WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Financial Statements

June 30, 2010 and 2009

(With Independent Auditors' Report Thereon)

WELLMONT HEALTH SYSTEM AND AFFILIATES

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Independent Auditors' Report

The Board of Directors
Wellmont Health System:

We have audited the accompanying consolidated balance sheets of Wellmont Health System and affiliates (Wellmont) as of June 30, 2010 and 2009, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of Wellmont's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Wellmont'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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Wellmont Health System and affiliates as of June 30, 2010 and 2009, and the consolidated results of their operations and changes in net assets, and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

October 28, 2010

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Balance Sheets

June 30, 2010 and 2009

(Dollars in thousands)

Assets		2010	2009
Current assets:			
Cash and cash equivalents	$	35,711	60,889
Assets limited as to use, required for current liabilities		1,815	2,201
Patient accounts receivable, less allowance for uncollectible accounts of approximately $25,113 and $27,890 in 2010 and 2009, respectively		94,057	98,071
Other receivables		10,919	11,173
Inventories		18,294	17,169
Prepaid expenses and other current assets		7,003	6,040
Total current assets		167,799	195,543
Assets limited as to use, net of current portion		301,807	245,600
Land, buildings, and equipment, net		450,205	442,610
Other assets:			
Long-term investments		32,391	31,974
Investments in affiliates		32,019	31,976
Deferred debt expense, net		4,644	4,824
Goodwill, net		9,501	9,509
Other		730	798
		79,285	79,081
Total assets	$	999,096	962,834
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	11,958	13,197
Lines of credit/short-term note payable		14,000	15,811
Accounts payable and accrued expenses		74,679	77,139
Estimated third-party payor settlements		11,672	12,441
Current portion of other long-term liabilities		7,251	6,352
Total current liabilities		119,560	124,940
Long-term debt, less current portion		467,833	474,608
Other long-term liabilities, less current portion		47,364	38,422
Total liabilities		634,757	637,970
Net assets:			
Unrestricted		358,620	320,030
Temporarily restricted		4,551	3,589
Permanently restricted		1,168	1,245
Total net assets		364,339	324,864
Commitments and contingencies			
Total liabilities and net assets	$	999,096	962,834

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2010 and 2009

(Dollars in thousands)

		2010	2009
Revenue:			
Net patient service revenue	$	692,920	680,056
Other revenues		31,472	27,842
Total revenue		724,392	707,898
Expenses:			
Salaries and benefits		310,667	323,801
Medical supplies and drugs		150,143	141,044
Purchased services		74,922	81,031
Interest		20,110	16,013
Provision for bad debts		35,293	33,402
Depreciation and amortization		43,711	42,957
Other		66,734	62,604
Total expenses		701,580	700,852
Income from operations		22,812	7,046
Nonoperating gains (losses):			
Investment income		1,012	4,181
Derivative valuation adjustments		(2,693)	(5,747)
Other, net		(1,870)	(625)
Nonoperating losses, net		(3,551)	(2,191)
Revenue and gains in excess of expenses and losses before discontinued operations		19,261	4,855
Discontinued operations		(1,109)	(4,455)
Revenue and gains in excess of expenses and losses		18,152	400
Other changes in unrestricted net assets:			
Change in net unrealized gains (losses) on investments		22,312	(60,663)
Net assets released from restrictions for additions to land, buildings, and equipment		1,555	2,758
Change in the funded status of benefit plans and other		(3,429)	(13,568)
Increase (decrease) in unrestricted net assets		38,590	(71,073)
Changes in temporarily restricted net assets:			
Contributions		2,934	1,944
Net assets released from temporary restrictions		(1,972)	(3,154)
Increase (decrease) in temporarily restricted net assets		962	(1,210)
Changes in permanently restricted net assets – investment (loss) income		(77)	645
Change in net assets		39,475	(71,638)
Net assets, beginning of year		324,864	396,502
Net assets, end of year	$	364,339	324,864

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2010 and 2009

(Dollars in thousands)

		2010	2009
Cash flows from operating activities:			
Change in net assets	$	39,475	(71,638)
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		43,755	43,393
Loss on disposal of land, buildings, and equipment		1,282	659
Equity in gain of affiliated organizations		(6,773)	(5,549)
Amortization of deferred financing costs		180	238
Net realized and unrealized (gains) losses on investments, other than trading		(17,994)	66,199
Provision for bad debts		35,950	33,821
Change in fair value of derivative instruments		2,693	5,747
Changes in assets and liabilities:			
Patient accounts receivable		(31,936)	(22,378)
Other current assets		(2,088)	(385)
Other assets		322	3,735
Accounts payable and accrued expenses		2,722	(5,796)
Estimated third-party payor settlements		(769)	10,355
Other current liabilities		899	1,437
Other liabilities		7,933	11,101
Net cash provided by operating activities		75,651	70,939
Cash flows from investing activities:			
Proceeds from sales and maturities of investments		88,887	67,580
Purchase of investments		(127,131)	(25,207)
Purchase of land, buildings, and equipment		(55,684)	(86,623)
Proceeds from the sale of buildings and equipment		4,357	31,251
Cash paid for acquisitions		(2,421)	—
Investment in affiliated organizations		—	(4,453)
Distributions from affiliated organizations		6,730	7,181
Distributions to affiliated organizations		(1,684)	(924)
Net cash used in investing activities		(86,946)	(11,195)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt		14,000	484
Payments on long-term debt		(12,083)	(11,005)
Payments on line of credit		(15,800)	(2,121)
Net cash used in financing activities		(13,883)	(12,642)
Net (decrease) increase in cash and cash equivalents		(25,178)	47,102
Cash and cash equivalents, beginning of year		60,889	13,787
Cash and cash equivalents, end of year	$	35,711	60,889

Supplemental disclosures of noncash items:

Wellmont entered into capital lease obligations for buildings and equipment in the amount of $1,290 and $18,050 in 2010 and 2009, respectively.

Additions to property and equipment financed through current liabilities of $5,182 and $5,977 in 2010 and 2009, respectively.

See accompanying notes to consolidated financial statements.

(1) Operations and Basis of Presentation

Wellmont Health System (Wellmont) was formed to assume operations of Bristol Regional Medical Center (BRMC) and Holston Valley Health Care, Inc. (HVHC), including Holston Valley Medical Center, Inc. (HVMC), and to act as sole corporate member of its consolidated foundations. Effective July 1, 1996, under terms of an agreement and plan of consolidation and merger, BRMC and HVHC, including HVMC, were merged and consolidated into Wellmont. Effective January 1, 1997, Lonesome Pine Hospital (LPH), a Virginia corporation, was merged into Wellmont under terms of a plan of merger and merger agreement. Effective July 1, 2000, Hawkins County Memorial Hospital (HCMH) transferred its operations and operating assets to Wellmont Hawkins County Memorial Hospital (WHCMH), a tax-exempt organization that is wholly owned and controlled by Wellmont. Hancock County Hospital (HCH), a critical access hospital, was opened in March 2005 to help provide for the immediate healthcare needs of the residents of Sneedville and the surrounding counties. As of July 16, 2007, Wellmont acquired Jenkins Community Hospital (Jenkins) in Kentucky. As of August 1, 2007, Wellmont acquired two hospitals in Virginia, Lee Regional Medical Center in Pennington Gap and Mountain View Regional Medical Center in Norton. On May 30, 2008, Wellmont acquired the Holston Valley Cath Lab, an outpatient lab. On May 1, 2010, Wellmont acquired Cardiovascular Associates.

As of April 30, 2009, Wellmont closed Jenkins, sold the majority of the facility's property and equipment to Appalachian Regional Healthcare, Inc for $1,000 and recorded a loss on sale of approximately $256. The consolidated financial statements for the years ended June 30, 2010 and 2009 present Jenkins as a discontinued operation. The operating losses of $474 and $3,659 for the years ended June 30, 2010 and 2009, respectively, and the impairment are included in the classification of discontinued operations.

As of June 30, 2010, it was announced that Wellmont will sell the majority of Medical Mall Pharmacy's assets to a national pharmacy company for $1,300 plus inventory value. The consolidated financial statements for the years ended June 30, 2010 and 2009 present Medical Mall Pharmacy as a discontinued operation. The operating losses of $635 and $540 for the years ended June 30, 2010 and 2009, respectively, are included in the classification of discontinued operations. The sale was completed on September 23, 2010.

All acute care operations remain separately licensed and are treated as operating divisions within Wellmont. Wellmont's operations consist primarily of the delivery of healthcare services in northeast Tennessee and southwest Virginia.

The consolidated financial statements include the acute care operations of the above entities along with:

- Wellmont Foundation (the Foundation), which was created from the merger of Bristol Regional Medical Center Foundation and Holston Valley Health Care Foundation, Inc. The Foundation conducts fund-raising activities for the benefit of Wellmont.
- Wellmont, Inc., a wholly owned taxable subsidiary of Wellmont, formed as the holding company of various other taxable subsidiaries that provide medical collection and medical laundry services, operate a pharmacy and physician practices, provide other healthcare-related services, and invest in affiliates and other activities.

- The Alzheimer's Center of East Tennessee was merged into Wellmont and changed its name to Wellmont Madison House effective September 1, 1997. Wellmont is the sole corporate member and the consolidated financial statements include the operations of this entity.

All significant intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

(2) Significant Accounting Policies

A summary of significant accounting policies follows:

(a) Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Significant estimates include: allowances for contractual adjustments and bad debts; third-party payor settlements; valuation of investments, land, buildings, equipment, and goodwill; and self-insurance and other liabilities. Actual results could differ from these estimates.

(b) Cash and Cash Equivalents

Wellmont considers all highly liquid investments with a maturity of three months or less when purchased, excluding amounts whose use is limited by board of director's designation or other arrangements under trust agreements, to be cash equivalents.

(c) Investments

Marketable equity securities and debt securities are recorded at fair value and classified as other than trading. Fair value is determined primarily using quoted prices (unadjusted) in active markets for identical assets or liabilities that Wellmont has the ability to access at the measurement date. However, Wellmont also uses observable and unobservable inputs for investments without quoted market prices to determine the fair value of certain investments at the measurement date. Investments in limited partnerships are recorded at fair value as determined by the partnership using net asset value. Wellmont elected to early adopt the measurement provisions of Accounting Standards Update No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent),* to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. Investments in affiliates in which Wellmont has significant influence but does not control are reported on the equity method of accounting, which represents Wellmont's equity in the underlying net book value. Long-term investments include those investments that have not been designated by the board of directors for specific purposes and are also not intended to be used for the liquidation of current liabilities. Investment income is recognized when earned.

Realized gains and losses are determined on the specific-identification method and included in investment income with interest and dividends. Investment income is reported net of related investment fees. Unrealized gains and losses are included in other changes in unrestricted net assets except for losses determined to be other than temporary, which are considered realized losses and included in investment income.

On July 1, 2008, Wellmont adopted new guidance issued by the Financial Accounting Standards Board (FASB), which defines fair value, establishes a framework for the measurement of fair value, and enhances disclosures about fair value measurements now codified into Accounting Standards Codification (ASC) 850. ASC 850 statement does not require any new fair value measures and did not have a material impact on Wellmont's consolidated financial statements for the year ended June 30, 2009, however, expanded fair value disclosures have been provided in note 19.

(d) Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under bond indenture and self-insurance agreements, as well as designated assets set aside by the board of directors for future capital improvements, over which the board of directors retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of Wellmont have been reclassified to current assets in the accompanying consolidated balance sheets.

(e) Inventories

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

(f) Land, Buildings, and Equipment

Land, buildings, and equipment are stated at cost, if purchased, or fair value at date of donation. Depreciation is computed using the straight-line method based on the estimated useful life of the asset, ranging from 3 to 40 years. Buildings and equipment held under capital leases are recorded at net present value of future lease payments and are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. Costs of maintenance and repairs are expensed as incurred. Upon sale or retirement of land, buildings, or equipment, the cost and related accumulated depreciation are eliminated from the respective accounts and the resulting gain or loss, if any, is included in other revenues on the consolidated statements of operations and changes in net assets. Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

Wellmont evaluates long-lived assets for impairment on annual basis. Long-lived assets are considered to be impaired whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable from future cash flows. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of an asset to future cash flows expected to be generated by the asset. When such assets are considered to be impaired, the impairment loss recognized is measured by the amount by which the carrying value of the asset exceeds the fair value of the asset.

(Dollars in thousands)

(g) Goodwill

Goodwill represents the difference between the cost of net assets acquired and estimated fair value at purchase date, and is being amortized using the straight-line method over periods of 5 to 15 years. For goodwill acquired by its taxable entities, the FASB has implemented a nonamortization approach to goodwill. However, the effective date for not-for-profit entities is not effective until fiscal year 2011 for Wellmont and, as such, Wellmont continues to amortize the goodwill associated with its tax-exempt entities. Wellmont assesses the recoverability and the amortization period of goodwill for not-for-profit entities by determining whether the amount can be recovered through undiscounted cash flows of the business acquired, excluding interest and amortization, over the remaining amortization period. If impairment is indicated by this analysis, measurement of the impairment recognized is based on the difference between the fair value and the carrying amount of the asset. Management considers external factors relating to each acquired business, including local market developments, regional and national trends, regulatory developments, and other pertinent factors in making its assessment. Goodwill for Wellmont's for-profit/taxable entities is reviewed for impairment at least annually in accordance with the provisions of FASB ASC 350, *Intangibles – Goodwill and Other* (Statement No. 142, *Goodwill and Other Intangible Assets*). The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test. Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. A summary of goodwill and related amortization for the years ended June 30 follows:

		2009	Additions	Decreases	2010
Goodwill	$	12,604	—	—	12,604
Amortization		(3,095)	(8)	—	(3,103)
	$	9,509	(8)	—	9,501

(Dollars in thousands)

	2008	Additions	Decreases	2009
Goodwill	$ 12,771	—	(167)	12,604
Amortization	(3,130)	(30)	65	(3,095)
	$ 9,641	(30)	(102)	9,509

(h) Deferred Debt Expense

Deferred debt expense is amortized over the life of the related bond issues using the effective-interest method.

(i) Derivative Financial Instruments

As further described in note 12, Wellmont is a party to interest rate swap and other derivative agreements. These financial instruments are not designated as hedges and are presented at estimated fair market value in the accompanying consolidated balance sheets. These fair values are based on the estimated amount Wellmont would receive, or be required to pay, to enter into equivalent agreements with a third party at the valuation date. Due to the nature of these financial instruments, such estimates are subject to significant change in the near term. Wellmont recognizes changes in the fair values of derivatives as nonoperating gains or losses in the consolidated statements of operations and changes in net assets. The cash settlements resulting from these interest rate swaps are reported as interest expense in the consolidated statements of operations and changes in net assets.

(j) Asset Retirement Obligations

Asset retirement obligations (AROs) are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value, and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, Wellmont records period-to-period changes in the ARO liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. Wellmont derecognizes ARO liabilities when the related obligations are settled.

(k) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Wellmont has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by Wellmont in perpetuity. Generally, donors of permanently restricted assets permit use of all or part of the income earned on related investments for general or specific purposes.

Temporarily restricted net assets relate primarily to amounts held by the Foundation and include amounts restricted for future capital expenditures and for operations of such areas as children's healthcare services, hospice, and cancer research.

(Continued)

Net assets are released from restrictions by Wellmont incurring expenses that satisfy the restricted purposes. Such net assets released during 2010 and 2009 primarily included amounts related to the purchase of buildings and equipment for pediatrics, cancer, and other healthcare operations.

(l) Net Patient Service Revenue and Accounts Receivable

Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts expected to be collected. Net patient service revenue includes amounts estimated by management to be reimbursable by patients and various third-party payors under provisions of reimbursement formulas in effect, including retroactive adjustments under reimbursement agreements. Estimated retroactive adjustments are accrued in the period related services are rendered and adjusted in future periods as final and other settlements are determined. Wellmont provides care to patients who meet criteria under its charity care policy without charge or at amounts less than its established rates. Because Wellmont does not pursue collection of amounts determined to qualify as charity care, they are not included in net patient service revenue.

Patient accounts receivable are reported net of both an allowance for uncollectible accounts and an allowance for contractual adjustments. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, TennCare, Medicaid, and other third-party payment programs. Wellmont's policy does not require collateral or other security for patient accounts receivable. Wellmont routinely obtains assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans, or policies.

(m) Revenue and Gains in Excess of Expenses and Losses

The consolidated statements of operations and changes in net assets include revenue and gains in excess of expenses and losses. Changes in unrestricted net assets that are excluded from revenue and gains in excess of expenses and losses, consistent with industry practice, include changes in net unrealized gains (losses) on investments other-than-trading securities, changes in the funded status of Wellmont's defined benefit plans, contributions of long-lived assets, including assets acquired using contributions that, by donor restriction, were to be used for the purpose of acquiring such assets, and cumulative effects of changes in accounting principles.

For purposes of financial statement display, those activities directly associated with Wellmont's mission of providing healthcare services are considered to be operating activities. Nonoperating activities primarily include investment and related activities. Other operating revenues primarily include cafeteria, rental, and income from affiliates.

(n) Contributed Resources

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted contributions, and are excluded from revenue and gains 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 contributions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expiration of donor restrictions is reported when the donated or acquired long-lived assets are placed in service.

Unconditional promises to give cash or other assets are reported at fair value at the date the promise is received. Gifts are reported as either a temporarily or permanently restricted contribution if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are recorded as unrestricted contributions. Unrestricted contributions are included in other revenues.

(o) Federal Income Taxes

The Wellmont entities are primarily classified as organizations exempt from federal income taxes under Section 501(a) as entities described in Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes has been included for these entities in the consolidated financial statements. The operations of Wellmont, Inc. and its subsidiaries are subject to state and federal income taxes, which are accounted for in accordance with ASC 740, *Income Taxes*; however, such amounts are not material.

On July 1, 2007, Wellmont adopted new guidance issued by on the accounting for uncertainty in income tax positions now codified into ASC 740. It also provides guidance on when tax positions are recognized in an entity's financial statements and how the values of these positions are determined. There was no impact on Wellmont's consolidated financial statements as a result of the adoption of the new guidance.

(p) New Accounting Pronouncements

Effective July 1, 2008, Wellmont adopted new guidance issued by FASB, which provides guidance on the net asset classification of donor-restricted endowment funds for a tax-exempt organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) now codified into ASC 958, *Not-for-Profit Entities*. Effective July 1, 2007, the State of Tennessee adopted legislation that incorporates the provisions outlined in UPMIFA. Wellmont's endowments consist solely of donor-restricted endowment funds. Wellmont's endowments consist of four individual funds established for a variety of purposes.

Wellmont has interpreted UPMIFA 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. As a result of this interpretation, Wellmont classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are approved for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Wellmont considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the organization and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the organization; and (7) the investment policies of the organization.

On June 30, 2009, Wellmont adopted guidance issued by the FASB for subsequent events, now codified into ASC 855, *Subsequent Events*. ASC 855 defines the period after the balance sheet date during which management shall evaluate events or transactions that may occur for potential recognition or disclosure, the circumstances under which an organization shall recognize events occurring after the balance sheet date and the disclosures that an organization shall make about those events or transactions. ASC 855 defines two types of subsequent events. The first type consists of events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent to the process of preparing financial statements (i.e., recognized subsequent events). The second type consists of events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the date (i.e., nonrecognized event).

Management evaluated all events and transactions that occurred through October 28, 2010. Other than described in note 11, Wellmont did not have any material subsequent events during this period.

On July 1, 2009, the FASB issued Statement No. 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles* (Statement 168). Statement 168 is the single source of authoritative nongovernmental GAAP, superseding existing FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force, and related accounting literature. Statement 168 reorganizes the thousands of pages of GAAP pronouncements into roughly 90 accounting topics and displays them using a consistent structure. Also included is relevant Securities and Exchange Commission guidance organized using the same topical structure in separate sections. Statement 168 is effective for interim and annual periods ending after September 15, 2009. The adoption of Statement 168 had no significant effect on the Wellmont's consolidated financial statements.

(q) Reclassifications

Certain 2009 amounts have been reclassified to conform to the 2010 consolidated financial statement presentation.

(Dollars in thousands)

(3) Net Patient Service Revenue

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations and changes in net assets is as follows for the years ended June 30:

		2010	2009
Gross patient service charges	$	2,158,847	2,178,018
Less:			
Contractual adjustments and other discounts		(1,411,435)	(1,440,519)
Charity care		(54,492)	(57,443)
		(1,465,927)	(1,497,962)
Net patient service revenue	$	692,920	680,056

(4) Third-Party Reimbursement Arrangements

Wellmont renders services to patients under contractual arrangements with the Medicare and Medicaid programs. The Medicaid program in Tennessee was replaced with a managed care program known as TennCare, which was designed to cover previous Medicaid eligible enrollees. Amounts earned under these contractual arrangements are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Management believes that adequate provision has been made for any adjustments that may result from such reviews. Participation in these programs subjects Wellmont to significant rules and regulations; failure to adhere to such could result in fines, penalties, or expulsion from the programs.

Wellmont contracts with various managed care organizations under the TennCare program. TennCare reimbursement for both inpatient and outpatient services is based upon prospectively determined rates, including diagnostic-related group assignments, fee schedules, and per diem amounts. Reimbursement under the Virginia Medicaid program is also based upon prospectively determined amounts.

The Medicare program pays for the costs of inpatient services on a prospective basis. Payments are based upon diagnostic-related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. Wellmont receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid-eligible and other low income patients. Outpatient services are also reimbursed primarily on a prospectively determined basis.

(Dollars in thousands)

Net patient service revenue in 2010 and 2009 related to Medicare, TennCare, and Virginia Medicaid and net patient accounts receivable at June 30, 2010 and 2009 from Medicare, TennCare, and Virginia Medicaid were as follows:

		2010	2009
Net patient service revenue:			
Medicare	$	277,372	272,259
TennCare		22,918	22,509
Virginia Medicaid		23,536	19,036
Net patient accounts receivable:			
Medicare	$	41,125	39,852
TennCare		2,206	4,072
Virginia Medicaid		3,739	3,172

Wellmont has filed cost reports with Medicare and Virginia Medicaid. The cost reports are subject to final settlement after audits by the fiscal intermediary. The Medicare and Virginia Medicaid cost reports have been audited by the intermediary through June 30, 2006.

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

Net patient service revenue is reported at the net amounts billed to patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Estimated retroactive adjustments are accrued in the period the related services are rendered and adjusted in future periods as changes in estimated provisions and final settlements are determined. Net patient service revenue increased (decreased) approximately $863 and $(2,600) in 2010 and 2009, respectively, due to final settlements and revised estimates in excess of amounts previously recorded, removal of allowances previously estimated that are no longer necessary as a result of final settlements, and years that are not longer subject to audits, reviews, and investigations.

Estimated settlements recorded at June 30, 2010 could differ materially from actual settlements based on the results of third-party audits.

(5) Charity Care and Community Services

Wellmont accepts all patients within its primary service area regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies that consider, among other factors, generally recognized poverty income levels.

Wellmont maintains records to identify and monitor the level of charity care it provides. Charges foregone for services and supplies furnished under its charity care policy, the estimated cost of those services, and the equivalent percentage of charity care patients to all patients serviced were $54,492, $15,567, and

(Dollars in thousands)

2.52%, respectively, for the year ended June 30, 2010 and $57,443, $16,203, and 2.63%, respectively, for the year ended June 30, 2009.

In addition to the charity care services described above, Wellmont provides a number of other services to benefit the indigent for which little or no payment is received. Medicare, Medicaid, and State indigent programs do not cover the full cost of those services. The shortfall between actual receipts from those programs and Wellmont's cost of providing care to those patients totaled $55,461 and $57,212 for the years ended June 30, 2010 and 2009, respectively.

Wellmont also provides services to the community at large for which it receives little or no payment. Health evaluations, screening programs, and specific services for the elderly and homebound are other services supplied. Wellmont also provides public health education, trains new health professionals, and conducts health research.

(6) Investment in Affiliates

Wellmont has investments with other healthcare providers, which include hospital, home care, regional laboratories, and other healthcare-related organizations. Wellmont records its share of equity in the operations of the respective organizations. Equity in net income of affiliates was approximately $6,773 and $5,549 for the years ended June 30, 2010 and 2009, respectively, and is included in other operating revenue in the consolidated financial statements. Wellmont made additional contributions of $0 and $4,453 during 2010 and 2009, respectively, to affiliates, which increased Wellmont's overall investment in affiliates. Wellmont received distributions of $6,730 and $7,181 during 2010 and 2009, respectively, which reduced Wellmont's overall investment in the affiliates.

The following table summarizes the unaudited aggregate financial information of Wellmont's investments in affiliates:

		2010	2009
Total assets	$	129,720	137,737
Total liabilities		13,943	39,913
Total net assets	$	115,777	97,824
Net revenues	$	166,815	178,253
Expenses		142,534	159,004
Revenues in excess of expenses	$	24,281	19,249

(Dollars in thousands)

Wellmont's equity investment in these affiliates and its ownership percentage as of June 30, 2010 and 2009 are as follows:

	Amount		Percentage	
	2010	**2009**	**2010**	**2009**
Takoma Regional Hospital	$ 12,645	12,302	60%	60%
Holston Valley Imaging Center (HVIC)	8,048	9,047	75	75
Advanced Home Care (AHC)	6,092	6,092	6	6
Spectrum Tennessee Network	3,850	3,462	20	20
Others	1,384	1,073	4% – 50%	4% – 50%
	$ 32,019	31,976		

Wellmont provided billing and management services to the affiliates. Income recognized by Wellmont for the services was $1,766 in 2010 and $1,501 in 2009 and is included in other revenues.

Included in other receivables are $124 and $135 as of June 30, 2010 and 2009, respectively, of amounts due to Wellmont from these entities.

Although Wellmont's ownership percentage in Takoma Regional Hospital and HVIC is greater than 50%, Wellmont does not consolidate these entities because Wellmont only has a 50% representation on each respective board and does not have control over these entities.

(Dollars in thousands)

(7) Investments

Long-term investments, including assets limited as to use, at June 30 are reported at fair value and consist of the following:

		2010	2009
Assets limited as to use by Board for capital improvements:			
Stock mutual funds	$	109,629	108,036
Bond mutual funds		71,698	5,910
Cash and money market funds		1,474	2,517
Real estate funds		7,468	5,419
Alternative investments (private equity, hedge funds, commingled funds, and real estate funds):			
Liquid		33,915	12,415
Illiquid		23,490	23,171
		247,674	157,468
Assets limited as to use under self-insurance agreements:			
Corporate bonds		6,867	7,464
Cash and money market funds		558	643
		7,425	8,107
Assets limited as to use under bond indenture agreements:			
Cash and money market funds		48,523	82,226
Less assets limited as to use that are required for current liabilities		1,815	2,201
Assets limited as to use, net of current portion	$	301,807	245,600
Long-term investments:			
Stock mutual funds	$	9,279	8,631
Bond mutual funds		7,599	3,648
Preferred equity investment and related options		11,512	11,512
Cash, money market funds, and certificates of deposit		287	5,202
Real estate funds		1,722	1,255
Alternative investments (private equity, hedge funds, commingled funds, and real estate funds):			
Liquid		1,992	1,726
Total long-term investments	$	32,391	31,974

Investments in certain alternative limited partnership investments contain agreements whereby Wellmont is committed to contribute approximately $12,112 as of June 30, 2010 of additional funds to the limited partnerships in the form of capital calls at the discretion of the general partner, of which $417 was paid subsequent to June 30, 2010.

