METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Combined Financial Statements

December 31, 2010 and 2009

(With Independent Auditors' Report Thereon)

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

Independent Auditors' Report

The Board of Directors
Methodist Le Bonheur Healthcare:

We have audited the accompanying combined balance sheets of Methodist Le Bonheur Healthcare and Affiliates (the System) as of December 31, 2010 and 2009, and the related combined statements of operations, changes in net assets, and cash flows for the years then ended. These combined financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Methodist Le Bonheur Healthcare and Affiliates as of December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 4, 2011 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

As discussed in note 1(x), in fiscal 2010 the System changed its method of accounting for noncontrolling interests as a result of the adoption of ASU No. 2010-07, *Not-for-Profit Entities: Mergers and Acquisitions*, which amended ASC 958 *Not-for-Profit Entities*. The fiscal 2009 combined financial statements were restated to reflect the resultant new presentation of noncontrolling interests.

KPMG LLP

May 4, 2011

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Combined Balance Sheets

December 31, 2010 and 2009

(In thousands)

Assets		2010	2009
Current assets:			
Cash and cash equivalents	$	84,803	16,033
Investments		565,555	661,174
Net patient accounts receivable		167,534	156,630
Other current assets		39,267	38,592
Assets limited as to use – current portion		719	849
Total current assets		857,878	873,278
Assets limited as to use, less current portion		40,176	39,808
Property and equipment, net		810,344	689,263
Other assets		58,448	74,085
Total assets	$	1,766,846	1,676,434
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	$	58,302	51,289
Accrued expenses and other current liabilities		78,027	77,829
Due to third-party payors		8,066	5,556
Long-term debt – current portion		14,009	12,774
Total current liabilities		158,404	147,448
Long-term debt, less current portion		532,819	547,403
Estimated professional and general liability costs		41,642	42,283
Accrued pension cost		119,906	134,376
Other long-term liabilities		54,229	42,241
Total liabilities		907,000	913,751
Net assets:			
Unrestricted		827,195	724,908
Temporarily restricted		22,743	28,714
Permanently restricted		2,840	2,227
Total net assets attributable to Methodist Le Bonheur Healthcare		852,778	755,849
Noncontrolling interests		7,068	6,834
Total net assets		859,846	762,683
Commitments and contingencies			
Total liabilities and net assets	$	1,766,846	1,676,434

See accompanying notes to combined financial statements.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Combined Statements of Operations

Years ended December 31, 2010 and 2009

(In thousands)

		2010	2009
Unrestricted revenues and other support:			
Net patient service revenue	$	1,255,227	1,208,954
Other revenue		38,123	29,944
Net assets released from restrictions used for operations		10,118	6,065
Total unrestricted revenues and other support		1,303,468	1,244,963
Expenses:			
Salaries and benefits		625,914	601,143
Supplies and other		441,738	408,900
Provision for uncollectible accounts		90,558	90,823
Depreciation and amortization		75,004	66,491
Interest		13,657	15,091
Total expenses		1,246,871	1,182,448
Operating income		56,597	62,515
Nonoperating gains (losses):			
Investment income, net		30,781	5,375
Change in fair value of interest rate swaps		(2,253)	46,676
Unrealized income on trading securities, net		27,277	75,051
Loss on impairment of land		(399)	(1,828)
Impairment loss on equity investee		(3,961)	—
Total nonoperating gains, net		51,445	125,274
Revenues, gains and other support in excess of expenses and losses, before noncontrolling interests		108,042	187,789
Noncontrolling interests		(2,383)	(1,862)
Revenues, gains and other support in excess of expenses and losses		105,659	185,927
Other changes in unrestricted net assets:			
Accrued pension cost adjustments		(10,730)	(11,902)
Other		40	(340)
Net assets released from restrictions used for capital purposes		7,318	13,301
Increase in unrestricted net assets	$	102,287	186,986

See accompanying notes to combined financial statements.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Combined Statements of Changes in Net Assets

Years ended December 31, 2010 and 2009

(In thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Noncontrolling interests	Total
Balances at December 31, 2008	$ 537,922	31,092	2,125	—	571,139
Adjustment to present noncontrolling interests as required by new accounting standard	—	—	—	6,991	6,991
Balance at December 31, 2008 (as adjusted)	537,922	31,092	2,125	6,991	578,130
Revenues, gains and other support in excess of expenses and losses	185,927	—	—	1,862	187,789
Distributions to minority shareholders	—	—	—	(2,019)	(2,019)
Accrued pension cost adjustments	(11,902)	—	—	—	(11,902)
Other	(340)	—	—	—	(340)
Donor-restricted gifts, grants, and bequests	—	16,215	102	—	16,317
Investment income, net	—	773	—	—	773
Net assets released from restrictions used for operations	—	(6,065)	—	—	(6,065)
Net assets released from restrictions used for capital purposes	13,301	(13,301)	—	—	—
Change in net assets	186,986	(2,378)	102	(157)	184,553
Balances at December 31, 2009	724,908	28,714	2,227	6,834	762,683
Revenues, gains and other support in excess of expenses and losses	105,659	—	—	2,383	108,042
Distributions to minority shareholders	—	—	—	(2,149)	(2,149)
Accrued pension cost adjustments	(10,730)	—	—	—	(10,730)
Other	40	—	—	—	40
Donor-restricted gifts, grants, and bequests	—	10,873	613	—	11,486
Investment income, net	—	592	—	—	592
Net assets released from restrictions used for operations	—	(10,118)	—	—	(10,118)
Net assets released from restrictions used for capital purposes	7,318	(7,318)	—	—	—
Change in net assets	102,287	(5,971)	613	234	97,163
Balances at December 31, 2010	$ 827,195	22,743	2,840	7,068	859,846

See accompanying notes to combined financial statements.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Combined Statements of Cash Flows

Years ended December 31, 2010 and 2009

(In thousands)

