METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Combined Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)

KPMG LLP
Suite 900
50 North Front Street
Memphis, TN 38103-1194

Independent Auditors' Report

The Board of Director
Methodist Le Bonheur Healthcare:

Report on the Financial Statements

We have audited the accompanying combined financial statements of Methodist Le Bonheur Healthcare and Affiliates (the System), which comprise the combined statement of financial position as of December 31, 2012, and the related combined statements of operations, change in net assets, and cash flows for the year then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audit. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Methodist Le Bonheur Healthcare and Affiliates as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 26, 2013 on our consideration of the System'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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

KPMG LLP

Memphis, Tennessee
April 26, 2013

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Combined Balance Sheets

December 31, 2012 and 2011

(In thousands)

Assets		**2012**	**2011**
Current assets:			
Cash and cash equivalents	$	71,677	71,558
Investments		746,608	569,779
Net patient accounts receivable		190,102	170,705
Due from third-party payors		—	523
Other current assets		49,373	45,013
Assets limited as to use – current portion		682	897
Total current assets		1,058,442	858,475
Assets limited as to use, less current portion		40,616	40,754
Property and equipment, net		821,718	808,006
Other assets		54,956	58,613
Total assets	$	1,975,732	1,765,848
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	$	57,829	58,581
Accrued expenses and other current liabilities		91,583	85,280
Due to third-party payors		17,903	—
Long-term debt – current portion		15,658	18,849
Total current liabilities		182,973	162,710
Long-term debt, less current portion		600,833	515,322
Estimated professional and general liability costs		25,081	25,392
Accrued pension cost		197,608	190,519
Other long-term liabilities		88,743	92,448
Total liabilities		1,095,238	986,391
Net assets:			
Unrestricted		852,139	751,126
Temporarily restricted		20,282	20,081
Permanently restricted		3,351	3,004
Total net assets attributable to Methodist Le Bonheur Healthcare		875,772	774,211
Noncontrolling interests		4,722	5,246
Total net assets		880,494	779,457
Commitments and contingencies			
Total liabilities and net assets	$	1,975,732	1,765,848

See accompanying notes to combined financial statements.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Combined Statements of Operations

Years ended December 31, 2012 and 2011

(In thousands)

		2012	2011
Unrestricted revenues and other support:			
Net patient service revenue	$	1,562,285	1,356,646
Provision for uncollectible accounts		(135,201)	(109,570)
Net patient service revenue less provision for uncollectible accounts		1,427,084	1,247,076
Other revenue		55,200	30,639
Net assets released from restrictions used for operations		13,012	9,055
Total unrestricted revenues and other support		1,495,296	1,286,770
Expenses:			
Salaries and benefits		724,897	662,305
Supplies and other		599,393	473,492
Depreciation and amortization		85,345	85,282
Interest		27,287	25,586
Total expenses		1,436,922	1,246,665
Operating income		58,374	40,105
Nonoperating gains (losses):			
Investment income, net		24,012	36,271
Change in fair value of interest rate swaps		3,798	(38,084)
Unrealized gain (loss) on trading securities, net		37,984	(27,261)
Impairment of land		(332)	—
Impairment of goodwill		(928)	(3,800)
Total nonoperating gains (losses), net		64,534	(32,874)
Revenues, gains and other support in excess of expenses and losses, before noncontrolling interests		122,908	7,231
Noncontrolling interests		(1,424)	(382)
Revenues, gains and other support in excess of expenses and losses		121,484	6,849
Other changes in unrestricted net assets:			
Accrued pension cost adjustments		(22,289)	(85,813)
Other		(68)	—
Net assets released from restrictions used for capital purposes		1,886	2,895
Increase (decrease) in unrestricted net assets	$	101,013	(76,069)

See accompanying notes to combined financial statements.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Combined Statements of Changes in Net Assets

Years ended December 31, 2012 and 2011

(In thousands)

		Unrestricted	Temporarily restricted	Permanently restricted	Noncontrolling interests	Total
Balances at December 31, 2010	$	827,195	22,743	2,840	7,068	859,846
Revenues, gains and other support in excess of expenses and losses		6,849	—	—	382	7,231
Distributions to minority shareholders		—	—	—	(2,204)	(2,204)
Accrued pension cost adjustments		(85,813)	—	—	—	(85,813)
Donor-restricted gifts, grants, and bequests		—	9,116	164	—	9,280
Investment income, net		—	172	—	—	172
Net assets released from restrictions used for operations		—	(9,055)	—	—	(9,055)
Net assets released from restrictions used for capital purposes		2,895	(2,895)	—	—	—
Change in net assets		(76,069)	(2,662)	164	(1,822)	(80,389)
Balances at December 31, 2011		751,126	20,081	3,004	5,246	779,457
Revenues, gains and other support in excess of expenses and losses		121,484	—	—	1,424	122,908
Distributions to minority shareholders		—	—	—	(1,948)	(1,948)
Accrued pension cost adjustments		(22,289)	—	—	—	(22,289)
Other		(68)	—	—	—	(68)
Donor-restricted gifts, grants, and bequests		—	14,502	347		14,849
Investment income, net		—	597	—	—	597
Net assets released from restrictions used for operations		—	(13,012)	—	—	(13,012)
Net assets released from restrictions used for capital purposes		1,886	(1,886)	—	—	—
Change in net assets		101,013	201	347	(524)	101,037
Balances at December 31, 2012	$	852,139	20,282	3,351	4,722	880,494

See accompanying notes to combined financial statements.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Combined Statements of Cash Flows

Years ended December 31, 2012 and 2011

(In thousands)

		2012	2011
Cash flows from operating activities:			
Change in net assets	$	101,037	(80,389)
Adjustments to reconcile change in net assets to net cash provided by operating activities, net of effects of acquisitions:			
Depreciation and amortization		85,345	85,282
Unrealized (gain) loss on trading securities, net		(37,984)	27,261
Change in fair value of interest rate swaps		(3,798)	38,084
Provision for uncollectible accounts		135,201	109,570
Restricted contributions and investment income		(1,117)	(1,184)
Equity in net income of equity investees		1,401	(163)
Impairment of land		332	—
Impairment of goodwill		928	3,800
Gain on disposal of property and equipment		(70)	(99)
Accrued pension cost adjustments		22,289	85,813
Changes in operating assets and liabilities:			
Accounts receivable		(154,598)	(112,742)
Other current assets and due from third-party payors		(3,835)	(4,056)
Other assets		1,336	(3,534)
Accounts payable, accrued expenses and due to third-party payors		23,454	(7,445)
Other long-term liabilities, estimated professional and general liability costs and accrued pension costs		(15,418)	(31,315)
Net cash provided by operating activities		154,503	108,883
Cash flows from investing activities:			
Capital expenditures		(98,812)	(73,344)
Proceeds from sales of property and equipment		253	561
Sales of investments		1,665,243	1,237,632
Purchases of investments		(1,803,922)	(1,269,685)
Change in assets limited as to use		237	(187)
Purchase of businesses		(74)	(2,389)
Net cash used in investing activities		(237,075)	(107,412)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt		100,500	128
Repayment of long-term debt		(18,926)	(16,028)
Restricted contributions and investment income		1,117	1,184
Net cash provided by (used in) financing activities		82,691	(14,716)
Net increase (decrease) in cash and cash equivalents		119	(13,245)
Cash and cash equivalents at beginning of year		71,558	84,803
Cash and cash equivalents at end of year	$	71,677	71,558

See accompanying notes to combined financial statements.

(1) Organization and Summary of Significant Accounting Policies

Methodist Le Bonheur Healthcare and Affiliates (the System) is a not-for-profit healthcare system providing a continuum of healthcare services primarily to residents of Memphis, West Tennessee, North Mississippi, and East Arkansas through its acute care and specialty care facilities. The System operates seven hospitals and a home health agency, with over 11,300 employees and over 1,700 licensed beds. The significant accounting policies used by the System in preparing and presenting its combined financial statements follow:

(a) Principles of Combination

The accompanying combined financial statements include Methodist Le Bonheur Healthcare (Methodist Le Bonheur), all affiliates for which Methodist Le Bonheur or its board of directors is the controlling member, and its wholly owned subsidiaries. Such affiliates and subsidiaries of the System include:

– Methodist Healthcare – Memphis Hospitals (Methodist Healthcare – University Hospital, North Hospital, South Hospital, Germantown Hospital and Le Bonheur Children’s Hospital),

– Methodist Healthcare – Fayette Hospital,

– Alliance Health Services, Inc.,

– Methodist Extended Care Hospital, Inc.,

– Methodist Le Bonheur Healthcare Foundation (comprised of Methodist Healthcare Foundation, Le Bonheur Children’s Hospital Foundation, and Le Bonheur Community Health and Well-Being),

– Methodist Healthcare Community Care Associates,

– Methodist Healthcare Primary Care Associates, and

– Ambulatory Operations, Inc.

All significant intercompany balances and transactions have been eliminated in combination.

(b) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires that management make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues and expenses, as well as disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Significant items subject to such estimates and assumptions include the determination of the allowances for uncollectible accounts and contractual adjustments, reserves for general and professional liability claims, reserves for workers’ compensation claims, reserves for employee healthcare claims, estimated third-party payor settlements, certain investments in alternative funds, and the actuarially determined benefit liability related to the System’s pension plan. In addition, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates related to these programs will change by a material amount in the near term.

(c) Cash Equivalents

The System considers highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

(d) Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the combined balance sheets. Investment income items (including realized and unrealized gains and losses on investments, interest, and dividends) are included in revenues, gains and other support in excess of expenses and losses unless the income or loss is temporarily or permanently restricted by donor or law. The System considers all of its investments to be trading securities.

The System also has investments in alternative funds, which represent investments in real estate through a private Real Estate Investment Trust (REIT) and hedge funds through direct and fund-of-funds structures generally organized as corporations or limited partnerships.

The System's investments in alternative funds are accounted for using the equity method, which generally approximates fair value. The change in carrying amount is reported as investment income or loss in the accompanying combined statements of operations.

Certain underlying holdings of alternative funds are typically valued by the general partner and/or trustee using quoted market prices for publicly traded securities and valuation estimates for derivative instruments. Other underlying holdings are typically valued at cost or adjusted value based on recent arms length transactions, appraisals by third parties of properties held, or other correspondence with the manager. The valuations provided by the general partners and trustees are reviewed by management, and management believes such values are reasonable.

(e) Inventories

Inventories, consisting principally of medical supplies and pharmaceuticals, are stated at the lower of cost (first-in, first-out method) or market.

(f) Assets Limited as to Use

Assets limited as to use include assets held by trustees under indenture and other funding agreements. Amounts required to meet current liabilities of the System are classified as current assets in the accompanying combined balance sheets.

(g) Property and Equipment

Property and equipment are stated at cost. Provisions for depreciation are computed using the straight-line method based on the estimated useful lives of the assets.

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted support and are excluded from revenues, gains and other support in excess of expenses and losses unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used, and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed into service. Contributions restricted for the purchase of property and equipment for which restrictions are met within the same year as the contributions are received are reported as increases in unrestricted net assets in the combined financial statements.

(h) Impairment of Long-lived Assets

Long–lived assets, such as property and equipment and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized to the extent the carrying amount of the asset exceeds its fair value. Assets to be disposed of are separately presented in the accompanying combined balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held for sale are presented separately in the asset and liability sections of the accompanying combined balance sheet.

(i) Goodwill

Goodwill is the amount by which the purchase price exceeds the fair value of assets acquired and is included in other assets within the accompanying combined balance sheets. Goodwill totaled $10,763,000 and $11,691,000 at December 31, 2012 and 2011, respectively. The System recognized a loss on the impairment of goodwill of $928,000 and $3,800,000 in 2012 and 2011, respectively. This amount is reported in the accompanying combined statements of operations as a nonoperating loss.

