

Annual Financial Report

Blount Memorial  
Hospital, Inc.

*Years ended June 30, 2012 and 2011  
with Report of Independent Auditors*

Blount Memorial Hospital, Inc.  
Annual Financial Report  
Years ended June 30, 2012 and 2011

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## Report of Independent Auditors

Board of Directors  
Blount Memorial Hospital, Inc.

We have audited the accompanying statements of net position of Blount Memorial Hospital, Inc. (the "Hospital"), a component unit of the County of Blount, Tennessee, as of June 30, 2012 and 2011, and the statements of revenues, expenses and changes in net position, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of Blount Memorial Hospital, Inc. as of June 30, 2012 and 2011, and the changes in its net position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 14, 2012 on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions, laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

Board of Directors  
Blount Memorial Hospital, Inc.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 of America, 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 financial statements, and other knowledge we obtained during our audit of the 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.

The List of Officials on page 25, which is of a nonaccounting nature, has not been subjected to the auditing procedures applied in the audit of the financial statements, and we express no opinion on it.

*Coulter & Justus, P.C.*

September 14, 2012

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

This section of Blount Memorial Hospital, Inc.'s annual financial report presents management's discussion and analysis of the Hospital's financial performance during the fiscal years ended June 30, 2012 and 2011. The information contained herein should be considered in conjunction with the Hospital's accompanying financial statements. Unless otherwise indicated, amounts are in thousands.

**Overview of the Financial Statements**

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

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

**Financial Highlights**

Condensed financial information as of and for the years June 30, 2012, 2011, and 2010 is provided in the tables below.

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Assets:			
Current assets	<b>\$ 28,186</b>	\$ 28,901	\$ 31,369
Assets limited as to use	<b>156,989</b>	160,478	152,694
Capital assets	<b>100,858</b>	102,605	104,647
Other	<b>5,828</b>	5,967	5,858
Total assets	<b><u>\$291,861</u></b>	<u>\$297,951</u>	<u>\$294,568</u>
Deferred outflows of resources--accumulated decrease in fair value of interest rate swaps	<b><u>\$ 15,845</u></b>	<u>\$ 7,497</u>	<u>\$ 10,281</u>
Liabilities:			
Current liabilities	<b>\$ 21,581</b>	\$ 21,501	\$ 20,647
Bonds payable, net of unamortized loss on refunding	<b>111,547</b>	107,034	113,462
Interest rate swap liabilities	<b>95,702</b>	99,537	103,181
Total liabilities	<b><u>15,845</u></b>	<u>7,497</u>	<u>10,281</u>
Net position:			
Invested in capital assets, net of related debt	<b>\$ 6,519</b>	\$ 4,517	\$ 2,973
Restricted	<b>860</b>	861	750
Unrestricted	<b>167,199</b>	171,535	167,017
Total net position	<b><u>\$174,578</u></b>	<u>\$176,913</u>	<u>\$170,740</u>

Blount Memorial Hospital, Inc.

Management's Discussion and Analysis (continued)

**Financial Highlights (continued)**

	<b>2012</b>	<b>2011</b>	<b>2010</b>
Changes in net position:			
Operating revenues	<b>\$182,670</b>	\$183,461	\$189,679
Operating expenses	<b>188,029</b>	190,379	187,495
Operating (loss) income	<b>(5,359)</b>	(6,918)	2,184
Nonoperating income	<b>3,024</b>	13,091	13,938
Excess of (expenses over revenues) revenues over expenses	<b>\$ (2,335)</b>	\$ 6,173	\$ 16,122

*Net Position*

Overall, the Hospital's net position decreased in 2012 due to the \$2,871 decrease in the fair value of investments. The Hospital's net position increased in 2011 from 2010 due to nonoperating investment income, including an increase in the fair value of investments of \$3,517. The changes in fair value also resulted in the corresponding changes in assets limited as to use in 2012 and 2011.

Property and equipment additions as well as debt repayments increased the amounts classified as invested in capital assets, net of related debt, at June 30, 2012 and 2011.

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

## Blount Memorial Hospital, Inc.

### Management's Discussion and Analysis (continued)

#### Financial Highlights (continued)

##### *Results of Operations*

Operating revenues and expenses are as follows for the years ended June 30, 2012, 2011 and 2010.