(Dollars in thousands)

Wellmont has invested $10,000 in the preferred equity of a regional managed services organization and $1,512 on a right of first refusal related to any future sale of this organization. This equity has a guaranteed annual return of at least 6.5% of the outstanding preferred equity balance.

Wellmont's investments are concentrated in stock and bond mutual funds. In the event of a downward trend in the stock and bond markets, Wellmont's overall market value of net assets could be adversely affected by a material amount. Investments in alternative investments are generally illiquid investments whose value is determined by the general partner such as hedge funds, private equity, commingled funds, and real estate funds. Distributions are only at the discretion of a voting majority of the general partners.

Wellmont evaluates whether unrealized losses on investment securities indicate other-than-temporary impairment. Based on this evaluation, the Company recognized other-than-temporary impairment losses of $8,233 and $4,654 on investments as of June 30, 2010 and 2009, respectively. The unrealized losses on these mutual funds were primarily caused by the overall decline in the world's economy in 2009 and 2010. Other-than-temporary impairment losses are considered as realized losses and are reported within "investment income" in the consolidated statements of operations and changes in net assets.

Gross unrealized losses on investments for which other-than-temporary impairments have not been recognized and the fair values of those investments, aggregated by the length of time that individual investments have been in a continuous unrealized loss position, at June 30, 2010 and 2009, were as follows:

	June 30, 2010					
	Less than 12 months		12 months or more		Total	
	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
Alternative investments	$ —	—	910	4,219	910	4,219
Stock mutual funds	2,184	29,658	24,817	83,713	27,001	113,371
	$ 2,184	29,658	25,727	87,932	27,911	117,590

	June 30, 2009					
	Less than 12 months		12 months or more		Total	
	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
Bond mutual funds	$ 191	4,112	—	—	191	4,112
Alternative investments	5,525	16,227	4,144	7,120	9,669	23,347
Stock mutual funds	22,243	74,147	17,460	35,983	39,703	110,130
	$ 27,959	94,486	21,604	43,103	49,563	137,589

(Dollars in thousands)

Investment income is comprised of the following for the years ended June 30:

		2010	2009
Interest and dividends, net of amounts capitalized	$	5,330	9,717
Realized losses on investments, including $8,233 and $4,654 recognized losses related to other-than-temporary impairments in 2010 and 2009, respectively.		(4,318)	(5,536)
Investment income, net	$	1,012	4,181
Change in net unrealized gains (losses) on investments	$	22,312	(60,663)

(8) Land, Buildings, and Equipment

Land, buildings, and equipment at June 30 consist of the following:

		2010	2009
Land	$	41,210	44,149
Buildings and improvements		488,285	392,593
Equipment		327,896	303,805
Buildings and equipment under capital lease obligations		39,591	38,734
		896,982	779,281
Less accumulated depreciation		(459,935)	(418,399)
		437,047	360,882
Construction in progress		13,158	81,728
Land, buildings, and equipment	$	450,205	442,610

Depreciation expense for the years ended June 30, 2010 and 2009 was $43,755 and $43,393, respectively. Included in depreciation expense is amortization related to capitalized software and equipment under capital leases. Accumulated amortization for equipment under capitalized software and lease obligations was $13,266 and $9,109 as of June 30, 2010 and 2009, respectively.

(Dollars in thousands)

(9) Other Long-Term Liabilities

Other long-term liabilities at June 30 consist of the following:

		2010	2009
Workers' compensation liability	$	6,606	5,706
Professional and general liability		11,183	9,494
Postretirement benefit obligation		5,861	5,653
Asset retirement obligation		3,710	3,621
Deferred gain on sale of assets		1,382	2,136
Derivative liability		12,943	10,250
Pension benefit liability		10,018	6,709
Other		2,912	1,205
		54,615	44,774
Less current portion		(7,251)	(6,352)
Total other long-term liabilities	$	47,364	38,422

(10) Lines of Credit/Notes Payable

During 2008, Wellmont entered into three lines of credit for $15,000, $1,800, and $10,000. The $15,000 line of credit had a variable interest rate based upon LIBOR plus 1% and a termination date of August 2009; at June 30, 2009, $14,000 was outstanding on this line. During 2010, the $15,000 line of credit was paid in full with a $14,000 note payable, which was initiated with one bank to pay off the line of credit. The $14,000 note payable has a variable interest rate based upon LIBOR plus 2% and a termination date of December 2010. At June 30, 2010, $14,000 was outstanding on this note. During 2008, a $1,800 line of credit was initiated with one bank and was paid in full with the funds from the $10,000 line of credit from another bank, which had variable interest rate based upon LIBOR plus 0.95% and a termination date of August 31, 2009; at June 30, 2010 and 2009, $0 and $1,811, respectively, was outstanding on this line. The $10,000 line of credit was paid in full in 2010.

(Dollars in thousands)

(11) Debt

(a) Long-Term Debt

Long-term debt consists of the following at June 30:

		2010	2009
Hospital Revenue Bonds, Series 2007A	$	55,000	55,000
Hospital Revenue Refunding Bonds, Series 2006C		200,000	200,000
Hospital Revenue Refunding Bonds, Series 2006A and 2006B		93,405	95,205
Hospital Revenue Refunding Bonds, Series 2005		61,810	63,940
Hospital Revenue Bonds, Series 2003		36,666	40,145
Notes payable		6,429	4,399
Capital lease obligations		19,698	22,388
Other		358	71
		473,366	481,148
Unamortized premium		7,538	7,800
Unamortized discount		(1,113)	(1,143)
		479,791	487,805
Less current maturities		(11,958)	(13,197)
	$	467,833	474,608

(b) Series 2007 Bonds

On July 24, 2007, The Virginia Small Business Financing Authority issued, on behalf of Wellmont, $55,000 of Hospital Revenue Bonds, Series 2007A. The Series 2007A Bonds, with other methods of financing, were used to purchase the assets of Mountain View Regional Medical Center and Lee Regional Medical Center.

Principal on outstanding Series 2007A Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $360 to $2,460 commencing on September 1, 2017 through September 1, 2036, with a balloon payment of $29,245 due on September 1, 2037. The outstanding bonds accrue interest at rates ranging from 5.125% to 5.25%.

(c) Series 2006C

On October 26, 2006, The Health, Educational and Housing Facilities Board of the County of Sullivan Tennessee issued, on behalf of Wellmont, $200,000 of Hospital Revenue Bonds, Series 2006C. The Series 2006C Bonds were used to: finance the costs of acquisition of land for expansion, construction, expansion, equipping, and renovation of HVMC, including the construction of a new patient tower (collectively known as Project Platinum); finance the costs of the construction, expansion, equipping, and renovation of the emergency department at BRMC (the Bristol Emergency Department Project); and finance the costs of construction, expansion, renovation, and equipping of an operating room and related facilities at HCMH.

Principal on outstanding Series 2006C Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $1,605 to $25,330 commencing on September 1, 2017 through September 1, 2036. The outstanding bonds accrue interest at rates ranging from 5.00% to 5.25%.

(d) Series 2006 A and B

On June 23, 2006, The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee issued, on behalf of Wellmont, $98,475 of Hospital Revenue Refunding Bonds, Series 2006. This bond issuance consists of Series A tax-exempt and Series B taxable bonds of $76,595 and $21,880, respectively. The Series 2006 Bonds together with other available funds were used to advance refund all the previously issued Hospital Revenue Bonds, Series 1993, to reimburse Wellmont for payments made on other taxable borrowings and to pay certain expenses incurred in connection with the issuance of the Series 2006 Bonds. Upon this refunding, a trust was established to pay all future bond payments related to the Series 1993 Bonds. Wellmont was deemed to have paid the Series 1993 Bonds and these Bonds are no longer deemed to be outstanding for purposes of the Series 1993 Trust Indenture.

Principal on outstanding Series 2006A Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $875 to $6,400 commencing on September 1, 2013 through September 1, 2032; and the outstanding bonds accrue interest on a variable rate, which is reset monthly based upon the AAA-insured Municipal Market Data Index, plus 85 basis points. Principal on outstanding Series 2006B Bonds is payable through maturity in annual amounts ranging from $1,600 to $2,930 commencing on September 1, 2007 through September 1, 2016, and the outstanding bonds accrue interest at a fixed rate of 6.95%.

Outstanding Series 2006A Bonds are subject to redemption prior to maturity at the option of The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee upon direction by Wellmont in whole at any time, or in part on any certain specified days at redemption prices of 100%–102% of the principal amount of the Series 2006A Bonds being redeemed, plus accrued interest thereon to the redemption date.

On October 1, 2010, the Series 2006B Bonds were called and paid in full at par value of $14,880.

(e) Series 2005

On December 8, 2005, The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $70,620 of Hospital Revenue Refunding Bonds, Series 2005. The Series 2005 Bonds together with other available funds were used to advance refund the previously issued Hospital Revenue Bonds, Series 2002, and to pay certain expenses incurred in connection with the issuance of the Series 2005 Bonds.

Principal on outstanding Series 2005 Bonds is payable through maturity or scheduled mandatory sinking fund redemption in annual amounts ranging from $1,945 to $3,390 commencing on September 1, 2007 through September 1, 2032. The terms of the bonds provide that bondholders may redeem or put the bonds to the remarketing agent on dates that approximate a weekly basis. The remarketing agent is obligated to remarket the redeemed bonds on a "best efforts" basis. Redeemed bonds are repaid to bondholders from the proceeds of the remarketing effort or, in the event of an inability to remarket the bonds, from a letter of credit. Subsequent to year-end, Wellmont amended its letter of credit to cover an amount equal to the principal and up to 40 days' interest on the bonds at a maximum interest rate of 12% per annum, and is effective through July 1, 2011. This letter secures the bonds in the event of a failed remarketing or liquidity issue. In the event of a liquidity drawing under the letter of credit, Wellmont shall pay the Base Rate for the first 90 days equal to the greater of (i) the Prime Rate plus 1.50% per annum, ii) the Federal Funds Rate plus 3.00% per annum, or iii) 7.50% per annum. ; the Base Rate plus 0.50% for days 91 through 366 and the Base Rate plus 1.00% thereafter until the amount is paid in full.

Outstanding Series 2005 Bonds are subject to redemption prior to maturity at the option of The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee upon direction by Wellmont in whole at any time, or in part on any certain specified days at redemption prices of 100%–102% of the principal amount of the Series 2005 Bonds being redeemed, plus accrued interest thereon to the redemption date.

(f) Series 2003

On June 1, 2003, The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee issued, on behalf of Wellmont, $59,100 of Hospital Revenue Bonds, Series 2003. The bonds were issued to provide funds necessary to refund Wellmont's Hospital Revenue Bonds, Series 1993 (HVHC), to fund a debt service reserve fund and to pay certain expenses incurred in connection with the issuance of the Series 2003 Bonds.

The Wellmont Series 2003 Bonds consist of $27,460 in fixed rate serial bonds and $19,280 in fixed rate term bonds payable through maturity or mandatory sinking fund redemption maturing in annual amounts ranging from $3,230 on September 1, 2007 to $4,140 on September 1, 2019, and carrying interest rates ranging from 2.5% to 5.00%.

(g) Master Trust Indenture

The master trust indenture and loan agreements for the 2007, 2006, 2005, and 2003 bonds contain certain requirements regarding deposits to trustee funds, maintenance of rates, maintenance of debt service coverage and liquidity, permitted indebtedness, and permitted disposition of assets. Gross receipts of Wellmont collateralize the bonds. The purpose of the master trust indenture is to provide a mechanism for the efficient and economical issuance of notes by individual members of Wellmont using the collective borrowing capacity and credit rating of Wellmont. The master trust indenture requires individual members of Wellmont to make principal and interest payments on notes issued for their benefit. The master trust indenture also requires Wellmont members to make payments on notes issued by other members of Wellmont if such other members are unable to satisfy their obligations under the master trust indenture. Payments of principal and interest on certain bonds are also insured by bond insurance policies.

Funds held by the trustee related to the various revenue bonds are available for specific purposes. The bond interest and revenue funds may be used only to pay interest and principal on the bonds; the debt service reserve fund may be used to pay interest and principal if sufficient funds are not available in the bond interest and revenue funds. The original issue discount and premium on all Bond Series outstanding are being amortized over the life of the bond issue using the effective-interest method.

(h) Notes Payable

During 2007, Wellmont entered into a five-year $3,000 note payable, which has a fixed interest rate of 7.25% and a termination date of July 2011; at June 30, 2010 and 2009, $2,062 and $2,319, respectively, was outstanding on this note.

During 2008, Wellmont entered into a five-year $2,400 term note payable, which has a fixed interest rate of 7.25% and a termination date of August 2012; at June 30, 2010 and 2009, $1,600 and $2,080, respectively, was outstanding on this note.

During 2010, Wellmont entered into a $2,767 note payable to finance the purchase of Cardiovascular Associates. The note payable has a fixed interest rate of 5.5% and a termination date of May 2013. At June 30, 2010, $2,767 was outstanding on this note.

(i) Capital Lease Obligations

Wellmont has entered into leases for certain equipment under agreements classified as capital leases that expire over periods through 2011. Assets under capital leases are included in property and equipment and have a net carrying value of $26,325 and $29,625 as of June 30, 2010 and 2009, respectively. Amortization of capital assets is included in depreciation expense. The lease obligations are recorded at the net present value of the minimum lease payments with interest rates from 4.3% to 6.0%.

(Dollars in thousands)

(j) Long-term Debt Maturities Schedule

Bond maturities in accordance with the original terms of the Master Trust Indenture and other long-term debt maturities for each of the next five years and in the aggregate at June 30, 2010 are as follows:

2011	$	11,958
2012		13,329
2013		12,935
2014		12,193
2015		12,415
Thereafter		410,536
	$	473,366

The following table reflects the required repayment terms for the years ended June 30 of Wellmont's debt obligations in the event that the put options associated with the 2005 bonds were exercised, but not successfully remarketed.

2011	$	11,958
2012		30,859
2013		30,365
2014		29,508
2015		9,755
Thereafter		360,921
	$	473,366

Interest paid for the years ended June 30, 2010 and 2009 was $20,792 and $21,564, respectively, net of amounts capitalized. Interest costs of $2,776 and $3,421, net of interest income of $683 and $3,293 in 2010 and 2009, respectively, were capitalized.

(12) Derivative Transactions

Interest Rate Swaps: Wellmont is a party to a number of interest rate swap agreements. Such swaps have not been designated as hedges and are valued at estimated fair value in the accompanying consolidated balance sheets. By using derivative financial instruments to hedge exposures to changes in interest rates, Wellmont exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes Wellmont, which creates credit risk for Wellmont. When the fair value of a derivative contract is negative, Wellmont owes the counterparty, and therefore, Wellmont is not exposed to the counterparty's credit risk in those circumstances. Pursuant to the terms of its interest rate swap agreements, Wellmont is required to postcollateral with its counterparties under certain specified conditions. Collateral posting requirements are based on the amount of Wellmont's derivative liability and

(Dollars in thousands)

Wellmont's bond rating. As of June 30, 2010 and 2009, Wellmont was not required to postcollateral related to its swaps.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

In September and October 2008, the counterparty and credit support provider to the swaps filed bankruptcy. Subsequent to the bankruptcy filings, no payments have been made by Wellmont or the counterparty to each other. As of June 30, 2010, the net amounts due to Wellmont for this period are less than $100 and have been fully reserved. The bankruptcy process is underway and the outcome cannot be determined at this time.

Management's primary objective in holding such derivatives is to introduce a fixed or variable rate component into its debt structure using LIBOR. The fair value as of June 30, 2010 and 2009 of approximately $(12,943) and $(10,250), respectively, is included in other liabilities in the consolidated balance sheets. The change in the fair value of the derivative instruments was approximately $(2,693) and $(5,747), respectively, in 2010 and 2009 and is included in nonoperating losses, net in the consolidated statements of operations. The terms of the swap agreements allow netting of all amounts due from/to the counterparty. The net amounts have been recorded pending the outcome of any bankruptcy proceedings. The following is a summary of the interest rate swap information as of June 30, 2010:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2006A	$ 76,595	June 29, 2006	September 1, 2011	1.103%	5.440%	$ 1,101
Pay fixed interest rate swap	Series 2005	65,975	December 13, 2005	September 1, 2016	3.548	0.217	(6,810)
Basis swap	Series 2002	67,965	September 1, 2002	September 1, 2032	0.253	0.198	(2,710)
Pay fixed interest rate swap	Series 2006A	35,342	October 24, 2003	September 1, 2021	3.613	0.162	(4,524)
							$ (12,943)

The following is a summary of the interest rate swap information as of June 30, 2009:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2006A	$ 76,595	June 29, 2006	September 1, 2011	2.744%	5.884%	$ 1,075
Pay fixed interest rate swap	Series 2005	65,975	December 13, 2005	September 1, 2016	3.548	0.309	(5,197)
Basis swap	Series 2002	67,965	September 1, 2002	September 1, 2032	1.894	1.728	(2,708)
Pay fixed interest rate swap	Series 2006A	35,342	October 24, 2003	September 1, 2021	3.613	1.184	(3,420)
							$ (10,250)

(13) Pension and Other Postretirement Benefits

Wellmont sponsors a retirement program and defined contribution retirement plan (Retirement Plan) that covers substantially all employees. This program and the related Retirement Plan were created from amendments, restatements, and mergers of existing defined contribution plans at BRMC and HVMC. Wellmont makes annual contributions to the Retirement Plan in an amount equal to 3% of each participant's base wages and contributes an additional amount, based on each participant's voluntary contributions, which cannot exceed certain limits established in the Internal Revenue Code, up to 3% of each participant's wages. The total pension expense related to the Retirement Plan was $9,990 and $9,937 for the years ended June 30, 2010 and 2009, respectively.

HVMC sponsored a noncontributory, defined benefit pension plan covering substantially all its employees. However, effective June 30, 1996, this plan was frozen and no further benefits accrue. LPH also sponsors a defined benefit pension plan covering substantially all its employees.

HVMC's defined pension benefits are actuarially determined based on a formula taking into consideration an employee's compensation and years of service. HVMC's funding policy is to make annual contributions to the plan based upon the funding standard developed by the plan actuary. This standard uses the projected unit credit actuarial cost method, including the amortization of prior service costs, over a 20-year period. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The LPH plan contains similar funding and actuarial policies.

On June 30, 2007, the HVMC plan merged into LPH plan and the plan name changed to Wellmont Health System Defined Benefit Plan. At the end of 2008, only a single defined pension plan exists. Collectively, the two defined benefit plans are referred to as the "Plans."

Wellmont recognizes the funded status (i.e., difference between the fair value of plan assets and projected benefit obligations) of its defined benefit pension plans as an asset or liability in its consolidated balance sheets and recognizes changes in that funded status in the year in which the changes occur as a change in unrestricted net assets. All defined benefit pension plans use a June 30 measurement date.

(Dollars in thousands)

The following table sets forth the funded status of the combined Plans, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

		2010	2009
Change in benefit obligation:			
Benefit obligation at beginning of year	$	40,035	37,212
Service cost		230	234
Interest cost		2,432	2,441
Actuarial losses		4,008	2,132
Benefits paid		(2,140)	(1,984)
Benefit obligation at end of year	$	44,565	40,035
Change in plan assets:			
Fair value of plan assets at beginning of year		33,326	43,420
Actual return on plan assets		3,361	(8,110)
Benefits paid		(2,140)	(1,984)
Fair value of plan assets at end of year		34,547	33,326
Funded status	$	(10,018)	(6,709)
Amounts recognized in the accompanying consolidated balance sheets:			
Pension liability – other long-term liability	$	(10,018)	(6,709)

(Continued)

(Dollars in thousands)

		2010	2009
Amounts not yet reflected in net periodic benefit cost and included as an accumulated charge to unrestricted net assets:			
Unrecognized actuarial loss	$	13,158	10,851
Unrecognized prior service cost		2	2
Net amounts included as an accumulated charge to unrestricted net assets	$	13,160	10,853
Calculation of change in unrestricted net assets:			
Accumulated charge to unrestricted net assets, end of year	$	13,160	10,853
Reversal of accumulated credit to unrestricted net assets, prior year		(10,853)	2,357
Change in unrestricted net assets	$	2,307	13,210
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Actuarial loss arising during the year	$	2,907	13,210
Amortization of actuarial gain or loss		(600)	—
Amortization of prior service cost		—	—
Net amounts recognized as a charge to unrestricted net assets	$	2,307	13,210

(Dollars in thousands)

		2010	2009
Estimate of amounts that will be amortized from unrestricted net assets to net pension cost in 2011:			
Amortization of net loss	$	791	—
Amortization of prior service cost		—	2
Estimated future benefit payments:			
Fiscal 2011		2,211	2,150
Fiscal 2012		2,220	2,189
Fiscal 2013		2,337	2,314
Fiscal 2014		2,472	2,456
Fiscal 2015 (FY09 fiscal 2015 – 2019)		2,578	13,769
Fiscal 2016 – 2020		14,278	
Weighted average assumptions used to determine benefit obligations:			
Settlement (discount) rate		5.50%	6.25%
Weighted average rate of increase in future compensation levels		3.00	3.00
Components of net periodic benefit cost (benefit):			
Service cost	$	230	234
Interest cost		2,432	2,441
Expected return on plan assets		(2,259)	(2,968)
Amortization of unrecognized net loss		600	—
Amortization of unrecognized prior service cost		—	0
Net periodic benefit cost (benefit)	$	1,003	(293)
Weighted average assumptions used to determine net periodic benefit cost:			
Settlement (discount) rate		6.25%	6.75%
Expected long-term return on plan assets (HVMC)		7.00	7.00
Expected long-term return on plan assets (LPH)		7.00	7.00
Weighted average rate of increase in future compensation levels		3.00	3.00

Wellmont's overall expected long-term rate of return on assets is 7.00%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

Wellmont does not expect to make any contributions to the Plans during 2011.

Wellmont has developed a plan investment policy, which is reviewed and approved by the board of directors. The policy established goals and objectives of the fund, asset allocations, asset classifications, and manager guidelines. The policy dictates a target asset allocation and an allowable range for such categories based on quarterly investment fluctuations. Investments are managed by independent advisers who are monitored by management and the board of directors.

(Dollars in thousands)

The table below shows the target allocation and actual asset allocations as of June 30, 2010 and 2009:

Asset	**Target allocation**	**June 30, 2010**	**June 30, 2009**
Equity securities	65%	56%	53%
Fixed income	28	27	29
Cash	5% – 15%	1	3
Other	5 – 15	16	15

Wellmont monitors the asset allocation and executes required recalibrations of the portfolio allocation on a regular basis in response to fluctuations in market conditions and the overall portfolio composition.

HVMC also participates in a health and welfare plan for its retirees. The plan provides postretirement medical and life insurance benefits to certain employees who meet minimum age and service requirements. Effective January 1, 1995, the death benefit was changed to provide a flat $5 benefit to all future retirees. During 1995, the medical program for retirees was amended to terminate medical benefits for any active employees who would not meet the full eligibility requirements of the program by January 1, 1996. The plan is contributory and contains other cost-sharing features such as deductibles and coinsurance.

(Dollars in thousands)

The following table sets forth the postretirement plan's funded status, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

		2010	2009
Change in benefit obligation:			
Benefit obligation at beginning of year	$	5,653	5,637
Interest cost		320	355
Plan participants contributions		73	36
Actuarial losses		197	23
Benefits paid		(382)	(398)
Benefit obligation at end of year		5,861	5,653
Change in plan assets:			
Fair value of plan assets at beginning of year		—	—
Employer contribution		309	362
Plan participants contributions		73	36
Benefits paid		(382)	(398)
Fair value of plan assets at end of year		—	—
Funded status	$	(5,861)	(5,653)
Amounts recognized in the consolidated balance sheets consist of:			
Noncurrent liaibilities	$	(5,861)	(5,653)
Accumulated credit to unrestricted net assets		3,560	4,076
	$	(2,301)	(1,577)

Amounts recognized as an accumulated credit to unrestricted net assets consist of:

		Postretirement benefits	
		2010	2009
Net actuarial gain	$	3,560	4,076

(Continued)

(Dollars in thousands)

Net periodic benefic cost recognized and other changes in plan assets and benefit obligations recognized in unrestricted net assets in 2010 and 2009 were:

		Postretirement benefits	
		2010	2009
Net periodic benefit cost:			
Interest cost	$	320	355
Amortization of net gain		(319)	(335)
Net periodic benefit cost recognized		1	20
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Net actuarial loss		197	23
Amortization of net gain		319	335
Total recognized as a charge to unrestricted net assets		516	358
Total recognized in net periodic benefit cost and unrestricted net assets	$	517	378

The net gain and prior service credit for the defined benefit postretirement plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year are $(261) and $0, respectively. Weighted average assumptions used to determine benefit obligations for 2010 and 2009 were as follows:

	Postretirement benefits	
	2010	2009
Discount rate	5.00%	6.00%
Rate of compensation increase	—	—
Healthcare cost trend rate	5.00	5.00

Weighted average assumptions used to determine net benefit cost for 2010 and 2009 were as follows:

	Postretirement benefits	
	2010	2009
Discount rate	6.00%	6.75%
Expected long-term rate of return on plan assets	N/A	N/A
Rate of compensation increase	N/A	N/A
Healthcare cost trend rate	5.00%	5.00%

Wellmont's overall expected long-term rate of return on assets is 7%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

(Dollars in thousands)

For measurement purposes, a 5% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2010.

The following table summarizes the effect of one-percentage-point increase/decrease in healthcare costs trends:

		2010	2009
Effect of one-percentage-point increase in healthcare cost trend on:			
Service and interest cost	$	20	22
Accumulated pension benefit obligation		330	326
Effect of one-percentage-point decrease in healthcare cost trend on:			
Service and interest cost		(18)	(20)
Accumulated pension benefit obligation		(294)	(291)

The asset allocations of Wellmont's pension and postretirement benefits as of June 30, 2010 and 2009, respectively, were as follows:

		Fair value measurement at June 30, 2010 pension benefits – plan assets			
Asset category		Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Stock mutual funds	$	28,803	19,412	9,391	—
Cash and money market funds		244	244	—	—
Alternative investments		5,500	—	—	5,500
Total	$	34,547	19,656	9,391	5,500

(Dollars in thousands)

	Fair value measurement at June 30, 2009 pension benefits – plan assets			
Asset category	**Total**	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Stock mutual funds	$ 27,444	17,710	9,734	—
Cash and money market funds	749	749	—	—
Alternative investments	5,133	—	—	5,133
Total	$ 33,326	18,459	9,734	5,133

The following tables presents Wellmont's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 820 for the years ended June 30, 2010 and 2009:

	Alternative investments
Balance at June 30, 2008	$ 7,960
Net change in value	(4,464)
Purchases, issuances, and settlements	1,637
Tranfers in and/or out of Level 3 (net)	—
Balance at June 30, 2009	5,133
Net change in value	254
Purchases, issuances, and settlements	113
Tranfers in and/or out of Level 3 (net)	—
Balance at June 30, 2010	$ 5,500

(14) Self-Insurance Programs

Wellmont is self-insured for professional and general liability and workers' compensation liability. Consulting actuaries have been retained to determine funding requirements and estimate claim liability exposures. Wellmont has established revocable self-insurance trust funds to provide for professional and general liability claims and workers' compensation claims and related expenses. Wellmont's contributions to the self-insurance trusts are based upon actuarial determinations by an independent service company. The professional and general liability self-insurance program is supplemented by umbrella excess liability policies consisting of various layers of coverage with commercial carriers based on policy year. The workers' compensation program is supplemented for Tennessee and Virginia by excess workers' compensation policies, with a commercial carrier for statutory limits per occurrence. Wellmont does not qualify as a self-insurer in Kentucky and hence purchases a separate policy for its operation in Kentucky. Provisions based on actuarial estimates are made for the ultimate cost of claims asserted, as well as estimates of claims incurred but not reported as of the respective consolidated balance sheet dates. Insurance expense under these programs amounted to approximately $3,414 and $5,658 for the years ended June 30, 2010 and 2009, respectively, and are included in other expense in the accompanying consolidated statements of operations and changes in net assets.