On January 1, 2010 the System adopted the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-07, *Not-for-Profit Entities: Mergers and Acquisitions* (ASU 2010-07), which amends Accounting Standards Codification (ASC) 958, *Not-for-Profit Entities*. ASU 2010-07 requires that all future acquired goodwill is generally non-amortizable and subject solely to routine impairment testing. Additionally, existing goodwill and indefinite-lived intangible assets are no longer amortized but are reviewed for impairment annually, or more frequently if circumstances indicate potential impairment. Separable intangible assets that are not deemed to have an indefinite life continue to be amortized over their useful lives. The System's adoption of this intangible asset accounting did not have any impact on its combined financial statements.

ASU 2010-07 additionally requires that noncontrolling ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the combined balance sheet within net assets, but separate from the parent's net assets. In addition, the standard requires that a combined statement of changes in net assets attributable to the parent and noncontrolling interests be provide for each class of net assets for which a noncontrolling interest exists during the reporting period.

(j) Costs of Borrowing

Bond discounts, premiums, and issuance costs are amortized over the terms of the related bond issues using the interest method.

The System capitalizes interest costs on qualified construction projects as a component of the cost of related projects.

(k) Equity Investees

Investments in the following affiliated companies, where the System's ownership interests range from 20% – 50%, are accounted for using the equity method (note 18):

– HealthSouth/Methodist Rehabilitation Hospital, L.P. (30% owned),

– Midtown Surgery Center, L.P. (32.65% owned),

– Le Bonheur East Surgery Center II, L.P. (34% owned),

– Hamilton Eye Institute Surgery Center, L.P. (33% owned),

– Health Choice, LLC (50% owned),

– Urology Ambulatory Surgery Center, LLC (30% owned),

– UT Le Bonheur Pediatric Specialists, Inc. (50% owned),

– UT Blood and Marrow Transplant Center, LLC (50% owned), and

– Acorn Research, LLC (28% owned)

(l) Derivative Instruments and Hedging Activities

On the date a derivative contract is entered into, the System designates the derivative as either (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge) or (2) a hedge of a forecasted transaction related to the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). The System formally assesses, both at inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the System discontinues hedge accounting prospectively.

The System does not currently apply hedge accounting with respect to any of its interest rate swaps. All of those swaps (including those originally dedesignated as hedges as a part of previous bond refinancing/conversion transactions) continue to be carried in the System's combined balance sheets at fair value, with related changes in fair value included as nonoperating gains or losses in the combined statements of operations.

(m) Pension Accounting Standard

The System follows the recognition and disclosure provisions of FASB ASC Subtopic 715-20 (Subtopic 715-20), *Defined Benefit Plans*. Subtopic 715-20 requires that the System recognize the unfunded status of its defined benefit plan on its combined balance sheets. The System measures the plan at December 31 each year.

Subtopic 715-20 additionally requires enhanced disclosures related to pension plan assets, including disclosures related to the fair value of the plan assets. These enhanced disclosures are included in these combined financial statements at note 13.

(n) Asset Retirement Obligations

The System recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. When the liability is initially recorded, the System capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the combined statement of operations.

(o) Guarantees

The System follows the provisions of FASB ASC Topic 460 (Topic 460), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.* Topic 460 requires entities to disclose additional information about certain guarantees, or groups of similar guarantees, even if the likelihood of the guarantor having to make any payments under the guarantee is remote. For certain guarantees, the interpretation also requires that a guarantor recognize a liability equal to the fair value of the guarantee upon its issuance. The provisions of Topic 460 have no impact on the combined financial statements and all additional disclosure requirements of Topic 460 have been included within the footnotes of the combined financial statements.

(p) Net Patient Service Revenue and Patient Receivables

Net patient service revenue is reported at the estimated net realizable amounts due from patients, third-party payors and others for services rendered, including estimated retroactive revenue adjustments (if necessary) due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

For uninsured patients who do not qualify for charity care, the System recognizes revenue based on established rates, subject to certain discounts as determined by the System. An estimated provision for uncollectible accounts is recorded that results in net patient service revenue being reported at the net amount expected to be received. The System has determined, based on an assessment at the combined entity level, that patient service revenue is primarily recorded prior to assessing the patient's ability to pay and as such, the entire provision for uncollectible accounts related to patient revenue is recorded as a deduction from patient service revenue in the accompanying combined statements of operations.

Patient receivables are reduced by an allowance for uncollectible accounts. The allowance for uncollectible accounts is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in healthcare coverage, major payor sources and other collection indicators. Periodically throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience by payor category. The results of this review are then used to make modifications to the provision for uncollectible accounts to establish an appropriate allowance for uncollectible receivables. After satisfaction of amounts due from insurance, the System follows established guidelines for placing certain past-due patient balances with collection agencies, subject to the terms of certain restrictions on collection efforts as determined by the System.

(q) Charity Care

The System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The System follows the provisions of FASB ASU 2010-23, *Health Care Entities (Topic 954): Measuring Charity Care for Disclosure*. ASU 2010-23 amends ASC Subtopic 954-605 for *Health Care Entities – Revenue Recognition* to require that cost be used as the measurement basis for charity care disclosure purposes. The method used to estimate such costs as well as any funds received to offset or subsidize charity services provided should also be disclosed.

(r) Revenues, Gains and Other Support in Excess of Expenses and Losses

Activities deemed by the System to be a provision of healthcare services are reported as unrestricted revenues, gains and other support, and expenses. Other activities that are peripheral to providing healthcare services are reported as nonoperating gains and losses.

The combined statements of operations include revenues, gains and other support in excess of expenses and losses. Changes in unrestricted net assets which are excluded from revenues, gains and other support in excess of expenses and losses include certain impacts of pension accounting adjustments, effects of defined accounting changes, and net assets released from restrictions used for capital purposes.

(s) Contributions

Conditional promises to give are recognized when the conditions are substantially met, and indications of intentions to give are reported at fair value at the date the gift is received. Unconditional promises to give cash and other assets are reported at fair value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises are received. Amortization of the discounts is included in other revenue in the accompanying combined statements of operations. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated asset. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the combined statements of operations as net assets released from restrictions. Donor-restricted contributions for which restrictions are met within the same year as the contributions are received are reported as unrestricted contributions in the combined statements of operations. To the extent that restricted resources from multiple donors are available for the same purpose, the System expends such gifts on a "first-in, first-out" basis.

(t) Income Taxes

The System and all of the nonprofit affiliates for which the System or its board of directors is the controlling member are exempt from Federal and state income tax on related income under Internal Revenue Code (IRC) Section 501(a) as organizations described in Section 501(c)(3). As qualified tax-exempt organizations, the System's nonprofit affiliates must operate in conformity with the IRC to maintain their tax-exempt status. Income tax from the operations of the System's wholly owned for–profit subsidiary, Ambulatory Operations, Inc., is not significant.

The System applies FASB ASC Topic 740 (Topic 740), *Accounting for Uncertainty in Income Taxes*. Topic 740 clarifies the accounting for uncertainty in income tax positions and provides guidance on when tax positions are recognized in an entity's financial statements and how the values of these positions are determined. Management has analyzed the tax positions taken by the System and has concluded that as of December 31, 2012, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the combined financial statements.

(u) Functional Expense Classification

All expenses in the accompanying combined statements of operations were incurred for or related to the provision of healthcare services by the System.

(v) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are assets whose use by the System is restricted by donors for a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained in perpetuity.

(w) Fair Value Measurements

The System applies FASB ASC Topic 820 (Topic 820), *Fair Value Measurements,* which establishes an enhanced framework for measuring fair value and expands disclosures about fair value measurements.

The System also follows FASB ASU 2010-06, *Improving Disclosures about Fair Value Measurements,* which amended Topic 820. ASU 2010-06 requires that the System provide enhanced disclosures related to its fair value measurements.

(x) New Accounting Standards

The FASB issued ASC Topic 954 (Topic 954), *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. ASC Topic 954 requires health care entities that recognize significant amounts of patient service revenue at the time the services are rendered, even though they do not assess the patient's ability to pay, to present the provision for bad debts related to patient service revenue as a deduction from patient service revenue (net of contractual allowances and discounts) on the statement of operations. The System adopted ASC Topic 954 in fiscal year 2012, and these enhanced disclosures are included in the combined statement of operations and at notes 2(p) and 16 in these combined financial statements.

(y) Healthcare Industry Environment

In light of the current sluggish recovery of the U.S. economy, System management continues to monitor economic conditions closely, both with respect to potential impacts on the healthcare provider industry and from a more general business perspective. While the System was able to achieve certain objectives of importance in the current economic environment, management recognizes that economic conditions may continue to impact the System in a number of ways, including (but not limited to) uncertainties associated with U.S. financial system reform and rising self-pay patient volumes and corresponding increases in uncompensated care.

Additionally, the general healthcare industry environment is increasingly uncertain, especially with respect to the impacts of federal healthcare reform legislation which was passed in the spring of 2010. Potential impacts of ongoing healthcare industry transformation include, but are not limited to:

- Significant (and potentially unprecedented) capital investment in healthcare information technology (HCIT);
- Continuing volatility in the state and federal government reimbursement programs;
- Lack of clarity related to the health benefit exchange framework mandated by reform legislation, including important open questions regarding the constitutionality of the legislation, exchange reimbursement levels, changes in combined state/federal disproportionate share payments, and impact on the healthcare "demand curve" as the previously uninsured enter the insurance system;
- Effective management of multiple major regulatory mandates, including achievement of meaningful use of HCIT and the transition to ICD-10; and

- Significant potential business model changes throughout the healthcare ecosystem, including within the healthcare commercial payor industry.

The business of healthcare in the current economic, legislative and regulatory environment is volatile. Any of the above factors, along with others both currently in existence and/or which may arise in the future, could have a material adverse impact on the System's financial position and operating results.

(2) Acquisitions

During 2012, the System completed three practice acquisitions, including two physician groups and one nurse practitioner, for a total purchase price of $74,000. The various acquisitions included the addition of 2 physicians and 10 other clinical and administrative staff. Each acquisition was funded with cash on hand.

During 2011, the System completed nine acquisitions of various physician practices for a total purchase price of $12,980,000. The System incurred $1,361,000 in consulting, legal and accounting expenses associated with the acquisitions, and these expenses have been included in supplies and other expenses in the accompanying 2011 combined statement of operations.

In total, the various physician acquisitions included the addition of 52 physicians, of which 24 are employed through the System and 28 through a professional service agreement, and 467 other clinical and administrative staff. The most significant of these acquisitions was the purchase of a comprehensive cancer center on December 26, 2011. Each acquisition was funded with cash on hand, with the exception of the comprehensive cancer center as a note payable of approximately $4 million was issued as part of the closing agreement. Additionally, not all physician practice acquisitions were funded in 2011, therefore resulting in a payable account on the System's books at December 31, 2011.

Each of the acquisitions were accounted for at fair value under the acquisition method of accounting in accordance with ASC 805, *Business Combinations*, and allocated as indicated in the table below. The combined financial statements included the results of each acquired physician practice from the dates of acquisition.

The following table summarizes the estimated accumulated fair value of the assets acquired and liabilities assumed, in 2011, at the dates of the acquisition (in thousands).

Current assets	$	2,213
Property and equipment		8,686
Other assets		2,281
Liabilities		(200)
Total purchase price	$	12,980

(3) Investments and Assets Limited as to use

In accordance with Topic 820, the System has categorized its financial instruments, based on the priority of inputs used in related valuation techniques, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

When available, the System generally uses quoted market prices to determine fair value, and classifies such items as Level 1. The System's Level 2 securities are commingled funds that invest in equity securities and bonds whose fair values are determined by independent vendors. The vendors compile prices from various sources and often apply matrix pricing for similar bonds or loans where no price is observable in an actively traded market. If available, the vendor may also use quoted prices for recent trading activity of assets with similar characteristics to the bond being valued.

In 2012, the System invested $100,000,000 of new funds into the operating investment portfolio, which were from the 2012 fixed rate bond issuance (note 11). In addition the System reallocated approximately $52,000,000 from a Level 1 money market. These additional funds from the 2012 bond issue and the Level 1 money market funds were reallocated into Level 1, Level 2 and Level 3 investments in the approximate amounts of $27,000,000, $95,000,000 and $30,000,000, respectively. The System recognizes transfers between levels on the actual date of the event. In 2011, the System underwent a significant transition of assets in its operating investment portfolio which resulted in a transfer of approximately $100,500,000 from Level 1, $83,000,000 into Level 2, and $17,500,000 into Level 3. Additionally in 2011, the System liquidated one of their hedge fund investments, within the operating investment portfolio, of approximately $28,700,000, which resulted in a transfer out of Level 3.