	2012	Relative %	2011	Relative %	2010	Relative %
Net patient service revenues	<b>\$167,086</b>	<b>91%</b>	\$169,452	92%	\$176,417	93%
Other revenues	<b>15,584</b>	<b>9%</b>	14,009	8%	13,262	7%
Total operating revenues	<b>\$182,670</b>	<b>100%</b>	\$183,461	100%	\$189,679	100%
Salaries and wages	<b>\$ 84,661</b>	<b>45%</b>	\$ 84,075	44%	\$ 82,737	44%
Employee benefits	<b>23,673</b>	<b>13%</b>	24,401	13%	22,979	12%
Contract salaries	<b>1,207</b>	<b>1%</b>	1,459	1%	1,403	1%
Professional fees	<b>3,645</b>	<b>2%</b>	5,817	3%	5,503	3%
Patient supplies	<b>28,925</b>	<b>15%</b>	28,795	15%	29,453	16%
Purchased maintenance	<b>7,729</b>	<b>4%</b>	7,174	4%	6,150	3%
Outside services	<b>5,945</b>	<b>3%</b>	5,520	3%	5,655	3%
Equipment rental	<b>2,879</b>	<b>2%</b>	2,758	1%	2,570	1%
Utilities	<b>4,463</b>	<b>2%</b>	4,427	2%	3,999	2%
Marketing	<b>640</b>	<b>0%</b>	638	0%	727	1%
Depreciation	<b>11,236</b>	<b>6%</b>	12,459	7%	13,276	7%
Interest	<b>3,762</b>	<b>2%</b>	3,655	2%	3,416	2%
Other expenses	<b>9,263</b>	<b>5%</b>	9,201	5%	9,627	5%
Total operating expenses	<b>\$188,028</b>	<b>100%</b>	\$190,379	100%	\$187,495	100%

Changes in patient volumes have resulted in declines in net patient service revenue of 1% from 2011 to 2012, and 4% from 2010 to 2011. Hospital fees and rates have increased each year but a significant portion of the price increases are not reimbursed by the Hospital's largest third party payors such as Medicare and TennCare. Overall, operating expenses have decreased 1% in 2012, as compared to a 2% increase in 2011.

Interest costs in 2012 are comparable to 2011 and 2010 as a result of overall market conditions with variable interest rates.

##### *Other Changes in Net Position*

The Hospital experienced net investment income of \$1,987 in 2012 and \$12,273 in 2011. Net investment income includes a decrease in interest and dividends as well as changes in fair value of investments (depreciation of \$2,871 in 2012 and appreciation of \$3,517 in 2011). The changes in fair value of investments in both years were due to the changes in the market value of investments.

## Blount Memorial Hospital, Inc.

### Management's Discussion and Analysis (continued)

#### **Capital Acquisitions and Construction Activities**

Note 6 to the financial statements summarizes property and equipment by class and changes for the years ended June 30, 2012 and 2011. Additional information regarding accounting policies for capital assets is provided in Note 1 to the financial statements.

Total additions to property and equipment were \$9,351 in 2012 and \$10,519 in 2011. Additions in 2012 and 2011 include software and equipment related to the new clinical documentation project, replacement of certain roofs due to storm damage, and routine upgrades and improvements. Construction in progress at June 30, 2012 consists primarily of additional purchases related to the clinical documentation project.

#### **Long-Term Debt Activity**

Principal payments on the 1998 bond issues were \$2,270 and \$2,165 for 2012 and 2011, respectively. The balances outstanding at June 30, 2012 and 2011 were \$9,885 and \$12,155, respectively. The outstanding 1998 bonds bear interest at fixed rates ranging from 4.6% to 5.15%.

The Series E-5-A bonds bear interest at a variable rate. Bonds totaling \$25,000 are subject to an interest rate swap agreement which fixes the rate at 4.9%. An additional portion of the bonds totaling \$30,700 are subject to an interest rate swap agreement which fixes the rate at 4.33%. The balance outstanding at June 30, 2012 and 2011 was \$90,705 and \$92,210, respectively. Principal payments totaled \$1,505 on the series E-5-A bonds during 2012 and \$1,455 in 2011.

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

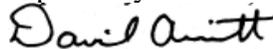
#### **Subsequent Event**

As described in Note 10, the Hospital has reached a tentative agreement to acquire East Tennessee Medical Group for an estimated \$24,300,000.

#### **Requests for Information**

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

Respectfully submitted,



David Avriett

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

Blount Memorial Hospital, Inc.