		2010	2009
Cash flows from operating activities:			
Change in net assets	$	97,163	184,553
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		75,004	66,491
Unrealized income on trading securities, net		(27,277)	(75,051)
Change in fair value of interest rate swaps		2,253	(46,676)
Provision for uncollectible accounts		90,558	90,823
Restricted contributions and investment income		(6,125)	(875)
Equity in net income of equity investees		(4,295)	(2,962)
Impairment loss on equity investee		3,961	—
Loss on impairment of land		399	1,828
(Gain) loss on disposal of property and equipment		(110)	543
Accrued pension cost adjustments		10,730	11,902
Distributions from equity investees		4,895	3,989
Changes in operating assets and liabilities:			
Accounts receivable		(101,462)	(77,218)
Other current assets and due from third-party payors		(629)	12,703
Other assets		21,100	7,230
Accounts payable, accrued expenses and other current liabilities		9,619	12,688
Other long-term liabilities, estimated professional and general liability costs and accrued pension costs		(26,853)	(37,741)
Net cash provided by operating activities		148,931	152,227
Cash flows from investing activities:			
Capital expenditures		(177,765)	(227,066)
Proceeds from sales of property and equipment		248	82
Sales of investments		1,532,582	2,137,088
Purchases of investments		(1,410,066)	(2,147,301)
Change in assets limited as to use		142	59,519
Purchase of businesses		(6,451)	—
Net cash used in investing activities		(61,310)	(177,678)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt		—	4,092
Repayment of long-term debt		(24,976)	(10,078)
Restricted contributions and investment income		6,125	875
Net cash used in financing activities		(18,851)	(5,111)
Net increase (decrease) in cash and cash equivalents		68,770	(30,562)
Cash and cash equivalents at beginning of year		16,033	46,595
Cash and cash equivalents at end of year	$	84,803	16,033

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 10,000 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 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 gains and losses on investments, interest, and dividends) are included in revenues, gains and other support in excess of (less than) 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 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, included in other assets, is the amount by which purchase price exceeds the fair value of assets acquired. Goodwill totaling $9,519,000 at December 31, 2010 is non-amortizable, and amortizable goodwill totaling $6,569,000 at December 31, 2010 has a remaining useful life of 13 years. Related amortization expense is calculated using the straight-line method.

As discussed in note 1(x), the System adopted a new accounting standard in fiscal 2010 under which all future acquired goodwill is generally non-amortizable and subject solely to routine impairment testing.

(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 (see note 17):

- HealthSouth/Methodist Rehabilitation Hospital, L.P. (30% owned),
- Midtown Surgery Center, L.P. (32.65% owned),
- Le Bonheur East Surgery Center II, L.P. (35% owned),
- Hamilton Eye Institute Surgery Center, L.P. (33% owned),
- HealthChoice, LLC (50% owned),
- Urology Ambulatory Surgery Center, LLC (30% owned), and
- UT Le Bonheur Pediatric Specialists, Inc. (50% 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 dedesignated as hedges as a part of previous bond refinancing/conversion transactions) continue to be carried in the System's combined balance sheet 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 Financial Accounting Standards Board (FASB) ASC Subtopic 715-20 (Subtopic 715-20), *Defined Benefit Plans*. Subtopic 175-20 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.

Effective December 31, 2009, the System adopted FASB ASC Subtopic 715-20 (Subtopic 715-20), *Employers' Disclosures about Postretirement Benefit Plan Assets*. Subtopic 715-20 required that the System provide enhanced disclosures related to pension plan assets, including disclosures related to the fair value of the plan assets. Subtopic 715-20 has had no financial impact on, and the System has complied with the additional disclosure requirements of Subtopic 715-20 in, these combined financial statements.

(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. Topic 460 accounting has had no financial impact on, and the System has complied with the additional disclosure requirements of Topic 460 in, these combined financial statements.

(p) Net Patient Service Revenue

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.

(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.

(r) Revenues, Gains and Other Support in Excess of Expenses 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 at the date the promise is received. 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 Internal Revenue Service has determined that the System and all of the nonprofit affiliates for which the System or its board of directors is controlling member are exempt from Federal 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. There has been no impact on the System's combined financial statements as a result of Topic 740.

(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 which 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

Effective January 1, 2008, the System adopted FASB ASC Topic 820 (Topic 820), *Fair Value Measurements*. Topic 820 establishes an enhanced framework for measuring fair value and expands disclosures about fair value measurements. Topic 820 did not significantly impact the fair value measurements included in these combined financial statements, but did result in expanded footnote disclosure in notes 2 and 11 to the combined financial statements.

Effective December 31, 2010, the System adopted FASB Accounting Standards Update (ASU) 2010-06, *Improving Disclosures about Fair Value Measurements,* which amended Topic 820. ASU 2010-06 required that the System provide enhanced disclosures related to its fair value measurements. The System has complied with the additional disclosure requirements of ASU 2010-06 in these combined financial statements.

(x) New Accounting Standard

In January 2010, the FASB issued ASU No. 2010-07, *Not-for-Profit Entities: Mergers and Acquisitions***,** which amends ASC 958**,** *Not-for-Profit Entities* (NFP). The amendments in this standard provide guidance on accounting for combinations of NFPs. It defines a merger of NFP as one in which one NFP cedes control to another NFP. In the case of a merger, the carryover method applies, which requires combining the assets and liabilities as of the merger date. Combinations are accounted for as acquisitions when consideration is transferred to the former owner or designee. Acquisitions are accounted for by applying fair market values to acquired assets and liabilities, including identifiable intangible assets and the recognition of goodwill in the case of NFPs with operations not predominantly supported by contributions. Any resulting goodwill is analyzed for impairment annually or if business conditions indicate an analysis is necessary, and is no longer amortized. The guidance 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 schedule of changes in net assets attributable to the parent and noncontrolling interests be provided for each class of net assets for which a noncontrolling interest exists during the reporting period. The System adopted ASU No. 2010-07 in fiscal year 2010, and has restated its previously presented fiscal 2009 combined financial statements to reflect the new presentation of noncontrolling interests.

(y) Healthcare Industry Environment

The U.S. economy appears to be slowly recovering from the downturn of the past several years. System's management monitors 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 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 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) 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 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. The System had no significant transfers of assets and liabilities into or out of Levels 1 and 2 during either 2010 or 2009.

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 investment is valued by the fund manager based upon third-party appraisals of the fund's properties.

The System is subject to limitations on redemption of the alternative investments. For the private REIT investment, redemption can only occur quarterly with at least 45 days notice given to the fund manager, or other times at the managers' discretion. For the limited partnerships, redemption can only occur on December 31 of any given year with either 60 or 90 days notice to the respective fund managers, or other times at the managers' discretion.