The System's Level 3 securities are comprised of alternative investments and bonds that have less liquidity, a stale quoted price, or varying prices from independent sources. The Level 3 bonds are priced using cash flow models, remittance data, and the investment manager's best estimate based on the likelihood of any cash flows. The System's Level 3 alternative investments' prices are obtained from the related fund manager. For the System's fund of funds, the manager receives account statements directly from independent administrators or the underlying hedge fund managers, who are responsible for the pricing of these funds. Before reliance on these valuations, the manager evaluates the investee fund's fair value estimation processes and control environment, the investee fund's policies and procedures for estimating fair value of underlying investments, the investee fund's use of independent third party valuation experts, the portion (approximately 97% for the System) of the underlying securities traded on active markets, and the professional reputation and standing of the investee fund's auditor. The System's private REIT investments are valued by the fund managers based upon third-party appraisals of the fund's properties.

The System is subject to limitations on redemption of certain alternative investments. For the private REIT investments, redemption can only occur quarterly with at least 45 days notice given to the fund manager, or other times at the managers' discretion. The limited partnerships have specific redemption provisions, with most allowing redemptions quarterly upon 30 to 60 day notice. Certain limited partnerships have one or two year lockups and others may charge 3 – 5% redemption fees for withdrawals within the first year.

The composition of investments follows:

		2012	2011
		(In thousands)	
U.S. Treasury obligations	$	25,619	4,127
Equity securities		65,976	43,772
Federal mortgage-backed securities		45,503	56,535
Corporate bonds		366,164	304,368
Mutual funds		70,556	45,837
Real estate – private REIT		48,623	22,088
Hedge funds – limited partnerships		38,483	31,671
Commingled funds		85,684	61,381
Total	$	746,608	569,779

There are no projected capital call commitments in 2013 and thereafter for the operating investment portfolio.

The fair value hierarchy of investments follows:

	2012			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
U.S. Treasury obligations	$ 25,619	—	—	25,619
Equity securities:				
Consumer discretionary	9,180	—	—	9,180
Consumer staples	3,192	—	—	3,192
Energy	6,188	—	—	6,188
Financials	10,716	—	—	10,716
Healthcare	9,306	—	—	9,306
Industrials	8,654	—	—	8,654
Information technology	11,278	—	—	11,278
Materials	5,646	—	—	5,646
Telecommunication	885	—	—	885
Utilities	931	—	—	931
Federal mortgage-backed securities:				
Residential	—	45,503	—	45,503
Corporate bonds:				
Financials	—	118,781	3	118,784
Industrials	—	185,086	—	185,086
Utilities	—	42,204	—	42,204
Other	—	18,821	1,269	20,090
Mutual funds:				
Equities	70,556	—	—	70,556
Real estate – private REIT	—	—	48,623	48,623
Hedge funds – limited partnerships	—	—	38,483	38,483
Commingled funds	—	85,684	—	85,684
Total	$ 162,151	496,079	88,378	746,608

	2011			
	Level 1	**Level 2**	**Level 3**	**Total**
	(In thousands)			
U.S. Treasury obligations	$ 4,127	—	—	4,127
Equity securities:				
Consumer discretionary	5,839	—	—	5,839
Consumer staples	2,853	—	—	2,853
Energy	3,914	—	—	3,914
Financials	6,871	—	—	6,871
Healthcare	6,008	—	—	6,008
Industrials	5,889	—	—	5,889
Information technology	6,934	—	—	6,934
Materials	3,685	—	—	3,685
Telecommunication	802	—	—	802
Utilities	977	—	—	977
Federal mortgage-backed securities:				
Residential	—	56,535	—	56,535
Corporate bonds:				
Financials	—	108,211	—	108,211
Industrials	—	140,236	—	140,236
Utilities	—	36,512	—	36,512
Other	—	18,000	1,409	19,409
Mutual funds:				
Equities	45,837	—	—	45,837
Real estate – private REIT	—	—	22,088	22,088
Hedge funds – limited partnerships	—	—	31,671	31,671
Commingled funds	—	61,381	—	61,381
Total	$ 93,736	420,875	55,168	569,779

The rollforward of Level 3 investments follows:

	2012	2011
	(In thousands)	
Beginning of year	$ 55,168	65,616
Net realized and unrealized gains	4,080	321
Purchases	29,600	18,190
Sales	(2,850)	(30,098)
Dividends	2,380	1,139
Contributions	—	—
Transfers into Level 3	—	—
Transfers out of Level 3	—	—
End of year	$ 88,378	55,168

The composition of assets limited as to use follows:

		2012	2011
		(In thousands)	
Under bond indenture agreements-held by trustee (note 4):			
Cash and short-term investments	$	5,716	3,894
U.S. Treasury obligations		323	782
Corporate and municipal bonds		20,067	21,173
Agency securities		13,834	14,203
Asset-backed securities		376	623
Interest receivable		230	258
		40,546	40,933
Under other funding arrangements-held by trustees:			
Cash and short-term investments		19	17
U.S. Treasury obligations		145	129
Corporate bonds		293	287
Mortgage-backed securities		295	285
		752	718
Total assets limited as to use		41,298	41,651
Less amounts required to meet current obligations		682	897
	$	40,616	40,754

All amounts under bond indenture agreements held by trustee are maintained in accordance with revenue bond trust indentures as further described in note 11.

The fair value hierarchy of assets limited as to use follows:

	2012			
	(In thousands)			
	Level 1	**Level 2**	**Level 3**	**Total**
Under bond indenture agreements-held by trustee:				
Cash and short-term investments	$ 5,716	—	—	5,716
U.S. Treasury obligations	323	—	—	323
Municipal obligations	—	13,235	900	14,135
Corporate bonds:				
Financials	—	1,955	—	1,955
Industrials	—	403	—	403
Other	—	3,574	—	3,574
Agency securities	—	13,834	—	13,834
Asset-backed securities	—	376	—	376
Interest receivable	230	—	—	230
	6,269	33,377	900	40,546
Under other funding arrangements-held by trustees:				
Cash and short-term investments	19	—	—	19
U.S. Treasury obligations	145	—	—	145
Corporate bonds	—	293	—	293
Mortgage-backed securities	—	295	—	295
	164	588	—	752
Total assets limited as to use	$ 6,433	33,965	900	41,298

		2011 (In thousands)			
		Level 1	**Level 2**	**Level 3**	**Total**
Under bond indenture agreements-held by trustee:					
Cash and short-term investments	$	3,894	—	—	3,894
U.S. Treasury obligations		782	—	—	782
Municipal obligations		—	10,844	900	11,744
Corporate bonds:					
Financials		—	6,101	—	6,101
Industrials		—	535	—	535
Other		—	2,793	—	2,793
Agency securities		—	14,203	—	14,203
Asset-backed securities		—	623	—	623
Interest receivable		258	—	—	258
		4,934	35,099	900	40,933
Under other funding arrangements-held by trustees:					
Cash and short-term investments		17	—	—	17
U.S. Treasury obligations		129	—	—	129
Corporate bonds		—	287	—	287
Mortgage-backed securities		—	285	—	285
		146	572	—	718
Total assets limited as to use	$	5,080	35,671	900	41,651

The Level 3 securities represent auction rate securities. There has been no activity related to this investment during the 2012 and 2011 fiscal years; therefore, a rollforward of the activity is not provided.

Investment income is comprised of the following:

		2012	**2011**
		(In thousands)	
Investment income:			
Interest and dividends	$	23,006	20,759
Realized gains on sales of securities		1,603	15,684
		24,609	36,443
Less investment income recognized in restricted net assets		597	172
Investment income in combined statements of operations	$	24,012	36,271

(4) Trusteed Bond Funds

The trusteed bond funds, included in assets limited as to use in the accompanying combined balance sheets (note 3), were established in accordance with the requirements of revenue bond indentures as further discussed in note 11.

		2012	2011
		(In thousands)	
Debt service reserve funds	$	40,094	40,295
Interest funds		452	638
	$	40,546	40,933

The interest funds are used to pay principal and interest on the various bond issues. The debt service reserve funds secure any potential deficiencies in the interest funds.

(5) Patient Accounts Receivable

The composition of net patient accounts receivable follows:

		2012	2011
		(In thousands)	
Patient accounts receivable, net of contractual and other allowances	$	231,637	215,174
Less allowance for uncollectible accounts		41,535	44,469
	$	190,102	170,705

(6) Other Current Assets

The composition of other current assets follows:

		2012	2011
		(In thousands)	
Other receivables, net of allowance for uncollectible accounts of $516 and $1,926 in 2012 and 2011, respectively	$	13,798	9,124
Inventories		23,177	23,081
Prepaid expenses and other current assets		7,727	8,099
Pledges receivable, net (note 8)		4,671	4,709
	$	49,373	45,013

(7) Property and Equipment

A summary of property and equipment follows:

	Useful lives (years)	2012	2011
		(In thousands)	
Land	—	$ 73,114	72,639
Land improvements	5 – 20	25,536	24,006
Buildings and improvements	10 – 40	681,528	665,033
Fixed equipment	5 – 30	307,041	301,554
Movable equipment	3 – 20	523,293	497,577
Construction-in-progress	—	48,327	7,950
		1,658,839	1,568,759
Less accumulated depreciation		837,121	760,753
		$ 821,718	808,006

The System capitalized approximately $803,000 and $327,000 of interest expense and associated construction fund investment income as part of major construction and development projects in 2012 and 2011, respectively.

(8) Other Assets

The composition of other assets follows:

	2012	2011
	(In thousands)	
Pledges receivable net, noncurrent	$ 3,944	6,200
Note receivable	6,341	7,022
Unamortized bond issuance costs	13,519	13,250
Investments in equity investees (note 18)	10,729	10,758
Cash surrender value and prepaid life insurance premiums	1,677	1,523
Goodwill	10,763	11,691
Other	7,983	8,169
	$ 54,956	58,613

Pledges receivable at December 31, 2012 are due as follows (in thousands):

Less than one year	$	4,671
One to five years		3,993
		8,664
Less unamortized discounts at 3.1% to 4.0%		49
	$	8,615

(9) Leases

The System has entered into non-cancelable operating leases for certain office space.

Rental expense for all operating leases for the years ended December 31, 2012 and 2011 was approximately $14,893,000 and $9,339,000, respectively. Future minimum payments under non-cancelable operating leases as of December 31, 2012 follow (in thousands):

2013	$	9,709
2014		9,134
2015		7,899
2016		6,633
2017		4,585
Thereafter		5,698
Total	$	43,658

In late 2010, the FASB issued for comment *Proposed Accounting Standards Update – Leases (Topic 840)*. After receiving and considering significant feedback, the FASB intends to issue a related final ASU in calendar year 2013. This new guidance is expected to require the System to recognize virtually all of its leases in the combined balance sheet. Assuming the ASU is in fact issued, adoption will cause considerable changes in the presentation of the System's debt and interest expense in its combined financial statements (among other things). Management is reviewing the implications of the proposed ASU for the System, including potential implications for many complex agreements and arrangements which might be impacted by this potential major accounting change. While that work is ongoing, management is optimistic that there will not be material issues associated with important related matters, such as overall System credit ratings or future debt covenant compliance.

