,268</u>

West Tennessee Healthcare and Related Affiliates

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

Federal Grantor/Pass-Through Grantor/Program Name	Contract Number	Expenditures
State Financial Assistance		
Tennessee Department of Education		
Provision of Part C of IDEA early intervention services to children birth to three years with disabilities and their families	DG12-C000007	\$ 500,000
Total Tennessee Department of Education		<u>500,000</u>
Tennessee Department of Health		
Healthy Start Program for Chester, Crockett and Madison Counties	GG1235555	286,300
Provision of Health Care Safety Net Primary Care Services for Uninsured Adult Tennesseans Ages 19-64	GG1236922	51,825
Service Coordination for TBI Survivors and Families	GG1235994	52,000
Total Tennessee Department of Health		<u>390,125</u>
Tennessee Department of Mental Health		
Adult and Juvenile Court-Ordered Forensic Evaluations	GG1235737	183,100
Adult Continuum of Care Program	GG1236249	203,466
Adult Mobile Crisis	GG1235736	194,203
Behavioral Health Safety Net Services	GG1236252	1,498,408
Children and Youth Homeless Outreach Program	GG1236268	35,883
Community Supportive Housing	GG1236251	32,450
Criminal Justice/Behavioral Health Liaison Project	GG1236593	20,000
Crisis Stabilization Unit/Walk-in Center	GG1236263	1,073,621
Inpatient Targeted Transitional Support	GG1236262	52,500
Medically Managed Inpatient Detoxification Program	GG1236247	200,000
Peer Support Centers, Peer Support Transportation, & My Health, My Choice, My Life	GG1236269	309,131
Projects for Assistance in the Transition from Homelessness	GG1236266	35,242
School Based Liaison For At-Risk Youth Program	GG1236392	103,600
Total Tennessee Department of Mental Health		<u>3,941,604</u>
Total State Awards		<u>4,831,729</u>
Total Federal and State Awards		<u>\$ 6,925,997</u>

West Tennessee Healthcare and Related Affiliates

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

June 30, 2012

1. Basis of Presentation

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

2. Contingencies

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

West Tennessee Healthcare

Schedule of Findings and Questioned Costs

For the year ended June 30, 2012

Part I—Summary of auditor’s results

Financial statements section

Type of auditor’s report issued (unqualified, qualified, adverse or disclaimer):

Unqualified

Internal control over financial reporting:

Material weakness(es) identified?

_____ **Yes** **X** **No**

Significant deficiency(ies) identified?

_____ **Yes** **X** **None reported**

Noncompliance material to financial statements noted?

_____ **Yes** **X** **No**

Federal awards section

Internal control over major programs:

Material weakness(es) identified?

_____ **Yes** **X** **No**

Significant deficiency(ies) identified?

_____ **Yes** **X** **None reported**

Type of auditor’s report issued on compliance for major programs (unqualified, qualified, adverse or disclaimer):

Unqualified

Any audit findings disclosed that are required to be reported in accordance with section .510(a) of OMB Circular A-133?

_____ **Yes** **X** **No**

West Tennessee Healthcare

Schedule of Findings and Questioned Costs (continued)

Identification of major programs:

<u>CFDA number(s)</u>	<u>Name of federal program or cluster</u>
93.959	Block Grants for Prevention and Treatment of Substance Abuse
Dollar threshold used to distinguish between Type A and Type B programs:	\$ 300,000
Auditee qualified as low-risk auditee?	<u> X </u> Yes _____ No

Part II—Financial statement findings section

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

No findings required to be reported.

Part III—Federal award findings and questioned costs section

This section identifies the audit findings required to be reported by Circular A-133 section .510(a) (for example, material weaknesses, significant deficiencies 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.

No findings required to be reported.

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