The composition of investments follows:

		2010	2009
		(In thousands)	
U.S. Treasury obligations	$	—	73
Equity securities		139,679	133,200
Federal mortgage-backed securities		43,159	118,600
Corporate bonds		273,958	312,118
Mutual funds		43,938	37,636
Real estate – private REIT		20,696	18,248
Hedge funds – limited partnerships		44,125	41,299
Total	$	565,555	661,174

The fair value hierarchy of investments follows:

	2010			
	Level 1	**Level 2**	**Level 3**	**Total**
	(In thousands)			
Equity securities:				
Consumer discretionary	$ 18,989	—	—	18,989
Consumer staples	6,704	—	—	6,704
Energy	14,813	—	—	14,813
Financials	20,906	—	—	20,906
Healthcare	15,896	—	—	15,896
Industrials	16,159	—	—	16,159
Information technology	29,862	—	—	29,862
Materials	6,802	—	—	6,802
Telecommunication	1,844	—	—	1,844
Utilities	3,623	—	—	3,623
Other	4,081	—	—	4,081
Federal mortgage-backed securities:				
Residential	—	43,159	—	43,159
Corporate bonds:				
Financials	—	88,360	—	88,360
Industrials	—	128,668	—	128,668
Utilities	—	34,196	—	34,196
Other	—	21,939	795	22,734
Mutual funds	43,938	—	—	43,938
Real estate – private REIT	—	—	20,696	20,696
Hedge funds – limited partnerships	—	—	44,125	44,125
Total	$ 183,617	316,322	65,616	565,555

	2009			
	Level 1	**Level 2**	**Level 3**	**Total**
	(In thousands)			
U.S. Treasury obligations	$ 73	—	—	73
Equity securities:				
Consumer discretionary	15,642	—	—	15,642
Consumer staples	8,541	—	—	8,541
Energy	13,986	—	—	13,986
Financials	18,102	—	45	18,147
Healthcare	17,890	—	—	17,890
Industrials	13,005	—	—	13,005
Information technology	29,184	—	—	29,184
Materials	5,102	—	—	5,102
Telecommunication	3,345	—	—	3,345
Utilities	3,715	—	—	3,715
Other	4,643	—	—	4,643
Federal mortgage-backed securities:				
Residential	—	118,600	—	118,600
Corporate bonds:				
Financials	—	93,236	—	93,236
Industrials	—	129,159	—	129,159
Utilities	—	40,050	—	40,050
Other	—	48,718	955	49,673
Mutual funds	37,636	—	—	37,636
Real estate – private REIT	—	—	18,248	18,248
Hedge funds – limited partnerships	—	—	41,299	41,299
Total	$ 170,864	429,763	60,547	661,174

The rollforward of Level 3 investments follows:

	2010	2009
	(In thousands)	
Beginning of year	$ 60,547	73,020
Net realized and unrealized gains (losses)	5,314	(3,273)
Purchases, sales, dividends, contributions, and withdrawals	(199)	(9,261)
Transfers in and/or out of Level 3	(46)	61
End of year	$ 65,616	60,547

The composition of assets limited as to use follows:

	2010	2009
	(In thousands)	
Under bond indenture agreements-held by trustee (see note 3):		
Cash and short-term investments	$ 7,482	7,075
U.S. Treasury obligations	769	481
Corporate and Municipal bonds	18,940	19,549
Agency securities	12,788	12,130
Asset-backed securities	—	500
Interest receivable	251	254
	40,230	39,989
Under other funding arrangements-held by trustees:		
Cash and short-term investments	11	17
U.S. Treasury obligations	94	56
Corporate bonds	314	277
Mortgage-backed securities	246	318
	665	668
Total assets limited as to use	40,895	40,657
Less amounts required to meet current obligations	719	849
	$ 40,176	39,808

All amounts under bond indenture agreements-held by trustee are maintained in accordance with revenue bond trust indentures as further described in note 10.

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

		2010 (In thousands)	
	Level 1	Level 2	Total
Under bond indenture agreements-held by trustee:			
Cash and short-term investments	$ 7,482	—	7,482
U.S. Treasury obligations	769	—	769
Municipal obligations	—	10,304	10,304
Corporate bonds:			
Financials	—	6,795	6,795
Industrials	—	534	534
Other	—	1,307	1,307
Agency securities	—	12,788	12,788
Interest receivable	251	—	251
	8,502	31,728	40,230
Under other funding arrangements-held by trustees:			
Cash and short-term investments	11	—	11
U.S. Treasury obligations	94	—	94
Corporate bonds	—	314	314
Mortgage-backed securities	—	246	246
	105	560	665
Total assets limited as to use	$ 8,607	32,288	40,895

(Continued)

	2009 (In thousands)		
	Level 1	**Level 2**	**Total**
Under bond indenture agreements-held by trustee (see note 3):			
Cash and short-term investments	$ 7,075	—	7,075
U.S. Treasury obligations	481	—	481
Municipal obligations	—	9,360	9,360
Corporate bonds:			
Financials	—	8,186	8,186
Industrials	—	522	522
Other	—	1,481	1,481
Agency securities	—	12,130	12,130
Asset-backed securities	—	500	500
Interest receivable	254	—	254
	7,810	32,179	39,989
Under other funding arrangements-held by trustees:			
Cash and short-term investments	17	—	17
U.S. Treasury obligations	56	—	56
Corporate bonds	—	277	277
Mortgage-backed securities	—	318	318
	73	595	668
Total assets limited as to use	$ 7,883	32,774	40,657

Investment income is comprised of the following:

	2010	2009
	(In thousands)	
Investment income:		
Interest and dividends	$ 21,496	19,449
Realized gains (losses) on sales of securities	9,877	(13,301)
	31,373	6,148
Less investment income recognized in restricted net assets	592	773
Investment income in combined statements of operations	$ 30,781	5,375

(3) Trusteed Bond Funds

The trusteed bond funds, included in assets limited as to use in the accompanying combined balance sheets (see note 2), were established in accordance with the requirements of revenue bond indentures as further discussed in note 10.

		2010	2009
		(In thousands)	
Debt service reserve funds	$	39,763	39,395
Interest funds		467	594
	$	40,230	39,989

The sinking and 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 and sinking funds.

(4) Patient Accounts Receivable

The composition of net patient accounts receivable follows:

		2010	2009
		(In thousands)	
Patient accounts receivable, net of contractual and other allowances	$	210,065	184,091
Less allowance for uncollectible accounts		42,531	27,461
	$	167,534	156,630

(5) Other Current Assets

The composition of other current assets follows:

		2010	2009
		(In thousands)	
Other receivables, net of allowance for uncollectible accounts of $2,899 and $3,791 in 2010 and 2009, respectively	$	9,284	8,748
Inventories		19,815	18,857
Prepaid expenses and other current assets		5,200	4,932
Pledges receivable, net (note 7)		4,968	6,055
	$	39,267	38,592

(Continued)

(6) Property and Equipment

A summary of property and equipment follows:

	Useful lives (years)		2010	2009
			(In thousands)	
Land	—	$	71,628	68,227
Land improvements	5 – 20		22,885	14,932
Buildings and improvements	10 – 40		620,351	419,187
Fixed equipment	5 – 30		292,868	130,725
Movable equipment	3 – 20		475,024	396,785
Construction-in-progress	—		24,716	305,189
			1,507,472	1,335,045
Less accumulated depreciation			697,128	645,782
		$	810,344	689,263

The System capitalized approximately $10,369,000 and $8,024,000 of interest expense and associated construction fund investment income (loss) as part of major construction and development projects in 2010 and 2009, respectively.