(10) Accrued Expenses and Other Current Liabilities

The composition of accrued expenses and other current liabilities follows:

		2012	2011
		(In thousands)	
Accrued payroll and payroll taxes	$	34,863	29,589
Accrued compensated absences		27,257	25,469
Accrued self-insurance costs		19,636	22,509
Accrued interest		5,024	3,879
Other accrued expenses		4,803	3,834
	$	91,583	85,280

(11) Long-term Debt

A summary of long-term debt follows:

		2012	2011
		(In thousands)	
The Health, Educational and Housing Facility Board (HEHFB) of the County of Shelby, Tennessee:			
Series 2004A/B, interest from 5.00% to 5.25%, through 2027	$	154,570	154,570
Series 2004C, interest of 4.00%, through 2014		2,525	5,025
Series 2008A/B, variable rate, through 2042		270,000	270,000
Series 2008C, interest from 4.00% to 5.25%, through 2018		69,285	80,980
Series 2012, interest from 4.00% to 5.00%, through 2042		98,260	—
		594,640	510,575
Other promissory notes, interest from 5.47% to 9.50%, through 2041		7,715	11,945
Total contractual long-term debt		602,355	522,520
Unamortized premiums and discounts, net		14,136	11,651
Total long-term debt		616,491	534,171
Less current portion of long-term debt		15,658	18,849
	$	600,833	515,322

The System utilizes interest rate swap agreements to synthetically convert certain of its variable rate long-term debt to fixed rate obligations. The maturity structure of such swaps generally corresponds with the maturity structure of the related debt.

Future maturities of long-term debt consist of the following at December 31, 2012 (in thousands):

2013	$	15,658
2014		15,637
2015		15,335
2016		16,737
2017		19,643
Thereafter		519,345
Total contractual long-term debt	$	602,355

In June 2008, the System issued $270,000,000 in HEHFB Series 2008A and 2008B variable rate revenue bonds (the Series 2008AB Bonds). The proceeds from the issuance were used to finance the cost of acquiring, constructing, and equipping certain renovations and improvements to health care facilities, refund $65,615,000 in aggregate principal amount of Series 2004C variable rate bonds, fund a debt service reserve and pay certain expenses incurred in connection with the issuance.

The Series 2008AB Bonds bear interest at a variable rate for weekly rate periods, but either series may be converted at the option of the System, subject to certain restrictions, to a different rate period. Holders of the Series 2008AB Bonds have the option to tender the bonds for purchase on any business day during a weekly rate period. The bonds are also subject to a mandatory tender for purchase upon the occurrence of certain events. Each remarketing agent has agreed to use its best efforts to solicit offers to purchase the tendered bonds, but in the event that there are insufficient funds available, no purchase of bonds of such series so tendered will be made. In such event (or any “default,” as defined), the System has in place a liquidity facility through March 31, 2015 to provide funds for the purchase of the tendered bonds that are not remarketed, which will bear interest from such date at a rate equal to the lesser of index rate of LIBOR plus 150 basis points for the first 90 days, and Prime Rate plus 100 basis points for any days thereafter, or the maximum lawful rate as defined in the indenture agreement until such default is cured or the bond is paid in full. Upon activation of the liquidity facility, the bonds will mature within five years, with payments due ratably in each of the five years of the maturity term. The bonds may be redeemed by the System, in whole or in part at any time during a daily rate period, at the principal amount of the bonds to be redeemed, plus accrued interest, and without premium. The average contractual interest rate on the 2008AB revenue bonds approximated 0.27% and 0.21%, for the years ended December 31, 2012 and 2011, respectively.

In June 2008, the System also issued $107,020,000 in HEHFB Series 2008C fixed rate revenue bonds (the Series 2008C Bonds). The proceeds from the issuance were used to refund all of the current outstanding portion of the Series 1985C, 1995D, and 1998 Revenue Bonds, fund a debt service reserve and pay certain expenses incurred in connection with the issuance. The Series 2008C Bonds are not subject to optional redemption prior to maturity, other than optional redemption under certain defined extraordinary circumstances.

In June 2008, the System effected a fixed rate conversion of $168,070,000 in HEHFB Series 2004ABC bonds to convert all of the then-outstanding Series 2004A and 2004B, and a portion of the 2004C, variable rate revenue bonds to fixed rate bonds. As noted above, the System also refunded the most significant portion of the Series 2004C Bonds through the issuance of Series 2008A and B Bonds. The Series 2004A, Series 2004B, and Series 2004C fixed rate bonds maturing on or after September 1, 2018 are subject to redemption prior to maturity on or after March 1, 2018, at redemption price equal to one hundred percent of the principal amount, plus accrued interest.

In May 2012, the System issued $98,260,000 in HEHFB Series 2012 fixed rate revenue bonds (the Series 2012 Bonds). The proceeds from the issuance were used to finance the cost of acquiring, constructing, and equipping certain renovations and improvements to health care facilities and pay certain expenses incurred in connection with the issuance.

All of the HEHFB revenue bonds are collateralized by related trusteed bond funds, certain municipal bond insurance policies and contribution agreements between the System and certain affiliates (the Combined Group, as defined). The System has also agreed under the Master Trust Indenture to subject the Combined Group to various operational and financial covenants typical of such agreements. In addition, the System has granted to the Master Trustee a deed of trust lien on three hospitals and a security interest in the Combined Group's accounts receivable to secure payment of the outstanding revenue bonds.

Included in other promissory notes is a note for the Memphis Professional Building in the amount of $6,446,000 at December 31, 2012, due 2021.

At December 31, 2012, the System has two defeased bond issues, with outstanding principal balances of approximately $41,760,000. Assets are held in trust, irrevocably restricted, to satisfy the debt service requirements of the defeased issues. These assets and related liabilities are not included in the accompanying combined balance sheets.

Interest paid, net of capitalized interest, totaled approximately $25,824,000 and $26,063,000 in 2012 and 2011, respectively.

(12) Interest Rate Swaps

In June 2004, the System entered into two forward-starting interest rate swaps with JP Morgan Chase Bank, N.A. (JP Morgan). Under these swap agreements, the System receives variable rate payments and makes fixed rate payments (which is known as a "fixed payor swap"). The total notional amount is $161,400,000, with an effective date of September 15, 2004. The System's payments on these swaps are fully insured by Financial Security Assurance, Inc.

In August 2004, the System entered into a forward-starting fixed payor swap with JP Morgan. The original notional amount was $23,450,000, with an effective date of September 15, 2004. The current notional amount is $20,720,000.

In July 2007, the System entered into a forward-starting fixed payor swap with JP Morgan. The total notional amount is $75,000,000, with an effective date of June 1, 2008. In August 2007, the System entered into an additional forward-starting fixed payor swap with JP Morgan. The total notional amount is $25,000,000, with an effective date of June 1, 2008. Both swaps contain a "knockout" provision whereby on each monthly payment date, if the daily weighted average of the SIFMA Municipal Swap Index for the prior 180 days is equal to or greater than 6.00%, no payments shall be due to either party on the swap payment date. The System's payments on these swaps are fully insured by Assured Guaranty Corp.

The System has the right to terminate the 2004 and 2007 fixed payor swaps at any time without notice. Termination of the agreements will result in market value settlement.

The System's credit risk involves the possible default of the counterparty. Collateral may be required in the future based on the System's credit rating, the insurer's credit rating, or market valuations of the swaps. At December 31, 2012 and through the date of these combined financial statements, no such collateral was required.

The swap fair values, if positive to the System, are included in other assets in the accompanying combined balance sheets. If negative to the System, the swap fair values are included in other long-term liabilities in the accompanying combined balance sheets. The following is a summary of the contracts outstanding at December 31, 2012 and 2011 (in thousands):

2012

Related bond issuance	Notional amount	Maturity date	Average variable rate (paid) received	Fixed rate (paid) received	Increase in interest expense	Swap fair value
2004	$ 80,700	August 2027	0.58%	(3.80)%	$ 2,598	(18,099)
2004	80,700	August 2027	0.58	(3.80)	2,589	(18,149)
2004	20,720	July 2024	0.24	(5.40)	1,116	(5,554)
2008	75,000	June 2042	0.16	(3.70)	2,649	(31,779)
2008	25,000	June 2038	0.16	(3.47)	826	(8,936)

2011

Related bond issuance	Notional amount	Maturity date	Average variable rate (paid) received	Fixed rate (paid) received	Increase in interest expense	Swap fair value
2004	$ 80,700	August 2027	0.57%	(3.80)%	$ 2,595	(18,094)
2004	80,700	August 2027	0.57	(3.80)	2,602	(18,134)
2004	22,010	July 2024	0.23	(5.40)	1,137	(5,691)
2008	75,000	June 2042	0.16	(3.70)	2,654	(34,671)
2008	25,000	June 2038	0.16	(3.47)	828	(9,725)

In accordance with Topic 820, the System has also categorized its interest rate swaps into a three-level fair value hierarchy (as described in note 3). The interest rate swaps that have been entered into by the System are executed over the counter and are valued using the net present value of the cash flow streams as no quoted market prices exist for such instruments. For swaps that have an option component, the value will reflect the time value and intrinsic value of the option as well as whether the option was bought or sold. The value of the option is driven by its term to maturity, volatility, forward rates, and strike. The System also employs an independent third party to perform a fair value assessment on the swaps to assess the reasonableness of the valuations otherwise received by the System.

The fair value hierarchy of interest rate swaps at December 31, 2012 follows (in thousands):

	Level 1	Level 2	Level 3	Total
Swap liabilities	$ —	(82,517)	—	(82,517)

The fair value hierarchy of interest rate swaps at December 31, 2011 follows (in thousands):

	Level 1	Level 2	Level 3	Total
Swap liabilities	$ —	(86,315)	—	(86,315)

(13) Employee Benefit Plans

(a) Pension Plan

The System sponsors a noncontributory defined benefit pension plan (the Plan) covering substantially all nonsupplemental employees hired prior to July 1, 2009. Benefits of the Plan are based on average monthly compensation and service with the System. The Plan assets primarily consist of United States Government securities, investment grade corporate bonds, equity securities, and hedge funds. The Plan has been determined to be a church plan under Section 414(e) of the IRC, and is therefore exempt from minimum funding and certain other requirements of the Employee Retirement Income Security Act of 1974.

The System's funding policy is to annually contribute an amount equal to the greater of accounting expense or an actuarially determined amount that amortizes unfunded past and future benefits as a level percent of payroll. In addition, this policy requires the System to contribute any additional amount necessary to ensure that accumulated benefits will be at least 100% funded within 5 years, using a long-term discount rate of 6.50%.

In February 2009, the System amended the Plan whereby employees hired subsequent to July 1, 2009 are not eligible for benefits under the Plan.

The following table sets forth the Plan's funded status and amounts recognized in the accompanying combined balance sheets at December 31, 2012 and 2011:

		2012	2011
		(In thousands)	
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	$	550,277	474,348
Service cost		12,791	13,702
Interest cost		24,714	25,774
Actuarial gain		59,008	56,450
Benefits paid		(22,510)	(19,997)
Projected benefit obligation at end of year		624,280	550,277
Change in plan assets:			
Fair value of plan assets at beginning of year		359,758	354,442
Actual return on plan assets		51,894	(6,845)
Employer contributions		37,530	32,158
Benefits paid		(22,510)	(19,997)
Fair value of plan assets at end of year		426,672	359,758
Funded status (deficit)	$	(197,608)	(190,519)
Amounts recognized in unrestricted net assets:			
Net actuarial loss	$	260,827	240,010
Prior service cost		(1,694)	(3,166)
	$	259,133	236,844

The accumulated benefit obligation at December 31, 2012 and 2011 totaled $592,566,000 and $519,134,000, respectively.

Components of net periodic benefit cost follow:

		2012	2011
		(In thousands)	
Service cost	$	12,791	13,702
Interest cost		24,714	25,774
Expected return on plan assets		(29,752)	(30,271)
Amortization of prior service cost		(1,472)	(1,472)
Amortization of net loss		16,049	9,225
Net periodic benefit cost	$	22,330	16,958

The amount of net actuarial loss and prior service cost expected to be amortized in net periodic pension cost in 2013 is $20,748,000 and $(1,472,000), respectively.

(Continued)

Additional information follows:

	2012	2011
Weighted average assumptions used to determine benefit obligations in the accompanying combined balance sheets at December 31:		
Discount rate	3.92%	4.53%
Rate of compensation increase	2.50	2.50
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31:		
Discount rate	4.53%	5.51%
Expected long-term rate of return on plan assets	7.50	8.00
Rate of compensation increase	2.50	4.00

The Plan's expected long-term rate of return on assets is determined by reviewing expected long-term returns by asset category. This review produces an annual return assumption for each asset category. The product of the annual return assumption and the Plan's target asset allocation percentage for each asset category equals the annual return attribution by asset category.