(Dollars in thousands)

At June 30, 2010 and 2009, Wellmont was involved in litigation relating to medical malpractice and workers' compensation claims arising in the ordinary course of business. There are also known incidents that occurred through June 30, 2010 that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. Claims have been filed requesting damages in excess of the amount accrued for estimated malpractice costs. Management of Wellmont is of the opinion that estimated professional and general liability amounts accrued at June 30, 2010 are adequate to provide for potential losses resulting from pending or potential litigation. Amounts of claim settlements may be more or less than what has been provided for by management. The ultimate settlement of claims could be different from recorded accruals, with such differences being potentially significant.

Wellmont is also self-insured for medical and other healthcare benefits provided to its employees and their families. A provision for estimated incurred but not reported claims has been provided in the consolidated financial statements.

(15) Commitments and Contingencies

Construction in progress at June 30, 2010 and 2009 relates primarily to the completion of certain buildings and renovations. Total costs to complete these and other projects were approximately $11,920 at June 30, 2010. Wellmont has entered into contracts of approximately $11,920 related to these projects.

Wellmont leases certain equipment and office space under operating lease agreements. Total rental expense under cancelable and noncancelable agreements was $16,857 and 16,441 for the years ended June 30, 2010 and 2009, respectively. Minimum future lease payments under noncancelable operating leases with initial or remaining lease terms in excess of one year as of June 30, 2010 are as follows:

2011	$	14,227
2012		12,318
2013		8,149
2014		3,763
2015		3,383
Thereafter		20,699
	$	62,539

The HCHM lease to WHCMH is for 20 years and can be automatically extended for two additional terms of 10 years each. Should WHCMH generate annual net excess revenue over expenses, 50% shall be transferred to a designated fund in the Foundation for the purpose of healthcare projects. No transfers were required for the years ended June 30, 2010 and 2009.

(Dollars in thousands)

Wellmont has entered into contractual employment relationships with physicians to provide services to Wellmont physician practices that are intended to qualify under the employee safe harbor of the Anti-Kickback Statute and the employee exception of the Physician Self-Referral Law. These contracts have terms of varying lengths, guarantee certain base payments, and may provide for additional incentives based upon productivity.

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, such matters as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes Wellmont is in compliance with fraud and abuse statutes and other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

(16) Functional Expense Disclosure

Wellmont provides healthcare services to residents within its geographic location. Expenses based upon functional classification related to providing these services during the years ended June 30 are as follows:

		2010	2009
Professional care of patients	$	605,360	617,198
Administrative and general		117,123	101,641
Fund-raising		1,235	1,260
	$	723,718	720,099

(17) Income Taxes

Wellmont, Inc. and its subsidiaries file consolidated federal and separate company state income tax returns. These companies have combined net operating loss carryforwards for federal income tax purposes of approximately $52,000 at June 30, 2010, which begin expiring in fiscal 2016 and expire through 2030. These net operating losses can be used to offset future consolidated taxable income of Wellmont, Inc. and subsidiaries. Wellmont participates in certain activities that generate unrelated business taxable income. These activities have generated net operating losses in prior years, and Wellmont files a Form 990-T with the Internal Revenue Service to report such activity. Wellmont has net operating loss carryforwards for federal income tax purposes of approximately $975 for unrelated business activities. Management believes that it is not more likely than not that deferred tax assets arising from net operating loss carryforwards will be realizable. Accordingly, these are fully reserved at June 30, 2010 and 2009.

(Dollars in thousands)

(18) Concentration of Credit Risk

Wellmont grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2010 and 2009 was as follows:

	2010	2009
Medicare	46%	45%
TennCare	4	4
Medicaid	8	8
Other third-party payors	31	31
Patients	11	12
	100%	100%

(19) Disclosures about Fair Value of Financial Instruments

(a) Fair Value of Financial Instruments

The following methods and assumptions were used to estimate fair value of each class of instruments:

Cash and Cash Equivalents

The carrying amount approximates fair value due to the short maturities of these instruments.

Patient Accounts and Other Receivables

The net recorded carrying value approximates fair value due to the short maturities of these instruments.

Investments and Assets Limited as to Use

The fair values of investments and assets limited as to use are based on quoted market prices and quotes obtained from security brokers or, in the case of the limited partnerships, by the general partner.

Accounts Payable and Accrued Expenses

The carrying amount approximates fair value due to the short maturities of these liabilities.

Estimated Third-Party Payor Settlements, Other Long-Term Liabilities

The carrying amount approximates fair market value due to the nature of these liabilities.

Long-Term Debt

The fair value of revenue bonds, using current market rates, was estimated at $422,290 and $344,863 for the years ended June 30, 2010 and 2009, respectively.

(b) Fair Value Hierarchy

On July 1, 2008, Wellmont adopted new guidance issued by FASB for fair value measurement of financial assets and financial liabilities and for fair value measurement of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis now codified into ASC 820, *Fair Value Measurements and Disclosures*. ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted market prices (unadjusted) in active markets for identical assets or liabilities that Wellmont has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted market prices including within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

In conjunction with the adoption of the new guidance, Wellmont elected to early adopt the measurement provisions of Accounting Standards Update No. 2009-12 to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. This guidance amends the previous guidance and allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent. Net asset value, in many instances may not equal fair value that would be calculated pursuant to ASC 820. The fair value of these investments was $56,972 and $37,312 at June 30, 2010 and 2009, respectively.

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2010:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 35,711	—	—	35,711
Assets limited as to use:				
Stock mutual funds	109,629	—	—	109,629
Bond mutual funds	71,698	—	—	71,698
Cash and money market funds	50,555	—	—	50,555
Real estate funds	7,468	—	—	7,468
Alternative investments		18,043	39,362	57,405
Corporate bonds	6,867	—	—	6,867
	246,217	18,043	39,362	303,622
Long-term investments:				
Stock mutual funds	9,279	—	—	9,279
Bond mutual funds	7,599	—	—	7,599
Cash and money market funds	287	—	—	287
Real estate funds	1,722	—	—	1,722
Alternative investments	—	1,992	—	1,992
	18,887	1,992	—	20,879
Total assets	$ 300,815	20,035	39,362	360,212
Liabilities:				
Interest rate derivatives liability	$ —	12,943	—	12,943
Total liability	$ —	12,943	—	12,943

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2009:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 60,889	—	—	60,889
Assets limited as to use:				
Stock mutual funds	108,036	—	—	108,036
Bond mutual funds	5,910	—	—	5,910
Cash and money market funds	85,386	—	—	85,386
Real estate funds	5,419	—	—	5,419
Alternative investments		2,295	33,291	35,586
Corporate bonds	7,464	—	—	7,464
	212,215	2,295	33,291	247,801
Long-term investments:				
Stock mutual funds	8,631	—	—	8,631
Bond mutual funds	3,648	—	—	3,648
Cash and money market funds	5,202	—	—	5,202
Real estate funds	1,255	—	—	1,255
Alternative investments	—	1,726	—	1,726
	18,736	1,726	—	20,462
Total assets	$ 291,840	4,021	33,291	329,152
Liabilities:				
Interest rate derivatives liability	$ —	10,250	—	10,250
Total liability	$ —	10,250	—	10,250

(Continued)

(Dollars in thousands)

The following table presents Wellmont's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 820 for the years ended June 30, 2010 and 2009:

		Alternative investments
Balance at June 30, 2008:	$	51,661
Total realized and unrealized gains (losses):		
Included in revenues and gains in excess of expenses and losses		—
Included in changes in net assets		(3,574)
Purchases, issuances, and settlements		(14,796)
Transfers in and/or out of Level 3 (net)		—
Balance at June 30, 2009:	$	33,291
Total realized and unrealized gains (losses):		
Included in revenues and gains in excess of expenses and losses		—
Included in changes in net assets		469
Purchases, issuances, and settlements		5,602
Transfers in and/or out of Level 3 (net)		—
Balance at June 30, 2010	$	39,362

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Financial Statements

June 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

WELLMONT HEALTH SYSTEM AND AFFILIATES

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KPMG LLP
Suite 1000
401 Commerce Street
Nashville, TN 37219-2422

Independent Auditors' Report

The Board of Directors
Wellmont Health System:

We have audited the accompanying consolidated balance sheets of Wellmont Health System and affiliates (Wellmont) as of June 30, 2011 and 2010, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of Wellmont's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Wellmont'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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Wellmont Health System and affiliates as of June 30, 2011 and 2010, and the consolidated results of their operations and changes in net assets, and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

October 27, 2011

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Balance Sheets

June 30, 2011 and 2010

(Dollars in thousands)

Assets		**2011**	**2010**
Current assets:			
Cash and cash equivalents	$	36,558	35,711
Assets limited as to use, required for current liabilities		1,902	1,815
Patient accounts receivable, less allowance for uncollectible accounts of approximately $24,246 and $25,113 in 2011 and 2010, respectively		101,565	94,057
Other receivables		9,904	10,919
Inventories		17,830	18,294
Prepaid expenses and other current assets		7,163	7,003
Total current assets		174,922	167,799
Assets limited as to use, net of current portion		319,387	301,807
Land, buildings, and equipment, net		454,937	450,205
Other assets:			
Long-term investments		36,437	32,391
Investments in affiliates		31,177	32,019
Deferred debt expense, net		5,847	4,644
Goodwill		16,721	9,501
Other		1,875	730
		92,057	79,285
Total assets	$	1,041,303	999,096
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	9,273	11,958
Short-term note payable		—	14,000
Accounts payable and accrued expenses		70,943	74,679
Estimated third-party payor settlements		9,533	11,672
Current portion of other long-term liabilities		8,527	7,251
Total current liabilities		98,276	119,560
Long-term debt, less current portion		459,260	467,833
Other long-term liabilities, less current portion		42,006	44,976
Total liabilities		599,542	632,369
Net assets:			
Unrestricted		434,661	358,620
Temporarily restricted		3,570	4,551
Permanently restricted		1,174	1,168
Total net assets attributable to Wellmont		439,405	364,339
Noncontrolling interests		2,356	2,388
Total net assets		441,761	366,727
Commitments and contingencies			
Total liabilities and net assets	$	1,041,303	999,096

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2011 and 2010

(Dollars in thousands)

		2011	2010
Revenue:			
Net patient service revenue	$	767,450	692,920
Other revenues		29,799	31,472
Total revenue		797,249	724,392
Expenses:			
Salaries and benefits		347,185	310,667
Medical supplies and drugs		160,565	150,143
Purchased services		80,348	74,922
Interest		20,750	20,110
Provision for bad debts		37,858	35,293
Depreciation and amortization		46,059	43,711
Other		87,319	66,734
Total expenses		780,084	701,580
Income from operations		17,165	22,812
Nonoperating gains (losses):			
Investment income		10,383	1,012
Derivative valuation adjustments		1,355	(2,693)
Other, net		(519)	(805)
Gain on refinancing		1,042	—
Nonoperating gains (losses), net		12,261	(2,486)
Revenue and gains in excess of expenses and losses before discontinued operations		29,426	20,326
Discontinued operations		44	(1,109)
Revenue and gains in excess of expenses and losses		29,470	19,217
Income attributable to noncontrolling interests		(1,238)	(1,062)
Revenues and gains in excess of expenses and losses attributable to Wellmont		28,232	18,155
Other changes in unrestricted net assets:			
Change in net unrealized gains on investments		42,186	22,312
Net assets released from restrictions for additions to land, buildings, and equipment		2,852	1,555
Change in the funded status of benefit plans and other		2,771	(3,428)
Increase in unrestricted net assets		76,041	38,594
Changes in temporarily restricted net assets:			
Contributions		2,566	2,934
Net assets released from temporary restrictions		(3,547)	(1,972)
(Decrease) increase in temporarily restricted net assets		(981)	962
Changes in permanently restricted net assets – investment income (loss)		6	(77)
Changes in noncontrolling interests:			
Adjustment due to adoption of authoritative guidance		—	2,054
Income attributable to noncontrolling interests		1,238	1,062
Distributions to noncontrolling interests		(1,178)	(711)
Change in noncontrolling percentages		(92)	(21)
(Decrease) increase in noncontrolling interests		(32)	2,384
Change in net assets		75,034	41,863
Net assets, beginning of year		366,727	324,864
Net assets, end of year	$	441,761	366,727

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2011 and 2010

(Dollars in thousands)

	2011	2010
Cash flows from operating activities:		
Change in net assets	$ 75,034	41,863
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	46,070	43,755
(Gain) loss on disposal of land, buildings, and equipment	(864)	1,282
Equity in earnings of affiliated organizations	(4,478)	(6,773)
Distributions from affiliated organizations	5,320	6,730
Amortization of deferred financing costs	158	180
Net realized and unrealized gains on investments	(43,162)	(17,994)
Provision for bad debts	37,893	35,950
Change in fair value of derivative instruments	(1,355)	2,693
Gain on refinancing	(1,042)	—
Changes in assets and liabilities:		
Patient accounts receivable	(45,402)	(31,936)
Other current assets	303	(2,088)
Other assets	(538)	322
Accounts payable and accrued expenses	(6,729)	2,722
Estimated third-party payor settlements	(2,139)	(769)
Other current liabilities	1,276	899
Other liabilities	(63)	5,545
Net cash provided by operating activities	60,282	82,381
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	186,085	88,887
Purchase of investments	(164,635)	(127,131)
Purchase of land, buildings, and equipment	(42,352)	(55,684)
Proceeds from the sale of buildings and equipment	244	4,357
Cash paid for acquisitions	(7,826)	(2,421)
Distributions to affiliated organizations	—	(1,684)
Net cash used in investing activities	(28,484)	(93,676)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	91,133	14,000
Payments on long-term debt	(106,069)	(12,083)
Payment of debt issuance costs	(2,015)	—
Payments on line of credit	(14,000)	(15,800)
Net cash used in financing activities	(30,951)	(13,883)
Net increase (decrease) in cash and cash equivalents	847	(25,178)
Cash and cash equivalents, beginning of year	35,711	60,889
Cash and cash equivalents, end of year	$ 36,558	35,711

Supplemental disclosures of noncash items:

Wellmont entered into capital lease obligations for buildings and equipment in the amount of $5,785 and $1,290 in 2011 and 2010, respectively.

Additions to property and equipment financed through current liabilities of $2,933 and $5,182 in 2011 and 2010, respectively.

See accompanying notes to consolidated financial statements.

(1) Operations and Basis of Presentation

Wellmont Health System (Wellmont) was formed to assume operations of Bristol Regional Medical Center (BRMC) and Holston Valley Health Care, Inc. (HVHC), including Holston Valley Medical Center, Inc. (HVMC), and to act as sole corporate member of its consolidated foundations. Effective July 1, 1996, under terms of an agreement and plan of consolidation and merger, BRMC and HVHC, including HVMC, were merged and consolidated into Wellmont. Effective January 1, 1997, Lonesome Pine Hospital (LPH), a Virginia corporation, was merged into Wellmont under terms of a plan of merger and merger agreement. Effective July 1, 2000, Hawkins County Memorial Hospital (HCMH) transferred its operations and operating assets to Wellmont Hawkins County Memorial Hospital (WHCMH), a tax-exempt organization that is wholly owned and controlled by Wellmont. Hancock County Hospital (HCH), a critical access hospital, was opened in March 2005 to help provide for the immediate healthcare needs of the residents of Sneedville and the surrounding counties. As of July 16, 2007, Wellmont acquired Jenkins Community Hospital in Kentucky. As of August 1, 2007, Wellmont acquired two hospitals in Virginia, Lee Regional Medical Center in Pennington Gap and Mountain View Regional Medical Center in Norton. On May 30, 2008, Wellmont acquired the Holston Valley Cath Lab, an outpatient lab. On May 1, 2010, Wellmont acquired Cardiovascular Associates. On January 1, 2011 Wellmont acquired Pulmonary Associates of Kingsport.

As of April 30, 2009, Wellmont closed Jenkins. The consolidated financial statements for the years ended June 30, 2011 and 2010 present Jenkins as a discontinued operation. Losses of $120 and $474 for the years ended June 30, 2011 and June 30, 2010, respectively, are included in discontinued operations.

As of September 23, 2010 Wellmont sold the majority of Medical Mall Pharmacy's assets to a national pharmacy company for $1,300 plus inventory value and recorded a gain of approximately $517 at June 30, 2011. The consolidated financial statements for the years ended June 30, 2011 and 2010 present Medical Mall Pharmacy as a discontinued operation. Losses of $353 and $635 for the years ended June 30, 2011 and June 30, 2010, respectively, are included in discontinued operations.

All acute care operations remain separately licensed and are treated as operating divisions within Wellmont. Wellmont's continuing operations consist primarily of the delivery of healthcare services in northeast Tennessee, and southwest Virginia.

The consolidated financial statements include the acute care operations of the above entities along with:

- Wellmont Foundation (the Foundation), which was created from the merger of Bristol Regional Medical Center Foundation and Holston Valley Health Care Foundation, Inc. The Foundation conducts fund-raising activities for the benefit of Wellmont.
- Wellmont, Inc., a wholly owned taxable subsidiary of Wellmont, formed as the holding company of various other taxable subsidiaries that provide medical collection and medical laundry services, operate physician practices, provide other healthcare-related services, and invest in affiliates and other activities.

- The Alzheimer's Center of East Tennessee was merged into Wellmont and changed its name to Wellmont Madison House effective September 1, 1997. Wellmont is the sole corporate member and the consolidated financial statements include the operations of this entity.

All significant intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

(2) Significant Accounting Policies

A summary of significant accounting policies follows:

(a) Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Significant estimates include: allowances for contractual adjustments and bad debts; third-party payor settlements; valuation of investments, land, buildings, equipment and goodwill; and self-insurance and other liabilities. Actual results could differ from these estimates.

(b) Cash and Cash Equivalents

Wellmont considers all highly liquid investments with a maturity of three months or less when purchased, excluding amounts whose use is limited by board of director's designation or other arrangements under trust agreements, to be cash equivalents.

(c) Investments

Marketable equity securities and debt securities are recorded at fair value and classified as other than trading. Fair value is determined primarily using quoted prices (unadjusted) in active markets for identical assets or liabilities that Wellmont has the ability to access at the measurement date. However, Wellmont also uses observable and unobservable inputs for investments without quoted market prices to determine the fair value of certain investments at the measurement date. Investments in limited partnerships are recorded at fair value as determined by the partnership using net asset value. Wellmont has adopted the measurement provisions of Accounting Standards Update No. 2009-12, *Investments in certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. Investments in affiliates in which Wellmont has significant influence but does not control are reported on the equity method of accounting, which represents Wellmont's equity in the underlying net book value. Long-term investments include those investments that have not been designated by the board of directors for specific purposes and are also not intended to be used for the liquidation of current liabilities. Investment income is recognized when earned.

Realized gains and losses are determined on the specific-identification method and included in investment income with interest and dividends. Investment income is reported net of related investment fees. Unrealized gains and losses are included in other changes in unrestricted net assets except for losses determined to be other than temporary, which are considered realized losses and included in investment income.

(d) Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under bond indenture and self-insurance agreements, as well as designated assets set aside by the board of directors for future capital improvements, over which the board of directors retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of Wellmont have been reclassified to current assets in the accompanying consolidated balance sheets.

(e) Inventories

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

(f) Land, Buildings, and Equipment

Land, buildings, and equipment are stated at cost, if purchased, or fair value at date of donation. Depreciation is computed using the straight-line method based on the estimated useful life of the asset, ranging from 3 to 40 years. Buildings and equipment held under capital leases are recorded at net present value of future lease payments and are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. Costs of maintenance and repairs are expensed as incurred. Upon sale or retirement of land, buildings, or equipment, the cost and related accumulated depreciation are eliminated from the respective accounts and the resulting gain or loss, if any, is included in other revenues on the consolidated statements of operations and changes in net assets. Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

Wellmont evaluates long-lived assets for impairment on annual basis. Long-lived assets are considered to be impaired whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable from future cash flows. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of an asset to future cash flows expected to be generated by the asset. When such assets are considered to be impaired, the impairment loss recognized is measured by the amount by which the carrying value of the asset exceeds the fair value of the asset.

(Dollars in thousands)

(g) Goodwill

Effective July 1, 2010, Wellmont adopted ASU 2010-07 which in part requires healthcare entities to follow ASC Topic 350-20-35, *Intangibles – Goodwill and Other*. ASC Topic 350-20-35 requires goodwill of not-for-profit entities to be evaluated for impairment at least annually. The goodwill impairment test is a two-step test. Under the first step, the fair value of each reporting unit is compared with its carrying value (including goodwill). If the fair value of a reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the entity must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. Wellmont has determined that the appropriate reporting unit for goodwill is the consolidated Wellmont entity and the annual impairment test is performed as of June 30. A summary of goodwill and related amortization for the year ended June 30 follows:

	2010	Additions	Decreases	2011
Goodwill	$ 9,501	7,220	—	16,721

	2009	Additions	Decreases	2010
Goodwill	$ 12,604	—	—	12,604
Amortization	(3,095)	(8)	—	(3,103)
	$ 9,509	(8)	—	9,501

(h) Deferred Debt Expense

Deferred debt expense is amortized over the life of the related bond issues using the effective-interest method.

(i) Derivative Financial Instruments

As further described in note 12, Wellmont is a party to interest rate swap and other derivative agreements. These financial instruments are not designated as hedges and are presented at estimated fair market value in the accompanying consolidated balance sheets. These fair values are based on the estimated amount Wellmont would receive, or be required to pay, to enter into equivalent agreements with a third party at the valuation date. Due to the nature of these financial instruments, such estimates are subject to significant change in the near term. Wellmont recognizes changes in the fair values of derivatives as nonoperating gains or losses in the consolidated statements of operations and changes in net assets. The cash settlements resulting from these interest rate swaps are reported as interest expense in the consolidated statements of operations and changes in net assets.

(j) Asset Retirement Obligations

Asset retirement obligations (AROs) are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value, and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, Wellmont records period-to-period changes in the ARO liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. Wellmont derecognizes ARO liabilities when the related obligations are settled.

(k) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Wellmont has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by Wellmont in perpetuity. Generally, donors of permanently restricted assets permit use of all or part of the income earned on related investments for general or specific purposes.

Temporarily restricted net assets relate primarily to amounts held by the Foundation and include amounts restricted for future capital expenditures and for operations of such areas as children's healthcare services, hospice, and cancer research.

Net assets are released from restrictions by Wellmont incurring expenses that satisfy the restricted purposes. Such net assets released during 2011 and 2010 primarily included amounts related to the purchase of buildings and equipment for pediatrics, cancer, and other healthcare operations.

Wellmont has adopted guidance issued by FASB, which provides guidance on the net asset classification of donor-restricted endowment funds for a tax-exempt organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). Effective July 1, 2007, the State of Tennessee adopted legislation that incorporates the provisions outlined in UPMIFA. Wellmont's endowments consist solely of donor-restricted endowment funds. Wellmont's endowments consist of four individual funds established for a variety of purposes.

Wellmont has interpreted UPMIFA 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. As a result of this interpretation, Wellmont classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are approved for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Wellmont considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the organization and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the organization; and (7) the investment policies of the organization.

(l) Net Patient Service Revenue and Accounts Receivable

Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts expected to be collected. Net patient service revenue includes amounts estimated by management to be reimbursable by patients and various third-party payors under provisions of reimbursement formulas in effect, including retroactive adjustments under reimbursement agreements. Estimated retroactive adjustments are accrued in the period related services are rendered and adjusted in future periods as final and other settlements are determined. Wellmont provides care to patients who meet criteria under its charity care policy without charge or at amounts less than its established rates. Because Wellmont does not pursue collection of amounts determined to qualify as charity care, they are not included in net patient service revenue.

Patient accounts receivable are reported net of both an allowance for contractual adjustments and an allowance for uncollectible accounts. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, TennCare, Medicaid, and other third-party payment programs. Wellmont's policy does not require collateral or other security for patient accounts receivable. Wellmont routinely obtains assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans, or policies.

(m) Revenue and Gains in Excess of Expenses and Losses

The consolidated statements of operations and changes in net assets include revenue and gains in excess of expenses and losses. Changes in unrestricted net assets that are excluded from revenue and gains in excess of expenses and losses, consistent with industry practice, include changes in net unrealized gains (losses) on investments other than trading securities, changes in the funded status of Wellmont's defined benefit plan, contributions of long-lived assets, including assets acquired using contributions that, by donor restriction, were to be used for the purposes of acquiring such assets, and cumulative effects of changes in accounting principles.

For purposes of financial statement display, those activities directly associated with Wellmont's mission of providing healthcare services are considered to be operating activities. Nonoperating activities primarily include investment and related activities. Other operating revenues primarily include cafeteria, rental, and income from affiliates.

(n) Contributed Resources

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted contributions, and are excluded from revenue and gains in excess of expenses and loses, 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 contributions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expiration of donor restrictions is reported when the donated or acquired long-lived assets are placed in service.

Unconditional promises to give cash or other assets are reported at fair value at the date the promise is received. Gifts are reported as either a temporarily or permanently restricted contribution if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are recorded as unrestricted contributions. Unrestricted contributions are included in other revenues.

(o) Federal Income Taxes

The Wellmont entities are primarily classified as organizations exempt from federal income taxes under Section 501(a) as entities described in Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes has been included for these entities in the consolidated financial statements. The operations of Wellmont, Inc. are subject to state and federal income taxes, which are accounted for in accordance with ASC 740, *Income Taxes*; however, such amounts are not material.

On July 1, 2007, Wellmont adopted new guidance issued on the accounting for uncertainty in income tax positions now codified into ASC 740. It also provides guidance on when tax positions are recognized in an entity's financial statements and how the values of these positions are determined. There was no impact on Wellmont's consolidated financial statements as a result of the adoption of the new guidance.