Substantial construction projects were placed into service in fiscal 2010, including a new hospital for Le Bonheur Children's Medical Center. Remaining construction-in-progress at December 31, 2010 generally represents routine replacement and expansion projects for various System facilities, the bulk of which is expected to be completed in fiscal 2011.

(7) Other Assets

The composition of other assets follows:

		2010	2009
		(In thousands)	
Pledges receivable net, noncurrent	$	9,425	10,447
Note receivable		7,667	8,279
Unamortized bond issuance costs		14,396	14,915
Investments in equity investees (note 17)		6,406	8,825
Cash surrender value and prepaid life insurance premiums		1,658	1,497
Goodwill		16,088	16,703
Fair value of derivative instruments		—	9,425
Other		2,808	3,994
	$	58,448	74,085

(Continued)

Pledges receivable at December 31, 2010 are due as follows (in thousands):

Less than one year	$	4,968
One to five years		9,350
More than five years		452
		14,770
Less unamortized discounts at 3.1% to 4.0%		377
	$	14,393

(8) Leases

The System has entered into noncancelable operating leases for certain office space.

Rental expense for all operating leases for the years ended December 31, 2010 and 2009 was approximately $8,464,000 and $9,298,000, respectively. Future minimum payments under noncancelable operating leases as of December 31, 2010 follow (in thousands):

2011	$	4,912
2012		4,166
2013		3,658
2014		3,207
2015		2,286
Thereafter		3,041
Total	$	21,270

(9) Accrued Expenses and Other Current Liabilities

The composition of accrued expenses and other current liabilities follows:

		2010	**2009**
		(In thousands)	
Accrued payroll and payroll taxes	$	23,379	22,390
Accrued compensated absences		26,524	24,284
Accrued self-insurance costs		20,369	23,296
Accrued interest		4,299	4,248
Other accrued expenses		3,456	3,611
	$	78,027	77,829

(10) Long-term Debt

A summary of long-term debt follows:

	2010	2009
	(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	7,125	9,425
Series 2008A/B, variable rate, through 2042	270,000	270,000
Series 2008C, interest from 4.00% to 5.25%, through 2018	91,085	99,735
	522,780	533,730
Other promissory notes, interest from 5.50% to 9.50%, through 2041	11,761	13,586
Total contractual long-term debt	534,541	547,316
Unamortized premiums and discounts, net	12,287	12,861
Total long-term debt	546,828	560,177
Less current portion of long-term debt	14,009	12,774
	$ 532,819	547,403

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, 2010 (in thousands):

2011	$ 14,009
2012	15,928
2013	16,632
2014	15,616
2015	15,313
Thereafter	457,043
Total contractual long-term debt	$ 534,541

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 November 1, 2013 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. 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 0.25% and 0.35%, respectively, for the years ended December 31, 2010 and 2009.

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.

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 $7,467,000 at December 31, 2010, due 2021, and a promissory note, executed in 2009 and due in 2013, for the acquisition of additional property for future expansion.

(Continued)

At December 31, 2010, the System has three defeased bond issues, with outstanding principal balances of approximately $272,115,000. 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 $13,606,000 and $14,989,000 in 2010 and 2009, respectively.

(11) 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 $22,010,000.

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 by either party will result in market value settlement.

In July 2007, the System entered into a Constant Maturity Swap (CMS) with JP Morgan. Under this swap agreement, the System receives variable rate payments based on the five-year International Swaps and Derivatives Association, Inc. (ISDA) swap rate and makes variable rate payments based on one-month LIBOR. The total notional amount is $120,000,000, with an effective date of June 1, 2008. Also in July 2007, the System entered into a similar CMS with Morgan Keegan Financial Products, Inc (Morgan Keegan). The total notional amount is $30,000,000, with an effective date of June 1, 2008.

In October 2010, the System assigned its duties and obligations related to the $120,000,000 CMS to another counterparty, effectively terminating the swap for the System. The System received a payment of $16,110,000 to settle this transaction. Also in October 2010, the System terminated the $30,000,000 CMS and received a payment of $4,040,000 to settle this transaction.

In July 2010, the System assumed two fixed payor swaps as part of a physician practice acquisition. The total notional amount for the two swaps when they were assumed in July 2010 was $12,192,000. In December 2010, the System terminated both swaps and made a payment of $1,812,000 to settle these transactions.

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, 2010 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, 2010 and 2009 (in thousands):

2010

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	0.59%	(3.80%)	$ 2,585	(10,976)
2004	80,700	August 2027	0.60%	(3.80%)	2,568	(11,002)
2004	22,010	July 2024	0.27%	(5.40%)	1,134	(3,690)
2008	75,000	June 2042	0.18%	(3.70%)	2,633	(17,729)
2008	25,000	June 2038	0.18%	(3.47%)	821	(4,834)

2009

Related bond issuance	Notional amount	Maturity date	Average variable rate (paid) received	Fixed rate (paid) received	(Decrease) increase in interest expense	Swap fair value
2004	$ 80,700	August 2027	0.64%	(3.80)%	$ 2,548	(8,260)
2004	80,700	August 2027	0.65	(3.80)	2,528	(8,267)
2004	22,010	July 2024	0.39	(5.40)	1,102	(2,662)
2008	75,000	June 2042	0.24	(3.70)	2,594	(14,378)
2008	25,000	June 2038	0.24	(3.47)	808	(3,773)
N/A	120,000	June 2038	(0.35%)/2.41%	—	(2,505)	7,684
N/A	30,000	June 2038	(0.35%)/2.41%	—	(629)	1,741

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 2). 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, 2010 follows (in thousands):

	Level 1	Level 2	Level 3	Total
Swap liabilities	$ —	(48,231)	—	(48,231)

The fair value hierarchy of interest rate swaps at December 31, 2009 follows (in thousands):

	Level 1	Level 2	Level 3	Total
Swap assets	$ —	9,425	—	9,425
Swap liabilities	—	(37,340)	—	(37,340)
Total	$ —	(27,915)	—	(27,915)

(12) 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 through fund-of-funds structures. 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 7.00%.

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, 2010 and 2009:

		2010	2009
		(In thousands)	
Change in projected benefit obligation:			
Projected benefit obligation at beginning of year	$	429,297	384,428
Service cost		14,121	13,521
Interest cost		24,958	24,755
Actuarial gain		26,768	25,112
Benefits paid		(20,796)	(18,520)
Projected benefit obligation at end of year		474,348	429,296
Change in plan assets:			
Fair value of plan assets at beginning of year		294,920	238,946
Actual return on plan assets		40,694	40,894
Employer contributions		39,624	33,600
Benefits paid		(20,796)	(18,520)
Fair value of plan assets at end of year		354,442	294,920
Funded status (deficit)	$	(119,906)	(134,376)
Amounts recognized in unrestricted net assets:			
Net actuarial loss	$	155,669	147,085
Prior service cost		(4,638)	(6,784)
	$	151,031	140,301

The accumulated benefit obligation at December 31, 2010 and 2009 totaled $439,531,000 and $398,361,000, respectively.