Statements of Net Position

	<b>June 30</b>	
	<b>2012</b>	<b>2011</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 4,480,033	\$ 4,680,383
Patient accounts receivable, less allowances for uncollectible accounts of \$5,300,614 in 2012 and \$5,319,288 in 2011	15,739,211	16,463,577
Inventories	2,859,139	2,836,711
Prepaid expenses	2,473,137	2,348,462
Funds held by trustee restricted to payment of current liabilities	2,633,977	2,572,140
Total current assets	<u>28,185,497</u>	<u>28,901,273</u>
Assets limited as to use:		
By Board	152,332,133	155,657,552
Foundation	1,298,394	1,309,172
Other investments--held by trustee	464,536	617,850
Under bond agreements--held by trustee	5,528,180	5,465,956
Less funds held by trustee restricted to payment of current liabilities	(2,633,977)	(2,572,140)
	<u>156,989,266</u>	<u>160,478,390</u>
Property and equipment, net	100,858,134	102,604,584
Deferred debt expense	723,166	811,917
Other assets	5,104,480	5,154,480
Total assets	<u>291,860,543</u>	<u>297,950,644</u>
<b>Deferred outflows of resources</b>		
Accumulated decrease in fair value of interest rate swaps	15,845,194	7,497,287
Total assets and deferred outflows of resources	<u>\$ 307,705,737</u>	<u>\$ 305,447,931</u>

Blount Memorial Hospital, Inc.

Statements of Net Position (continued)

	June 30	
	2012	2011
<b>Liabilities and net position</b>		
Current liabilities:		
Accounts payable	\$ 3,470,321	\$ 4,322,718
Accrued compensation, benefits and withholdings	9,435,623	9,015,968
Other accrued expenses	3,224,228	2,799,095
Estimated third party payor settlements	1,046,649	1,119,141
Accrued interest payable	438,871	469,008
Current portion of bonds payable	3,965,000	3,775,000
Total current liabilities	<u>21,580,692</u>	21,500,930
Bonds payable, net of unamortized loss on refunding	95,701,725	99,536,357
Interest rate swap liabilities	15,845,194	7,497,287
Total liabilities	<u>133,127,611</u>	128,534,574
Net position:		
Invested in capital assets, net of related debt	6,519,479	4,517,457
Restricted--nonexpendable	859,773	861,315
Unrestricted	167,198,874	171,534,585
Total net position	<u>174,578,126</u>	176,913,357
Total liabilities and net position	<u><u>\$ 307,705,737</u></u>	<u><u>\$ 305,447,931</u></u>

See accompanying Notes to Financial Statements.

Blount Memorial Hospital, Inc.

Statements of Revenues, Expenses and Changes in Net Position

	<b>Year ended June 30</b>	
	<b>2012</b>	<b>2011</b>
Operative revenues:		
Net patient service revenue	\$ 167,085,932	\$ 169,452,018
Other revenue	<b>15,583,759</b>	14,008,564
Total operating revenues	<b>182,669,691</b>	183,460,582
Operating expenses:		
Salaries and wages	<b>84,662,302</b>	84,075,103
Employee benefits	<b>23,673,204</b>	24,401,017
Contract salaries	<b>1,206,629</b>	1,459,201
Professional fees	<b>3,645,531</b>	5,817,219
Patient supplies	<b>28,925,189</b>	28,794,872
Purchased maintenance	<b>7,728,669</b>	7,174,043
Outside services	<b>5,944,611</b>	5,519,554
Equipment rental	<b>2,878,719</b>	2,758,186
Utilities	<b>4,462,899</b>	4,427,385
Marketing	<b>640,082</b>	638,441
Depreciation and amortization	<b>11,235,807</b>	12,458,571
Interest	<b>3,762,252</b>	3,654,506
Other expenses	<b>9,262,903</b>	9,200,461
Total operating expenses	<b>188,028,797</b>	190,378,559
Operating loss	<b>(5,359,106)</b>	(6,917,977)
Nonoperating revenues:		
Investment income	<b>1,986,978</b>	12,273,324
Contributions and other	<b>1,036,897</b>	818,106
Total nonoperating revenues	<b>3,023,875</b>	13,091,430
Excess of (expenses over revenue) revenues over expenses	<b>(2,335,231)</b>	6,173,453
Net position at beginning of year	<b>176,913,357</b>	170,739,904
Net position at end of year	<b>\$ 174,578,126</b>	<b>\$ 176,913,357</b>

*See accompanying Notes to Financial Statements.*

Blount Memorial Hospital, Inc.