(p) New Accounting Pronouncements

Effective July 1, 2010, Wellmont adopted the new provisions of ASC 810-10-65-1 regarding noncontrolling interests in consolidated financial statements. This guidance requires Wellmont to clearly identify and present ownership interest in subsidiaries held by parties other than Wellmont in the consolidated financial statements within the net assets section. It also requires the amounts of consolidated revenues and gains in excess of expenses and losses attributable to Wellmont and to the noncontrolling interest to be clearly identified and presented on the face of the consolidated statements of operations. Upon adoption, Wellmont recorded a reclassification of $2,054 to reclass noncontrolling interest to net assets as of July 1, 2009.

In January 2010, the Financial Accounting Standards Board issued ASU 2010-06, *Improving Disclosures about Fair Value Measurements* (ASU 2010-06). ASU 2010-06 amends ASC Subtopic 820-10, Fair Value Measurements and Disclosures, to provide additional disclosure requirements for transfers into and out of Levels 1 and 2 and for activity in Level 3 and to clarify other existing disclosure requirements. WHS implemented ASU 2010-06 for the period ended June 30, 2011.

In January 2010, the Financial Accounting Standards Board issued ASU 2010-07, *Not-for-Profit Entities: Mergers and Acquisitions* (ASU 2010-07). ASU 2010-07 provides guidance on a transaction or other event in which a not-for-profit entity that is a reporting entity combines with one or more other not-for-profit, businesses or nonprofit activities in a transaction that meets the definition of a merger of not-for-profit entities or an acquisition by a not-for-profit entity. In addition the ASU provides transitional guidance on existing goodwill at the time this ASU is adopted. WHS adopted ASU 2010-07 effective July 1, 2010.

In August 2010, the Financial Accounting Standards Board issued ASU 2010-23, *Measuring Charity Care for Disclosure* (ASU 2010-23). ASU 2010-23 requires that cost be used as the measurement basis for charity care disclosures purposes and that cost can be identified as direct and indirect costs of providing charity care. The adoption of ASU 2010-23 will be effective for WHS beginning in fiscal year 2012.

In August 2010, the Financial Accounting Standards Board issued ASU 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries* (ASU 2010-24). ASU 2010-24 clarifies that healthcare entities should not net insurance recoveries against the related claim liability and that the claim liability amount should be determined without consideration of insurance recoveries. The adoption of ASU 2010-24 will be effective for WHS beginning in fiscal year 2012.

In July 2011, the Financial Accounting Standards Board issued ASU 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* (ASU 2011-07). ASU 2011-07 will change WHS' presentation of provision for bad debts in the consolidated statements of operations and changes in net assets to a deduction from net patient service revenue. In addition there are enhanced disclosures about the entities policies for recognizing revenue and assessing bad debts. The ASU also requires disclosures of patient service revenue as well as qualitative and quantitative information about changes in the allowance for doubtful accounts. The adoption of ASU 2011-07 will be effective for WHS beginning in fiscal year 2013 with early adoption permitted.

(q) Reclassifications

Certain 2010 amounts have been reclassified to conform to the 2011 consolidated financial statement presentation. The reclassifications had no impact on total assets or changes in net assets.

(Dollars in thousands)

(3) Net Patient Service Revenue

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations and changes in net assets is as follows for the years ended June 30:

		2011	2010
Gross patient service charges	$	2,260,489	2,158,847
Less:			
Contractual adjustments and other discounts		(1,431,215)	(1,411,435)
Charity care		(61,824)	(54,492)
		(1,493,039)	(1,465,927)
Net patient service revenue	$	767,450	692,920

(4) Third-Party Reimbursement Arrangements

Wellmont renders services to patients under contractual arrangements with the Medicare and Medicaid programs. The Medicaid program in Tennessee was replaced with a managed care program known as TennCare, which was designed to cover previous Medicaid eligible enrollees. Amounts earned under these contractual arrangements are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Management believes that adequate provision has been made for any adjustments that may result from such reviews. Participation in these programs subjects Wellmont to significant rules and regulations; failure to adhere to such could result in fines, penalties, or expulsion from the programs.

Wellmont contracts with various managed care organizations under the TennCare program. TennCare reimbursement for both inpatient and outpatient services is based upon prospectively determined rates, including diagnostic-related group assignments, fee schedules and per diem amounts. Reimbursement under the Virginia Medicaid program is also based upon prospectively determined amounts.

The Medicare program pays for the costs of inpatient services on a prospective basis. Payments are based upon diagnostic-related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. Wellmont receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid-eligible and other low-income patients. Outpatient services are also reimbursed primarily on a prospectively determined basis.

(Dollars in thousands)

Net patient service revenue in 2011 and 2010 related to Medicare, TennCare and Virginia Medicaid and net patient accounts receivable at June 30, 2011 and 2010 from Medicare, TennCare, and Virginia Medicaid were as follows:

		2011	2010
Net patient service revenue:			
Medicare	$	286,977	277,372
TennCare		23,575	22,918
Virginia Medicaid		22,555	23,536
Net patient accounts receivable:			
Medicare	$	34,671	41,125
TennCare		2,798	2,206
Virginia Medicaid		3,427	3,739

Wellmont has filed cost reports with Medicare and Virginia Medicaid. The cost reports are subject to final settlement after audits by the fiscal intermediary. The Medicare and Virginia Medicaid cost reports have been audited and final settled by the intermediary through June 30, 2006 and audit adjustments have been received and considered for certain hospital and year-ends through June 30, 2010.

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

Net patient service revenue is reported at the net amounts billed to patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Estimated retroactive adjustments are accrued in the period the related services are rendered and adjusted in future periods as changes in estimated provisions and final settlements are determined. Net patient service revenue increased approximately $2,319 and $863 in 2011 and 2010, respectively, due to final settlements and revised estimates in excess of amounts previously recorded, removal of allowances previously estimated that are no longer necessary as a result of audits and final settlements, and years that are no longer subject to audits, reviews, and investigations.

Estimated settlements recorded at June 30, 2011 could differ materially from actual settlements based on the results of third-party audits.

(5) Charity Care and Community Services

Wellmont accepts all patients within its primary service area regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies that consider, among other factors, generally recognized poverty income levels.

Wellmont maintains records to identify and monitor the level of charity care it provides. Charges foregone for services and supplies furnished under its charity care policy, the estimated cost of those services, and

(Continued)

(Dollars in thousands)

the equivalent percentage of charity care patients to all patients serviced were $61,824, $18,080, and 2.73%, respectively, for the year ended June 30, 2011 and $54,492, $15,567, and 2.52%, respectively, for the year ended June 30, 2010.

In addition to the charity care services described above, Wellmont provides a number of other services to benefit the indigent for which little or no payment is received. Medicare, Medicaid, and State indigent programs do not cover the full cost of those services. The shortfall between actual receipts from those programs and Wellmont's cost of providing care to those patients totaled $56,658 and $55,461 for the years ended June 30, 2011 and 2010, respectively.

Wellmont also provides services to the community at large for which it receives little or no payment. Health evaluations, screening programs, and specific services for the elderly and homebound are other services supplied. Wellmont also provides public health education, trains new health professionals and conducts health research.

(6) Investment in Affiliates

Wellmont has investments with other healthcare providers, which include hospital, home care, regional laboratories, and other healthcare-related organizations. Wellmont records its share of equity in the operations of the respective organizations. Equity in earnings of affiliates was approximately $4,478 and $6,773 for the years ended June 30, 2011 and 2010, respectively, and is included in other operating revenue in the consolidated financial statements. During FY2011, Wellmont Health Services, Inc. 20% membership interest in Spectrum Tennessee Network, LLC was exchanged through a capital contribution for a 1.19% membership interest in Lab Group Holdings, LLC. Wellmont received distributions of $5,320 and $6,730 during 2011 and 2010, respectively, which reduced Wellmont's overall investment in the affiliates.

The following table summarizes the unaudited aggregate financial information of Wellmont's investments in affiliates:

		2011	2010
Total assets	$	127,545	129,720
Total liabilities		31,326	13,943
Total net assets	$	96,219	115,777
Net revenues	$	184,648	166,815
Expenses		171,070	142,534
Revenues in excess of expenses	$	13,578	24,281

(Dollars in thousands)

Wellmont's equity investment in these affiliates and its ownership percentage as of June 30, 2011 and 2010 are as follows:

	Amount		Percentage	
	2011	**2010**	**2011**	**2010**
Takoma Regional Hospital	$ 11,161	12,645	60%	60%
Holston Valley Imaging Center (HVIC)	8,689	8,048	75	75
Advanced Home Care (AHC)	6,092	6,092	6	6
Spectrum Tennessee Network	—	3,850	—	20
Lab Group Holdings LLC	3,500	—	1	—
Others	1,735	1,384	4% – 50%	4% – 50%
	$ 31,177	32,019		

Wellmont provided billing, management, and professional services to the affiliates. Income recognized by Wellmont for the services was $943 in 2011 and $1,766 in 2010 and is included in other revenues.

Included in other receivables are $0 and $124 as of June 30, 2011 and 2010, respectively, of amounts due to Wellmont from these entities.

Although Wellmont's ownership percentage in Takoma Regional Hospital and HVIC is greater than 50%, Wellmont does not consolidate these entities because Wellmont only has a 50% representation on each respective board and does not have control over these entities.

(Dollars in thousands)

(7) Investments

Long-term investments, including assets limited as to use, at June 30 are reported at fair value and consist of the following:

		2011	2010
Assets limited as to use by Board for capital improvements:			
Stock mutual funds	$	88,073	109,629
Bond mutual funds		112,176	71,698
Cash and money market funds		904	1,474
Real estate funds		8,475	7,468
Alternative investments (private equity, hedge funds, commingled funds, and real estate funds)			
Liquid		37,421	33,915
Illiquid		26,837	23,490
		273,886	247,674
Assets limited as to use under self-insurance agreements:			
Corporate bonds		7,877	6,867
Cash and money market funds		652	558
		8,529	7,425
Assets limited as to use under bond indenture agreements:			
Cash and money market funds		37,659	47,286
U.S. Treasury bonds		1,215	1,237
Less assets limited as to use that are required for current liabilities		1,902	1,815
Assets limited as to use, net of current portion	$	319,387	301,807
Long-term investments:			
Stock mutual funds	$	12,198	9,279
Bond mutual funds		9,433	7,599
Preferred equity investment and related options		11,512	11,512
Cash, money market funds, and certificates of deposit		191	287
Real estate funds		832	1,722
Alternative investments (private equity, hedge funds, commingled funds, and real estate funds)		2,271	1,992
Total long-term investments	$	36,437	32,391

Investments in certain alternative limited partnership investments contain agreements whereby Wellmont is committed to contribute approximately $8,805 as of June 30, 2011 of additional funds to the limited partnerships in the form of capital calls at the discretion of the general partner, of which $353 was paid subsequent to June 30, 2011.

(Dollars in thousands)

Wellmont has invested $10,000 in the preferred equity of a regional managed services organization and $1,512 on a right of first refusal related to any future sale of this organization. This equity has a guaranteed annual return of at least 6.5% of the outstanding preferred equity balance.

Wellmont's investments are concentrated in stock and bond mutual funds. In the event of a downward trend in the stock and bond markets, Wellmont's overall market value of net assets could be adversely affected by a material amount. Investments in alternative investments are generally illiquid investments whose value is determined by the general partner such as hedge funds, private equity, commingled funds and real estate funds. Distributions are only at the discretion of a voting majority of the general partners.

Wellmont evaluates whether unrealized losses on investment securities indicate other-than-temporary impairment. Based on this evaluation, the Company recognized other-than-temporary impairment losses of $610 and $8,233 on investments as of June 30, 2011 and 2010, respectively. The unrealized losses on these mutual funds were primarily caused by the overall decline in the world's economy. Other-than-temporary impairment losses are considered as realized losses and are reported within "investment income" in the consolidated statements of operations and changes in net assets.

Gross unrealized losses on investments for which other-than-temporary impairments have not been recognized and the fair values of those investments, aggregated by the length of time that individual investments have been in a continuous unrealized loss position, at June 30, 2011 and 2010, were as follows:

		Less than 12 months		12 months or more		Total	
		Unrealized Losses	Fair value	Unrealized Losses	Fair value	Unrealized Losses	Fair value
2011:							
Alternative investments	$	—	—	402	5,421	402	5,421
Stock mutual funds		616	75,091	9	158	625	75,249
	$	616	75,091	411	5,579	1,027	80,670

		Less than 12 months		12 months or more		Total	
		Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
2010:							
Alternative investments	$	—	—	910	4,219	910	4,219
Stock mutual funds		2,184	29,658	24,817	83,713	27,001	113,371
	$	2,184	29,658	25,727	87,932	27,911	117,590

(Dollars in thousands)

Investment income is comprised of the following for the years ended June 30:

		2011	2010
Interest and dividends net of amounts capitalized	$	9,407	5,330
Realized gains (losses) on investments		976	(4,318)
Investment income, net	$	10,383	1,012
Change in net unrealized gains on investments	$	42,186	22,312

(8) Land, Buildings, and Equipment

Land, buildings, and equipment at June 30 consist of the following:

		2011	2010
Land	$	49,060	41,210
Buildings and improvements		509,382	488,285
Equipment		328,604	327,896
Buildings and equipment under capital lease obligations		39,661	39,591
		926,707	896,982
Less accumulated depreciation		(484,187)	(459,935)
		442,520	437,047
Construction in progress		12,417	13,158
Land, buildings, and equipment	$	454,937	450,205

Depreciation expense for the years ended June 30, 2011 and 2010 was $46,070 and $43,755, respectively. Included in depreciation expense is amortization related to capitalized software and equipment under capital leases. Accumulated amortization for equipment under capitalized software and lease obligations was $15,336 and $13,266 as of June 30, 2011 and 2010, respectively.

(Dollars in thousands)

(9) Other Long-Term Liabilities

Other long-term liabilities at June 30 consist of the following:

		2011	2010
Workers' compensation liability	$	7,812	6,606
Professional and general liability		12,830	11,183
Postretirement benefit obligation		7,763	5,861
Asset retirement obligation		2,912	3,710
Deferred gain on sale of assets		628	1,382
Derivative liability		11,588	12,943
Pension benefit liability		6,526	10,018
Other		474	524
		50,533	52,227
Less current portion		(8,527)	(7,251)
Total other long-term liabilities	$	42,006	44,976

(10) Short-Term Note Payable

At June 30, 2010, WHS had a $14,000 note payable with a variable interest rate based upon LIBOR plus 2% and a termination date of December, 2010. During 2011, the $14,000 note payable was paid in full.

(Dollars in thousands)

(11) Debt

(a) Long-Term Debt

Long-term debt consists of the following at June 30:

	2011	2010
Hospital Revenue Refunding Bonds, Series 2011	$ 76,165	—
Hospital Revenue Bonds, Series 2010 (Bank Qualified)	14,968	—
Hospital Revenue Bonds, Series 2007A	55,000	55,000
Hospital Revenue Refunding Bonds, Series 2006C	200,000	200,000
Hospital Revenue Refunding Bonds, Series 2006A and 2006B	—	93,405
Hospital Revenue Refunding Bonds, Series 2005	59,580	61,810
Hospital Revenue Bonds, Series 2003	33,035	36,666
Notes payable	4,749	6,429
Capital lease obligations	16,889	19,698
Other	1,237	358
	461,623	473,366
Unamortized premium	7,287	7,538
Unamortized discount	(377)	(1,113)
	468,533	479,791
Less current maturities	(9,273)	(11,958)
	$ 459,260	467,833

(b) Series 2011 Bonds

On May 5, 2011, Wellmont refunded the Revenue Bonds, Series 2006A, with the proceeds of the Revenue Bonds, Series 2011. The Series 2011 Bonds were issued by Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee on behalf of Wellmont. Under the terms of the bond indenture, the proceeds were used to advance refund the Revenue Bonds, Series 2006A and to pay the costs of issuing the Series 2011 Bonds.

In order to refund the Series 2006A Bonds, Wellmont made a tender offer to the holders of the Series 2006A Bonds. The holders of all outstanding Series 2006A Bonds agreed to tender their Series 2006A Bonds to Wellmont. Proceeds of the Series 2011 Bonds were used to pay the purchase price of Series 2006A Bonds tendered for purchase. All outstanding Series 2006A Bonds were purchased by the Wellmont on the date of issuance of the Bonds and were immediately surrendered to the trustee for the Series 2006A Bonds for retirement and cancellation.

The Series 2011 Bonds were issued with two maturities of $42,385 and $33,780 for 2026 and 2032, respectively. The Series 2011 Bonds maturing September 1, 2026 are subject to mandatory redemption prior to maturity pursuant to the operation of a sinking fund, in part by lot starting on the redemption dates starting on September 1, 2013 and ending on September 1, 2026 in annual amounts ranging from $865 to $4,680. The Series 2011 Bonds maturing September 1, 2032 are subject to mandatory redemption prior to maturity pursuant to the operation of a sinking fund, in part by lot starting on the redemption dates starting on September 1, 2027 and ending on September 1, 2032 in annual amounts ranging from $4,980 to $6,300. The Series 2011 Bonds were issued as fixed rate obligations at 6.0% and 6.5% for the two maturities (2026 and 2032, respectively).

(c) Series 2010 Bank Qualified Bonds

On November 1, 2010, The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee (the Board) issued $30,000 Hospital Revenue Bonds, Series 2010 (Bank Qualified). The Series 2010 Bonds were issued and sold pursuant to the Bond Purchase Agreement dated as of November 1, 2010, between the Board and First Tennessee Bank National Association. As of June 30, 2011, Wellmont has received advances on the bonds in the amount of $14,968.

Commencing on January 1, 2011, and continuing on the first day of each fiscal quarter thereafter, WHS shall pay accrued interest on the outstanding balance of the loan. Commencing on October 1, 2011 and continuing on the first day of each fiscal quarter thereafter, WHS shall also make principal payments equal to $500,000. The outstanding bonds accrue interest at a rate equal to the product of 65% of the sum of LIBOR plus the applicable margin which at June 30, 2011 was set at 1.95%.

(d) Series 2007 Bonds

On July 24, 2007, The Virginia Small Business Financing Authority issued, on behalf of Wellmont, $55,000 of Hospital Revenue Bonds, Series 2007A. The Series 2007A Bonds, with other methods of financing, were used to purchase the assets of Mountain View Regional Medical Center and Lee Regional Medical Center.

Principal on outstanding Series 2007A Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $360 to $2,460 commencing on September 1, 2017 through September 1, 2036, with a balloon payment of $29,245 due on September 1, 2037. The outstanding bonds accrue interest at rates ranging from 5.125% to 5.25%.

(e) Series 2006 C

On October 26, 2006, The Health, Educational and Housing Facilities Board of the County of Sullivan Tennessee issued, on behalf of Wellmont, $200,000 of Hospital Revenue Bonds, Series 2006C. The Series 2006C Bonds were used to: finance the costs of acquisition of land for expansion, construction, expansion, equipping, and renovation of HVMC, including the construction of a new patient tower (collectively known as Project Platinum); finance the costs of the construction, expansion, equipping, and renovation of the emergency department at BRMC (the Bristol Emergency Department Project); and finance the costs of construction, expansion, renovation and equipping of an operating room and related facilities at HCMH.

Principal on outstanding Series 2006C Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $1,605 to $25,330 commencing on September 1, 2017 through September 1, 2036. The outstanding bonds accrue interest at rates ranging from 5.00% to 5.25%.

(f) Series 2006 A and B

On June 23, 2006, The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $98,475 of Hospital Revenue Refunding Bonds, Series 2006. This bond issuance consisted of Series A tax-exempt and Series B taxable bonds of $76,595 and $21,880, respectively. The Series 2006 Bonds together with other available funds were used to advance refund all the previously issued Hospital Revenue Bonds, Series 1993, to reimburse Wellmont for payments made on other taxable borrowings and to pay certain expenses incurred in connection with the issuance of the Series 2006 Bonds. Upon this refunding, a trust was established to pay all future bond payments related to the Series 1993 Bonds. Wellmont was deemed to have paid the Series 1993 Bonds and these Bonds are no longer deemed to be outstanding for purposes of the Series 1993 Trust Indenture.

Principal on outstanding Series 2006A Bonds was payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $875 to $6,400 commencing on September 1, 2013 through September 1, 2032; and the outstanding bonds accrued interest on a variable rate, which was reset monthly based upon the AAA-insured Municipal Market Data Index, plus 85 basis points. Principal on outstanding Series 2006B Bonds was payable through maturity in annual amounts ranging from $1,600 to $2,930 commencing on September 1, 2007 through September 1, 2016, and the outstanding bonds accrued interest at a fixed rate of 6.95%.

Outstanding Series 2006A Bonds were subject to redemption prior to maturity at the option of The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee, upon direction by Wellmont in whole at any time, or in part on any certain specified days at redemption prices of 100%-102% of the principal amount of the Series 2006A Bonds being redeemed, plus accrued interest thereon to the redemption date.

On October 1, 2010, the Series 2006B Bonds were called and paid in full at par value of $14,880.

On May 5, 2011, the Series 2006A Bonds were refunded with the proceeds of the Revenue Bonds, Series 2011.

(g) Series 2005

On December 8, 2005, The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $70,620 of Hospital Revenue Refunding Bonds, Series 2005. The Series 2005 Bonds together with other available funds were used to advance refund the previously issued Hospital Revenue Bonds, Series 2002, and to pay certain expenses incurred in connection with the issuance of the Series 2005 Bonds.

Principal on outstanding Series 2005 Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $1,945 to $3,390 commencing on September 1, 2007 through September 1, 2032. The terms of the bonds provide that bondholders may redeem or put the bonds to the remarketing agent on dates that approximate a weekly basis. The remarketing agent is obligated to remarket the redeemed bonds on a "best efforts" basis. Redeemed bonds are repaid to bondholders from the proceeds of the remarketing effort or, in the event of an inability to remarket the bonds, from a letter of credit. This letter secures the bonds in the event of a failed remarketing or liquidity issue. In the event of a liquidity drawing under the letter of credit, Wellmont shall pay the Base Rate equal to the greater of (i) the Prime Rate plus 1.5% per annum, (ii) LIBOR plus 2.5% per annum, or (iii) 7.50% per annum. Wellmont shall repay the liquidity drawing amount in twelve equal quarterly installments, with the first such installment due on the first anniversary of the related liquidity drawing.

Outstanding Series 2005 Bonds are subject to redemption prior to maturity at the option of The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee, upon direction by Wellmont in whole at any time, or in part on any certain specified days at redemption prices of 100%-102% of the principal amount of the Series 2005 Bonds being redeemed, plus accrued interest thereon to the redemption date.

(h) Series 2003

On June 1, 2003, The Health, Educational and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $59,100 of Hospital Revenue Bonds, Series 2003. The bonds were issued to provide funds necessary to refund Wellmont's Hospital Revenue Bonds, Series 1993 (HVHC), to fund a debt service reserve fund and to pay certain expenses incurred in connection with the issuance of the Series 2003 Bonds.

The Wellmont Series 2003 Bonds consist of $27,460 in fixed-rate serial bonds and $19,280 in fixed-rate term bonds payable through maturity or mandatory sinking fund redemption maturing in annual amounts ranging from $3,230 on September 1, 2007 to $4,140 on September 1, 2019, and carrying interest rates ranging from 2.5% to 5.00%.

(i) Master Trust Indenture

The master trust indentures and loan agreements for the 2011, 2010, 2007, 2006, 2005, and 2003 bonds contain certain requirements regarding deposits to trustee funds, maintenance of rates, maintenance of debt service coverage and liquidity, permitted indebtedness, and permitted disposition of assets. Gross receipts of Wellmont collateralize the bonds. The purpose of the master trust indenture is to provide a mechanism for the efficient and economical issuance of notes by individual members of Wellmont using the collective borrowing capacity and credit rating of Wellmont. The master trust indenture requires individual members of Wellmont to make principal and interest payments on notes issued for their benefit. The master trust indenture also requires Wellmont members to make payments on notes issued by other members of Wellmont if such other members are unable to satisfy their obligations under the master trust indenture. Payments of principal and interest on certain bonds are also insured by bond insurance policies.

(Dollars in thousands)

Funds held by the trustee related to the various revenue bonds are available for specific purposes. The bond interest and revenue funds may be used only to pay interest and principal on the bonds; the debt service reserve fund may be used to pay interest and principal if sufficient funds are not available in the bond interest and revenue funds. The original issue discount and premium on all Bond Series outstanding are being amortized over the life of the bond issue using the effective-interest method.

(j) Notes Payable

During 2007, Wellmont entered into a five-year $3,000 note payable, which has a fixed interest rate of 7.25% and a termination date of July 2011. At June 30, 2011 and 2010, $1,784 and $2,062, respectively, was outstanding on this note.

During 2008, Wellmont entered into a five-year $2,400 term note payable, which has a fixed interest rate of 7.25% and a termination date of August 2012. At June 30, 2011 and 2010, $1,120 and $1,600, respectively, was outstanding on this note.

During 2010, Wellmont entered into a $2,767 note payable to finance the purchase of Cardiovascular Associates. The note payable has a fixed interest rate of 5.5% and a termination date of May, 2013. At June 30, 2011 and 2010, $1,845 and $2,767, respectively, was outstanding on this note.

(k) Capital Lease Obligations

Wellmont has entered into leases for certain equipment under agreements classified as capital leases that expire over periods through 2011. Assets under capital leases are included in property and equipment and have a net carrying value of $24,325 and $26,325 as of June 30, 2011 and 2010, respectively. Amortization of capital assets is included in depreciation expense. The lease obligations are recorded at the net present value of the minimum lease payments with interest rates from 4.3% to 12%.

(l) Long-term Debt Maturities Schedule

Bond maturities in accordance with the original terms of the Master Trust Indenture and other long-term debt maturities for each of the next five years and in the aggregate at June 30, 2011 are as follows:

2012	$	9,273
2013		13,454
2014		9,572
2015		9,608
2016		9,896
Thereafter		409,820
	$	461,623

(Dollars in thousands)

The following table reflects the required repayment terms for the years ended June 30 of Wellmont's debt obligations in the event that the put options associated with the 2005 bonds were exercised, but not successfully remarketed.

2012	$	9,273
2013		25,337
2014		26,110
2015		26,032
2016		11,887
Thereafter		362,984
	$	461,623

Interest paid for the years ended June 30, 2011 and 2010 was $20,750 and $20,792, respectively, net of amounts capitalized. Interest costs of $590 and $2,776, net of interest income of $49 and $683 in 2011 and 2010, respectively, were capitalized.

(12) Derivative Transactions

Wellmont is a party to a number of interest rate swap agreements. Such swaps have not been designated as hedges and are valued at estimated fair value in the accompanying consolidated balance sheets. By using derivative financial instruments to hedge exposures to changes in interest rates, Wellmont exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes Wellmont, which creates credit risk for Wellmont. When the fair value of a derivative contract is negative, Wellmont owes the counterparty, and therefore, Wellmont is not exposed to the counterparty's credit risk in those circumstances. Pursuant to the terms of its interest rate swap agreements, Wellmont is required to post collateral with its counterparties under certain specified conditions. Collateral posting requirements are based on the amount of Wellmont's derivative liability and Wellmont's bond rating. As of June 30, 2011, and 2010, Wellmont was not required to post collateral related to its swaps.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

In September and October, 2008, the counterparty and credit support provider, for four of the swaps held at June 30, 2010, filed bankruptcy. Subsequent to the bankruptcy filings and into 2011, no payments were made by Wellmont or the counterparty to each other. During 2011, Wellmont and the counterparty agreed to settle all amounts due on the swaps for net cash flow receivables or payables. The bankruptcy process is underway and the ultimate outcome regarding any final settlement cannot be determined at this time.