Components of net periodic benefit cost follow:

		2010	2009
		(In thousands)	
Service cost	$	14,121	13,521
Interest cost		24,958	24,755
Expected return on plan assets		(27,693)	(26,250)
Amortization of prior service cost		(2,147)	(2,320)
Amortization of net loss		5,185	886
Net periodic benefit cost	$	14,424	10,592

The amount of net actuarial loss and prior service cost expected to be amortized in net periodic pension cost in 2011 is $8,686,000 and $(1,472,000), respectively.

(Continued)

Additional information follows:

	2010	2009
	(In thousands)	
Weighted average assumptions used to determine benefit obligations in the accompanying combined balance sheets at December 31:		
Discount rate	5.51%	6.02%
Rate of compensation increase	4.00	4.00
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31:		
Discount rate	6.02%	6.74%
Expected long-term rate of return on plan assets	8.00	8.00
Rate of compensation increase	4.00	4.50

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	2010	2009
Asset category:				
Equity securities	35%	55%	41%	38%
Real estate – private REIT	5	15	6	7
International equity securities	5	15	13	13
Hedge funds – fund-of-funds	5	13	10	11
Debt securities*	20	30	26	28
Cash and cash equivalents*			4	3
Total			100%	100%

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

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 $31,500,000 to the Plan in 2011.

Expected Future Benefit Payments

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

	Pension benefits
	(In thousands)
2011	$ 22,900
2012	23,800
2013	24,900
2014	26,700
2015	31,100
2016 – 2020	174,900

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 explained in note 2.

The fair value hierarchy of investments follows:

	2010			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Cash	$ 10,719	—	—	10,719
U.S. Treasury obligations	18,306	—	—	18,306
Equity securities:				
Consumer discretionary	20,440	—	—	20,440
Consumer staples	7,603	—	—	7,603
Energy	16,843	—	—	16,843
Financials	17,293	—	—	17,293
Healthcare	18,156	—	—	18,156
Industrials	17,059	—	—	17,059
Information technology	32,100	—	—	32,100
Materials	6,938	—	—	6,938
Telecommunication	2,155	—	—	2,155
Utilities	2,573	—	—	2,573
Other	3,154	—	—	3,154
Residential agency MBS	—	22,986	—	22,986
Commercial MBS	—	5,155	—	5,155
Agency securities	—	5,626	—	5,626
Asset-backed securities	—	3,319	—	3,319
Residential non-agency MBS	—	2,847	—	2,847
Corporate bonds:				
Financials	—	9,420	—	9,420
Industrials	—	1,556	—	1,556
Utilities	—	1,803	—	1,803
Other	—	19,184	589	19,773
Municipal obligations	—	1,023	—	1,023
Mutual funds:				
Equities	44,317	—	—	44,317
Bonds	4,212	—	—	4,212
Real estate – private REIT	—	—	22,741	22,741
Hedge funds – limited partnerships	—	—	36,325	36,325
Total	$ 221,868	72,919	59,655	354,442

	2009			
	Level 1	Level 2	Level 3	Total
	(In thousands)			
Cash	$ 2,760	—	—	2,760
U.S. Treasury obligations	17,325	—	—	17,325
Equity securities:				
Consumer discretionary	12,714	—	—	12,714
Consumer staples	6,439	—	—	6,439
Energy	10,888	—	—	10,888
Financials	11,020	—	34	11,054
Healthcare	17,984	—	—	17,984
Industrials	10,716	—	—	10,716
Information technology	25,976	—	—	25,976
Materials	4,350	—	—	4,350
Telecommunication	2,444	—	—	2,444
Utilities	2,464	—	—	2,464
Other	5,115	—	—	5,115
Residential agency MBS	—	30,984	—	30,984
Commercial MBS	—	3,616	—	3,616
Agency securities	—	1,051	—	1,051
Asset-backed securities	—	2,812	—	2,812
Residential non-agency MBS	—	2,626	—	2,626
Corporate bonds:				
Financials	—	8,860	—	8,860
Industrials	—	1,782	—	1,782
Utilities	—	2,849	—	2,849
Other	—	13,323	605	13,928
Municipal obligations	—	472	—	472
Mutual funds				
Equities	37,896	—	—	37,896
Bonds	3,754	—	—	3,754
Real estate – private REIT	—	—	20,052	20,052
Hedge funds – limited partnerships	—	—	34,009	34,009
Total	$ 171,845	68,375	54,700	294,920

The rollforward of Level 3 investments follows:

		2010	2009
		(In thousands)	
Beginning of year	$	54,700	58,644
Net realized and unrealized losses		5,083	(5,881)
Purchases, sales, dividends, contributions, and withdrawals		(95)	1,937
Transfers in/out of Level 3		(33)	—
End of year	$	59,655	54,700

(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 recent regulations, these matching amounts were made into the defined contribution plan in 2009. The System contributed approximately $12,999,000 and $12,224,000 to the defined contribution plans during the years ended December 31, 2010 and 2009, 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 $1,906,000 and $1,472,000 at December 31, 2010 and 2009, respectively.

(13) 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, 2010 and 2009) was approximately $4,478,000 and $4,184,000 at December 31, 2010 and 2009, 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, 2010 and 2009 was approximately $50,287,000 and $47,529,000, respectively, and is included in salaries and benefits expense in the accompanying combined statements of operations.

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, 2010 and 2009) was approximately $2,891,000 and $3,612,000 at December 31, 2010 and 2009, 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, 2010 and 2009 was approximately $1,726,000 and $2,984,000, respectively, and is included in salaries and benefits expense in the accompanying combined statements of operations.

Effective June 1, 2003, the System has a first-dollar $5,000,000 unaggregated self-insured retention limit. Effective June 1, 2006 through May 31, 2008, the medical professional liability is subject to a one-time additional deductible of $5,000,000.

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, 2011. 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, 2010 and 2009) was approximately $54,642,000 and $57,783,000 at December 31, 2010 and 2009, respectively, of which $13,000,000 and $15,500,000 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, 2010 and 2009 was approximately $12,246,000 and $8,987,000, respectively, and is included in supplies and other expense in the accompanying combined statements of operations. During 2010, 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.