Plan Assets

The Plan's target minimum and maximum and weighted average asset allocations follow:

	Target allocation		Plan assets at December 31	
	Minimum	Maximum	2012	2011
Asset category:				
Equity securities	20%	56%	34%	32%
Real estate – private REIT	—	13	6	7
International equity securities	10	32	17	15
Global equity securities	—	16	8	7
Hedge funds – fund-of-funds & direct	3	20	7	7
Debt securities*	15	50	24	27
Cash and cash equivalents*			4	5
Total			100%	100%

* Target is combined debt securities and cash and cash equivalents.

In 2012, the Plan funded a new hedge fund manager for approximately $1,600,000, which resulted in transfer from Level 1 to Level 3. Additionally the Plan had an asset reallocation of approximately $21,200,000, which resulted in movement within Level 1 investments and a transfer of approximately $3,000,000 in Level 2. In 2011, the Plan underwent a significant transition of assets in its pension investment portfolio, which resulted in a transfer of approximately $124,000,000 from

Level 1, $110,000,000 into Level 2, and $14,000,000 into Level 3. Additionally in 2011, the System liquidated one of their hedge fund investments, within the pension investment portfolio, of approximately $22,400,000, which resulted in a transfer out of Level 3. The System recognizes transfers of the Plan's assets between levels on the actual date of the event.

At December 31, 2012, the System's remaining outstanding commitments to private equity interests total $8,425,000 in the pension investment portfolio. There is approximately $4,225,000 in projected capital call commitments in 2013 and $4,200,000 thereafter for the pension investment portfolio.

The Plan's investment objectives are to protect long-term asset values by applying prudent, low risk, high quality investment disciplines and to enhance the values by maximizing investment returns through active security management within the framework of the investment policy. Asset allocation strategies and investment management structure are designed to meet the Plan's investment objectives.

Cash Flows

The System expects to contribute approximately $41,423,000 to the Plan in 2013.

Expected Future Benefit Payments

The following benefit payments, which reflect future services as appropriate, are expected to be paid:

	Pension benefits (In thousands)
2013	$ 26,524
2014	25,725
2015	29,615
2016	30,672
2017	31,807
2018 – 2022	189,296

Fair Value of Plan Assets

In accordance with Topic 715-20, the System has categorized its plan assets, based on Topic 820 and the priority of inputs used in related valuation techniques, into a three-level fair value hierarchy as described in note 3.

The fair value hierarchy of investments follows:

	2012			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Cash	$ 18,432	—	—	18,432
U.S. Treasury obligations	14,582	—	—	14,582
Equity securities:				
Consumer discretionary	8,850	—	—	8,850
Consumer staples	793	—	—	793
Energy	3,888	—	—	3,888
Financials	7,224	—	—	7,224
Healthcare	7,964	—	—	7,964
Industrials	6,585	—	—	6,585
Information technology	9,398	—	—	9,398
Materials	2,690	—	—	2,690
Telecommunication	1,296	—	—	1,296
Residential agency mortgage backed securities	—	14,778	—	14,778
Commercial mortgage backed securities	—	5,686	—	5,686
Agency securities	—	1,389	—	1,389
Asset-backed securities	—	1,228	15	1,243
Residential non-agency mortgage backed securities	—	7,705	565	8,270
Corporate bonds:				
Financials	—	22,698	3	22,701
Industrials	—	22,295	—	22,295
Utilities	—	5,212	—	5,212
Municipal obligations	—	1,259	—	1,259
Mutual funds:				
Equities	79,286	—	—	79,286
Bonds	2,328	—	—	2,328
Real estate – private REIT	—	—	24,745	24,745
Hedge funds – limited partnerships	—	—	30,038	30,038
Commingled funds	—	125,740	—	125,740
Total	$ 163,316	207,990	55,366	426,672

	2011			
	Level 1	**Level 2**	**Level 3**	**Total**
	(In thousands)			
Cash	$ 21,645	—	—	21,645
U.S. Treasury obligations	5,113	—	—	5,113
Equity securities:				
Consumer discretionary	5,250	—	—	5,250
Consumer staples	912	—	—	912
Energy	3,116	—	—	3,116
Financials	4,496	—	—	4,496
Healthcare	4,889	—	—	4,889
Industrials	5,057	—	—	5,057
Information technology	6,440	—	—	6,440
Materials	1,219	—	—	1,219
Telecommunication	761	—	—	761
Residential agency mortgage backed securities	—	15,825	—	15,825
Commercial mortgage backed securities	—	7,233	—	7,233
Agency securities	—	5,570	—	5,570
Asset-backed securities	—	833	15	848
Residential non-agency mortgage backed securities	—	8,072	1,072	9,144
Corporate bonds:				
Financials	—	22,611	—	22,611
Industrials	—	20,299	—	20,299
Utilities	—	5,116	—	5,116
Municipal obligations	—	1,551	—	1,551
Mutual funds:				
Equities	56,022	—	—	56,022
Bonds	1,834	—	—	1,834
Real estate – private REIT	—	—	24,271	24,271
Hedge funds – limited partnerships	—	—	26,444	26,444
Commingled funds	—	104,092	—	104,092
Total	$ 116,754	191,202	51,802	359,758

(Continued)

The rollforward of Level 3 investments follows:

		2012	2011
		(In thousands)	
Beginning of year	$	51,802	59,655
Net realized and unrealized gains		2,639	444
Purchases		1,575	14,000
Sales		(1,966)	(23,891)
Dividends		1,316	1,594
Contributions		—	—
Withdrawals		—	—
Transfers into Level 3		—	—
Transfers out of Level 3		—	—
End of year	$	55,366	51,802

(b) Defined Contribution Savings Plans

The System also sponsors 403(b), 401(k) and 457(b) defined contribution savings plans (the defined contribution plans) for the System's employees, in which all employees meeting certain age and service requirements are eligible to participate. The defined contribution plans allow employees to contribute a portion of their compensation on a pre-tax basis in accordance with specific guidelines. For certain of the plans in 2008 and prior, additional matching contributions were made into the defined benefit pension plan. As required by regulations, these matching amounts were made into the defined contribution plan starting in 2009. The System contributed approximately $16,758,000 and $14,519,000 to the defined contribution plans during the years ended December 31, 2012 and 2011, respectively.

(c) Supplemental Employee Retirement Plan

The System also has an unfunded supplemental employee retirement plan (SERP) for certain senior executives that provide for defined benefit payments upon continued employment with the System to age 65. There is no obligation of the System to make payments to these individuals under the SERP in the event that employment voluntarily ceases prior to age 65. The related obligation, included in other long-term liabilities in the accompanying combined financial statements, was approximately $2,745,000 and $2,355,000 at December 31, 2012 and 2011, respectively.

(14) Insurance Programs

The System is self-insured for certain coverages related to employee health insurance. The employee health insurance liability (unfunded at both December 31, 2012 and 2011) was approximately $5,525,000 and $4,529,000 at December 31, 2012 and 2011, respectively, and is included in accrued expenses and other current liabilities in the accompanying combined balance sheets. The total expense for the years ended December 31, 2012 and 2011 was approximately $57,374,000 and $46,429,000, respectively, and is included in salaries and benefits expense in the accompanying combined statements of operations.

(Continued)

The System is routinely involved in litigation as part of its health system operations and is self-insured for a substantial portion of its workers' compensation and professional and general liability risks. The System's reserves for professional and general liability risks are based upon historical claims data, demographic considerations, severity factors and other actuarial assumptions, and advice from an independent consulting actuary.

The reserve for workers' compensation risk (unfunded at both December 31, 2012 and 2011) was approximately $2,611,000 and $2,981,000 at December 31, 2012 and 2011, respectively, and is included in accrued expenses and other current liabilities in the accompanying combined balance sheets. The total expense for the years ended December 31, 2012 and 2011 was approximately $1,581,000 and $1,767,000, respectively, and is included in salaries and benefits expense in the accompanying combined statements of operations.

The System also has substantial excess liability coverage available under the provisions of certain claims-made policies. The excess policies currently expire on June 1, 2013. Management anticipates that the claims-made coverage currently in place will be renewed or replaced with equivalent insurance as the term of such coverage expires.

The reserve for professional and general liability claims (unfunded at both December 31, 2012 and 2011) was approximately $36,581,000 and $40,392,000 at December 31, 2012 and 2011, respectively, of which $11,500,000 and $15,000,000 is included in accrued expenses and other current liabilities in the accompanying combined balance sheets. The total expense of this coverage for the years ended December 31, 2012 and 2011 was approximately $11,459,000 and $6,923,000, respectively, and is included in supplies and other expense in the accompanying combined statements of operations. During 2012 and 2011, the System's recorded expense under its professional and general liability insurance program was positively impacted by certain actuarial reserving adjustments associated with the System's overall historical favorable experience in the program.

The FASB issued ASU 2010-24, *Health Care Entities (Topic 954): Presentation of Insurance Claims and Related Insurance Recoveries*, in August 2010. ASU 2010-24 amends ASC Subtopic 954-450 for *Health Care Entities – Contingencies* to clarify that a healthcare entity should not net insurance recoveries against a related liability and the claim liability should be determined without consideration of insurance recoveries. The System adopted ASU 2010-24 in fiscal year 2011.

(15) Other Long-term Liabilities

The composition of other long-term liabilities follows:

	2012	2011
	(In thousands)	
Fair value of derivative instruments	$ 82,517	86,315
Asset retirement obligations	2,065	2,038
Other	4,161	4,095
	$ 88,743	92,448

(16) Net Patient Service Revenue and Patient Receivables

Net patient service revenue before the provision for uncollectible accounts by major payor source for the years ended December 31, 2012 and 2011, are as follows (in thousands):

	2012		2011	
Medicare	$ 475,385	30%	$ 411,102	30%
Medicaid	273,963	18	254,244	19
Managed care	732,307	47	626,549	46
Self-pay	80,630	5	64,751	5
	1,562,285	100%	1,356,646	100%

For patient receivables associated with self-pay patients, including patients with deductible and copayment balances for which third-party coverage provides for a portion of the services provided, the System records an estimated provision for uncollectible accounts in the year of service. The System has experienced an increase in the provision for uncollectible accounts as a result of high unemployment, loss of employer-sponsored insurance plans and rising patient responsibility balances. Self-pay write-offs increased $1,200,000 in 2012 compared to 2011. The allowance for uncollectible accounts for self-pay patients as a percentage of self-pay accounts receivable decreased from 93% at December 31, 2011 to 91% at December 31, 2012. The System does not maintain a material allowance for uncollectible from third-party payors.

The System has agreements with governmental and other third-party payors that provide for reimbursement to the System at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with major third-party payors follows:

- *Medicare* – Substantially all acute care and skilled nursing facility services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Certain types of exempt services and other defined payments related to Medicare beneficiaries are paid based on cost reimbursement or other retroactive-determination methodologies. The System is paid for retroactively determined items at tentative rates, with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare fiscal intermediary.

  The System's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the System. The System's Medicare cost reports for most of its hospitals have been audited and settled by the Medicare fiscal intermediary through December 31, 2006. Revenue from the Medicare program accounted for approximately 30% of the System's net patient service revenue for both the years ended December 31, 2012 and 2011.

- *TennCare* – Under the TennCare program, patients traditionally covered by the State of Tennessee Medicaid program and certain members of the uninsured population enroll in managed care organizations that have contracted with the State of Tennessee to ensure healthcare coverage to their enrollees. The System contracts with the managed care organizations to receive reimbursement for providing services to these patients. Payment arrangements with these managed care organizations consist primarily of prospectively determined rates per discharge, discounts from established charges or prospectively determined per diem rates. Revenue from the TennCare program accounted for approximately 18% and 19% of the System's net patient service revenue for the years ended December 31, 2012 and 2011, respectively.