Wellmont has a Total Return Swap on the Series 2011 Bonds with a new counterparty.

Management's primary objective in holding such derivatives is to introduce a fixed or variable rate component into its variable rate debt structure using LIBOR rates. The fair value as of June 30, 2011 and

(Dollars in thousands)

2010 of approximately $(11,588) and $(12,943), respectively, is included in other liabilities in the consolidated balance sheets. The change in the fair value of the derivative instruments was approximately $1,355 and $(2,693), respectively, in 2011 and 2010 and is included in nonoperating gains (losses), net in the consolidated statements of operations. The terms of the swap agreements allow netting of all amounts due from/to the counterparty. The following is a summary of the interest rate swap information as of June 30, 2011:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2011	$ 76,165	May 5, 2011	September 1, 2032	1.440%	6.200%	$ (377)
Pay fixed interest rate swap	Series 2005	59,580	December 13, 2005	September 1, 2016	3.548	0.309	(5,954)
Basis swap	Series 2002	62,730	September 1, 2002	September 1, 2032	0.090	0.124	(1,715)
Pay fixed interest rate swap	*	35,342	October 24, 2003	September 1, 2021	3.613	0.124	(3,542)
							$ (11,588)

* Previously designated bond series has been refinanced.

The following is a schedule detailing the swap information as of June 30, 2010:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2006A	$ 76,595	June 29, 2006	September 1, 2011	1.103%	5.440%	$ 1,101
Pay fixed interest rate swap	Series 2005	65,975	December 13, 2005	September 1, 2016	3.548	0.217	(6,810)
Basis swap	Series 2002	67,965	September 1, 2002	September 1, 2032	0.253	0.198	(2,710)
Pay fixed interest rate swap	Series 2006A	35,342	October 24, 2003	September 1, 2021	3.613	0.162	(4,524)
							$ (12,943)

(13) Pension and Other Postretirement Benefits

Wellmont sponsors a retirement program and defined contribution retirement plan (Retirement Plan) that covers substantially all employees. This program and the related Retirement Plan were created from amendments, restatements, and mergers of existing defined contribution plans at BRMC and HVMC. Wellmont makes annual contributions to the Retirement Plan in an amount equal to 3% of each participant's base wages and contributes an additional amount, based on each participant's voluntary contributions, which cannot exceed certain limits established in the Internal Revenue Code, up to 3% of each participant's wages. The total pension expense related to the Retirement Plan was $10,344 and $9,990 for the years ended June 30, 2011 and 2010, respectively.

HVMC sponsored a noncontributory, defined benefit pension plan covering substantially all its employees. However, effective June 30, 1996, this plan was frozen and no further benefits accrue. LPH also sponsors a defined benefit pension plan covering substantially all its employees.

(Dollars in thousands)

HVMC's defined pension benefits are actuarially determined based on a formula taking into consideration an employee's compensation and years of service. HVMC's funding policy is to make annual contributions to the plan based upon the funding standard developed by the plan actuary. This standard uses the projected unit credit actuarial cost method, including the amortization of prior service costs, over a 20-year period. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The LPH plan contains similar funding and actuarial policies.

On June 30, 2007, the HVMC plan merged into LPH plan and the plan name changed to Wellmont Health System Defined Benefit Plan. At the end of 2008, only a single defined pension plan exists. Collectively, the two defined benefit plans are referred to as the "Plans." Effective June 30, 2010, the plan was frozen for all Lonesome Pine Hospital employees and no further benefits will be accrued.

Wellmont recognizes the funded status (i.e., difference between the fair value of plan assets and projected benefit obligations) of its defined benefit pension plans as an asset or liability in its consolidated balance sheet and recognizes changes in that funded status in the year in which the changes occur as a change in unrestricted net assets. All defined benefit pension plans use a June 30 measurement date.

The following table sets forth the funded status of the combined Plans, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

		2011	2010
Change in benefit obligation:			
Benefit obligation at beginning of year	$	44,565	40,035
Service cost		220	230
Interest cost		2,390	2,432
Actuarial losses		896	4,008
Benefits paid		(2,239)	(2,140)
Curtailments *		(495)	—
Benefit obligation at end of year		45,337	44,565
Change in plan assets:			
Fair value of plan assets at beginning of year		34,547	33,326
Actual return on plan assets		6,503	3,361
Benefits paid		(2,239)	(2,140)
Fair value of plan assets at end of year		38,811	34,547
Funded status	$	(6,526)	(10,018)
Amounts recognized in the accompanying consolidated balance sheets:			
Pension benefit liability (other long-term liabilities)	$	(6,526)	(10,018)

* Reflects frozen benefit accruals for Lonesome Pine participants as of June 30, 2011.

(Dollars in thousands)

		2011	2010
Amounts not yet reflected in net periodic benefit cost and included as an accumulated charge to unrestricted net assets:			
Unrecognized actuarial loss	$	8,565	13,158
Unrecognized prior service cost		—	2
Net amounts included as an accumulated charge to unrestricted net assets	$	8,565	13,160
Calculation of change in unrestricted net assets:			
Accumulated charge to unrestricted net assets, end of year	$	8,565	13,160
Reversal of accumulated charge to unrestricted net assets, prior year		(13,160)	(10,853)
Change in unrestricted net assets	$	(4,595)	2,307
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Prior service credit adjustment for curtailment	$	(1)	—
Actuarial (gain) loss arising during the year		(3,763)	2,907
Amortization of actuarial loss		(831)	(600)
Amortization of prior service cost		—	—
Net amounts recognized as a charge to unrestricted net assets	$	(4,595)	2,307

(Dollars in thousands)

		2011	2010
Estimate of amounts that will be amortized from unrestricted net assets to net pension cost in 2012:			
Amortization of net loss	$	382	791
Amortization of prior service cost		—	—
Estimated future benefit payments:			
Fiscal 2012		2,276	2,220
Fiscal 2013		2,369	2,337
Fiscal 2014		2,492	2,472
Fiscal 2015		2,596	2,578
Fiscal 2016 (FY10 fiscal 2016 – 2020)		2,671	14,278
Fiscal 2017 – 2021		14,819	
Weighted average assumptions used to determine benefit obligations:			
Settlement (discount) rate		5.50%	5.50%
Weighted average rate of increase in future compensation levels		3.00	3.00
Components of net periodic benefit cost (benefit):			
Service cost	$	220	230
Interest cost		2,390	2,432
Expected return on plan assets		(2,340)	(2,259)
Amortization of net loss		831	600
Amortization of unrecognized prior service cost curtailments		1	—
Net periodic benefit cost	$	1,102	1,003
Weighted average assumptions used to determine net periodic benefit cost:			
Settlement (discount) rate		5.50%	6.25%
Expected long-term return on plan assets (HVMC)		7.00	7.00
Expected long-term return on plan assets (LPH)		7.00	7.00
Weighted average rate of increase in future compensation levels		3.00	3.00

Wellmont's overall expected long-term rate of return on assets is 7.00%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

Wellmont has developed a Plan investment policy, which is reviewed and approved by the board of directors. The policy established goals and objectives of the fund, asset allocations, asset classifications, and manager guidelines. The policy dictates a target asset allocation and an allowable range for such categories based on quarterly investment fluctuations. Investments are managed by independent advisers who are monitored by management and the board of directors.

(Dollars in thousands)

The table below shows the target allocation and actual asset allocations as of June 30, 2011 and 2010:

Asset	Target allocation	2011	2010
Equity securities	65%	46%	56%
Fixed income	28	35	27
Cash	5 – 15%	2	1
Other	5 – 15%	17	16

Wellmont monitors the asset allocation and executes required recalibrations of the portfolio allocation on a regular basis in response to fluctuations in market conditions and the overall portfolio composition.

HVMC also participates in a health and welfare plan for its retirees. The plan provides postretirement medical and life insurance benefits to certain employees who meet minimum age and service requirements. Effective January 1, 1995, the death benefit was changed to provide a flat $5 benefit to all future retirees. During 1995, the medical program for retirees was amended to terminate medical benefits for any active employees who would not meet the full eligibility requirements of the program by January 1, 1996. The plan is contributory and contains other cost-sharing features such as deductibles and coinsurance.

(Dollars in thousands)

The following table sets forth the postretirement plan's funded status, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

		Postretirement benefits	
		2011	**2010**
Change in benefit obligation:			
Benefit obligation at beginning of year	$	5,861	5,653
Interest cost		365	320
Plan participants contributions		79	73
Actuarial losses		1,686	197
Benefits Paid		(228)	(382)
Benefit obligation at end of year		7,763	5,861
Change in plan assets:			
Fair value of plan assets at beginning of year		—	—
Employer contribution		149	309
Plan participants contributions		79	73
Benefits paid		(228)	(382)
Fair value of plan assets at end of year		—	—
Funded Status	$	7,763	5,861
Amounts recognized in the consolidated balance sheets consist of:			
Noncurrent assets	$	—	—
Current liabilities		(271)	(499)
Noncurrent liabilities		(7,492)	(5,362)
Accumulated charge to unrestricted net assets		1,755	3,560
	$	(6,008)	(2,301)

Amounts recognized as an accumulated credit to unrestricted net assets consist of:

		2011	2010
Net actuarial gain	$	1,755	3,560

(Continued)

(Dollars in thousands)

Net periodic benefic cost recognized and other changes in plan assets and benefit obligations recognized in unrestricted net assets in 2011 and 2010 were:

	Postretirement benefits 2011	Postretirement benefits 2010
Net periodic benefit cost		
Interest cost	$ 365	320
Amortization of net gain	(119)	(319)
Net periodic benefit cost recognized	246	1
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:		
Net actuarial loss	1,686	197
Amortization of net gain	119	319
Total recognized as a charge to unrestricted net assets	1,805	516
Total recognized in net periodic benefit cost and unrestricted net assets	$ 2,051	517

The net gain and prior service credit for the defined benefit postretirement plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year are $(88) and $(261), respectively. Weighted average assumptions used to determine benefit obligations for 2011 and 2010 were as follows:

	2011	2010
Discount rate	5.00%	5.00%
Rate of compensation increase	—	—
Healthcare cost trend rate	5.00	5.00

Weighted average assumptions used to determine net benefit cost for 2011 and 2010 were as follows:

	Postretirement benefits 2011	Postretirement benefits 2010
Discount rate	5.00%	6.00%
Expected long-term rate of return on plan assets	N/A	N/A
Rate of compensation increase	N/A	N/A
Healthcare cost trend rate	5.00	5.00

(Dollars in thousands)

Wellmont's overall expected long-term rate of return on assets is 7%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

For measurement purposes, a 5% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2011.

The following table summarizes the effect of one-percentage-point increase/decrease in healthcare costs trends:

		2011	2010
Effect of one-percentage point increase in healthcare cost trend on:			
Service and interest cost	$	27	20
Accumulated pension benefit obligation		545	330
Effect of one-percentage point decrease in healthcare cost trend on:			
Service and interest cost		(24)	(18)
Accumulated pension benefit obligation		(486)	(294)

The asset allocations of Wellmont's pension and postretirement benefits as of June 30, 2011 and 2010, respectively, were as follows:

		Fair Value measurement at June 30, 2011 Pension benefits – plan assets			
		Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:					
Stock mutual funds	$	31,311	31,311	—	—
Cash and money market funds		764	764	—	—
Alternative funds		6,868	—	3,280	3,588
Total	$	38,943	32,075	3,280	3,588

(Dollars in thousands)

		Fair Value measurement at June 30, 2010 Pension benefits - plan assets			
		Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:					
Stock mutual funds	$	28,803	19,412	9,391	—
Cash and money market funds		244	244	—	—
Alternative funds		5,500	—	—	5,500
Total	$	34,547	19,656	9,391	5,500

The following table presents Wellmont's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (level 3) as defined in ASC 820 for the years ended June 30, 2011 and 2010:

		Alternative investments
Balance at June 30, 2009	$	5,133
Net change in value		254
Purchases, issuances, and settlements		113
Transfers in and/or out of Level 3 (net)		—
Balance at June 30, 2010		5,500
Net change in value		1,349
Purchases, issuances, and settlements		19
Transfers in and/or out of Level 3 (net)		(3,280)
Balance at June 30, 2011	$	3,588

(14) Self-Insurance Programs

Wellmont is self-insured for professional and general liability and workers' compensation liability. Consulting actuaries have been retained to determine funding requirements and estimate claim liability exposures. Wellmont has established revocable self-insurance trust funds to provide for professional and general liability claims and workers' compensation claims and related expenses. Wellmont's contributions to the self-insurance trusts are based upon actuarial determinations by an independent service company. The professional and general liability self-insurance program is supplemented by umbrella excess liability policies consisting of various layers of coverage with commercial carriers based on policy year. The workers' compensation program is supplemented for Tennessee and Virginia by excess workers' compensation policies, with a commercial carrier for statutory limits per occurrence. Provisions based on actuarial estimates are made for the ultimate cost of claims asserted, as well as estimates of claims incurred but not reported as of the respective consolidated balance sheet dates. Insurance expense under these programs amounted to approximately $4,692 and $3,414 for the years ended June 30, 2011 and 2010, respectively, and are included in other expense in the accompanying consolidated statements of operations and changes in net assets.

(Dollars in thousands)

At June 30, 2011 and 2010, Wellmont was involved in litigation relating to medical malpractice and workers' compensation claims arising in the ordinary course of business. There are also known incidents which occurred through June 30, 2011 that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. Claims have been filed requesting damages in excess of the amount accrued for estimated malpractice costs. Management of Wellmont is of the opinion that estimated professional and general liability amounts accrued at June 30, 2011 are adequate to provide for potential losses resulting from pending or potential litigation. Amounts of claim settlements may be more or less than what has been provided for by management. The ultimate settlement of claims could be different from recorded accruals, with such differences being potentially significant.

Wellmont is also self-insured for medical and other healthcare benefits provided to its employees and their families. A provision for estimated incurred but not reported claims has been provided in the consolidated financial statements.

(15) Commitments and Contingencies

Construction in progress at June 30, 2011 and 2010 relates primarily to the completion of certain buildings and renovations. Total costs to complete these and other projects were approximately $12,448 at June 30, 2011. Wellmont has entered into contracts of $12,448 related to these projects.

Wellmont leases certain equipment and office space under operating lease agreements. Total rental expense under cancelable and noncancelable agreements was $18,179 and $16,857 for the years ended June 30, 2011 and 2010, respectively. Minimum future lease payments under noncancelable operating leases with initial or remaining lease terms in excess of one year as of June 30, 2011 are as follows:

2012	$	13,168
2013		10,071
2014		6,269
2015		5,491
2016		4,190
Thereafter		28,904
	$	68,093

Wellmont has entered into contractual employment relationships with physicians to provide services to Wellmont physician practices that are intended to qualify under the employee safe harbor of the Anti-Kickback Statute and the employee exception of the Physician Self-Referral Law. These contracts have terms of varying lengths, guarantee certain base payments, and may provide for additional incentives based upon productivity.

(Dollars in thousands)

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, such matters as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes Wellmont is in compliance with fraud and abuse statutes and other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

(16) Functional Expense Disclosure

Wellmont provides healthcare services to residents within its geographic location. Expenses based upon functional classification related to providing these services during the years ended June 30 are as follows:

		2011	2010
Professional care of patients	$	636,403	583,222
Administrative and general		142,768	117,123
Fund-raising		913	1,235
	$	780,084	701,580

(17) Income Taxes

Wellmont, Inc. and its subsidiaries file consolidated federal and separate company state income tax returns. These companies have combined net operating loss carry forwards for federal income tax purposes of approximately $67,000 at June 30, 2011, which begin expiring in fiscal 2018 and expire through 2032. These net operating losses can be used to offset future consolidated taxable income of Wellmont, Inc. and subsidiaries. Wellmont Health System participates in certain activities that generate unrelated business taxable income. These activities have generated net operating losses in prior years, and Wellmont Health System files a Form 990-T with the IRS to report such activity. Wellmont Health System has net operating loss carry forwards for federal income tax purposes of approximately $1,766 for unrelated business activities. Management believes that it is not more likely than not that deferred tax assets arising from net operating loss carry forwards will be realizable. Accordingly, these are fully reserved at June 30, 2011 and 2010.

(Dollars in thousands)

(18) Concentration of Credit Risk

Wellmont grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2011 and 2010, was as follows:

	2011	2010
Medicare	42%	46%
TennCare	4	4
Medicaid	9	8
Other third-party payors	35	31
Patients	10	11
	100%	100%

(19) Disclosures about Fair Value of Financial Instruments

(a) Fair Value of Financial Instruments

The following methods and assumptions were used to estimate fair value of each class of instruments:

- *Cash and Cash Equivalents*

  The carrying amount approximates fair value due to the short maturities of these instruments.

- *Patient Accounts and Other Receivables*

  The net recorded carrying value approximates fair value due to the short maturities of these instruments.

- *Investments and Assets Limited as to Use*

  The fair values of investments and assets limited as to use are based on quoted market prices and quotes obtained from security brokers or, in the case of the limited partnerships, by the general partner.

- *Accounts Payable and Accrued Expenses*

  The carrying amount approximates fair value due to the short maturities of these liabilities.

- *Estimated Third-Party Payor Settlements, Other Long-Term Liabilities*

  The carrying amount approximates fair market value due to the nature of these liabilities.

- *Long-Term Debt*

  The fair value of revenue bonds, using current market rates, was estimated at $419,960 and $422,290 for the years ended June 30, 2011 and 2010, respectively.

(b) Fair Value Hierarchy

On July 1, 2008, Wellmont adopted new guidance issued by FASB for fair value measurement of financial assets and financial liabilities and for fair value measurement of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis now codified into ASC 820, *Fair Value Measurements and Disclosures*. ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted market prices (unadjusted) in active markets for identical assets or liabilities that Wellmont has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted market prices including within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

In conjunction with the adoption of the new guidance, Wellmont elected to early adopt the measurement provisions of Accounting Standards Update No. 2009-12 to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. This guidance amends the previous guidance and allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent. Net asset value, in many instances may not equal fair value that would be calculated pursuant to ASC 820. The fair value of these investments was $66,529 and $59,397 at June 30, 2011 and 2010, respectively.

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2011:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 36,558	—	—	36,558
Assets limited as to use:				
Stock mutual funds	88,073	—	—	88,073
Bond mutual funds	112,176	—	—	112,176
Cash and money market funds	39,215	—	—	39,215
Real estate funds	8,475	—	—	8,475
Alternative investments	—	26,480	37,778	64,258
Corporate bonds	7,877	—	—	7,877
U.S. Treasury bonds	1,215	—	—	1,215
Subtotal	293,589	26,480	37,778	357,847
Long-term investments:				
Stock mutual funds	12,198	—	—	12,198
Bond mutual funds	9,433	—	—	9,433
Cash and money market funds	191	—	—	191
Real estate funds	832	—	—	832
Alternative investments	—	2,271	—	2,271
Subtotal	22,654	2,271	—	24,925
	$ 316,243	28,751	37,778	382,772
Liabilities:				
Derivatives liability	$ —	11,588	—	11,588
Total	$ —	11,588	—	11,588

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2010:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 35,711	—	—	35,711
Assets limited as to use:				
Stock mutual funds	109,629	—	—	109,629
Bond mutual funds	71,698	—	—	71,698
Cash and money market funds	49,318	—	—	49,318
Real estate funds	7,468	—	—	7,468
Alternative investments	—	18,043	39,362	57,405
Corporate bonds	6,867	—	—	6,867
U.S. Treasury bonds	1,237	—	—	1,237
Subtotal	281,928	18,043	39,362	339,333
Long-term investments:				
Stock mutual funds	9,279	—	—	9,279
Bond mutual funds	7,599	—	—	7,599
Cash and money market funds	287	—	—	287
Real estate funds	1,722	—	—	1,722
Alternative investments	—	1,992	—	1,992
Subtotal	18,887	1,992	—	20,879
	$ 300,815	20,035	39,362	360,212
Liabilities:				
Derivatives liability	$ —	12,943	—	12,943
Total	$ —	12,943	—	12,943

(Dollars in thousands)

The following table presents Wellmont's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 820 for the years ended June 30, 2011 and 2010:

		Alternative investments
Balance at June 30, 2009:	$	33,291
Total realized and unrealized gains (losses)		
Included in revenues and gains in excess of expenses and losses		—
Included in changes in net assets		469
Purchases, issuances and settlements		5,602
Transfers in and/or out of Level 3 (net)		—
Balance at June 30, 2010		39,362
Total realized and unrealized gains (losses)		
Included in revenues and gains in excess of expenses and losses		
Included in changes in net assets		(3,401)
Purchases, issuances and settlements		1,817
Transfers in and/or out of Level 3 (net)		—
Balance at June 30, 2011	$	37,778

(20) Subsequent Events

WHS has evaluated subsequent events from the balance sheet date through October 27, 2011, the date at which the financial statements were available to be issued. No material subsequent events were identified for recognition.

KPMG

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Financial Statements

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

WELLMONT HEALTH SYSTEM AND AFFILIATES

Table of Contents

KPMG LLP
Suite 1000
401 Commerce Street
Nashville, TN 37219-2422

Independent Auditors' Report

The Board of Directors
Wellmont Health System:

We have audited the accompanying consolidated balance sheets of Wellmont Health System and affiliates (Wellmont) as of June 30, 2012 and 2011, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of Wellmont's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Wellmont'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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Wellmont Health System and affiliates as of June 30, 2012 and 2011, and the consolidated results of their operations and changes in their net assets, and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in note 2 to the consolidated financial statements, Wellmont changed its presentation of provision for bad debts as a result of the adoption of Accounting Standards Update No. 2011-07, *Health Care Entities: Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*.

KPMG LLP

October 24, 2012

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Balance Sheets

June 30, 2012 and 2011

(Dollars in thousands)

Assets		**2012**	**2011**
Current assets:			
Cash and cash equivalents	$	44,930	36,558
Assets limited as to use, required for current liabilities		4,372	1,902
Patient accounts receivable, less allowance for uncollectible accounts of approximately $25,656 and $24,246 in 2012 and 2011, respectively		108,265	101,565
Other receivables		23,805	9,904
Inventories		17,862	17,830
Prepaid expenses and other current assets		7,462	7,163
Total current assets		206,696	174,922
Assets limited as to use, net of current portion		339,030	319,387
Land, buildings, and equipment, net		458,048	454,937
Other assets:			
Long-term investments		36,633	36,437
Investments in affiliates		32,646	31,177
Deferred debt expense, net		5,419	5,847
Goodwill		17,090	16,721
Other		651	1,875
		92,439	92,057
Total assets	$	1,096,213	1,041,303
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	11,913	9,273
Accounts payable and accrued expenses		81,243	70,943
Estimated third-party payor settlements		15,535	9,533
Current portion of other long-term liabilities		5,782	8,527
Total current liabilities		114,473	98,276
Long-term debt, less current portion		459,654	458,882
Other long-term liabilities, less current portion		54,060	42,384
Total liabilities		628,187	599,542
Net assets:			
Unrestricted		458,218	434,661
Temporarily restricted		5,739	3,570
Permanently restricted		1,304	1,174
Total net assets attributable to Wellmont		465,261	439,405
Noncontrolling interests		2,765	2,356
Total net assets		468,026	441,761
Commitments and contingencies			
Total liabilities and net assets	$	1,096,213	1,041,303

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2012 and 2011

(Dollars in thousands)

		2012	2011
Revenue:			
Patient service revenue	$	813,229	767,450
Provision for bad debt		(71,407)	(37,858)
Net patient revenue less provision for bad debt		741,822	729,592
Other revenues		47,904	29,799
Total revenue		789,726	759,391
Expenses:			
Salaries and benefits		368,772	347,185
Medical supplies and drugs		164,397	160,565
Purchased services		79,509	80,348
Interest		21,677	20,750
Depreciation and amortization		46,403	46,059
Other		86,645	87,319
Total expenses		767,403	742,226
Income from operations		22,323	17,165
Nonoperating gains (losses):			
Investment income		17,272	10,383
Derivative valuation adjustments		1,807	1,355
Other, net		—	(519)
Gain on refinancing		—	1,042
Nonoperating gains, net		19,079	12,261
Revenue and gains in excess of expenses and losses before discontinued operations		41,402	29,426
Discontinued operations		88	44
Revenue and gains in excess of expenses and losses		41,490	29,470
Income attributable to noncontrolling interests		(1,670)	(1,238)
Revenues and gains in excess of expenses and losses attributable to Wellmont		39,820	28,232
Other changes in unrestricted net assets:			
Change in net unrealized gains on investments		(9,534)	42,186
Net assets released from restrictions for additions to land, buildings, and equipment		3,766	2,852
Change in the funded status of benefit plans and other		(10,495)	2,771
Increase in unrestricted net assets		23,557	76,041
Changes in temporarily restricted net assets:			
Contributions		6,661	2,566
Net assets released from temporary restrictions		(4,492)	(3,547)
Increase (decrease) in temporarily restricted net assets		2,169	(981)
Changes in permanently restricted net assets – investment income		130	6
Changes in noncontrolling interests:			
Income attributable to noncontrolling interests		1,670	1,238
Distributions to noncontrolling interests		(1,261)	(1,178)
Change in noncontrolling percentages		—	(92)
Increase (decrease) in noncontrolling interests		409	(32)
Change in net assets		26,265	75,034
Net assets, beginning of year		441,761	366,727
Net assets, end of year	$	468,026	441,761

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2012 and 2011

(Dollars in thousands)

		2012	2011
Cash flows from operating activities:			
Change in net assets	$	26,265	75,034
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		46,403	46,070
Gain on disposal of land, buildings, and equipment		(458)	(864)
Equity in earnings of affiliated organizations		(7,233)	(4,478)
Distributions from affiliated organizations		5,764	5,320
Amortization of deferred financing costs		428	158
Net realized and unrealized loss (gain) on investments		2,633	(43,162)
Provision for bad debts		71,407	37,893
Change in fair value of derivative instruments		(1,807)	(1,355)
Gain on refinancing		—	(1,042)
Changes in assets and liabilities:			
Patient accounts receivable		(78,107)	(45,402)
Other current assets		(331)	303
Other assets		(13,920)	(538)
Accounts payable and accrued expenses		10,230	(6,729)
Estimated third-party payor settlements		6,002	(2,139)
Other current liabilities		(2,745)	1,276
Other liabilities		13,672	(63)
Net cash provided by operating activities		78,203	60,282
Cash flows from investing activities:			
Proceeds from sales and maturities of investments		149,087	186,085
Purchase of investments		(174,029)	(164,635)
Purchase of land, buildings, and equipment		(46,026)	(42,352)
Proceeds from the sale of buildings and equipment		1,721	244
Cash paid for acquisitions		(813)	(7,826)
Net cash used in investing activities		(70,060)	(28,484)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt		11,368	91,133
Payments on long-term debt		(11,139)	(106,069)
Payment of debt issuance costs		—	(2,015)
Payments on line of credit		—	(14,000)
Net cash provided by (used in) financing activities		229	(30,951)
Net increase in cash and cash equivalents		8,372	847
Cash and cash equivalents, beginning of year		36,558	35,711
Cash and cash equivalents, end of year	$	44,930	36,558

Supplemental disclosures of noncash items:

Wellmont entered into capital lease obligations for buildings and equipment in the amount of $3,281 and $5,785 in 2012 and 2011, respectively.