(14) Other Long-term Liabilities

The composition of other long-term liabilities follows:

		2010	2009
		(In thousands)	
Fair value of derivative instruments	$	48,231	37,340
Asset retirement obligations		2,028	1,913
Other		3,970	2,988
	$	54,229	42,241

(15) Net Patient Service Revenue

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 29% of the System's net patient service revenue for both the years ended December 31, 2010 and 2009.

- *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 19% and 20% of the System's net patient service revenue for the years ended December 31, 2010 and 2009, 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 $9,593,000 and $9,157,000 in 2010 and 2009, respectively. The System also received a distribution of $1,568,000 from a federal match pool in 2010. 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. The System paid taxes totaling $18,114,000 and received a distribution of $18,114,000. 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 statement of operations.

- 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.

(Continued)

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:

		2010	2009
		(In thousands)	
Medicare	$	990,494	881,527
Medicaid and TennCare		611,187	546,321
Other deductions		855,360	800,924
	$	2,457,041	2,228,772

Changes in estimates related to prior cost reporting periods resulted in an increase of $50,000 and $5,300,000 in net patient service revenue during the years ended December 31, 2010 and 2009, respectively, which were associated with increased reimbursement from Medicare and Medicaid. The amount of these settlements was not determinable in prior periods and therefore no accruals were recognized for such settlements in prior years' combined financial statements.

(16) 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. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. Charges foregone, based on established rates, totaled approximately $295,714,000 and $234,378,000 in 2010 and 2009, respectively. The System's charity care guidelines provide for an expansive definition of charity care patients, including a discount from standard charges for uninsured patients. Such discount is included in the charges foregone as the System does not pursue collection, and totaled $139,917,000 and $102,586,000 in 2010 and 2009, respectively.

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 2010 and 2009 were approximately $90,558,000 and $90,823,000, respectively.

In addition to community services directly associated with providing hospital-based care, the System serves the community in numerous other ways. For example:

- To assist in educating the community regarding health related issues, the System participates in numerous Health Fairs and gives talks to various schools and industry regarding such issues as drug abuse, safety in the workplace, etc.

- The System also organizes employee participation in fundraising for organizations such as the United Way, among others. In addition, the System gave approximately $2,012,000 during 2010 and $2,027,000 during 2009 in charitable corporate donations to various area community service organizations.

Although the System has estimated the cost of each of these efforts to serve the Memphis, West Tennessee, North Mississippi and East Arkansas areas, management and the Board of Directors believe that such costs represent only one facet of the many ways the System serves the greater Memphis community. The above examples relate only to certain measurable benefits that the System provides to its service area. This presentation is not intended to measure all such community benefits, many of which are intangible in nature or otherwise not quantifiable.

(17) 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, 2010 and 2009 follows:

		2010	2009
		(In thousands)	
Total assets	$	39,787	54,144
Total liabilities		25,520	26,324
Total net operating revenues		60,031	61,158
Total net income		15,019	10,864

At December 31, 2010, the System has guaranteed approximately $968,000 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.

The System is a 29%-share participant in an air ambulance provider with other local health systems. During fiscal 2010, all of the participants in this venture determined that their investment was impaired and recorded associated write-downs. The System's impairment charge totaled $3,961,000 and has been recognized as a nonoperating loss in the accompanying 2010 combined statement of operations.

(Continued)

(18) 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, 2010 follow (in thousands):

2011	$	7,606
2012		7,536
2013		7,570
2014		7,542
2015		7,093
Thereafter		14,186
Total	$	51,533

(19) 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:

	2010	2009
Medicare	33%	37%
Medicaid and TennCare	27	23
Blue Cross	9	8
Patient	4	4
Other third-party payors	27	28
	100%	100%

Federal deposit insurance is unlimited on all noninterest bearing accounts as of December 31, 2010.

(20) 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, 2010 and 2009. 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.

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 $546,445,000 and $562,167,000 at December 31, 2010 and 2009, respectively.

(21) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes:

		2010	2009
		(In thousands)	
Le Bonheur capital campaign	$	13,347	16,370
Annuities		2,435	2,548
Specific patient care units		2,667	6,023
Education/Community Outreach		2,716	1,816
Professorships, research and scholarships		1,578	1,957
	$	22,743	28,714

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.

(22) 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, 2010 and 2009 the note receivable balance of $8,279,000 and $8,859,000, respectively, and the mortgage payable balance of $7,467,000 and $7,922,000, 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, 2010 and 2009 is approximately $812,000 and $937,000, respectively.

(23) Subsequent Events

The System has evaluated subsequent events through May 4, 2011, the date at which the consolidated financial statements were available to be issued, and determined that there are no other necessary subsequent event disclosures, other than the matter described in the following paragraph.

In August 2010, the System requested a full withdrawal of its hedge fund investment with Alternative Investments Institutional, L.P. (AI) totaling approximately $51,291,000, including operating and pension accounts. Per the investment agreement with AI, the System received 95% of this balance in January 2011, and will receive the remaining 5% balance upon the completion of the audit of AI's financial statements.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Report on Federal Awards in Accordance with OMB Circular A-133

December 31, 2010

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

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KPMG LLP
Morgan Keegan Tower
Suite 900
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 Audit and Compliance Committee
Methodist Le Bonheur Healthcare:

We have audited the combined financial statements of Methodist Le Bonheur Healthcare and Affiliates (the System) as of and for the year ended December 31, 2010, and have issued our report thereon dated May 4, 2011. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

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

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

Compliance and Other Matters

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

* * * * * * *

We noted certain matters that we intend to report to management of the System in a separate letter dated no later than 60 days from the date of this letter.

This report is intended solely for the information and use of management, the Audit and Compliance Committee, and others within the System, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

May 4, 2011

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

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

The Audit and Compliance Committee
Methodist Le Bonheur Healthcare:

Compliance

We have audited Methodist Le Bonheur Healthcare and Affiliates' (the System) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget *(OMB) Circular A-133 Compliance Supplement* (Compliance Supplement) that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2010. The System's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the System's management. Our responsibility is to express an opinion on the System's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements described in the Compliance Supplement 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. Our audit does not provide a legal determination of the System's compliance with those requirements.

In our opinion, the System complied, in all material respects, with the requirements referred to in the first paragraph above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2010.

Internal Control over Compliance

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

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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

We have audited the basic combined financial statements of the System as of and for the year ended December 31, 2010, and have issued our report thereon dated May 4, 2011. Our audit was performed for the purpose of forming an opinion on the basic combined financial statements taken 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 basic 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 basic combined financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic combined financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic combined financial statements taken as a whole.