Statements of Cash Flows

	<b>Year ended June 30</b>	
	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities</b>		
Receipts from and on behalf of patients	\$ 183,321,565	\$ 183,167,947
Payments to employees for services	(85,154,829)	(83,765,617)
Payments to suppliers and contractors	(87,396,307)	(90,510,892)
Net cash provided by operating activities	<u>10,770,429</u>	8,891,438
<b>Cash flows from noncapital financing activities</b>		
Contributions and other	1,036,897	818,106
<b>Cash flows from capital and related financing activities</b>		
Additions to property and equipment	(9,984,920)	(10,959,284)
Repayments of long-term debt	(3,775,000)	(3,620,000)
Interest paid on long-term debt	(3,662,021)	(3,550,154)
Net cash used in capital and related financing activities	<u>(17,421,941)</u>	(18,129,438)
<b>Cash flows from investing activities</b>		
Interest and dividends	4,857,988	8,756,743
Investment in affiliates	-	(246,757)
Net sale (purchases) of investment securities designated as assets limited as to use	<u>249,746</u>	(4,114,102)
Net cash provided by investing activities	<u>5,107,734</u>	4,395,884
Net decrease in cash and cash equivalents	(506,881)	(4,024,010)
Cash and cash equivalents at beginning of year	10,989,179	15,013,189
Cash and cash equivalents at end of year	<u>\$ 10,482,298</u>	<u>\$ 10,989,179</u>
<b>Reconciliation of cash and cash equivalents to the statements of net position</b>		
Cash and cash equivalents in current assets	\$ 4,480,033	\$ 4,680,383
Cash and cash equivalents included in assets limited as to use	<u>6,002,265</u>	6,308,796
Total cash and cash equivalents	<u>\$ 10,482,298</u>	<u>\$ 10,989,179</u>

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

	<b>Year ended June 30</b>	
	<b>2012</b>	<b>2011</b>
<b>Reconciliation of operating loss to net cash provided by operating activities</b>		
Operating loss	\$ (5,359,106)	\$ (6,917,977)
Adjustments to reconcile to net cash flows provided by operating activities:		
Depreciation and amortization	11,235,807	12,458,571
Amortization of loss of bond refunding	130,368	130,359
Interest payments	3,662,021	3,550,154
Changes in operating assets and liabilities:		
Net patient accounts receivable	724,366	(525,954)
Inventories and prepaid expenses	(147,103)	(1,183,797)
Accounts payable, other accrued expenses and interest	176,913	526,066
Accrued compensation, benefits and withholdings	419,655	620,697
Estimated third party payor settlements	(72,492)	233,319
Net cash provided by operating activities	\$ 10,770,429	\$ 8,891,438

**Noncash investing, capital and financing activities**

At June 30, 2012 and 2011, accounts payable and accrued expenses include \$193,605 and \$827,919 respectively, for property and other capital additions.

Investment income includes a decrease of \$2,871,010 in 2012 and an increase of \$3,516,581 in 2011 to reflect the net change in fair value of investments during each year.

*See accompanying Notes to Financial Statements.*

# Blount Memorial Hospital, Inc.

## Notes to Financial Statements

June 30, 2012

### 1. Description of Reporting Entity and Significant Accounting Policies

#### Reporting Entity

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

The Hospital uses enterprise fund accounting and is included as a discretely presented component unit in the financial statements of the County.

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

#### Basis of Presentation

The Hospital's financial statements are presented on the accrual basis of accounting in accordance with Governmental Accounting Standards Board ("GASB"), which establishes standards for external financial reporting for all state and local governmental entities. GASB requires the classification of net position into three components which are defined as follows:

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

Restricted - This component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.

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

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

**Basis of Presentation (continued)**

Unrestricted - This component of net position consists of the net amounts of assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination invested in capital assets, net of related debt or restricted components of net position.

**Affiliate Entities**

Other assets include the Hospital's \$2,040,000 investment in a general partnership which operates a medical facility in Blount County, as well as approximately \$2,900,000 related to the acquisition of a rehabilitation clinic in 2009. The Hospital also has ownership interests in other entities which are involved in activities related to the Hospital's mission of providing healthcare services. The Hospital has not included these entities or presented summarized disclosures in its financial statements due to the relative insignificance of the financial activities of these entities.

**Cash and Cash Equivalents**

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

**Inventories**

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

**Investments**

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

The Hospital diversifies its investments into a broad range of asset classes in order to reduce concentration risk and to maximize return with reasonable and prudent levels of risk. It is also the Hospital's policy to limit the maximum position for each type of investment at varying levels within these classifications. As of June 30, 2012, the Hospital's fixed income investments all have quality ratings of A+ or better (by both Standard & Poor's and Moody's Investors Service).