Additions to property and equipment financed through current liabilities of $2,487 and $2,933 in 2012 and 2011, respectively.

See accompanying notes to consolidated financial statements.

(1) Operations and Basis of Presentation

Wellmont Health System (Wellmont) was formed to assume operations of Bristol Regional Medical Center (BRMC) and Holston Valley Health Care, Inc. (HVHC), including Holston Valley Medical Center, Inc. (HVMC), and to act as sole corporate member of its consolidated foundation. Effective July 1, 1996, under terms of an agreement and plan of consolidation and merger, BRMC and HVHC, including HVMC, were merged and consolidated into Wellmont. Effective January 1, 1997, Lonesome Pine Hospital (LPH), a Virginia corporation, was merged into Wellmont under terms of a plan of merger and merger agreement. Effective July 1, 2000, Hawkins County Memorial Hospital (HCMH) transferred its operations and operating assets to Wellmont Hawkins County Memorial Hospital (WHCMH), a tax-exempt organization that is wholly owned and controlled by Wellmont. Hancock County Hospital (HCH), a critical access hospital, was opened in March 2005 to help provide for the immediate healthcare needs of the residents of Sneedville and the surrounding counties. As of July 16, 2007, Wellmont acquired Jenkins Community Hospital in Kentucky. As of August 1, 2007, Wellmont acquired two hospitals in Virginia, Lee Regional Medical Center in Pennington Gap and Mountain View Regional Medical Center in Norton. On May 30, 2008, Wellmont acquired the Holston Valley Cath Lab, an outpatient lab. On May 1, 2010, Wellmont acquired Cardiovascular Associates. On January 1, 2011, Wellmont acquired Pulmonary Associates of Kingsport.

As of April 30, 2009, Wellmont closed Jenkins. The consolidated financial statements for the years ended June 30, 2012 and 2011 present Jenkins as a discontinued operation. Losses of $4 and $120 for the years ended June 30, 2012 and June 30, 2011, respectively, are included in discontinued operations.

As of September 23, 2010 Wellmont sold the majority of Medical Mall Pharmacy’s assets to a national pharmacy company for $1,300 plus inventory value and recorded a gain of approximately $517 at June 30, 2011. The consolidated financial statements for the years ended June 30, 2012 and 2011 present Medical Mall Pharmacy as a discontinued operation. The gains (losses) of $92 and $(353) for the years ended June 30, 2012 and June 30, 2011, respectively, are included in discontinued operations.

All acute care operations remain separately licensed and are treated as operating divisions within Wellmont. Wellmont’s continuing operations consist primarily of the delivery of healthcare services in northeast Tennessee and southwest Virginia.

The consolidated financial statements include the acute care operations of the above entities along with:

- Wellmont Foundation (the Foundation), which was created from the merger of Bristol Regional Medical Center Foundation and Holston Valley Health Care Foundation, Inc. The Foundation conducts fund-raising activities for the benefit of Wellmont.
- Wellmont, Inc., a wholly owned taxable subsidiary of Wellmont, formed as the holding company of various other taxable subsidiaries that provide medical collection and medical laundry services, operate physician practices, provide other healthcare-related services, and invest in affiliates and other activities.

- The Alzheimer's Center of East Tennessee was merged into Wellmont and changed its name to Wellmont Madison House effective September 1, 1997. Wellmont is the sole corporate member and the consolidated financial statements include the operations of this entity.

All significant intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

(2) Significant Accounting Policies

A summary of significant accounting policies is as follows:

(a) Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Significant estimates include: allowances for contractual adjustments and bad debts; third-party payor settlements; valuation of investments, land, buildings, equipment and goodwill; and self-insurance and other liabilities. Actual results could differ from these estimates.

(b) Cash and Cash Equivalents

Wellmont considers all highly liquid investments with a maturity of three months or less when purchased, excluding amounts whose use is limited by board of directors' designation or other arrangements under trust agreements, to be cash equivalents.

(c) Investments

Marketable equity securities and debt securities are recorded at fair value and classified as other than trading. Fair value is determined primarily using quoted prices (unadjusted) in active markets for identical assets or liabilities that Wellmont has the ability to access at the measurement date. However, Wellmont also uses observable and unobservable inputs for investments without quoted market prices to determine the fair value of certain investments at the measurement date. Investments in limited partnerships are recorded at fair value as determined by the partnership using net asset value. Wellmont has adopted the measurement provisions of Accounting Standards Update (ASU) No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. Investments in affiliates in which Wellmont has significant influence but does not control are reported on the equity method of accounting, which represents Wellmont's equity in the underlying net book value. Long-term investments include those investments that have not been designated by the board of directors for specific purposes and are also not intended to be used for the liquidation of current liabilities. Investment income is recognized when earned.

Realized gains and losses are determined on the specific-identification method and included in investment income with interest and dividends. Investment income is reported net of related investment fees. Unrealized gains and losses are included in other changes in unrestricted net assets except for losses determined to be other than temporary, which are considered realized losses and included in investment income.

(d) Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under bond indenture and self-insurance agreements, as well as designated assets set aside by the board of directors for future capital improvements, over which the board of directors retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of Wellmont have been reclassified to current assets in the accompanying consolidated balance sheets.

(e) Inventories

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

(f) Land, Buildings, and Equipment

Land, buildings, and equipment are stated at cost, if purchased, or fair value at date of donation. Depreciation is computed using the straight-line method based on the estimated useful life of the asset, ranging from 3 to 40 years. Buildings and equipment held under capital leases are recorded at net present value of future lease payments and are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. Costs of maintenance and repairs are expensed as incurred. Upon sale or retirement of land, buildings, or equipment, the cost and related accumulated depreciation are eliminated from the respective accounts and the resulting gain or loss, if any, is included in other revenues on the consolidated statements of operations and changes in net assets. Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

Wellmont evaluates long-lived assets for impairment on annual basis. Long-lived assets are considered to be impaired whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable from future cash flows. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of an asset to future cash flows expected to be generated by the asset. When such assets are considered to be impaired, the impairment loss recognized is measured by the amount by which the carrying value of the asset exceeds the fair value of the asset.

(Dollars in thousands)

(g) Goodwill

Effective July 1, 2010, Wellmont adopted Accounting Standards Update (ASU) No. 2010-07, *Not for Profit Entities: Mergers and Acquisitions* which in part requires healthcare entities to follow Accounting Standards Codification (ASC) Topic 350-20-35, *Intangibles – Goodwill and Other*. ASC Topic 350-20-35 requires goodwill of not-for-profit entities to be evaluated for impairment at least annually. The goodwill impairment test is a two-step test. Under the first step, the fair value of each reporting unit is compared with its carrying value (including goodwill). If the fair value of a reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the entity must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. The annual impairment test is performed as of June 30. A summary of goodwill and related amortization for the years ended June 30 follows:

	2011	Additions	Decreases	2012
Goodwill	$ 16,721	369	—	17,090

	2010	Additions	Decreases	2011
Goodwill	$ 9,501	7,220	—	16,721

(h) Deferred Debt Expense

Deferred debt expense is amortized over the life of the related bond issues using the effective-interest method.

(i) Derivative Financial Instruments

As further described in note 12, Wellmont is a party to interest rate swap and other derivative agreements. These financial instruments are not designated as hedges and are presented at estimated fair market value in the accompanying consolidated balance sheets. These fair values are based on the estimated amount Wellmont would receive, or be required to pay, to enter into equivalent agreements with a third party at the valuation date. Due to the nature of these financial instruments, such estimates are subject to significant change in the near term. Wellmont recognizes changes in the fair values of derivatives as nonoperating gains or losses in the consolidated statements of operations and changes in net assets. The cash settlements resulting from these interest rate swaps are reported as interest expense in the consolidated statements of operations and changes in net assets.

(j) Asset Retirement Obligations

Asset retirement obligations (AROs) are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value, and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, Wellmont records period-to-period changes in the ARO liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. Wellmont derecognizes ARO liabilities when the related obligations are settled.

(k) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Wellmont has been limited by donors to a specific-time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by Wellmont in perpetuity. Generally, donors of permanently restricted assets permit use of all or part of the income earned on related investments for general or specific purposes.

Temporarily restricted net assets relate primarily to amounts held by the Foundation and include amounts restricted for future capital expenditures and for operations of such areas as children's healthcare services, hospice, and cancer care.

Net assets are released from restrictions by Wellmont incurring expenses that satisfy the restricted purposes. Such net assets released during 2012 and 2011 primarily included amounts related to the purchase of equipment for pediatrics, cancer, and other healthcare operations.

Wellmont has adopted guidance issued by Financial Accounting Standards Board (FASB), which provides guidance on the net asset classification of donor-restricted endowment funds for a tax-exempt organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). Effective July 1, 2007, the State of Tennessee adopted legislation that incorporates the provisions outlined in UPMIFA. Wellmont's endowments consist solely of donor-restricted endowment funds. Wellmont's endowments consist of five individual funds established for a variety of purposes.

Wellmont has interpreted UPMIFA 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. As a result of this interpretation, Wellmont classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are approved for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Wellmont considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the organization and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the organization; and (7) the investment policies of the organization.

(l) Net Patient Service Revenue and Accounts Receivable

Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts expected to be collected. Net patient service revenue includes amounts estimated by management to be reimbursable by patients and various third-party payors under provisions of reimbursement formulas in effect, including retroactive adjustments under reimbursement agreements. Estimated retroactive adjustments are accrued in the period related services are rendered and adjusted in future periods as final and other settlements are determined. On the basis of historical experience, a significant portion of Wellmont's uninsured patients will be unable or unwilling to pay for the services provided. Therefore, Wellmont records a significant provision for bad debts related to uninsured patients in the period the services are provided. This provision for bad debts is presented on the statement of operations as a component of net patient revenue. Wellmont provides care to patients who meet criteria under its charity care policy without charge or at amounts less than its established rates. Because Wellmont does not pursue collection of amounts determined to qualify as charity care, they are not included in net patient service revenue.

Patient accounts receivable are reported net of both an allowance for contractual adjustments and an allowance for uncollectible accounts. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, TennCare, Medicaid, and other third-party payment programs. Wellmont's policy does not require collateral or other security for patient accounts receivable. Wellmont routinely obtains assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans, or policies.

(m) Revenue and Gains in Excess of Expenses and Losses

The consolidated statements of operations and changes in net assets include revenue and gains in excess of expenses and losses. Changes in unrestricted net assets that are excluded from revenue and gains in excess of expenses and losses, consistent with industry practice, include changes in net unrealized gains (losses) on investments other than trading securities, changes in the funded status of Wellmont's defined-benefit plan, contributions of long-lived assets, including assets acquired using contributions that, by donor restriction, were to be used for the purposes of acquiring such assets, and cumulative effects of changes in accounting principles.

For purposes of financial statement display, those activities directly associated with Wellmont's mission of providing healthcare services are considered to be operating activities. Nonoperating activities primarily include investment and related activities. Other operating revenues primarily include cafeteria, rental, meaningful use incentives, and income from affiliates.

(n) Contributed Resources

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted contributions, and are excluded from revenue and gains 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 contributions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expiration of donor restrictions is reported when the donated or acquired long-lived assets are placed in service.

Unconditional promises to give cash or other assets are reported at fair value at the date the promise is received. Gifts are reported as either a temporarily or permanently restricted contribution if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are recorded as unrestricted contributions. Unrestricted contributions are included in other revenues.

(o) Federal Income Taxes

The Wellmont entities are primarily classified as organizations exempt from federal income taxes under Section 501(a) as entities described in Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes has been included for these entities in the consolidated financial statements. The operations of Wellmont, Inc. are subject to state and federal income taxes, which are accounted for in accordance with ASC Topic 740, *Income Taxes*; however, such amounts are not material.

On July 1, 2007, Wellmont adopted new guidance issued on the accounting for uncertainty in income tax positions now codified into ASC 740. It also provides guidance on when tax positions are recognized in an entity's financial statements and how the values of these positions are determined. There was no impact on Wellmont's consolidated financial statements as a result of the adoption of the new guidance.

(p) New Accounting Pronouncements

In August 2010, the Financial Accounting Standards Board issued ASU No. 2010-23, *Measuring Charity Care for Disclosure* (ASU 2010-23). ASU 2010-23 requires that cost be used as the measurement basis for charity care disclosures purposes and that cost can be identified as direct and indirect costs of providing charity care. The adoption of ASU 2010-23 as of July 1, 2011 had no impact on the consolidated financial statements. In August 2010, the Financial Accounting Standards Board issued ASU No. 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries* (ASU 2010-24). ASU 2010-24 clarifies that healthcare entities should not net insurance recoveries against the related claim liability and that the claim liability amount should be determined without consideration of insurance recoveries. The adoption of ASU 2010-24 as of July 1, 2011 had no impact on the consolidated financial statements.

In July 2011, the Financial Accounting Standards Board issued ASU No. 2011-07, *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities* (ASU 2011-07). Wellmont adopted ASU 2011-07 on July 1, 2011 and applied it retrospectively to fiscal year 2011. Wellmont's presentation of provision for bad debts in the consolidated statements of operations and changes in net assets is now shown as a deduction from net patient service revenue. In addition, there are enhanced disclosures about the entities policies for recognizing revenue and assessing bad debts. The ASU also requires disclosures of patient service revenue as well as qualitative and quantitative information about changes in the allowance for doubtful accounts.

The Financial Accounting Standards Board issued ASU No. 2011-08, *Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment* (ASU 2011-08) in September 2011. ASU 2011-08 allows entities to assess qualitative factors first to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the initial determination is negative, then the entity does not need to perform the two-step impairment test. If the conclusion is otherwise, then the entity must perform the first step of the two-step impairment test. The adoption of ASU 2011-08 will be effective for Wellmont beginning in fiscal year 2013.

The Financial Accounting Standards Board issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities* (ASU 2011011) in December 2011. This ASU requires improved disclosures about financial instruments and derivative instruments that are offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The adoption of ASU 2011-11 will be effective for Wellmont beginning in fiscal year 2014.

(q) Reclassifications

Certain 2011 amounts have been reclassified to conform to the 2012 consolidated financial statement presentation. The reclassifications had no impact on total assets or changes in net assets.

(Dollars in thousands)

(3) Net Patient Service Revenue

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations and changes in net assets is as follows for the years ended June 30:

		2012	2011
Gross patient service revenue	$	2,398,999	2,260,489
Less:			
Contractual adjustments and other discounts		(1,524,110)	(1,431,215)
Charity care		(61,660)	(61,824)
Net patient service revenue before provision for bad debts		813,229	767,450
Less provision for bad debts		(71,407)	(37,858)
Net patient service revenue	$	741,822	729,592

Wellmont's allowance for doubtful accounts is predominantly for self-pay patients and patient balances remaining after third-party payments. The provision for bad debts increased $33,549 from fiscal 2011 to fiscal 2012 and the net write-offs increased $31,272 from fiscal 2011 to fiscal 2012. Both increases were the result of negative trends experienced in the collection of amounts from patients in fiscal year 2012 as a result of the economic conditions and due to the increased proportion of patient financial responsibility for those patients with health insurance. Wellmont has not changed its charity care or uninsured discount policies during fiscal 2012. Wellmont does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

(4) Third-Party Reimbursement Arrangements

Wellmont renders services to patients under contractual arrangements with the Medicare and Medicaid programs. The Medicaid program in Tennessee was replaced with a managed care program known as TennCare, which was designed to cover previous Medicaid eligible enrollees. Amounts earned under these contractual arrangements are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Management believes that adequate provision has been made for any adjustments that may result from such reviews. Participation in these programs subjects Wellmont to significant rules and regulations; failure to adhere to such could result in fines, penalties, or expulsion from the programs.

Wellmont contracts with various managed care organizations under the TennCare program. TennCare reimbursement for both inpatient and outpatient services is based upon prospectively determined rates, including diagnostic-related group assignments, fee schedules, and per diem amounts. Reimbursement under the Medicaid program is also based upon prospectively determined amounts.

(Dollars in thousands)

The Medicare program pays for the costs of inpatient services on a prospective basis. Payments are based upon diagnostic-related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. Wellmont receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid-eligible and other low-income patients. Outpatient services are also reimbursed primarily on a prospectively determined basis.

Net patient service revenue in 2012 and 2011 related to Medicare, TennCare, and Medicaid and net patient accounts receivable at June 30, 2012 and 2011 from Medicare, TennCare, and Medicaid were as follows:

		2012	2011
Net patient service revenue:			
Medicare	$	312,202	285,821
TennCare		28,548	23,791
Medicaid		19,541	22,336
Net patient accounts receivable:			
Medicare	$	41,883	34,671
TennCare		2,957	2,798
Medicaid		5,244	3,427

Wellmont has filed cost reports with Medicare and Medicaid. The cost reports are subject to final settlement after audits by the fiscal intermediary. The Medicare and Medicaid cost reports have been audited and final settled by the intermediary through June 30, 2006 and audit adjustments have been received and considered for certain hospitals and year-ends through June 30, 2010.

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

Net patient service revenue is reported at the net amounts billed to patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Estimated retroactive adjustments are accrued in the period the related services are rendered and adjusted in future periods as changes in estimated provisions and final settlements are determined. Net patient service revenue increased approximately $3,575 and $2,319 in 2012 and 2011, respectively, due to final settlements and revised estimates in excess of amounts previously recorded, removal of allowances previously estimated that are no longer necessary as a result of audits and final settlements, and years that are no longer subject to audits, reviews, and investigations.

Estimated settlements recorded at June 30, 2012 could differ materially from actual settlements based on the results of third-party audits.

(Continued)

(5) Meaningful Use Incentives

The American Recovery and Reinvestment Act of 2009 (ARRA) established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record (EHR) technology. The Medicare incentive payments are paid out to qualifying hospitals and physician groups over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals and physician groups must meet EHR "meaningful use" criteria that become more stringent over three stages as determined by Centers for Medicare & Medicaid Services (CMS). Medicaid programs and payment schedules vary from state to state.

During the fiscal year ended June 30, 2012, Wellmont recorded $13.1 million in other operating revenue related to the EHR and meaningful use incentives. These incentives have been recognized following the grant accounting model, recognizing income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria.

Amounts recognized represent management's best estimates for payments ultimately expected to be received based on estimated discharges, charity care, and other input data. Subsequent changes to these estimates will be recognized in other operating revenue in the period in which additional information is available. Such estimates are subject to audit by the federal government or its designee.

(6) Charity Care and Community Services

Wellmont accepts all patients within its primary service area regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies that consider, among other factors, generally recognized poverty income levels.

Wellmont maintains records to identify and monitor the level of charity care it provides. Charges foregone for services and supplies furnished under its charity care policy, the estimated cost of those services, and the equivalent percentage of charity care patients to all patients serviced were $61,660, $16,144, and 2.57%, respectively, for the year ended June 30, 2012 and $61,824, $16,982, and 2.73%, respectively, for the year ended June 30, 2011.

In addition to the charity care services described above, Wellmont provides a number of other services to benefit the indigent for which little or no payment is received. Medicare, Medicaid, and State indigent programs do not cover the full cost of those services. The shortfall between actual receipts from those programs and Wellmont's cost of providing care to those patients totaled $44,432 and $49,180, for the years ended June 30, 2012 and 2011, respectively.

Wellmont also provides services to the community at large for which it receives little or no payment. Health evaluations, screening programs, and specific services for the elderly and homebound are other services supplied. Wellmont also provides public health education, trains new health professionals, and conducts health research.

(Dollars in thousands)

(7) Investment in Affiliates

Wellmont has investments with other healthcare providers, which include hospital, home care, regional laboratories, and other healthcare-related organizations. Wellmont records its share of equity in the operations of the respective organizations. Equity in earnings of affiliates was approximately $7,233 and $4,478 for the years ended June 30, 2012 and 2011, respectively, and is included in other operating revenue in the consolidated financial statements. Wellmont received distributions of $5,764 and $5,320 during 2012 and 2011, respectively, which reduced Wellmont's overall investment in the affiliates.

The following table summarizes the unaudited aggregate financial information of Wellmont's investments in affiliates:

		2012	2011
Total assets	$	127,206	127,545
Total liabilities		27,732	31,326
Total net assets	$	99,474	96,219
Net revenues	$	228,644	184,648
Expenses		207,806	171,070
Revenues in excess of expenses	$	20,838	13,578

Wellmont's equity investment in these affiliates and its ownership percentage as of June 30, 2012 and 2011 is as follows:

		Amount		Percentage	
		2012	2011	2012	2011
Takoma Regional Hospital	$	12,350	11,161	60%	60%
Holston Valley Imaging Center (HVIC)		8,818	8,689	75	75
Advanced Home Care (AHC)		6,092	6,092	6	6
Lab Group Holdings LLC		3,500	3,500	1	1
Others		1,886	1,735	4% – 50%	4% – 50%
	$	32,646	31,177		

Although Wellmont's ownership percentage in Takoma Regional Hospital and HVIC is greater than 50%, Wellmont does not consolidate these entities because Wellmont only has a 50% representation on each respective board and does not have control over these entities.

Wellmont provided billing, management, and professional services to some of the affiliates. Income recognized by Wellmont for the services was $929 in 2012 and $943 in 2011 and is included in other revenues.

(Dollars in thousands)

During the fiscal year ended June 30, 2012, Takoma Regional Hospital recorded $3.2 million in net revenue related to the EHR and meaningful use incentives of which $1.9 million is included as income in affiliates in Wellmont's consolidated financial statements. These incentives have been recognized following the grant accounting model, recognizing income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria.

Included in other receivables are $374 and $320 as of June 30, 2012 and 2011, respectively, of amounts due to Wellmont from these entities.

(8) Investments

Long-term investments, including assets limited as to use, at June 30 are reported at fair value and consist of the following:

		2012	2011
Assets limited as to use by Board for capital improvements:			
Stock mutual funds	$	88,942	80,413
Bond mutual funds		163,401	119,836
Cash and money market funds		1,492	904
Real estate funds		7,157	8,475
Alternative investments (private equity, hedge funds, commingled funds, and real estate funds):			
Liquid		9,616	37,421
Illiquid		27,373	26,837
		297,981	273,886
Assets limited as to use under self-insurance agreements:			
Corporate bonds		2,673	7,877
Cash and money market funds		32	652
		2,705	8,529
Assets limited as to use under bond indenture agreements:			
Cash and money market funds		42,716	37,659
U.S. Treasury bonds		—	1,215
Less assets limited as to use that are required for current liabilities		4,372	1,902
Assets limited as to use, net of current portion	$	339,030	319,387

(Dollars in thousands)

		2012	2011
Long-term investments:			
Stock mutual funds	$	10,321	10,897
Bond mutual funds		13,926	10,734
Preferred equity investment and related option		11,512	11,512
Cash, money market funds, and certificates of deposit		189	191
Real estate funds		685	832
Alternative investments (private equity, hedge funds, commingled funds, and real estate funds)		—	2,271
Total long-term investments	$	36,633	36,437

Investments in certain alternative limited partnership investments contain agreements whereby Wellmont is committed to contribute approximately $6,705 as of June 30, 2012 of additional funds to the limited partnerships in the form of capital calls at the discretion of the general partner, of which $157 was paid subsequent to June 30, 2012.

Wellmont has invested $10,000 in the preferred equity of a regional managed services organization and $1,512 on a right of first refusal related to any future sale of this organization. This equity has a guaranteed annual return of at least 6.5% of the outstanding preferred equity balance.

Wellmont's investments are concentrated in stock and bond mutual funds. In the event of a downward trend in the stock and bond markets, Wellmont's overall market value of net assets could be adversely affected by a material amount. Investments in alternative investments are generally illiquid investments whose value is determined by the general partner such as hedge funds, private equity, commingled funds and real estate funds. Distributions are only at the discretion of a voting majority of the general partners.

Wellmont evaluates whether unrealized losses on investment securities indicate other-than-temporary impairment. Based on this evaluation, Wellmont recognized other-than-temporary impairment losses of $265 and $610 on investments as of June 30, 2012 and 2011, respectively. The unrealized losses on these mutual funds were primarily caused by the overall decline in the world's economy. Other-than-temporary impairment losses are considered as realized losses and are reported within "investment income" in the consolidated statements of operations and changes in net assets.

(Dollars in thousands)

Gross unrealized losses on investments for which other-than-temporary impairments have not been recognized and the fair values of those investments, aggregated by the length of time that individual investments have been in a continuous unrealized loss position, at June 30, 2012 and 2011, were as follows:

	Less than 12 months		12 months or more		Total	
	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
2012:						
Alternative investments	$ 129	52	—	—	129	52
Mutual funds	2,692	55,142	2,903	15,407	5,595	70,549
	$ 2,821	55,194	2,903	15,407	5,724	70,601

	Less than 12 months		12 months or more		Total	
	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
2011:						
Alternative investments	$ —	—	402	5,421	402	5,421
Mutual funds	616	75,091	9	158	625	75,249
	$ 616	75,091	411	5,579	1,027	80,670

Investment income comprises the following for the years ended June 30:

	2012	2011
Interest and dividends net of amounts capitalized	$ 10,371	9,407
Realized gains on investments	6,901	976
Investment income, net	$ 17,272	10,383
Change in net unrealized (losses) gains on investments	$ (9,534)	42,186

(Dollars in thousands)

(9) Land, Buildings, and Equipment

Land, buildings, and equipment at June 30 consist of the following:

		2012	2011
Land	$	49,397	49,060
Buildings and improvements		526,243	509,382
Equipment		364,973	328,604
Buildings and equipment under capital lease obligations		42,404	39,661
		983,017	926,707
Less accumulated depreciation		(527,828)	(484,187)
		455,189	442,520
Construction in progress		2,859	12,417
Land, buildings, and equipment	$	458,048	454,937

Depreciation expense for the years ended June 30, 2012 and 2011 was $46,359 and $46,070, respectively. Included in depreciation expense is amortization related to capitalized software and equipment under capital leases. Accumulated amortization for equipment under capitalized software and lease obligations was $17,234 and $15,336 as of June 30, 2012 and 2011, respectively.