* * * * * * *

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

KPMG LLP

June 30, 2011, except as to the paragraph
relating to the Schedule of Expenditures of
Federal Awards and Schedule of Expenditures
of State of Tennessee Financial Assistance,
which is as of May 4, 2011.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Schedule of Expenditures of Federal Awards

Year ended December 31, 2010

Federal sponsor/program title	CFDA	Pass-through award number	Pass-through entity		Direct expenditures	Pass-through expenditures	Federal expenditures
U.S. Department of Agriculture:							
Food and Nutrition Service:							
Child and Adult Care Food Program	10.558	03-47-64393-001	Tennessee Department of Human Services	$	—	10,002	10,002
U.S. Department of Education:							
Office of Special Education & Rehabilitative Services:							
Special Education Grants for Infants & Families Recovery Act	84.393A	DGA-C000006	Tennessee Department of Education		—	98,903	98,903
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				836,850	—	836,850
Nurse Education , Practice, and Retention Grants	93.359				73,353	—	73,353
Health Care and Other Facilities*	93.887				290,064	—	290,064
Rural Health Care Services Outreach and Rural Health Network Development Program	93.912	D60RH08546-02-01	Hardeman County Community Health Center		—	309,361	309,361
Rural Health Care Services Outreach and Rural Health Network Development Program	93.912	D60RH18951-01-00	Paris Henry County Healthcare Foundation		—	73,228	73,228
Total					—	382,589	382,589
Ryan White Part A Comprehensive HIV Emergency Relief Grant Program	93.914	A2611	Shelby County Government		—	37,867	37,867
Maternal and Child Health Services Block Grant to the States (2)*	93.994	GR-10-28587-00	Tennessee Department of Health		—	304,593	304,593
Maternal and Child Health Services Block Grant to the States (2)*	93.994	GR-11-32762-00	Tennessee Department of Health		—	303,113	303,113
Total CFDA					—	607,706	607,706
Total Health Resources and Services Administration					1,200,267	1,028,162	2,228,429
Office of the Secretary-Public Health Service:							
Teen Pregnancy Prevention-Replication of Evidence Base Programs	93.297				18,777	—	18,777
Administration for Children and Families:							
Child Care and Development Block Grant	93.575	GR-09-25256-01	Tennessee Department of Human Services		—	366,638	366,638
Child Care and Development Block Grant	93.575	GR-11-31681	Tennessee Department of Human Services		—	354,819	354,819
Total CFDA					—	721,457	721,457
Community-Based Child Abuse Prevention Grants	93.590	GR-10-29678-00	Tennessee Department of Children's Services		—	51,067	51,067
Community-Based Child Abuse Prevention Grants	93.590	GR-10-29677-00	Tennessee Department of Children's Services		—	50,496	50,496
Total CFDA					—	101,563	101,563
Child Abuse and Neglect Discretionary Activities	93.670				484,630	—	484,630
Total Administration for Children and Families					484,630	823,020	1,307,650
Centers for Medicare and Medicaid Services:							
Medical Assistance Program*(1)	93.778	GR-10-30471-00	Tennessee Department of Health		—	273,027	273,027

(Continued)

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Schedule of Expenditures of Federal Awards

Year ended December 31, 2010

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	$	—	239,424	239,424
Office of the Secretary:							
National Bioterrorism Hospital Preparedness Program	93.889	Z-08-200435-01	Tennessee Department of Health		—	3,973	3,973
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30291	Tennessee Department of Health		—	52,895	52,895
National Bioterrorism Hospital Preparedness Program	93.889	GR-11-32819	Tennessee Department of Health		—	7,609	7,609
National Bioterrorism Hospital Preparedness Program	93.889	Z-08-200434-01	Tennessee Department of Health		—	2,445	2,445
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30329	Tennessee Department of Health		—	28,144	28,144
National Bioterrorism Hospital Preparedness Program	93.889	GR-11-32817	Tennessee Department of Health		—	2,214	2,214
National Bioterrorism Hospital Preparedness Program	93.889	Z-08-200433-01	Tennessee Department of Health		—	3,010	3,010
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30331	Tennessee Department of Health		—	35,405	35,405
National Bioterrorism Hospital Preparedness Program	93.889	GR-11-32818	Tennessee Department of Health		—	6,424	6,424
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30327	Tennessee Department of Health		—	36,392	36,392
National Bioterrorism Hospital Preparedness Program	93.889	GR-11-32816	Tennessee Department of Health		—	4,114	4,114
National Bioterrorism Hospital Preparedness Program	93.889	GR-10-30326	Tennessee Department of Health		—	136,168	136,168
National Bioterrorism Hospital Preparedness Program	93.889	GR-11-32815	Tennessee Department of Health		—	6,155	6,155
National Bioterrorism Hospital Preparedness Program	93.889	Z-08-200432-01	Tennessee Department of Health		—	2,665	2,665
National Bioterrorism Hospital Preparedness Program	93.889	GR-11-30325	Tennessee Department of Health		—	17,220	17,220
National Bioterrorism Hospital Preparedness Program	93.889	GR-11-32820	Tennessee Department of Health		—	5,027	5,027
Total CFDA					—	349,860	349,860
Centers for Disease Control and Prevention:							
HIV Prevention Activities Health Department Based*	93.940	GR-10-30711-00	Tennessee Department of Health/ United Way of the Mid South		—	46,526	46,526
HIV Prevention Activities Health Department Based*	93.940	GR-10-30294-00	Tennessee Department of Health		—	78,628	78,628
HIV Prevention Activities Health Department Based*	93.940	GR-11-33833-00	Tennessee Department of Health		—	24,814	24,814
Total CFDA					—	149,968	149,968
Total U.S. Department of Health and Human Services					1,703,674	2,863,461	4,567,135
Total Federal Expenditures				$	1,703,674	2,972,366	4,676,040

* Denotes Major program.

(1) Denotes Medicaid Cluster.

(2) Denotes Healthy Start Cluster.

See accompanying Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133.