The System has historically received Essential Access payments associated with its participation in the TennCare Program. Amounts received by the System under this program were approximately $13,889,000 and $10,621,000 in 2012 and 2011, respectively. The System also received a distribution of $1,553,000 from a federal match pool in 2011. There was no federal match received in 2012. These amounts have been recognized as reductions in related contractual adjustments in the accompanying combined statements of operations. There can be no assurance that the System will continue to qualify for future participation in this program or that the program will not ultimately be discontinued or materially modified.

In July 2010, the State of Tennessee instituted a hospital tax based on the hospital's net patient revenue. Because the hospital tax is in effect a vehicle for the State to appropriately access available federal matching funds, the System's policy is to recognize the net effect of the hospital tax as a reduction in contractual adjustments in the accompanying combined statements of operations. The System paid taxes totaling approximately $51,936,000 and received a distribution of approximately $51,936,000 in 2012. The System paid taxes totaling approximately $41,245,000 and received a distribution of approximately $41,245,000 in 2011.

- The System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The reimbursement methodologies under these agreements include prospectively determined rates per discharge, discounts from established charges and prospectively determined per diem rates.

Laws and regulations governing the Medicare, TennCare, and Medicaid programs are complex and subject to interpretation. 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, TennCare, and Medicaid programs. Changes in the Medicare, TennCare and Medicaid programs and the reduction of funding could have an adverse impact on the System. Charges exceeding amounts reimbursed from these governmental programs and other third-party payor reimbursement arrangements and not included in net patient service revenue follow:

		2012	2011
		(In thousands)	
Medicare	$	1,290,758	1,059,929
Medicaid and TennCare		796,969	668,510
Other deductions		1,088,683	924,558
	$	3,176,410	2,652,997

Changes in estimates related to prior cost reporting periods resulted in an increase of $3,400,000 in net patient service revenue during the year ended December 31, 2011, which were associated with increased reimbursement from Medicare and Medicaid. There were no changes in estimates related to prior cost reporting periods during the year ended December 31, 2012.

(17) Charity Care

The System is an active, caring member of the community it serves. In carrying out its teaching and healing ministry, the System has established a policy under which it provides care to the needy members of its community. Following that policy, the System maintains records to identify and monitor the level of charity care it provides.

When defining charity care, the System employs the Federal Poverty Guideline (FPG) to determine the level of discount uninsured patients receive. The level by which assistance is determined is through the scale set by DHHS (Department of Health and Human Services), which includes factors such as residents per household and income. The System's methodology includes a sliding scale for patients that fall at or below the 200% FPG baseline. The System does not have a cap to which patients will not qualify for a discount. Additionally, the System's charity care guidelines provide for an expansive definition of charity care patients, including a discount from standard charges for uninsured patients.

In order to uphold its mission and dedication to its community, the System turns no patient away whether they possess or lack insurance. It is this commitment that enables the System to utilize its charity care policy. Once deemed charity, payments are no longer sought after and the amount is covered by the System at no cost to the patient or community.

Reported below as community commitment are charity care, Medicaid and other means tested programs, and unbilled community services at cost. Revenue received for each of these categories is substantially lower than the costs to operate. The revenue is offset against the community commitment to calculate net community commitment. A provider tax of 4.5% of net patient revenue from the fiscal year 2008 cost report was assessed during 2012. A provider tax of 3.5% for the first 2 quarters and 4.5% for the last 2 quarters of net patient revenue from the fiscal year 2008 cost report was assessed during 2011. The provider tax assessment has been included in the Medicaid and other means tested programs section, while the reimbursement for the programs has been included in offsetting revenue. The unbilled community services section includes other services provided to the community at a net loss to the program; it includes programs such as educational programs, health fairs, and sponsorships among others.

		Charity Care	Medicaid and Other Programs	Unbilled Community Service	Total
			(In thousands)		
For year ended December 31, 2012:					
Community commitment	$	88,131	341,845	43,652	473,628
Offsetting revenue		(143)	(318,393)	(11,423)	(329,959)
Net community commitment	$	87,988	23,452	32,229	143,669

		Charity Care	Medicaid and Other Programs	Unbilled Community Service	Total
			(In thousands)		
For year ended December 31, 2011:					
Community commitment	$	91,595	324,288	41,994	457,877
Offsetting revenue		(110)	(290,269)	(11,131)	(301,510)
Net community commitment	$	91,485	34,019	30,863	156,367

The System also provides healthcare services to a significant portion of the uninsured population in the surrounding community. While a portion of these patients may ultimately qualify for coverage under the Medicaid program or the charity care policy discussed above, the System pursues collection of amounts due but is unable to collect a significant portion of these accounts. Charges deemed uncollectible during 2012 and 2011 were approximately $135,201,000 and $109,570,000, respectively.

(18) Equity Investees

Equity investees consist mainly of affiliated surgery centers, rehabilitation facilities and other support service components. Summary combined unaudited financial information for the investee companies, in total, as of and for the years ended December 31, 2012 and 2011 follows:

		2012	2011
		(In thousands)	
Total assets	$	52,115	52,236
Total liabilities		38,223	35,058
Total net operating revenues		102,693	96,862
Total net income (loss)		(2,047)	5,398

At December 31, 2012, the System has guaranteed approximately $1,785,000 of indebtedness of certain of these affiliated healthcare providers and is generally obligated for its proportionate share of the investees' underlying debt. The System will become obligated to perform under these guarantee arrangements if the investee is unable to fulfill its responsibility as primary obligor. These guarantee arrangements do not have any recourse or security provisions included therein.

(19) Commitments

In March 2002, the System entered into an agreement with a vendor to provide computer hardware and software along with implementation and maintenance services in connection with the upgrade of certain of the System's information systems. In September 2006, an additional agreement was entered into to provide a remote hosting option for certain information system applications. The agreements may not be terminated by either party without cause. In December 2009, both agreements were extended and now expire December 31, 2017. Future payments under the agreements at December 31, 2012 follow (in thousands):

2013	$	7,686
2014		7,657
2015		7,209
2016		7,208
2017		7,208
Total	$	36,968

(20) Concentrations of Credit Risk

The System grants credit to patients, substantially all of whom reside in the System's service area as described in note 1. The System generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, TennCare, preferred provider arrangements, and commercial insurance policies).

The following table represents the composition of the System's accounts receivable balance by payor type:

	2012	2011
Medicare	35%	32%
Medicaid and TennCare	23	26
Blue Cross	9	10
Patient	4	4
Other third-party payors	29	28
	100%	100%

Federal deposit insurance is unlimited on all noninterest bearing accounts as of December 31, 2012. On January 1, 2013 the federal deposit insurance on all noninterest bearing accounts changed to $250,000.

(21) Financial Instruments

Reported amounts of applicable asset and liability financial instruments as defined under relevant accounting standards, excluding long-term debt, approximate their estimated fair values, in all significant respects, at December 31, 2012 and 2011. Fair value of a financial instrument is generally defined as the amount at which the instrument could be exchanged in a current transaction between willing parties, as expanded by the previously described Topic 820.

(Continued)

The fair value of the System's long-term debt has been estimated using discounted cash flow analyses, based on the System's current incremental borrowing rates for similar types of borrowing arrangements. The fair value of the System's long-term debt was approximately $636,597,000 and $546,292,000 at December 31, 2012 and 2011, respectively.

(22) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

		2012	2011
		(In thousands)	
Le Bonheur capital campaign	$	5,293	10,524
Annuities		3,183	2,548
Specific patient care units		4,256	2,661
Education/Community Outreach		5,781	2,960
Professorships, research and scholarships		1,769	1,388
	$	20,282	20,081

Permanently restricted net assets are to be held in perpetuity, the income from which is expendable for education and research.

The System has historically and to-date received a limited amount of donor-restricted endowment funds, and does not maintain any Board-designated endowments. The System's Board has interpreted Tennessee's State Prudent Management of Institutional Funds Act (SPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. In all material respects, income from the System's donor-restricted endowment funds is itself restricted to specific donor-directed purposes, and is, therefore, accounted for within temporarily restricted net assets until expended in accordance with the donor's wishes. The System oversees individual donor-restricted endowment funds to ensure that the fair value of the original gift is preserved.

The System invests donor-restricted endowment funds within the framework of the System's overall investment management program, as described elsewhere in the notes to the combined financial statements.

(23) Related Parties

In 2001, the System entered into an agreement with Medical Center Associates, L.P. (MCA) to purchase the existing mortgage on a professional building in which the System leases space for its administrative and executive offices adjacent to the University Hospital campus. The financing arrangement resulted in the execution of a note receivable from MCA and the System entering into a mortgage on the building with a financial institution. At December 31, 2012 and 2011 the note receivable balance of $7,022,000 and $7,667,000, respectively, and the mortgage payable balance of $6,446,000 and $6,975,000, respectively, are both reflected on the books of Ambulatory Operations, Inc., a wholly owned subsidiary of the System.

In connection with this transaction, the System also realized a deferred gain, which is being amortized over the life of the mortgage loan. The remainder of the gain still to be recognized at December 31, 2012 and 2011 is approximately $576,000 and $692,000, respectively.

(24) Subsequent Events

The System has evaluated subsequent events through April 26, 2013, the date at which the combined financial statements were issued, and determined that there are no subsequent events to be recognized in the combined financial statements related notes.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

OMB Circular A-133 Reports

December 31, 2012

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

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KPMG LLP
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50 North Front Street
Memphis, TN 38103-1194

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*

The Board of Directors
Methodist Le Bonheur Healthcare:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the combined financial statements of Methodist Le Bonheur Healthcare and Affiliates (the System), which comprise the combined balance sheet as of December 31, 2012, and the related combined statements of operations, change in net assets, and cash flows for the year then ended, and the related notes to the combined financial statements, and have issued our report thereon dated April 26, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the System's combined financial statements, we considered the System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the combined financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

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. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control 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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs that we consider to be significant deficiencies over financial reporting as item 2012-1.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's combined financial statements are free from 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 *Governmental Auditing Standards*.

The System's Response to Findings

The System's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The System's response was not subjected to the auditing procedures applied in the audit of the combined financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Memphis, Tennessee
April 26, 2013

KPMG LLP
Suite 900
50 North Front Street
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Independent Auditors' Report on Compliance for Each Major Program; Report on Internal Control over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and Schedule of Expenditures of State of Tennessee Financial Assistance

The Board of Directors
Methodist Le Bonheur Healthcare:

Report on Compliance for Each Major Federal Program

We have audited Methodist Le Bonheur Healthcare and Affiliates' (the System) compliance with the types of compliance requirements described in the OMB Circular A-133 Compliance Supplement that could have a direct and material effect on each of the System's major federal programs for the year ended December 31, 2012. The System's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the System's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the System'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 on compliance for each major federal program. However, our audit does not provide a legal determination of the System's compliance.

Opinion on Each Major Federal Program

In our opinion, the System complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2012.

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 2012-3. Our opinion on each major federal program is not modified with respect to this matter.

The System's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The System's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of the System is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the System's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 System'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. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 over compliance that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as items 2012-2 and 2012-3 that we consider to be significant deficiencies.

The System's response to the internal control over compliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The System's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no onion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133 and Schedule of Expenditures of State of Tennessee Financial Assistance

We have audited the combined financial statements of the System as of and for the year ended December 31, 2012, and have issued our report thereon dated April 26, 2013, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the combined financial statements. In addition, the accompanying schedule of expenditures of State of Tennessee financial assistance is presented for purposes of additional analysis as required by the State of Tennessee and is not a required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedules of expenditures of federal awards and expenditures of State of Tennessee financial assistance are fairly stated in all material respects in relation to the combined financial statements as a whole.