(10) Other Long-Term Liabilities

Other long-term liabilities at June 30 consist of the following:

		2012	2011
Workers’ compensation liability	$	9,097	7,812
Professional and general liability		12,535	12,830
Postretirement benefit obligation		7,039	7,763
Asset retirement obligation		2,994	2,912
Deferred gain on sale of assets		439	628
Derivative liability		9,781	11,588
Pension benefit liability		17,290	6,526
Other		667	852
		59,842	50,911
Less current portion		(5,782)	(8,527)
Total other long-term liabilities	$	54,060	42,384

(Dollars in thousands)

(11) Debt

(a) Long-Term Debt

Long-term debt consists of the following at June 30:

	2012	2011
Hospital Revenue Refunding Bonds, Series 2011	$ 76,165	76,165
Hospital Revenue Bonds, Series 2010 (Bank Qualified)	24,836	14,968
Hospital Revenue Bonds, Series 2007A	55,000	55,000
Hospital Revenue Refunding Bonds, Series 2006C	200,000	200,000
Hospital Revenue Refunding Bonds, Series 2005	57,250	59,580
Hospital Revenue Bonds, Series 2003	29,230	33,035
Notes payable	3,102	4,749
Capital lease obligations	18,514	16,889
Other	826	859
	464,923	461,245
Unamortized premium	7,005	7,287
Unamortized discount	(361)	(377)
	471,567	468,155
Less current maturities	(11,913)	(9,273)
	$ 459,654	458,882

(b) Series 2011 Bonds

On May 5, 2011, Wellmont refunded the Revenue Bonds, Series 2006A, with the proceeds of the Revenue Bonds, Series 2011. The Series 2011 Bonds were issued by Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee on behalf of Wellmont. Under the terms of the bond indenture, the proceeds were used to advance refund the Revenue Bonds, Series 2006A and to pay the costs of issuing the Series 2011 Bonds.

In order to refund the Series 2006A Bonds, Wellmont made a tender offer to the holders of the Series 2006A Bonds. The holders of all outstanding Series 2006A Bonds agreed to tender their Series 2006A Bonds to Wellmont. Proceeds of the Series 2011 Bonds were used to pay the purchase price of Series 2006A Bonds tendered for purchase. All outstanding Series 2006A Bonds were purchased by the Wellmont on the date of issuance of the Bonds and were immediately surrendered to the trustee for the Series 2006A Bonds for retirement and cancellation.

The Series 2011 Bonds were issued with two maturities of $42,385 and $33,780 for 2026 and 2032, respectively. The Series 2011 Bonds maturing September 1, 2026 are subject to mandatory redemption prior to maturity pursuant to the operation of a sinking fund, in part by lot starting on the redemption dates beginning on September 1, 2013 and ending on September 1, 2026 in annual amounts ranging from $865 to $4,680. The Series 2011 Bonds maturing September 1, 2032 are subject to mandatory redemption prior to maturity pursuant to the operation of a sinking fund, in part by lot starting on the redemption dates beginning on September 1, 2027 and ending on September 1, 2032 in annual amounts ranging from $4,980 to $6,300. The Series 2011 Bonds were issued as fixed-rate obligations at 6.0% and 6.5% for the two maturities (2026 and 2032, respectively).

(c) Series 2010 Bank Qualified Bonds

On November 1, 2010, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee (the Board) issued $30,000 Hospital Revenue Bonds, Series 2010 (Bank Qualified). The Series 2010 Bonds were issued and sold pursuant to the Bond Purchase Agreement dated as of November 1, 2010, between the Board and First Tennessee Bank National Association. During the fiscal year ended June 30, 2012 and 2011, Wellmont has received advances on the bonds in the amounts of $11,368 and $14,968, respectively.

Commencing on January 1, 2011, and continuing on the first day of each fiscal quarter thereafter, Wellmont shall pay accrued interest on the outstanding balance of the loan. Commencing on October 1, 2011 and continuing on the first day of each fiscal quarter thereafter, Wellmont shall also make principal payments equal to $500. The outstanding bonds accrue interest at a rate equal to the product of 65% of the sum of LIBOR plus the applicable margin, which at June 30, 2012 was set at 1.95%.

(d) Series 2007 Bonds

On July 24, 2007, The Virginia Small Business Financing Authority issued, on behalf of Wellmont, $55,000 of Hospital Revenue Bonds, Series 2007A. The Series 2007A Bonds, with other methods of financing, were used to purchase the assets of Mountain View Regional Medical Center and Lee Regional Medical Center.

Principal on outstanding Series 2007A Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $360 to $2,460 commencing on September 1, 2017 through September 1, 2036, with a balloon payment of $29,245 due on September 1, 2037. The outstanding bonds accrue interest at rates ranging from 5.125% to 5.250%.

(e) Series 2006 C

On October 26, 2006, The Health, Educational, and Housing Facilities Board of the County of Sullivan Tennessee issued, on behalf of Wellmont, $200,000 of Hospital Revenue Bonds, Series 2006C. The Series 2006C Bonds were used to: finance the costs of acquisition of land for expansion, construction, expansion, equipping, and renovation of HVMC, including the construction of a new patient tower (collectively known as Project Platinum); finance the costs of the construction, expansion, equipping, and renovation of the emergency department at BRMC (the Bristol Emergency Department Project); and finance the costs of construction, expansion, renovation and equipping of an operating room and related facilities at HCMH.

(Continued)

Principal on outstanding Series 2006C Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $1,605 to $25,330 commencing on September 1, 2017 through September 1, 2036. The outstanding bonds accrue interest at rates ranging from 5.00% to 5.25%.

(f) Series 2006 A and B

On June 23, 2006, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $98,475 of Hospital Revenue Refunding Bonds, Series 2006. This bond issuance consisted of Series A tax-exempt and Series B taxable bonds of $76,595 and $21,880, respectively. The Series 2006 Bonds together with other available funds were used to advance refund all the previously issued Hospital Revenue Bonds, Series 1993, to reimburse Wellmont for payments made on other taxable borrowings and to pay certain expenses incurred in connection with the issuance of the Series 2006 Bonds. Upon this refunding, a trust was established to pay all future bond payments related to the Series 1993 Bonds. Wellmont was deemed to have paid the Series 1993 Bonds and these Bonds are no longer deemed to be outstanding for purposes of the Series 1993 Trust Indenture.

Principal on outstanding Series 2006A Bonds was payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $875 to $6,400 commencing on September 1, 2013 through September 1, 2032; and the outstanding bonds accrued interest on a variable rate, which was reset monthly based upon the AAA-insured Municipal Market Data Index, plus 85 basis points. Principal on outstanding Series 2006B Bonds was payable through maturity in annual amounts ranging from $1,600 to $2,930 commencing on September 1, 2007 through September 1, 2016, and the outstanding bonds accrued interest at a fixed rate of 6.95%.

Outstanding Series 2006A Bonds were subject to redemption prior to maturity at the option of The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee, upon direction by Wellmont in whole at any time, or in part on any certain specified days at redemption prices of 100% – 102% of the principal amount of the Series 2006A Bonds being redeemed, plus accrued interest thereon to the redemption date.

On October 1, 2010, the Series 2006B Bonds were called and paid in full at par value of $14,880.

On May 5, 2011, the Series 2006A Bonds were refunded with the proceeds of the Revenue Bonds, Series 2011.

(g) Series 2005

On December 8, 2005, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $70,620 of Hospital Revenue Refunding Bonds, Series 2005. The Series 2005 Bonds together with other available funds were used to advance refund the previously issued Hospital Revenue Bonds, Series 2002, and to pay certain expenses incurred in connection with the issuance of the Series 2005 Bonds.

Principal on outstanding Series 2005 Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $1,945 to $3,390 commencing on September 1, 2007 through September 1, 2032. The terms of the bonds provide that bondholders may redeem or put the bonds to the remarketing agent on dates that approximate a weekly basis. The remarketing agent is obligated to remarket the redeemed bonds on a "best efforts" basis. Redeemed bonds are repaid to bondholders from the proceeds of the remarketing effort or, in the event of an inability to remarket the bonds, from a letter of credit. This letter secures the bonds in the event of a failed remarketing or liquidity issue. In the event of a liquidity drawing under the letter of credit, Wellmont shall pay the Base Rate equal to the greater of (i) the Prime Rate plus 1.50% per annum, (ii) LIBOR plus 2.50% per annum, or (iii) 7.50% per annum. Wellmont shall repay the liquidity drawing amount in 12 equal quarterly installments, with the first such installment due on the first anniversary of the related liquidity drawing.

Outstanding Series 2005 Bonds are subject to redemption prior to maturity at the option of The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee, upon direction by Wellmont in whole at any time, or in part on any certain specified days at redemption prices of 100% – 102% of the principal amount of the Series 2005 Bonds being redeemed, plus accrued interest thereon to the redemption date.

(h) Series 2003

On June 1, 2003, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $59,100 of Hospital Revenue Bonds, Series 2003. The bonds were issued to provide funds necessary to refund Wellmont's Hospital Revenue Bonds, Series 1993 (HVHC), to fund a debt service reserve fund and to pay certain expenses incurred in connection with the issuance of the Series 2003 Bonds.

The Wellmont Series 2003 Bonds consist of $27,460 in fixed-rate serial bonds and $19,280 in fixed-rate term bonds payable through maturity or mandatory sinking fund redemption maturing in annual amounts ranging from $3,230 on September 1, 2007 to $4,140 on September 1, 2019, and carrying interest rates ranging from 2.5% to 5.00%.

(i) Master Trust Indenture

The master trust indentures and loan agreements for the 2011, 2010, 2007, 2006, 2005, and 2003 bonds contain certain requirements regarding deposits to trustee funds, maintenance of rates, maintenance of debt service coverage and liquidity, permitted indebtedness, and permitted disposition of assets. Gross receipts of Wellmont collateralize the bonds. The purpose of the master trust indenture is to provide a mechanism for the efficient and economical issuance of notes by individual members of Wellmont using the collective borrowing capacity and credit rating of Wellmont. The master trust indenture requires individual members of Wellmont to make principal and interest payments on notes issued for their benefit. The master trust indenture also requires Wellmont members to make payments on notes issued by other members of Wellmont if such other members are unable to satisfy their obligations under the master trust indenture. Payments of principal and interest on certain bonds are also insured by bond insurance policies.

(Dollars in thousands)

Funds held by the trustee related to the various revenue bonds are available for specific purposes. The bond interest and revenue funds may be used only to pay interest and principal on the bonds; the debt service reserve fund may be used to pay interest and principal if sufficient funds are not available in the bond interest and revenue funds. The original issue discount and premium on all Bond Series outstanding are being amortized over the life of the bond issue using the effective-interest method.

(j) Notes Payable

During 2007, Wellmont entered into a five-year $3,000 note payable, which has a fixed interest rate of 7.25% and a termination date of July 2011. In August 2011, Wellmont renewed this note agreement in the amount of $1,760 with a variable interest rate indexed to the Wall Street Journal U.S. Prime Rate with a ceiling of 7.75% and a floor of 4.00% and a maturity date of August 2016. At June 30, 2012 and 2011, $1,540 and $1,784, respectively, was outstanding on this note.

During 2009, Wellmont entered into a five-year $2,400 term note payable with a variable interest rate indexed to the Wall Street Journal U.S. Prime Rate and a maturity date of October 2013. At June 30, 2012 and 2011, $640 and $1,120, respectively, was outstanding on this note.

During 2010, Wellmont entered into a $2,767 note payable to finance the purchase of Cardiovascular Associates. The note payable has a fixed interest rate of 5.5% and a termination date of May, 2013. At June 30, 2012 and 2011, $922 and $1,845, respectively, was outstanding on this note.

(k) Capital Lease Obligations

Assets under capital leases are included in property and equipment and have a net carrying value of $25,170 and $24,325 as of June 30, 2012 and 2011, respectively. Amortization of capital assets is included in depreciation expense. The lease obligations are recorded at the net present value of the minimum lease payments with interest rates from 4.3% to 12.0%.

(l) Long-Term Debt Maturities Schedule

Bond maturities in accordance with the original terms of the Master Trust Indenture and other long-term debt maturities for each of the next five years and in the aggregate at June 30, 2012 are as follows:

2013	$	11,913
2014		10,230
2015		10,294
2016		10,610
2017		11,253
Thereafter		410,623
	$	464,923

(Dollars in thousands)

The following table reflects the required repayment terms for the years ended June 30 of Wellmont's debt obligations in the event that the put options associated with the 2005 bonds were exercised, but not successfully remarketed.

2013	$	11,913
2014		21,390
2015		25,907
2016		26,103
2017		12,916
Thereafter		366,694
	$	464,923

Interest paid for the years ended June 30, 2012 and 2011 was $22,216 and $21,957, respectively, net of amounts capitalized. Interest costs of $0 and $590, net of interest income of $0 and $49 in 2012 and 2011, respectively, were capitalized.

(12) Derivative Transactions

Wellmont is a party to a number of interest rate swap agreements. Such swaps have not been designated as hedges and are valued at estimated fair value in the accompanying consolidated balance sheets. By using derivative financial instruments to hedge exposures to changes in interest rates, Wellmont exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes Wellmont, which creates credit risk for Wellmont. When the fair value of a derivative contract is negative, Wellmont owes the counterparty, and therefore, Wellmont is not exposed to the counterparty's credit risk in those circumstances. Pursuant to the terms of its interest rate swap agreements, Wellmont is required to post collateral with its counterparties under certain specified conditions. Collateral posting requirements are based on the amount of Wellmont's derivative liability and Wellmont's bond rating. As of June 30, 2012 and 2011, Wellmont was not required to post collateral related to its swaps.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

In September and October, 2008, the counterparty and credit support provider, for four of the swaps held at June 30, 2010, filed bankruptcy. Subsequent to the bankruptcy filings and into 2011, no payments were made by Wellmont or the counterparty to each other. During 2011, Wellmont and the counterparty agreed to settle all amounts due on the swaps for net cash flow receivables or payables. The bankruptcy process is underway and the ultimate outcome regarding any final settlement cannot be determined at this time.

Wellmont has a Total Return Swap on the Series 2011 Bonds with a new counterparty.

(Dollars in thousands)

Management's primary objective in holding such derivatives is to introduce a fixed or variable rate component into its variable rate debt structure using LIBOR rates. The fair value as of June 30, 2012 and 2011 of approximately $(9,781) and $(11,588), respectively, is included in other long-term liabilities in the consolidated balance sheets. The change in the fair value of the derivative instruments was approximately $1,807 and $1,355, respectively, in 2012 and 2011 and is included in nonoperating gains (losses), net in the consolidated statements of operations. The terms of the swap agreements allow netting of all amounts due from/to the counterparty. The following is a summary of the interest rate swap information as of June 30, 2012:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2011	$ 76,165	May 5, 2011	September 1, 2032	1.530%	6.200%	$ 2,888
Pay fixed interest rate swap	Series 2005	57,250	December 13, 2005	September 1, 2016	3.548	0.165	(6,471)
Basis swap	Series 2002	60,765	September 1, 2002	September 1, 2032	0.180	0.339	(1,662)
Pay fixed interest rate swap	*	32,880	October 24, 2003	September 1, 2021	3.613	0.165	(4,536)
							$ (9,781)

* Previously designated bond series has been refinanced.

The following is a schedule detailing the swap information as of June 30, 2011:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2011	$ 76,165	May 5, 2011	September 1, 2032	1.440%	6.200%	$ (377)
Pay fixed interest rate swap	Series 2005	59,580	December 13, 2005	September 1, 2016	3.548	0.124	(5,954)
Basis swap	Series 2002	62,730	September 1, 2002	September 1, 2032	0.090	0.181	(1,715)
Pay fixed interest rate swap	*	35,342	October 24, 2003	September 1, 2021	3.613	0.124	(3,542)
							$ (11,588)

* Previously designated bond series has been refinanced.

(13) Pension and Other Postretirement Benefits

Wellmont sponsors a retirement program and defined-contribution retirement plan (Retirement Plan) that covers substantially all employees. This program and the related Retirement Plan were created from amendments, restatements, and mergers of existing defined-contribution plans at BRMC and HVMC. Wellmont makes annual contributions to the Retirement Plan in an amount equal to 3% of each participant's base wages and contributes an additional amount, based on each participant's voluntary contributions, which cannot exceed certain limits established in the Internal Revenue Code, up to 3% of each participant's wages. The total pension expense related to the Retirement Plan was $10,346 and $10,344 for the years ended June 30, 2012 and 2011, respectively.

HVMC sponsored a noncontributory, defined-benefit pension plan covering substantially all its employees. However, effective June 30, 1996, this plan was frozen and no further benefits accrue. LPH also sponsors a defined-benefit pension plan covering substantially all its employees.

HVMC's defined-pension benefits are actuarially determined based on a formula taking into consideration an employee's compensation and years of service. HVMC's funding policy is to make annual contributions to the plan based upon the funding standard developed by the plan actuary. This standard uses the projected unit credit actuarial cost method, including the amortization of prior service costs, over a 20-year period. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The LPH plan contains similar funding and actuarial policies.

On June 30, 2007, the HVMC plan merged into LPH plan and the plan name changed to Wellmont Health System Defined Benefit Plan. At the end of 2008, only a single defined-pension plan exists. Collectively, the two defined-benefit plans are referred to as the "Plans." Effective June 30, 2010, the plan was frozen for all Lonesome Pine Hospital employees and no further benefits will be accrued.

Wellmont recognizes the funded status (i.e., difference between the fair value of plan assets and projected benefit obligations) of its defined-benefit pension plans as an asset or liability in its consolidated balance sheet and recognizes changes in that funded status in the year in which the changes occur as a change in unrestricted net assets. All defined-benefit pension plans use a June 30 measurement date.

(Dollars in thousands)

The following table sets forth the funded status of the combined Plans, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

		2012	2011
Change in benefit obligation:			
Benefit obligation at beginning of year	$	45,337	44,565
Service cost		—	220
Interest cost		2,422	2,390
Actuarial losses		8,614	896
Benefits paid		(2,292)	(2,239)
Curtailments *		—	(495)
Benefit obligation at end of year		54,081	45,337
Change in plan assets:			
Fair value of plan assets at beginning of year		38,811	34,547
Actual return on plan assets		(304)	6,503
Employer contribution		576	—
Benefits paid		(2,292)	(2,239)
Fair value of plan assets at end of year		36,791	38,811
Funded status	$	(17,290)	(6,526)
Amounts recognized in the accompanying consolidated balance sheets:			
Pension benefit liability (other long-term liabilities)	$	(17,290)	(6,526)

* Reflects frozen benefit accruals for Lonesome Pine participants as of June 30, 2011.

(Dollars in thousands)

		2012	2011
Amounts not yet reflected in net periodic benefit cost and included as an accumulated charge to unrestricted net assets:			
Unrecognized actuarial loss	$	19,773	8,565
Unrecognized prior service cost		—	—
Net amounts included as an accumulated charge to unrestricted net assets	$	19,773	8,565
Calculation of change in unrestricted net assets:			
Accumulated charge to unrestricted net assets, end of year	$	19,773	8,565
Reversal of accumulated charge to unrestricted net assets, prior year		(8,565)	(13,160)
Change in unrestricted net assets	$	11,208	(4,595)
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Prior service credit adjustment for curtailment	$	—	(1)
Actuarial loss (gain) arising during the year		11,577	(3,763)
Amortization of actuarial loss		(369)	(831)
Amortization of prior service cost		—	—
Net amounts recognized in unrestricted net assets	$	11,208	(4,595)

(Dollars in thousands)

		2012	2011
Estimate of amounts that will be amortized from unrestricted net assets to net pension cost in 2012:			
Amortization of net loss	$	2,186	382
Amortization of prior service cost		—	—
Estimated future benefit payments:			
Fiscal 2012		—	2,276
Fiscal 2013		2,609	2,369
Fiscal 2014		2,732	2,492
Fiscal 2015		2,821	2,596
Fiscal 2016		2,996	2,671
Fiscal 2017 – 2021		16,054	14,819
Weighted average assumptions used to determine benefit obligations:			
Settlement (discount) rate		4.00%	5.50%
Weighted average rate of increase in future compensation levels		N/A	N/A
Components of net periodic benefit cost (benefit):			
Service cost	$	—	220
Interest cost		2,422	2,390
Expected return on plan assets		(2,658)	(2,340)
Amortization of net loss		369	831
Amortization of unrecognized prior service cost curtailments		—	1
Net periodic benefit cost	$	133	1,102
Weighted average assumptions used to determine net periodic benefit cost:			
Settlement (discount) rate		5.50%	5.50%
Expected long-term return on plan assets (HVMC)		7.00	7.00
Expected long-term return on plan assets (LPH)		7.00	7.00
Weighted average rate of increase in future compensation levels		N/A	3.00

Wellmont's overall expected long-term rate of return on assets is 7.00%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

Wellmont has developed a plan investment policy, which is reviewed and approved by the board of directors. The policy established goals and objectives of the fund, asset allocations, asset classifications, and manager guidelines. The policy dictates a target asset allocation and an allowable range for such categories based on quarterly investment fluctuations. Investments are managed by independent advisers who are monitored by management and the board of directors.

(Dollars in thousands)

The table below shows the target allocation and actual asset allocations as of June 30, 2012 and 2011:

Asset	Target allocation	2012	2011
Equity securities	65%	47%	46%
Fixed income	28	32	35
Cash	5 – 15%	2	2
Other	5 – 15%	19	17

Wellmont monitors the asset allocation and executes required recalibrations of the portfolio allocation on a regular basis in response to fluctuations in market conditions and the overall portfolio composition.

HVMC also participates in a health and welfare plan for its retirees. The plan provides postretirement medical and life insurance benefits to certain employees who meet minimum age and service requirements. Effective January 1, 1995, the death benefit was changed to provide a flat $5 benefit to all future retirees. During 1995, the medical program for retirees was amended to terminate medical benefits for any active employees who would not meet the full eligibility requirements of the program by January 1, 1996. The plan is contributory and contains other cost-sharing features such as deductibles and coinsurance.

The following table sets forth the postretirement plan's funded status, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

	Postretirement benefits	
	2012	2011
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 7,763	5,861
Interest cost	298	365
Plan participants contributions	34	79
Actuarial losses	(975)	1,686
Benefits paid	(81)	(228)
Benefit obligation at end of year	7,039	7,763
Change in plan assets:		
Fair value of plan assets at beginning of year	—	—
Employer contribution	47	149
Plan participants contributions	34	79
Benefits paid	(81)	(228)
Fair value of plan assets at end of year	—	—
Funded status	$ 7,039	7,763

(Dollars in thousands)

		Postretirement benefits	
		2012	2011
Amounts recognized in the consolidated balance sheets consist of:			
Noncurrent assets	$	—	—
Current liabilities		(245)	(271)
Noncurrent liabilities		(6,794)	(7,492)
Accumulated charge to unrestricted net assets		2,469	1,755
	$	(4,570)	(6,008)

Amounts recognized as an accumulated credit to unrestricted net assets consist of:

		2012	2011
Net actuarial gain	$	2,469	1,755

Net periodic benefic cost recognized and other changes in plan assets and benefit obligations recognized in unrestricted net assets in 2012 and 2011 were:

		Postretirement benefits	
		2012	2011
Net periodic benefit cost:			
Interest cost	$	299	365
Amortization of net gain		(262)	(119)
Net periodic benefit cost recognized		37	246
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Net actuarial loss		(975)	1,686
Amortization of net gain		262	119
Total recognized in unrestricted net assets		(713)	1,805
Total recognized in net periodic benefit cost and unrestricted net assets	$	(676)	2,051

(Continued)

(Dollars in thousands)

The net gain and prior service credit for the defined-benefit postretirement plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year are $(168) and $(88), respectively. Weighted average assumptions used to determine benefit obligations for 2012 and 2011 were as follows:

	2012	2011
Discount rate	3.50%	5.00%
Rate of compensation increase	—	—
Healthcare cost trend rate	5.00	5.00

Weighted average assumptions used to determine net benefit cost for 2012 and 2011 were as follows:

	Postretirement benefits	
	2012	2011
Discount rate	5.00%	5.00%
Expected long-term rate of return on plan assets	N/A	N/A
Rate of compensation increase	N/A	N/A
Healthcare cost trend rate	5.00	5.00

Wellmont's overall expected long-term rate of return on assets is 7%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

For measurement purposes, a 5% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2012.

The following table summarizes the effect of one-percentage-point increase/decrease in healthcare costs trends:

		2012	2011
Effect of one-percentage-point increase in healthcare cost trend on:			
Service and interest cost	$	21	27
Accumulated pension benefit obligation		533	545
Effect of one-percentage-point decrease in healthcare cost trend on:			
Service and interest cost	$	(19)	(24)
Accumulated pension benefit obligation		(473)	(486)

(Dollars in thousands)

The asset allocations of Wellmont's pension and postretirement benefits as of June 30, 2012 and 2011, respectively, were as follows:

	Fair value measurement at June 30, 2012 pension benefits – plan assets			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Stock mutual funds	$ 29,223	29,223	—	—
Cash and money market funds	578	578	—	—
Alternative funds	6,990	—	3,443	3,547
Total	$ 36,791	29,801	3,443	3,547

	Fair value measurement at June 30, 2011 pension benefits – plan assets			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Stock mutual funds	$ 31,311	31,311	—	—
Cash and money market funds	632	632	—	—
Alternative funds	6,868	—	3,280	3,588
Total	$ 38,811	31,943	3,280	3,588

(Dollars in thousands)

The following table presents Wellmont's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 820 for the years ended June 30, 2012 and 2011:

		Alternative investments
Balance at June 30, 2010	$	5,500
Net change in value		1,349
Purchases, issuances, and settlements		19
Transfers in and/or out of Level 3 (net)		(3,280)
Balance at June 30, 2011		3,588
Net change in value		(29)
Purchases, issuances, and settlements		(12)
Transfers in and/or out of Level 3 (net)		—
Balance at June 30, 2012	$	3,547

(14) Self-Insurance Programs

Wellmont is self-insured for professional and general liability and workers' compensation liability. Consulting actuaries have been retained to determine funding requirements and estimate claim liability exposures. Wellmont has established revocable self-insurance trust funds to provide for professional and general liability claims and workers' compensation claims and related expenses. Wellmont's contributions to the self-insurance trusts are based upon actuarial determinations by an independent service company. The professional and general liability self-insurance program is supplemented by umbrella excess liability policies consisting of various layers of coverage with commercial carriers based on policy year. The workers' compensation program is supplemented for Tennessee and Virginia by excess workers' compensation policies, with a commercial carrier for statutory limits per occurrence. Provisions based on actuarial estimates are made for the ultimate cost of claims asserted, as well as estimates of claims incurred but not reported as of the respective consolidated balance sheet dates. Workers' compensation expense under these programs amounted to approximately $4,100 and $4,056 for the years ended June 30, 2012 and 2011, respectively, and are included in salaries and benefits expense in the accompanying consolidated statements of operations and changes in net assets. All other self-insurance expense under these programs amounted to approximately $2,763 and $3,097 for the years ended June 30, 2012 and 2011, respectively, and are included in other expense in the accompanying consolidated statements of operations and changes in net assets.

At June 30, 2012 and 2011, Wellmont was involved in litigation relating to medical malpractice and workers' compensation claims arising in the ordinary course of business. There are also known incidents that occurred through June 30, 2012 that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. Claims have been filed requesting damages in excess of the amount accrued for estimated malpractice costs. Management of Wellmont is of the opinion that estimated professional and general liability amounts accrued at June 30, 2012 are adequate to provide for potential losses resulting from pending or potential litigation. Amounts of claim settlements may be more or less than what has been provided for by management. The ultimate settlement of claims could be different from recorded accruals, with such differences being potentially significant.

(Dollars in thousands)

Wellmont is also self-insured for medical and other healthcare benefits provided to its employees and their families. A provision for estimated incurred but not reported claims has been provided in the consolidated financial statements.