See accompanying notes to 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, 2010

Program name	CFDA number	Contract number	Award amount	Accrued revenue January 1, 2010	Cash receipts	Transfers in	Disbursements	Refunds to grantors/ other	Transfers out	Accrued revenue December 31, 2010
Passed through Tennessee (TN) Department of Human Services:										
Child Care and Development Block Grant	93.575	GR-09-25256-01	$ 735,633	174,000	(540,638)	—	366,638	—	—	—
Child Care and Development Block Grant	93.575	GR-11-31681	735,633	—	(57,746)	—	354,819	—	—	297,073
Child and Adult Care Food Program	10.558	03-47-64393-001	110,000	3,191	(13,193)	—	10,002	—	—	—
Total passed through TN Department of Human Services			1,581,266	177,191	(611,577)	—	731,459	—	—	297,073
Passed through TN Department of Children's Services:										
Social Service Block Grant – Evaluation DCS (non-federal)	NONE	GR-10-29329-00	375,000	61,450	(205,605)	—	144,155	—	—	—
Community-Based Child Abuse Prevention Grants	93.590	GR-10-29678-00	135,611	7,886	(50,460)	—	51,067	—	—	8,493
Community-Based Child Abuse Prevention Grants	93.590	GR-10-29677-00	102,000	22,946	(65,617)	—	50,496	—	—	7,825
Total passed through TN Department of Children's Services			612,611	92,282	(321,682)	—	245,718	—	—	16,318
Passed through TN Department of Health:										
National Bioterrorism Hospital Preparedness Program-U	93.889	Z-08-200435-01	101,000	(3,973)	—	—	3,973	—	—	—
National Bioterrorism Hospital Preparedness Program-U	93.889	GR-10-30291	57,584	—	(57,584)	—	52,895	—	—	(4,689)
National Bioterrorism Hospital Preparedness Program-U	93.889	GR-11-32819	78,090	—	(78,090)	—	7,609	—	—	(70,481)
National Bioterrorism Hospital Preparedness Program-S	93.889	Z-08-20-043401	49,500	(2,445)	—	—	2,445	—	—	—
National Bioterrorism Hospital Preparedness Program-S	93.889	GR-10-30329	30,584	—	(30,584)	—	28,144	—	—	(2,440)
National Bioterrorism Hospital Preparedness Program-S	93.889	GR-11-32817	34,758	—	(34,758)	—	2,214	—	—	(32,544)
National Bioterrorism Hospital Preparedness Program-N	93.889	Z-08-20-043301	63,000	(3,010)	—	—	3,010	—	—	—
National Bioterrorism Hospital Preparedness Program-N	93.889	GR-10-30331	38,792	—	(38,792)	—	35,405	—	—	(3,387)
National Bioterrorism Hospital Preparedness Program-N	93.889	GR-11-32818	39,468	—	(39,468)	—	6,424	—	—	(33,044)
National Bioterrorism Hospital Preparedness Program-G	93.889	GR-10-30327	37,172	—	(37,172)	—	36,392	—	—	(780)
National Bioterrorism Hospital Preparedness Program-G	93.889	GR-11-32816	44,963	—	(44,963)	—	4,114	—	—	(40,849)
National Bioterrorism Hospital Preparedness Program-L	93.889	GR-10-30326	136,524	—	(136,524)	—	136,168	—	—	(356)
National Bioterrorism Hospital Preparedness Program-L	93.889	GR-11-32815	96,533	—	(96,533)	—	6,155	—	—	(90,378)
National Bioterrorism Hospital Preparedness Program-Fayette	93.889	Z-08-200432-01	34,240	(2,665)	—	—	2,665	—	—	—
National Bioterrorism Hospital Preparedness Program-Fayette	93.889	GR-10-30325	20,000	—	(20,000)	—	17,220	—	—	(2,780)
National Bioterrorism Hospital Preparedness Program-Fayette	93.889	GR-11-32820	20,000	—	(20,000)	—	5,027	—	—	(14,973)
Maternal and Child Health Services Block Grant to the States	93.994	GR-10-28587-00	630,700	89,187	(394,516)	—	304,593	736	—	—
Maternal and Child Health Services Block Grant to the States	93.994	GR-11-32762-00	630,700	—	(208,705)	—	303,113	—	—	94,408
Medical Assistance Program	93.778	GR-10-30471-00	500,000	70,100	(343,127)	–	273,027	—	—	—
Project Diabetes (non-federal)	NONE	GR-10-30791-00	121,700	—	(116,165)	—	116,165	—	—	—
Nurse Family Partnership Program (non-federal)	NONE	GR-09-29630-00	390,000	63,884	(239,056)	—	174,672	500	—	—
Nurse Family Partnership Program (non-federal)	NONE	GR-10-32278-00	345,000	—	(139,761)	—	198,641	—	—	58,880
HIV Prevention Activities - Health Department Based	93.940	GR-10-30294-00	106,100	18,636	(97,264)	—	78,628	—	—	—
HIV Prevention Activities - Health Department Based	93.940	GR-11-33833-00	116,800	—	(9,133)	—	24,814	—	—	15,681
HIV Prevention Activities - Health Department Based	93.940	GR-09-27417-00	55,000	12,963	(12,963)	—	—	—	—	—
HIV Prevention Activities - Health Department Based	93.940	GR-10-30711-00	50,000	—	(29,039)	—	46,526	—	—	17,487
Total passed through TN Department of Health			3,828,208	242,677	(2,224,197)	—	1,870,039	1,236	—	(110,245)
Passed through TN Department of Education:										
T.E.I.S. (non-federal-FY 2011)	NONE	DGA-C000006	1,345,600	112,559	(447,844)	—	569,295	—	—	234,010
T.E.I.S. (federal-FY 2011)	84.393A	DGA-C000006	302,000	—	(6,500)	—	98,903	—	—	92,403
Total passed through TN Department of Education			1,647,600	112,559	(454,344)	—	668,198	—	—	326,413
Total State of Tennessee Financial Assistance			$ 7,669,685	624,709	(3,611,800)	—	3,515,414	1,236	—	529,559

(1) Denotes Healthy Start Cluster.

See accompanying Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133.

See accompanying notes to 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, 2010

(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, 2010. The accompanying Schedule of Expenditures of State of Tennessee Financial Assistance summarizes the expenditures of the System under programs of the state government that requires an audit in accordance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* (collectively with the Schedule of Expenditures of Federal Awards, the Schedules). 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 Schedules 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 2010 under the Coordinated Services and Access to Research for Women, Infants, Children, and Youth Program and Rural Health Care Services Outreach and Rural Health Network Development Program totaling $383,102 and $98,192 respectively.

METHODIST LE BONHEUR HEALTHCARE AND AFFILIATES

Schedule of Findings and Questioned Costs

Year ended December 31, 2010

(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?		yes	x	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?		yes	x	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?		yes	x	no

Identification of major programs:

CFDA Numbers	Name of federal program or cluster
93.778	Medical Assistance Program/Medicaid Cluster
93.887	Health Care and Other Facilities
93.940	HIV Prevention Activities - Health Department Based
93.994	Maternal and Child Health Services Block Grant to the States

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*

There were no findings and questioned costs related to the financial statements reported in accordance with *Government Auditing Standards* for the year ended December 31, 2010.

(3) Findings and Questioned Costs Relating to Federal Awards

There were no findings and questioned costs relating to federal awards for the year ended December 31, 2010.

Corrective Action Plan and Schedule of Prior Year Findings:

It should be noted that for the 2009 and 2010 Methodist Le Bonheur Healthcare A-133 audits, no findings were noted within the report. Therefore a corrective action plan and a listing of prior year findings is N/A.