To limit its exposure to fair value losses arising from changing interest rates, the Hospital's investment policy restricts the type and maturities of fixed income investments in order to increase the overall investment horizon. The current duration of the Hospital's fixed income investments ranges up to approximately 8 years with an average duration of 5 years, based on timing of interest payments, maturity dates, and expectations of minimal interest rate changes.

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

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

**Assets Limited as to Use by Board and Foundation**

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

**Property and Equipment**

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

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

**Deferred Debt Expense**

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

**Accrual for Compensated Absences**

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

**Operating Revenues and Expenses**

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

**Income Taxes**

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

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

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

**Charity Care**

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

**Patient Service Revenue**

Patient service revenue is reported in the period in which services are provided, at rates which reflect the amount expected to be collected. Net patient service revenue includes amounts estimated by management to be reimbursable by third party payors under provisions of reimbursement formulas in effect and is net of the provision for bad debts.

**Risk Management**

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

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of: assets and liabilities; net position; disclosures of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

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

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

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

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

	June 30 2012	%	June 30 2011	%
U.S. Treasury Portfolio (cash equivalents)	\$ 5,725,709	4%	\$ 6,031,833	4%
U.S. Government Agency Securities	12,934,081	8%	11,181,446	7%
Municipal bonds	6,633,375	4%	3,527,150	2%
Corporate bonds	23,743,796	15%	26,729,275	16%
Bond mutual funds	72,205,133	46%	83,682,088	52%
Equity mutual funds	37,082,755	23%	30,589,566	19%
	<b>\$ 158,324,849</b>	<b>100%</b>	<b>\$ 161,741,358</b>	<b>100%</b>

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

	June 30 2012	June 30 2011
Cash	\$ 63,515	\$ 89,022
U.S. Treasury Portfolio (cash equivalents)	213,041	187,941
Bond mutual funds	452,883	446,553
Equity mutual funds	568,955	585,656
	<b>\$ 1,298,394</b>	<b>\$ 1,309,172</b>

**3. Net Patient Service Revenue**

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the Statements of Revenues, Expenses and Changes in Net Position is as follows:

	Year ended June 30 2012	Year ended June 30 2011
Gross patient service charges	\$ 622,573,918	\$ 601,570,242
Contractual adjustments and discounts	(412,761,549)	(388,214,805)
Charity care charges foregone	(34,740,234)	(36,136,600)
Provision for bad debts	(7,986,203)	(7,766,819)
Net patient service revenue	<b>\$ 167,085,932</b>	<b>\$ 169,452,018</b>

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

**4. Third Party Payor Agreements**

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

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

Contractual adjustments for Medicare, TennCare and other third party discount arrangements are recognized when the related revenues are reported in the financial statements. The percentage of gross patient charges from the Medicare and TennCare programs was approximately 34% and 11%, respectively, for 2012 and 34% and 12%, respectively, in 2011.

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

**5. Malpractice Trust Fund and Employee Group Health Claims**

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

The Hospital provides professional liability coverage through a self-insurance malpractice trust fund. Under the trust agreement, the trust assets can only be used for payment of malpractice losses, related expenses, and the cost of administering the trust. The assets of, and contributions to, the trust are reported in the Statements of Net Position; income from the trust assets, claims and administrative costs are reported in the Statements of Revenues, Expenses and Changes in Net Position.

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

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

Claims and expenses of \$173,773 and \$257,538 were paid from the fund during the years ended June 30, 2012 and 2011, respectively. At June 30, 2012, the Hospital is involved in medical malpractice litigation in which management of the Hospital, after consultation with legal counsel, is of the opinion that liability, if any, related to these claims would not be material to the financial statements. No amounts are accrued for potential losses related to unreported incidents or reported incidents which have not yet resulted in asserted claims as the Hospital is not able to estimate such amounts.

The Hospital is self-insured for employee (and dependent) group health claims and records a liability for claims known but unpaid and estimated claims incurred but not reported. The liability for employee group health claims was \$1,546,438 and \$1,498,214 at June 30, 2012 and 2011, respectively. The total expense related to employee group health claims (net of employee paid premiums) was approximately \$12,952,000 and \$12,858,000 for 2012 and 2011, respectively.