KPMG LLP

Memphis, Tennessee
June 28, 2013, except for our report on
the Schedule of Expenditures of Federal
Awards and the Schedule of Expenditures
of State of Tennessee Financial Assistance,
for which the date is April 26, 2013.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Schedule of Expenditures of Federal Awards

Year ended December 31, 2012

Federal Sponsor/Program Title	CFDA	Pass-through Award Number	Pass-through Entity	Direct Expenditures	Pass-through Expenditures	Federal Expenditures
U.S. Department of Education:						
Office of Special Education & Rehabilitative Services:						
Early Intervention Services (IDEA) Cluster (2)	84.181	DG12-C000005	Tennessee Department of Education	$ —	52,815	52,815
Early Intervention Services (IDEA) Cluster (2)	84.181	33195-01713	Tennessee Department of Education	—	28,309	28,309
Total U.S. Department of Education				—	81,124	81,124
U.S. Department of Justice:						
Office of Juvenile Justice and Delinquency Prevention:						
Reduction and Prevention of Children's Exposure to Violence (Safe Start)	16.730	CA-121376	Shelby County Office of Early Childhood and Youth	—	35,646	35,646
Total U.S. Department of Justice				—	35,646	35,646
U.S. Department of Health and Human Services:						
Health Resources and Services Administration:						
Coordinated Services and Access to Research for Women, Infants, Children, and Youth*	93.153			353,796		353,796
Coordinated Services and Access to Research for Women, Infants, Children, and Youth*	93.153			717,809		717,809
Coordinated Services and Access to Research for Women, Infants, Children, and Youth*	93.153			126,014		126,014
Total CFDA				1,197,619	—	1,197,619
Teenage Pregnancy Prevention Program*	93.297			584,317		584,317
Teenage Pregnancy Prevention Program*	93.297			197,493		197,493
Total CFDA				781,810	—	781,810
Nurse Education , Practice, and Retention Grants	93.359			69,007	—	69,007
Rural Health Care Services Outreach, Rural Health Network Development and Small Health Care Provider Quality Improvement Program	93.912	D60RH18951	Paris Henry County Healthcare Foundation	—	319,333	319,333
Rural Health Care Services Outreach, Rural Health Network Development and Small Health Care Provider Quality Improvement Program	93.912	D60RH18951	Paris Henry County Healthcare Foundation	—	146,179	146,179
Total CFDA				—	465,512	465,512
Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	93.505	GR-12-35741-00	Tennessee Department of Health	—	196,780	196,780
Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	93.505	GR-13-38952-00	Tennessee Department of Health	—	46,244	46,244
Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	93.505	GR-13-34599-00	Tennessee Department of Health	—	55	55
Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	93.505	None	Tennessee Department of Health	—	388,263	388,263
Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	93.505	GR-12-38133-00	Tennessee Department of Health	—	516,707	516,707
Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	93.505	GR-13-34092-00	Tennessee Department of Health	—	148,920	148,920
Total CFDA				—	1,296,969	1,296,969
Maternal and Child Health Services Block Grant to the States (1)	93.994	GR-12-36183-00	Tennessee Department of Health	—	293,761	293,761
Maternal and Child Health Services Block Grant to the States (1)	93.994	GR-13-32769-00	Tennessee Department of Health	—	287,470	287,470
Total CFDA				—	581,231	581,231
Total Health Resources and Services Administration				2,048,436	2,343,712	4,392,148
Administration for Children and Families:						
Child Care and Development Block Grant*	93.575	GR-12-35623-00	Signal Centers Inc.	—	211,027	211,027
Child Care and Development Block Grant*	93.575	GR-12-35623-00	Signal Centers Inc.	—	188,665	188,665
Total CFDA				—	399,692	399,692
Community-Based Child Abuse Prevention Grants	93.590	GR-10-29678-00	Tennessee Department of Children's Services	—	26,877	26,877
Community-Based Child Abuse Prevention Grants	93.590	31743	Tennessee Department of Children's Services	—	13,816	13,816
Community-Based Child Abuse Prevention Grants	93.590	GR-10-29677-00	Tennessee Department of Children's Services	—	25,195	25,195
Community-Based Child Abuse Prevention Grants	93.590	31744	Tennessee Department of Children's Services	—	21,671	21,671
Total CFDA				—	87,559	87,559
Total Administration for Children and Families				—	487,251	487,251

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Schedule of Expenditures of Federal Awards

Year ended December 31, 2012

Federal Sponsor/Program Title	CFDA	Pass-through Award Number	Pass-through Entity	Direct Expenditures	Pass-through Expenditures	Federal Expenditures
National Institutes of Health:						
Aging Research	93.866	UF07120	University of Florida	$ —	49,974	49,974
Office of the Secretary:						
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30291	Tennessee Department of Health	—	3,405	3,405
National Bioterrorism Hospital Preparedness Program	93.889	GR-12-37200	Tennessee Department of Health	—	40,344	40,344
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30331	Tennessee Department of Health	—	3,387	3,387
National Bioterrorism Hospital Preparedness Program	93.889	GR-12-37253	Tennessee Department of Health	—	29,666	29,666
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30326	Tennessee Department of Health	—	523	523
National Bioterrorism Hospital Preparedness Program	93.889	GR-12-37201	Tennessee Department of Health	—	80,375	80,375
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30329	Tennessee Department of Health	—	2,440	2,440
National Bioterrorism Hospital Preparedness Program	93.889	GR-12-37202	Tennessee Department of Health	—	27,600	27,600
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30327	Tennessee Department of Health	—	780	780
National Bioterrorism Hospital Preparedness Program	93.889	GR-12-37205	Tennessee Department of Health	—	32,800	32,800
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30325	Tennessee Department of Health	—	2,780	2,780
National Bioterrorism Hospital Preparedness Program	93.889	GR-12-37185	Tennessee Department of Health	—	20,000	20,000
Total CFDA				—	244,100	244,100
Support for Pregnant and Parenting Teens and Women	93.500	CA-1214257	Shelby County Office of Early Childhood and Youth	—	69,912	69,912
Total Office of Secretary				—	314,012	314,012
Centers for Disease Control and Prevention:						
HIV Prevention Activities Health Department Based	93.940	GR-11-35048-00	Tennessee Department of Health/United Way of the Mid South	$ —	42,267	42,267
HIV Prevention Activities Health Department Based	93.940	GR-12-37489-00	Tennessee Department of Health	—	156,093	156,093
Total CFDA				—	198,360	198,360
Centers for Medicare and Medicaid Services:						
Health Care Innovation Awards (HCIA)	93.610			$ 47,581	—	47,581
Project SAFEMED: Improving Safety and Adherence for Effective Medication Use	93.610	1C1CMS331067-01-00	University of Tennessee	—	42,506	42,506
Total CFDA				47,581	42,506	90,087
Total U.S. Department of Health and Human Services				2,096,017	3,435,815	5,531,832
Total Federal Expenditures				$ 2,096,017	3,552,585	5,648,602

* Denotes Major program.

(1) Denotes Healthy Start Cluster

(2) Denotes IDEA Cluster

See accompanying Independent Auditors' Report.

See accompanying notes to the Schedule of Federal Awards and Schedule of Expenditures of State of Tennessee Financial Assistance.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Schedule of Expenditures of State of Tennessee Financial Assistance

Year ended December 31, 2012

Program name	CFDA number	Contract number	Award amount	Accrued revenue January 1, 2012	Cash receipts	Transfers in	Disbursements	Refunds to grantors/ other	Transfers out	Accrued revenue December 31, 2012
Tennessee (TN) Department of Human Services:										
Child Care and Development Block Grant	93.575	GR-12-35623-00	$ 423,131	212,101	(404,785)	—	211,027	—	—	18,343
Child Care and Development Block Grant	93.575	GR-12-35623-00	411,565	—	—	—	188,665	—	—	188,665
Total TN Department of Human Services			834,696	212,101	(404,785)	—	399,692	—	—	207,008
TN Department of Children's Services:										
Community-Based Child Abuse Prevention Grants	93.590	GR-10-29678-00	171,012	807	(27,684)	—	26,877	—	—	—
Community-Based Child Abuse Prevention Grants	93.590	31743	100,000	—	(4,142)	—	13,816	—	—	9,674
Community-Based Child Abuse Prevention Grants	93.590	GR-10-29677-00	153,000	6,287	(31,482)	—	25,195	—	—	—
Community-Based Child Abuse Prevention Grants	93.590	31744	100,000	—	(7,692)	—	21,671	—	—	13,979
Total TN Department of Children's Services			524,012	7,094	(71,000)	—	87,559	—	—	23,653
TN Department of Health:										
National Bioterrorism Hospital Preparedness Program-U	93.889	GR-10-30291	57,584	(3,405)	—	—	3,405	—	—	—
National Bioterrorism Hospital Preparedness Program-U	93.889	GR-11-32819	78,090	463	—	(463)	—	—	—	—
National Bioterrorism Hospital Preparedness Program-U	93.889	GR-12-37200	50,100	(24,957)	(25,050)	463	40,344	—	—	(9,200)
National Bioterrorism Hospital Preparedness Program-U	93.889	GE-13-34927-00	49,000	—	—	—	—	—	—	—
National Bioterrorism Hospital Preparedness Program-S	93.889	GR-10-30329	30,584	(2,440)	—	—	2,440	—	—	—
National Bioterrorism Hospital Preparedness Program-S	93.889	GR-12-37202	27,600	(13,800)	(13,800)	—	27,600	—	—	—
National Bioterrorism Hospital Preparedness Program-S	93.889	GE-13-34934-00	27,300	—	—	—	—	—	—	—
National Bioterrorism Hospital Preparedness Program-N	93.889	GR-10-30331	38,792	(3,387)	—	—	3,387	—	—	—
National Bioterrorism Hospital Preparedness Program-N	93.889	GR-12-37253	30,000	334	(30,000)	—	29,666	—	—	—
National Bioterrorism Hospital Preparedness Program-N	93.889	GE-13-34928-00	33,100	—	—	—	—	—	—	—
National Bioterrorism Hospital Preparedness Program-G	93.889	GR-10-30327	37,172	(780)	—	—	780	—	—	—
National Bioterrorism Hospital Preparedness Program-G	93.889	GR-12-37205	32,800	(16,400)	(16,400)	—	32,800	—	—	—
National Bioterrorism Hospital Preparedness Program-G	93.889	GE-13-34932-00	38,400	—	—	—	—	—	—	—
National Bioterrorism Hospital Preparedness Program-L	93.889	GR-10-30326	136,524	(523)	—	—	523	—	—	—
National Bioterrorism Hospital Preparedness Program-L	93.889	GR-12-37201	83,600	(38,575)	(41,800)	—	80,375	—	—	—
National Bioterrorism Hospital Preparedness Program-L	93.889	GE-13-34934-00	83,600	—	—	—	—	—	—	—
National Bioterrorism Hospital Preparedness Program-Fayette	93.889	GR-10-30325	20,000	(2,780)	—	—	2,780	—	—	—
National Bioterrorism Hospital Preparedness Program-Fayette	93.889	GR-12-37185	20,000	(10,000)	(10,000)	—	20,000	—	—	—
Maternal and Child Health Services Block Grant to the States (1)	93.994	GR-12-36183-00	630,700	87,072	(381,098)	265	293,761	—	—	—
Maternal and Child Health Services Block Grant to the States (1)	93.994	GR-13-32769-00	630,700	—	(193,195)	—	287,470	—	—	94,275
Affordable Care Act (ACA) Maternal, Infant and Early Childhood Home Visiting Program	93.505	GR-12-35741-00	349,000	32,416	(229,196)	—	196,780	—	—	—
Affordable Care Act (ACA) Maternal, Infant and Early Childhood Home Visiting Program	93.505	GR-13-38952-00	355,600	—	(14,136)	—	46,244	—	—	32,108
Affordable Care Act (ACA) Maternal, Infant and Early Childhood Home Visiting Program	93.505	GR-13-34599-00	1,680,300	—	—	—	55	—	—	55
Affordable Care Act (ACA) Maternal, Infant and Early Childhood Home Visiting Program	93.505	None	673,000	(330,130)	—	27,079	388,263	—	(85,212)	—
Affordable Care Act (ACA) Maternal, Infant and Early Childhood Home Visiting Program	93.505	GR-12-38133-00	673,000	—	(673,000)	85,212	516,707	—	—	(71,081)
Affordable Care Act (ACA) Maternal, Infant and Early Childhood Home Visiting Program	93.505	GR-13-34092-00	673,000	—	(673,000)	—	148,920	—	—	(524,080)
Nurse Family Partnership Program (non-Federal)	NONE	GR-12-35156-00	530,900	77,998	(265,095)	—	187,097	—	—	—
Nurse Family Partnership Program (non-Federal)	NONE	GR-13-38966-00	345,000	—	(107,655)	—	150,727	—	—	43,072
HIV Prevention Activities Health Department Based	93.940	GR-11-33833-00	116,800	10,543	(10,543)	—	—	—	—	—
HIV Prevention Activities Health Department Based	93.940	GR-12-37489-00	204,000	36,440	(174,153)	—	156,093	—	—	18,380
HIV Prevention Activities Health Department Based (non-Federal)	NONE	GR-12-37489-00	141,000	24,156	(119,318)	—	124,380	—	—	29,218
HIV Prevention Activities Health Department Based	93.940	GR-11-35048-00	55,000	—	(32,288)	—	42,267	—	—	9,979
HIV Prevention Activities Health Department Based	93.940	GR-11-35048-00	50,000	12,971	(12,971)	—	—	—	—	—
Minority Health Initiative-Obesity Prevention	NONE	GR-13-35159-00	100,000	—	—	—	20,058	—	—	20,058
Project Diabetes Initiative Services	NONE	GR-13-33672-00	133,040	—	(6,581)	—	24,627	—	—	18,046
Total TN Department of Health			8,215,286	(164,784)	(3,029,279)	112,556	2,827,549	—	(85,212)	(339,170)