**6. Property and Equipment**

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

	<b>Balance July 1, 2011</b>	<b>Additions</b>	<b>Retirements and Transfers</b>	<b>Balance June 30, 2012</b>
Cost:				
Land	\$ 9,494,550	\$ 99,875	\$ -	\$ 9,594,425
Land improvements	2,382,783	-	-	2,382,783
Buildings, improvements, and fixed equipment	134,994,404	1,255,465	-	136,249,869
Equipment	86,779,744	3,593,827	(27,640)	90,345,931
Construction in progress	9,026,917	5,155,825	(754,386)	13,428,356
Total cost	<u>242,678,398</u>	<u>10,104,992</u>	<u>(782,026)</u>	<u>252,001,364</u>
Allowances for depreciation:				
Land improvements	(2,214,888)	(54,167)	-	(2,269,055)
Buildings, improvements, and fixed equipment	(68,047,647)	(5,257,045)	-	(73,304,692)
Equipment	(69,811,279)	(5,785,844)	27,640	(75,569,483)
Total allowances	<u>(140,073,814)</u>	<u>(11,097,056)</u>	<u>27,640</u>	<u>(151,143,230)</u>
Net property and equipment	<u>\$102,604,584</u>	<u>\$ (992,064)</u>	<u>\$ (754,386)</u>	<u>\$100,858,134</u>

Construction in progress at June 30, 2012 consists primarily of costs related to the clinical documentation project, pharmacy expansion, patient waiting area, and a special procedure room for the catheterization laboratory, with total estimated costs to complete of approximately \$11,500,000.

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

**6. Property and Equipment (continued)**

	<b>Balance July 1, 2010</b>	<b>Additions</b>	<b>Retirements and Transfers</b>	<b>Balance June 30, 2011</b>
Cost:				
Land	\$ 9,212,081	\$ 282,469	\$ –	\$ 9,494,550
Land improvements	2,382,783	–	–	2,382,783
Buildings, improvements, and fixed equipment	133,459,385	1,656,969	(121,950)	134,994,404
Equipment	89,676,598	4,610,983	(7,507,837)	86,779,744
Construction in progress	5,058,658	5,617,490	(1,649,231)	9,026,917
Total cost	<u>239,789,505</u>	<u>12,167,911</u>	<u>(9,279,018)</u>	<u>242,678,398</u>
Allowances for depreciation:				
Land improvements	(2,146,281)	(68,607)	–	(2,214,888)
Buildings, improvements, and fixed equipment	(62,572,025)	(5,597,044)	121,422	(68,047,647)
Equipment	(70,424,651)	(6,654,164)	7,267,536	(69,811,279)
Total allowances	<u>(135,142,957)</u>	<u>(12,319,815)</u>	<u>7,388,958</u>	<u>(140,073,814)</u>
Net property and equipment	<u>\$104,646,548</u>	<u>\$ (151,904)</u>	<u>\$(1,890,060)</u>	<u>\$102,604,584</u>

**7. Long-term Debt**

Changes in long-term debt are summarized as follows:

	<b>Balance July 1, 2011</b>	<b>Principal Payments</b>	<b>Balance June 30, 2012</b>
Series 1998A Bonds	\$ 2,960,000	\$ 1,445,000	\$ 1,515,000
Series 1998B Bonds	9,195,000	825,000	8,370,000
Series E-5-A Bonds	92,210,000	1,505,000	90,705,000
Total outstanding	<u>104,365,000</u>	<u>3,775,000</u>	<u>100,590,000</u>
Less current portion	(3,775,000)		(3,965,000)
Less unamortized loss on bond refunding	(1,053,643)		(923,275)
Long-term portion	<u>\$ 99,536,357</u>		<u>\$ 95,701,725</u>

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

**7. Long-term Debt (continued)**

	<b>Balance July 1, 2010</b>	<b>Principal Payments</b>	<b>Balance June 30, 2011</b>
Series 1998A Bonds	\$ 4,340,000	\$1,380,000	\$ 2,960,000
Series 1998B Bonds	9,980,000	785,000	9,195,000
Series E-5-A Bonds	93,665,000	1,455,000	92,210,000
Total outstanding	<u>107,985,000</u>	<u>3,620,000</u>	104,365,000
Less current portion	(3,620,000)		(3,775,000)
Less unamortized loss on bond refunding	(1,184,002)		(1,053,643)
Long-term portion	<u>\$103,180,998</u>		<u>\$ 99,536,357</u>

In December 1998, Blount County issued, on behalf of the Hospital, \$15,420,000 of Hospital Revenue Refunding Bonds, Series 1998A and \$16,000,000 of Hospital Revenue Improvement Bonds, Series 1998B. The Series 1998A Bonds provided the funds necessary to refund the previously issued Blount County Hospital Revenue Bonds. The Hospital computed a loss on the refunding in 1999 of \$959,455 which was deferred and is being amortized over the life of the refunded debt (\$71,070 in 2012 and 2011). The proceeds of the Series 1998B Bonds provided funds for the Hospital's facilities and equipment.