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Schedule of Expenditures of State of Tennessee Financial Assistance

Year ended December 31, 2012

Program name	CFDA number	Contract number	Award amount	Accrued revenue January 1, 2012	Cash receipts	Transfers in	Disbursements	Refunds to grantors/ other	Transfers out	Accrued revenue December 31, 2012
TN Department of Education:										
T.E.I.S. (non-federal-FY 2012)	NONE	DGA-12C000005-1	$ 672,800	344,136	(645,962)	—	328,664	—	—	26,838
T.E.I.S. (non-federal-FY 2013)	NONE	33195-01713	672,800	—	(166,553)	—	315,607	—	—	149,054
T.E.I.S. (federal-FY 2012) (2)	84.181	DGA-12C000005	462,064	332,283	(385,098)	—	52,815	—	—	—
T.E.I.S. (federal-FY 2013) (2)	84.181	33195-01713	75,623	—	(5,075)	—	28,309	—	—	23,234
Total TN Department of Education			1,883,287	676,419	(1,202,688)	—	725,395	—	—	199,126
Total State of Tennessee Financial Assistance			$ 11,457,281	730,830	(4,707,752)	112,556	4,040,195	—	(85,212)	90,617

(1) Denotes Healthy Start Cluster

(2) Denotes IDEA Cluster

See accompanying Independent Auditors' Report.

See accompanying notes to the Schedule of Federal Awards and Schedule of Expenditures of State of Tennessee Financial Assistance.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

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

Year ended December 31, 2012

(1) Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards summarizes the expenditures of Methodist Le Bonheur Healthcare and affiliates (the System) under programs of the federal government for the year ended December 31, 2012. The accompanying Schedule of Expenditures of State of Tennessee Financial Assistance (collectively with the Schedule of Expenditures of Federal Awards, the Schedules) summarizes the expenditures of the System under programs of the state government. The amounts reported as federal and state expenditures were obtained from the System's general ledger. Because the Schedules present only a selected portion of the operations of the System, they are not intended to and do not present the financial position, results of operations, changes in net assets and cash flows of the System.

For purposes of the Schedules, federal awards include all grants, contracts, and similar agreements entered into directly between the System, the agencies and departments of the federal government and the State of Tennessee and all subawards to the System by nonfederal organizations pursuant to federal grants, contracts, and similar agreements. The information in the Schedule of Expenditures of Federal Awards is presented in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.*

(2) Summary of Significant Accounting Policies

For the purposes of the Schedules, expenditures of federal and state award programs are recognized on the accrual basis of accounting.

(3) Subrecipients

Of the federal expenditures presented in the Schedules, the System provided federal awards to subrecipients during 2012 follows:

Coordinated Services and Access to Research for Women, Infants, Children, and Youth Program	$	711,275
Rural Health Care Services Outreach, Rural Health Network Development and Small Health Care Provider Quality Improvement Program		141,134
Affordable Care Act (ACA), Maternal, Infant, and Early Childhood Home Visiting Program		86,664

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Schedule of Findings and Questioned Costs

Year ended December 31, 2012

(1) Summary of Auditors' Results

Financial Statements

Type of auditors' report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness(es) identified?	____ yes	x no
Significant deficiency(ies) identified not considered to be material weaknesses?	x yes	____ none reported
Noncompliance material to financial statement noted?	____ yes	x no

Federal Awards

Internal control over major programs:		
Material weakness(es) identified?	____ yes	x no
Significant deficiency(ies) identified not considered to be material weaknesses?	x yes	____ none reported
Type of auditors' report issued on compliance for major programs:	Unqualified	
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?	x yes	____ no

Identification of major programs:

CFDA Numbers	Name of federal program or cluster
93.575	Child Care and Development Block Grant
93.297	Teenage Pregnancy Prevention Program
93.153	Coordinated Services and Access to Research for Women, Infants, Children and Youth

Dollar threshold used to distinguish between Type A and Type B programs:	$300,000	
Auditee qualified as low-risk auditee?	x yes	____ no

(2) Findings Related to the Financial Statements Reported in Accordance with *Government Auditing Standards*

Finding No. 2012-1-The West Clinic

Criteria

Proper IT general controls should be in place surrounding the Mosaiq system and all revenue manual controls should be operating at a level of precision to catch errors of a material nature.

Condition

During our review of general IT controls surrounding Mosaiq, we noted that general IT controls (access, change management, etc.) are not in place. Also manual revenue controls that are in place are not operating at a level of precision to identify errors of a material nature.

Questioned Costs

None

Context

We noted that the general IT controls were not in place for the Mosaiq system and that the compensating manual controls were not operating at a level of precision to catch errors of a material nature.

Effect

Lack of general IT controls and operating effectiveness of manual revenue controls could result in a misstatement within the System's financial statements.

Recommendation

We recommend that the System put into place processes to ensure that the controls related to the Mosaiq system are in place and operating effectively and that all manual controls are being performed at a level of precision to identify errors of a material nature.

Management's Response

The West Clinic team under the supervision of their Chief Financial Officer has developed an action plan to address the noted control issues. The action plan has specific completion dates which will be monitored by management, corporate audit, and KPMG to ensure the issues are effectively and timely resolved.

(3) Findings and Questioned Costs Relating to Federal Awards

Finding No. 2012-2 – Allowable Costs

Federal Program:	Teenage Pregnancy Prevention Program, CFDA No. - 93.297, Award No. 6TP1AH00053-02-01
Federal Agency:	U.S. Department of Health and Human Services
Pass-through Entity:	None
Award Years:	September 1, 2011 thru August 31, 2012

Criteria

Per OMB Circular A-122, *Cost Principles for Non-Profit Organizations*, Attachment B, Paragraph (m)(1), charges to awards for salaries and wages will be based on documented payrolls approved by a responsible official(s) of the System.

Condition

The System did not perform timely review of grant personnel timecards and maintain this documentation for 11 of the 30 payroll timecards selected for the Teenage Pregnancy and Prevention Program.

Questioned Costs

None

Cause

The control in place to ensure timely review of all timecards prior to submission was not operating effectively during the period.

Effect

The System did not comply with internal guidelines to ensure all timecards related to effort reporting are timely reviewed and ensure that documentation of this is maintained.

Recommendation

The System should strengthen the controls related to review of payroll timecards for effort reporting to ensure that all payroll charged to grants is appropriate.

Management Response

The System will strengthen the controls related to the review of payroll timecards for effort reporting and monitor these controls closely to ensure that they are operating effectively throughout the year.

Finding No. 2012-3 – Reporting

Federal Program:	Coordinated Services and Access to Research for Women, Infants, Children, and Youth, CFDA No. - 93.153, Award No. 6H12HA06978-07-03, 6H12HA06979-07-03, and 1H12HA24874-01-00
Federal Agency:	U.S. Department of Health and Human Services
Pass-through Entity:	None
Award Years:	September 1, 2011 thru August 31, 2012 August 1, 2011thru July 31, 2012 August 1, 2012 thru July 31, 2013

Criteria

A new federal grant awarded as of October 1, 2010 is subject to Federal Funding Accountability and Transparency Act (FFATA) sub-award reporting requirements. The prime awardee is required to file a FFATA sub-award report by the end of the month following the month in which the prime recipient awards any sub-grant greater than or equal to $25,000.

Condition

During our review reports submitted by the System for the above program, we noted that the System did not submit any reports required under the Federal Funding Accountability and Transparency Act.

Cause and Effect

Management was not aware of the FFATA reporting requirements and did not realize that the System was the responsible party for submission. Therefore, they did not submit any reporting as required.

Questioned Costs

None

Recommendation

The System should strengthen internal controls around management review of reporting to ensure that all necessary reports are properly prepared and submitted timely.

Management Response

The System concurs with the recommendation to strengthen internal control for reporting. The Grant Administration Department and other appropriate departments are working on development of procedures and process to comply with FFATA requirements. All appropriate information to comply with the FFATA requirements for previous and current grant years will be uploaded to the USASpending.gov site before August 30, 2013.

Finding No. 2012-2 – Allowable Costs

Corrective Action Plan

1. Name of the contact person responsible for corrective action
   Corey D Johnson
2. The corrective action planned
   A division-wide strategy was implemented in July 2012 to standardize timekeeping and review processes to assure accuracy and timely review by the Associate and their Leader.
3. Anticipated completion date
   As noted above this corrective action plan was implemented in July 2012, as this was an audit finding within the 2011 audit and as such was communicated to management in June of 2012. Due to lack of knowledge of the existing problem, timecards in within the first six months of the 2012 fiscal year were not reviewed timely. All existing timesheets for the current calendar year will be reviewed by the Associates and their Leader in a timely fashion and will be retained.
4. If the client does not agree with audit findings or believes corrective action is not required, include an explanation and specific reasons.
   Agree with Finding No. 2012-2.
5. The reference numbers the auditors assigned to the audit findings in the schedule of findings and questioned costs.
   Finding No. 2012-2

Finding No. 2012-3 – Reporting

Corrective Action Plan

1. Name of the contact person responsible for corrective action
   Corey D Johnson
2. The corrective action planned
   A new procedure will be implemented within the Grant Administration department to submit and track the required Federal Funding Accountability and Transparency Act (FFATA) reporting for all new and modified subawards equal to or greater than $25,000.
3. Anticipated completion date
   The appropriate information for all new subrecipient awards made after October 2010 will be uploaded by Nicole Gottier, Grant Reimbursement Specialist, to the FFATA Subaward Reporting System before August 30th, 2013.
4. If the client does not agree with audit findings or believes corrective action is not required, include an explanation and specific reasons.
   Agree with Finding No. 2012-3.
5. The reference numbers the auditors assigned to the audit findings in the schedule of findings and questioned costs.
   Finding No. 2012-3

Methodist Le Bonheur Healthcare
Results of Prior Year audit Findings
12/31/2012

Finding 2011-1- Allowable Costs

Finding- The System did not perform timely review of grant personnel timecards and maintain this documentation.

Corrective Action Plan/Partially corrected- Finding 2011-1 was an audit finding within the 2011 audit as well. As such, this finding was communicated to management in June of 2012. A division-wide strategy was implemented in July 2012 to standardize timekeeping and review processes to assure accuracy and timely review by the Associate and their Leader. In the last half of 2012 management implemented the standardized timekeeping and review process for this grant. Due to lack of knowledge of the existing problem in the early part of 2012, timecards in within the first six months of the 2012 fiscal year were not reviewed timely. From July 2012 forward all existing timesheets for the current calendar year will be reviewed by the Associates and their Leader in a timely fashion and will be retained.

The corrective action plan was properly implemented in July 2012 and the reviews of timecards for the second half of the 2012 audit were performed properly. The System will continue this standardized timekeeping and review process going in future years as well.