The Series 1998A Bonds mature with a final payment of \$1,515,000 in fiscal year 2013 and have an interest rate of 4.60%. The Series 1998B Bonds mature in increasing annual amounts ranging from \$870,000 in 2013 to \$1,245,000 in 2020 at interest rates ranging from 5.05% to 5.15%. The Series 1998A and 1998B Bonds are subject to redemption at the option of the County, in whole or in part, at the redemption price of par, without premium, plus accrued interest to the redemption date. The Series 1998B Bonds maturing on July 1, 2019 are subject to mandatory sinking fund redemptions prior to maturity beginning on July 1, 2016.

In August 2008, Blount County issued, on behalf of the Hospital, \$96,350,000 of Local Government Public Improvement Bonds, Series E-5-A. The Series E-5-A Bonds provided the funds necessary to refund the previously issued Series A-3-A and C-2-A Bonds and to reimburse issuance costs of \$775,000. The Hospital computed a loss on the refunding of \$1,155,490 which was deferred and is being amortized over the life of the refunded debt (\$59,298 in 2012 and 2011).

The Series E-5-A Bonds bear interest at variable rates; however, the interest rate swap agreements described below effectively fix the interest rate on the portion of the E-5-A Bonds totaling \$55,700,000. Scheduled principal reductions on the Series E-5-A Bonds increase in annual amounts ranging from \$1,580,000 in 2013 to \$8,425,000 in 2029. The Series E-5-A Bonds are subject to redemption at the option of the Hospital, in whole or in part, at the redemption price of par plus accrued interest to the redemption date.

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

**7. Long-term Debt (continued)**

To protect against the potential of rising interest rates and to balance its mixture of variable and fixed rate debt, the Hospital utilized two separate interest rate swap agreements to effectively fix the interest rates on a portion of the bonds. One interest rate swap agreement maturing in June 2026 establishes interest at an effective rate of 4.90% on \$25,000,000. The second interest rate swap agreement maturing in June 2029 establishes interest at an effective rate of 4.33% on \$30,700,000. The counterparties to these agreements owe the Hospital interest based on a variable rate that is calculated based on a published index rate. The bond principal subject to the swap agreements is not exchanged; only the net difference in interest payments is actually exchanged with the counterparties and recorded by the Hospital as interest expense. The Hospital, through the trustee, continues to pay interest to the bondholders at the variable rate provided by the bonds. During the term of each swap agreement, the Hospital effectively pays a fixed rate on the debt plus or minus the difference between the variable rate due on the bonds and the variable rate received from the counterparty.

The Hospital records the fair value liability of its interest rate swaps, which were determined by an independent third-party advisory firm from a model that calculates future cash flows by projecting forward rates and then discounts those cash flows to their present value.

As of June 30, 2012, the Hospital was not exposed to credit risk because the swaps have negative fair values. However, should interest rates change and the fair value of the swaps become positive, the Hospital would be exposed to credit risk in the amount of the fair value of the swaps. As of June 30, 2012, the counterparty to the swaps, Deutsche Bank, was rated A2/A+/A2 by Moody's, Standard & Poor's and Fitch, respectively.

The Hospital is exposed to variable rates if the counterparties to the swaps default, if the variable rate received from the counterparties is less than that due on the bonds or if the swaps are terminated. The termination of the swap agreements could also result in the Hospital making or receiving a termination payment.

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

**7. Long-term Debt (continued)**

Maturities and mandatory sinking fund payments related to the balances outstanding as of June 30, 2012, are summarized as follows:

	Series E-5-A	Series 1998A and B	Total
2013	\$ 1,580,000	\$ 2,385,000	3,965,000
2014	3,200,000	915,000	4,115,000
2015	3,375,000	960,000	4,335,000
2016	3,525,000	1,015,000	4,540,000
2017	3,700,000	4,610,000	8,310,000
2018 – 2022	24,025,000	–	24,025,000
2023 – 2027	34,850,000	–	34,850,000
2028 – 2029	16,450,000	–	16,450,000
	<u>\$90,705,000</u>	<u>\$ 9,885,000</u>	<u>\$100,590,000</u>

Future interest payments related to the bonds are as follows (interest for variable portion of the Series E-5-A Bond is determined using the rate in effect at June 30, 2012, which was .20%).

	Series E-5-A	Series 1998A and B	Total
2013	\$ 2,625,054	\$ 440,973	\$ 3,066,027
2014	2,621,624	360,828	2,982,452
2015	2,615,195	313,015	2,928,210
2016	2,608,420	262,399	2,870,819
2017	2,601,341	208,972	2,810,313
2018 – 2022	12,739,230	278,928	13,018,158
2023 – 2027	8,290,413	–	8,290,413
2028 – 2029	1,018,494	–	1,018,494
	<u>\$35,119,771</u>	<u>\$1,865,115</u>	<u>36,984,886</u>

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

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

**7. Long-term Debt (continued)**

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

	<b>June 30</b>	
	<b>2012</b>	<b>2011</b>
Debt service reserve funds	<b>\$2,894,203</b>	\$2,893,816
Bond funds	<b>2,633,977</b>	2,572,140
	<b>\$5,528,180</b>	\$5,465,956

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

**8. Retirement Plans**

The Blount Memorial Hospital Retirement Plan (the “Plan”) includes three defined contribution plans available to all employees who are age 18 or older and have completed 1,000 hours of service. Participants are 100% vested after five years of service; however, effective April 1, 2012, the Plan was amended to change the vesting schedule to 20% each year from two years of service to six years of service. The Plan provides for the Hospital to contribute an amount equal to 4% of each eligible employee’s compensation plus a matching contribution (limited to 2% of compensation) based upon voluntary employee contributions to the Plan. Pension contributions are made biweekly. Hospital contributions to the Plan, net of forfeitures used of \$520,000 and \$120,000 in 2012 and 2011, respectively, totaled \$3,665,159 and \$4,114,515 in 2012 and 2011, respectively. Employee contributions were \$3,578,186 and \$3,435,835 in 2012 and 2011, respectively.

**9. Foundation**

At June 30, 2012 and 2011, the Foundation’s assets and net position total \$1,298,394 and \$1,309,172, respectively, and consist of cash and investments (*Note 2*). A portion of the investments at June 30, 2012 and 2011 totaling \$859,773 and \$861,315, respectively, is restricted in perpetuity (nonexpendable) under an irrevocable endowment trust. Endowment trust net income is available for various Foundation activities. The 2012 statement of revenues, expenses and changes in net position includes Foundation contribution revenue of \$430,978, net investment income of \$29,765 and distributions and other expenses of \$471,521. The 2011 Statements of Revenues, Expenses and Changes in Net Position includes Foundation contribution revenue of \$373,480, net investment income of \$152,352 and distributions and other expenses of \$344,347. Separate financial statements of the Foundation are maintained by Foundation and Hospital management. Except for certain expenses paid directly by the Foundation, the Hospital provides administrative services and pays for operating expenses to support the Foundation’s activities.

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

**10. Subsequent Event**

The Hospital has reached a tentative agreement to acquire East Tennessee Medical Group (“ETMG”) for an estimated \$24,300,000. ETMG, which is located in Alcoa, Tennessee, offers primary care services, as well as more than 10 specialty services. The acquisition will expand the Hospital’s outpatient services.

Blount Memorial Hospital, Inc.

List of Officials (Unaudited)

June 30, 2012

**Board of Directors**

Robert P. Redwine, President

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

Jim C. Fiegle

Susan Hitch Keller

Francis M. Gross, Ed.D

Clarence B. Williams

David E. Pesterfield

David L. Cockrill

Denny J. Mayes

**Executive Administration**

I. Donald Heinemann, II

Jane T. Nelson

David E. Avriett

Sonya Newman

Clay Puckett

Connie W. Huffman

Harold Naramore, M.D.



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

Board of Directors  
Blount Memorial Hospital, Inc.

We have audited the financial statements of Blount Memorial Hospital, Inc. (the "Hospital") as of and for the year ended June 30, 2012, and have issued our report thereon dated September 14, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Internal Control Over Financial Reporting

Management of the Hospital is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Hospital'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 Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital'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 Hospital'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 over financial reporting 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.

Board of Directors  
Blount Memorial Hospital, Inc.

Compliance and Other Matters

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

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This report is intended solely for the information and use of the board of directors, management, and the State of Tennessee Comptroller of the Treasury and is not intended to be and should not be used by anyone other than these specified parties.

*Coulter & Justus, P.C.*

September 14, 2012