(15) Commitments and Contingencies

Construction in progress at June 30, 2012 and 2011 relates primarily to the completion of certain buildings and renovations. Total costs to complete these and other projects were approximately $2,768 at June 30, 2012. Wellmont has entered into contracts of $2,768 related to these projects.

Wellmont leases certain equipment and office space under operating lease agreements. Total rental expense under cancelable and noncancelable agreements was $19,391 and $18,179 for the years ended June 30, 2012 and 2011, respectively. Minimum future lease payments under noncancelable operating leases with initial or remaining lease terms in excess of one year as of June 30, 2012 are as follows:

2013	$	13,473
2014		7,613
2015		6,564
2016		4,527
2017		4,364
Thereafter		19,713
	$	56,254

Wellmont has entered into contractual employment relationships with physicians to provide services to Wellmont physician practices that are intended to qualify under the employee safe harbor of the Anti-Kickback Statute and the employee exception of the Physician Self-Referral Law. These contracts have terms of varying lengths, guarantee certain base payments, and may provide for additional incentives based upon productivity.

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, such matters as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes Wellmont is in compliance with fraud and abuse statutes and other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

(Dollars in thousands)

(16) Functional Expense Disclosure

Wellmont provides healthcare services to residents within its geographic location. Expenses based upon functional classification related to providing these services during the years ended June 30 are as follows:

		2012	2011
Professional care of patients	$	619,560	598,545
Administrative and general		146,740	142,768
Fund-raising		1,103	913
	$	767,403	742,226

(17) Income Taxes

Wellmont, Inc. and its subsidiaries file consolidated federal and separate company state income tax returns. These companies have combined net operating loss carryforwards for federal income tax purposes of approximately $84,000 at June 30, 2012, which begin expiring in fiscal 2018 and expire through 2032. These net operating losses can be used to offset future consolidated taxable income of Wellmont, Inc. and subsidiaries. Wellmont Health System participates in certain activities that generate unrelated business taxable income. These activities have generated net operating losses in prior years, and Wellmont Health System files a Form 990-T with the IRS to report such activity. Wellmont Health System has net operating loss carry forwards for federal income tax purposes of approximately $1,800 for unrelated business activities. Management believes that it is not more likely than not that deferred tax assets arising from net operating loss carry forwards will be realizable. Accordingly, these are fully reserved at June 30, 2012 and 2011.

(18) Concentration of Credit Risk

Wellmont grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2012 and 2011, was as follows:

	2012	2011
Medicare	50%	42%
TennCare	5	4
Medicaid	7	9
Other third-party payors	31	35
Patients	7	10
	100%	100%

(19) Disclosures about Fair Value of Financial Instruments

(a) Fair Value of Financial Instruments

The following methods and assumptions were used to estimate fair value of each class of instruments:

- *Cash and Cash Equivalents*

  The carrying amount approximates fair value due to the short maturities of these instruments.

- *Patient Accounts and Other Receivables*

  The net recorded carrying value approximates fair value due to the short maturities of these instruments.

- *Investments and Assets Limited as to Use*

  The fair values of investments and assets limited as to use are based on quoted market prices and quotes obtained from security brokers or, in the case of the limited partnerships, by the general partner.

- *Accounts Payable and Accrued Expenses*

  The carrying amount approximates fair value due to the short maturities of these liabilities.

- *Estimated Third-Party Payor Settlements, Other Long-Term Liabilities*

  The carrying amount approximates fair market value due to the nature of these liabilities.

- *Long-Term Debt*

  The fair value of revenue bonds, using current market rates, was estimated at $436,634 and $419,960 for the years ended June 30, 2012 and 2011, respectively.

(b) Fair Value Hierarchy

On July 1, 2008, Wellmont adopted new guidance issued by FASB for fair value measurement of financial assets and financial liabilities and for fair value measurement of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis now codified into ASC 820, *Fair Value Measurement*. ASC 820 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted market prices (unadjusted) in active markets for identical assets or liabilities that Wellmont has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted market prices including within Level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

Wellmont also applies the measurement provisions of ASU No. 2009-12 to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. This guidance amends the previous guidance and allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent. Net asset value, in many instances may not equal fair value that would be calculated pursuant to ASC 820. The fair value of these investments was $36,989 and $66,529 at June 30, 2012 and 2011, respectively.

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2012:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 44,930	—	—	44,930
Assets limited as to use:				
Stock mutual funds	88,942	—	—	88,942
Bond mutual funds	163,401	—	—	163,401
Cash and money market funds	44,240	—	—	44,240
Real estate funds	7,157	—	—	7,157
Alternative investments	—	—	36,989	36,989
Corporate bonds	2,673	—	—	2,673
U.S. Treasury bonds	—	—	—	—
Subtotal	351,343	—	36,989	388,332
Long-term investments:				
Stock mutual funds	10,321	—	—	10,321
Bond mutual funds	13,926	—	—	13,926
Cash and money market funds	189	—	—	189
Real estate funds	685	—	—	685
Alternative investments	—	—	—	—
Subtotal	25,121	—	—	25,121
	$ 376,464	—	36,989	413,453
Liabilities:				
Derivatives liability	$ —	9,781	—	9,781
Total	$ —	9,781	—	9,781

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2011:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 36,558	—	—	36,558
Assets limited as to use:				
Stock mutual funds	80,413	—	—	80,413
Bond mutual funds	119,836	—	—	119,836
Cash and money market funds	39,215	—	—	39,215
Real estate funds	8,475	—	—	8,475
Alternative investments	—	26,480	37,778	64,258
Corporate bonds	7,877	—	—	7,877
U.S. Treasury bonds	1,215	—	—	1,215
Subtotal	293,589	26,480	37,778	357,847
Long-term investments:				
Stock mutual funds	10,890	—	—	10,890
Bond mutual funds	10,741	—	—	10,741
Cash and money market funds	191	—	—	191
Real estate funds	832	—	—	832
Alternative investments	—	2,271	—	2,271
Subtotal	22,654	2,271	—	24,925
	$ 316,243	28,751	37,778	382,772
Liabilities:				
Derivatives liability	$ —	11,588	—	11,588
Total	$ —	11,588	—	11,588

(Dollars in thousands)

The following table presents Wellmont's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 820 for the years ended June 30, 2012 and 2011:

		Alternative investments
Balance at June 30, 2010	$	39,362
Total realized and unrealized gains (losses):		
Included in revenues and gains in excess of expenses and losses		—
Included in changes in net assets		(3,401)
Purchases, issuances, and settlements		1,817
Transfers in and/or out of Level 3 (net)		—
Balance at June 30, 2011		37,778
Total realized and unrealized gains (losses):		
Included in revenues and gains in excess of expenses and losses		264
Included in changes in net assets		(420)
Purchases, issuances, and settlements		(633)
Transfers in and/or out of Level 3 (net)		—
Balance at June 30, 2012	$	36,989

(20) Subsequent Events

On September 7, 2012, Wellmont entered into a $55 million contract with a major information systems service provider to replace its clinical information systems. Wellmont expects to spend approximately $100 million on the project.

Wellmont has evaluated subsequent events from the balance sheet date through October 24, 2012, the date at which the financial statements were available to be issued. No other material subsequent events were identified for recognition.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Financial Statements

June 30, 2013 and 2012

(With Independent Auditors' Report Thereon)

WELLMONT HEALTH SYSTEM AND AFFILIATES

Table of Contents

KPMG LLP
Suite 1000
401 Commerce Street
Nashville, TN 37219-2422

Independent Auditors' Report

The Board of Directors
Wellmont Health System:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Wellmont Health System and affiliates, which comprise the consolidated balance sheets as of June 30, 2013 and 2012, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Wellmont Health System and affiliates as of June 30, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Nashville, Tennessee
October 23, 2013

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Balance Sheets

June 30, 2013 and 2012

(Dollars in thousands)

Assets		**2013**	**2012**
Current assets:			
Cash and cash equivalents	$	55,958	44,930
Assets limited as to use, required for current liabilities		5,061	4,372
Patient accounts receivable, less allowance for uncollectible accounts of approximately $26,209 and $25,656 in 2013 and 2012, respectively		107,029	108,265
Other receivables		17,995	23,805
Inventories		18,361	17,862
Prepaid expenses and other current assets		8,949	7,462
Total current assets		213,353	206,696
Assets limited as to use, net of current portion		375,709	339,030
Land, buildings, and equipment, net		474,730	458,048
Other assets:			
Long-term investments		28,628	36,633
Investments in affiliates		31,874	32,646
Deferred debt expense, net		5,178	5,419
Goodwill		15,096	17,090
Other		547	651
		81,323	92,439
Total assets	$	1,145,115	1,096,213
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	15,002	11,913
Accounts payable and accrued expenses		84,300	81,243
Estimated third-party payor settlements		7,157	15,535
Current portion of other long-term liabilities		6,198	5,782
Total current liabilities		112,657	114,473
Long-term debt, less current portion		475,946	459,654
Other long-term liabilities, less current portion		41,567	54,060
Total liabilities		630,170	628,187
Net assets:			
Unrestricted		503,934	458,218
Temporarily restricted		6,927	5,739
Permanently restricted		1,311	1,304
Total net assets attributable to Wellmont		512,172	465,261
Noncontrolling interests		2,773	2,765
Total net assets		514,945	468,026
Commitments and contingencies			
Total liabilities and net assets	$	1,145,115	1,096,213

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2013 and 2012

(Dollars in thousands)

		2013	2012
Revenue:			
Patient service revenue	$	809,517	811,882
Provision for bad debt		(55,029)	(71,407)
Net patient revenue less provision for bad debt		754,488	740,475
Other revenues		43,735	47,904
Total revenue		798,223	788,379
Expenses:			
Salaries and benefits		381,210	368,287
Medical supplies and drugs		163,922	164,350
Purchased services		80,179	78,732
Interest		21,833	21,677
Depreciation and amortization		51,319	46,369
Other		86,816	86,501
Total expenses		785,279	765,916
Income from operations		12,944	22,463
Nonoperating gains:			
Investment income		19,467	17,272
Derivative valuation adjustments		2,356	1,807
Nonoperating gains, net		21,823	19,079
Revenue and gains in excess of expenses and losses before discontinued operations		34,767	41,542
Discontinued operations		(2,167)	(52)
Revenue and gains in excess of expenses and losses		32,600	41,490
Income attributable to noncontrolling interests		(1,228)	(1,670)
Revenues and gains in excess of expenses and losses attributable to Wellmont		31,372	39,820
Other changes in unrestricted net assets:			
Change in net unrealized gains (losses) on investments		6,157	(9,534)
Net assets released from restrictions for additions to land, buildings, and equipment		828	3,766
Change in the funded status of benefit plans and other		7,359	(10,495)
Increase in unrestricted net assets		45,716	23,557
Changes in temporarily restricted net assets:			
Contributions		2,977	6,661
Net assets released from temporary restrictions		(1,789)	(4,492)
Increase in temporarily restricted net assets		1,188	2,169
Changes in permanently restricted net assets – investment income		7	130
Changes in noncontrolling interests:			
Income attributable to noncontrolling interests		1,228	1,670
Distributions to noncontrolling interests		(1,220)	(1,261)
Increase in noncontrolling interests		8	409
Change in net assets		46,919	26,265
Net assets, beginning of year		468,026	441,761
Net assets, end of year	$	514,945	468,026

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2013 and 2012

(Dollars in thousands)

		2013	2012
Cash flows from operating activities:			
Change in net assets	$	46,919	26,265
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		51,392	46,403
Loss (gain) on disposal of land, buildings, and equipment		211	(458)
Equity in earnings of affiliated organizations		(4,594)	(7,233)
Distributions from affiliated organizations		5,366	5,764
Amortization of deferred financing costs		486	428
Net realized and unrealized (gain) loss on investments		(9,580)	2,633
Provision for bad debts		55,029	71,407
Change in fair value of derivative instruments		(2,356)	(1,807)
Impairment of goodwill		2,007	—
Changes in assets and liabilities:			
Patient accounts receivable		(53,793)	(78,107)
Other current assets		(1,986)	(331)
Other assets		5,872	(13,920)
Accounts payable and accrued expenses		(2,532)	10,230
Estimated third-party payor settlements		(8,378)	6,002
Other current liabilities		416	(2,745)
Other liabilities		(10,137)	13,672
Net cash provided by operating activities		74,342	78,203
Cash flows from investing activities:			
Proceeds from sales and maturities of investments		115,439	149,087
Purchase of investments		(135,222)	(174,029)
Purchase of land, buildings, and equipment		(57,747)	(46,026)
Proceeds from the sale of buildings and equipment		355	1,721
Cash paid for acquisitions		(13)	(813)
Net cash used in investing activities		(77,188)	(70,060)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt		28,908	11,368
Payments on long-term debt		(14,789)	(11,139)
Payment of debt issuance costs		(245)	—
Net cash provided by financing activities		13,874	229
Net increase in cash and cash equivalents		11,028	8,372
Cash and cash equivalents, beginning of year		44,930	36,558
Cash and cash equivalents, end of year	$	55,958	44,930

Supplemental disclosures of noncash items:

Wellmont entered into capital lease obligations for buildings and equipment in the amount of $5,262 and $3,281 in 2013 and 2012, respectively.

Additions to property and equipment financed through current liabilities of $5,589 and $2,487 in 2013 and 2012, respectively.

See accompanying notes to consolidated financial statements.

(1) Operations and Basis of Presentation

Wellmont Health System (Wellmont), a Tennessee not-for-profit corporation, currently operates seven community acute care hospitals in Tennessee and Virginia that include Bristol Regional Medical Center in Bristol, Tennessee, Holston Valley Medical Center in Kingsport, Tennessee, Lonesome Pine Hospital in Big Stone Gap, Virginia, Hawkins County Memorial Hospital in Rogersville, Tennessee, Hancock County Hospital in Sneedville, Tennessee, Lee Regional Medical Center in Pennington Gap, Virginia, and Mountain View Regional Medical Center in Norton, Virginia.

Wellmont also operates physician organizations and practices that are organized within Wellmont Medical Associates and Wellmont Cardiology Services.

As of May 17, 2013, a subsidiary of Wellmont ceased operating its sleep labs, which were managed by a third party. The consolidated financial statements for the year ended June 30, 2013 present the sleep labs as discontinued operations. The losses of $2,302, including an impairment loss of $2,007, and $140 for the years ended June 30, 2013 and 2012, respectively, are included in discontinued operations.

Wellmont's continuing operations consist primarily of the delivery of healthcare services in northeast Tennessee and southwest Virginia.

The consolidated financial statements include the operations of the above entities along with:

- Wellmont Foundation (the Foundation), which conducts fund-raising activities for the benefit of Wellmont
- Wellmont, Inc., a wholly owned taxable subsidiary of Wellmont, formed as the holding company of various other taxable subsidiaries that provide medical collection and medical laundry services, operate physician practices, provide other healthcare-related services, and invest in affiliates and other activities.

All significant intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

(2) Significant Accounting Policies

A summary of significant accounting policies is as follows:

(a) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Significant estimates include allowances for contractual adjustments and bad debts; third-party payor settlements; valuation of investments, land, buildings, equipment and goodwill; and self-insurance and other liabilities. Actual results could differ from these estimates.

(b) Cash and Cash Equivalents

Wellmont considers all highly liquid investments with a maturity of three months or less when purchased, excluding amounts whose use is limited by board of directors' designation or other arrangements under trust agreements, to be cash equivalents.

(c) Investments

Marketable equity securities and debt securities are recorded at fair value and classified as other than trading. Fair value is determined primarily using quoted prices (unadjusted) in active markets for identical assets or liabilities that Wellmont has the ability to access at the measurement date. However, Wellmont also uses observable and unobservable inputs for investments without quoted market prices to determine the fair value of certain investments at the measurement date. Investments in limited partnerships are recorded at fair value as determined by the partnership using net asset value. Wellmont has adopted the measurement provisions of Accounting Standards Update (ASU) No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. Investments in affiliates in which Wellmont has significant influence but does not control are reported on the equity method of accounting, which represents Wellmont's equity in the underlying net book value. Long-term investments include those investments that have not been designated by the board of directors for specific purposes and are also not intended to be used for the liquidation of current liabilities. Investment income is recognized when earned.

Realized gains and losses are determined on the specific-identification method and included in investment income with interest and dividends. Investment income is reported net of related investment fees. Unrealized gains and losses are included in other changes in unrestricted net assets except for losses determined to be other than temporary, which are considered realized losses and included in investment income.

(d) Assets Limited as to Use

Assets limited as to use primarily include assets held by trustees under bond indenture and self-insurance agreements, as well as designated assets set aside by the board of directors for future capital improvements, over which the board of directors retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of Wellmont have been reclassified to current assets in the accompanying consolidated balance sheets.

(e) Inventories

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

(f) Land, Buildings, and Equipment

Land, buildings, and equipment are stated at cost, if purchased, or fair value at date of donation. Depreciation is computed using the straight-line method based on the estimated useful life of the asset, ranging from 3 to 40 years. Buildings and equipment held under capital leases are recorded at net present value of future lease payments and are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. Costs of maintenance and repairs are expensed as incurred. Upon sale or retirement of land, buildings, or equipment, the cost and related accumulated depreciation are eliminated from the respective accounts and the resulting gain or loss, if any, is included in other revenues on the consolidated statements of operations and changes in net assets. Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

Wellmont evaluates long-lived assets for impairment on annual basis. Long-lived assets are considered to be impaired whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable from future cash flows. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of an asset to future cash flows expected to be generated by the asset. When such assets are considered to be impaired, the impairment loss recognized is measured by the amount by which the carrying value of the asset exceeds the fair value of the asset.

(g) Goodwill

Wellmont adopted ASU No. 2010-07, *Not for Profit Entities: Mergers and Acquisitions*, which in part requires healthcare entities to follow Accounting Standards Codification (ASC) Topic 350-20-35, *Intangibles – Goodwill and Other* along with ASU 2011-08, *Testing Goodwill for Impairment,* effective July 1, 2012. ASC Topic 350-20-35 requires goodwill of not-for-profit entities to be evaluated for impairment at least annually. An entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. The more-likely than-not threshold is defined as having a likelihood of more than 50 percent. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount (including goodwill) of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss. Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. The annual impairment test is performed as of June 30. A summary of goodwill for the years ended June 30 is as follows:

(Dollars in thousands)

	2012	Additions	Decreases	2013
Goodwill	$ 17,090	13	(2,007)	15,096

	2011	Additions	Decreases	2012
Goodwill	$ 16,721	369	—	17,090

(h) Deferred Debt Expense

Deferred debt expense is amortized over the life of the related bond issues using the effective-interest method.

(i) Derivative Financial Instruments

As further described in note 12, Wellmont is a party to interest rate swap and other derivative agreements. These financial instruments are not designated as hedges and are presented at estimated fair market value in the accompanying consolidated balance sheets. These fair values are based on the estimated amount Wellmont would receive, or be required to pay, to enter into equivalent agreements with a third party at the valuation date. Due to the nature of these financial instruments, such estimates are subject to significant change in the near term. Wellmont recognizes changes in the fair values of derivatives as nonoperating gains or losses in the consolidated statements of operations and changes in net assets. The cash settlements resulting from these interest rate swaps are reported as interest expense in the consolidated statements of operations and changes in net assets.

(j) Asset Retirement Obligations

Asset retirement obligations (AROs) are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value, and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, Wellmont records period-to-period changes in the ARO liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. Wellmont derecognizes ARO liabilities when the related obligations are settled.

(k) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Wellmont has been limited by donors to a specific-time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by Wellmont in perpetuity. Generally, donors of permanently restricted assets permit use of all or part of the income earned on related investments for general or specific purposes.

(Continued)

Temporarily restricted net assets relate primarily to amounts held by the Foundation and include amounts restricted for future capital expenditures and for operations of such areas as children's healthcare services, hospice, and cancer care.

Net assets are released from restrictions by Wellmont incurring expenses that satisfy the restricted purposes. Such net assets released during 2013 and 2012 primarily included amounts related to the purchase of equipment for pediatrics, cancer, and other healthcare operations.

Wellmont has adopted guidance issued by Financial Accounting Standards Board (FASB), which provides guidance on the net asset classification of donor-restricted endowment funds for a tax-exempt organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). Effective July 1, 2007, the State of Tennessee adopted legislation that incorporates the provisions outlined in UPMIFA. Wellmont's endowments consist solely of donor-restricted endowment funds. Wellmont's endowments consist of five individual funds established for a variety of purposes.

Wellmont has interpreted UPMIFA 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. As a result of this interpretation, Wellmont classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are approved for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Wellmont considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the organization and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the organization; and (7) the investment policies of the organization.

(l) Net Patient Service Revenue and Accounts Receivable

Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts expected to be collected. Net patient service revenue includes amounts estimated by management to be reimbursable by patients and various third-party payors under provisions of reimbursement formulas in effect, including retroactive adjustments under reimbursement agreements. Estimated retroactive adjustments are accrued in the period related services are rendered and adjusted in future periods as final and other settlements are determined. On the basis of historical experience, a significant portion of Wellmont's uninsured patients will be unable or unwilling to pay for the services provided. Therefore, Wellmont records a significant provision for bad debts related to uninsured patients in the period the services are provided. This provision for bad debts is presented on the statement of operations as a component of net patient revenue. Wellmont provides care to patients who meet criteria under its charity care policy without charge or at amounts less than its established rates. Because Wellmont does not pursue collection of amounts determined to qualify as charity care, they are not included in net patient service revenue.

Patient accounts receivable are reported net of both an allowance for contractual adjustments and an allowance for uncollectible accounts. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, TennCare, Medicaid, and other third-party payment programs. Wellmont's policy does not require collateral or other security for patient accounts receivable. Wellmont routinely obtains assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans, or policies.

(m) Revenue and Gains in Excess of Expenses and Losses

The consolidated statements of operations and changes in net assets include revenue and gains in excess of expenses and losses. Changes in unrestricted net assets that are excluded from revenue and gains in excess of expenses and losses, consistent with industry practice, include changes in net unrealized gains (losses) on investments other than trading securities, changes in the funded status of Wellmont's defined-benefit plan, contributions of long-lived assets, including assets acquired using contributions that, by donor restriction, were to be used for the purposes of acquiring such assets, and cumulative effects of changes in accounting principles.

For purposes of financial statement display, those activities directly associated with Wellmont's mission of providing healthcare services are considered to be operating activities. Nonoperating activities primarily include investment and related activities. Other operating revenues primarily include cafeteria, rental, meaningful use incentives, and income from affiliates.

(n) Contributed Resources

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted contributions, and are excluded from revenue and gains 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 contributions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expiration of donor restrictions is reported when the donated or acquired long-lived assets are placed in service.

Unconditional promises to give cash or other assets are reported at fair value at the date the promise is received. Gifts are reported as either a temporarily or permanently restricted contribution if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are recorded as unrestricted contributions. Unrestricted contributions are included in other revenues.

(o) Federal Income Taxes

The Wellmont entities are primarily classified as organizations exempt from federal income taxes under Section 501(a) as entities described in Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes has been included for these entities in the consolidated financial statements. The operations of Wellmont, Inc. are subject to state and federal income taxes, which are accounted for in accordance with ASC Topic 740, *Income Taxes*; however, such amounts are not material.

On July 1, 2007, Wellmont adopted new guidance issued on the accounting for uncertainty in income tax positions now codified into ASC 740. It also provides guidance on when tax positions are recognized in an entity's financial statements and how the values of these positions are determined. There was no impact on Wellmont's consolidated financial statements as a result of the adoption of the new guidance.

(p) Recently Adopted Accounting Standards

The FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, in May 2011. This ASU requires the reason for the fair value measurement to be disclosed, a description of the valuation techniques, and descriptions of the inputs used for all Level 2 and Level 3 fair value measurements. It also requires all transfers between levels of the fair value hierarchy to be separately reported and described. Wellmont adopted ASU 2011-04 as of July 1, 2012.

(q) Reclassifications

Certain 2012 amounts have been reclassified to conform to the 2013 consolidated financial statement presentation. The reclassifications had no impact on total assets or changes in net assets.

(Dollars in thousands)

(3) Net Patient Service Revenue

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations and changes in net assets is as follows for the years ended June 30:

		2013	2012
Gross patient service revenue	$	2,517,774	2,396,167
Less:			
Contractual adjustments and other discounts		(1,646,455)	(1,522,625)
Charity care		(61,802)	(61,660)
Net patient service revenue before provision for bad debts		809,517	811,882
Less provision for bad debts		(55,029)	(71,407)
Net patient service revenue	$	754,488	740,475

Wellmont's allowance for doubtful accounts is predominantly for self-pay patients and patient balances remaining after third-party payments. The provision for bad debts decreased $16,378 from fiscal 2012 to fiscal 2013 and the net write-offs decreased $15,521 from fiscal 2012 to fiscal 2013. Both decreases were the result of significant decreases in inpatient and emergency room volumes, which are the primary source of patients with bad debt. Wellmont has not changed its charity care or uninsured discount policies during fiscal 2013. Wellmont does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

(4) Third-Party Reimbursement Arrangements

Wellmont renders services to patients under contractual arrangements with the Medicare and Medicaid programs. The Medicaid program in Tennessee is a managed care program known as TennCare, which is designed to cover Medicaid eligible enrollees. Amounts earned under these contractual arrangements are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Management believes that adequate provision has been made for any adjustments that may result from such reviews. Participation in these programs subjects Wellmont to significant rules and regulations; failure to adhere to such could result in fines, penalties, or expulsion from the programs.

Wellmont contracts with various managed care organizations under the TennCare program. TennCare reimbursement for both inpatient and outpatient services is based upon prospectively determined rates, including diagnostic-related group assignments, fee schedules, and per diem amounts. Reimbursement under the Medicaid program is also based upon prospectively determined amounts.

The Medicare program pays for the costs of inpatient services on a prospective basis. Payments are based upon diagnostic-related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. Wellmont receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid-eligible and other low-income patients. Outpatient services are also reimbursed primarily on a prospectively determined basis.

(Dollars in thousands)

Net patient service revenue in 2013 and 2012 related to Medicare, TennCare, and Medicaid and net patient accounts receivable at June 30, 2013 and 2012 from Medicare, TennCare, and Medicaid were as follows:

		2013	2012
Net patient service revenue:			
Medicare	$	303,694	312,202
TennCare		28,749	28,548
Medicaid		30,413	19,541
Net patient accounts receivable:			
Medicare	$	44,702	41,883
TennCare		3,298	2,957
Medicaid		6,980	5,244

Wellmont has filed cost reports with Medicare and Medicaid. The cost reports are subject to final settlement after audits by the fiscal intermediary. The Medicare and Medicaid cost reports have been audited and final settled by the intermediary through June 30, 2007 and audit adjustments have been received and considered for certain hospitals and year-ends through June 30, 2011.

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

Net patient service revenue is reported at the net amounts billed to patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Estimated retroactive adjustments are accrued in the period the related services are rendered and adjusted in future periods as changes in estimated provisions and final settlements are determined. Net patient service revenue increased approximately $6,605 and $3,575 in 2013 and 2012, respectively, due to final settlements and revised estimates in excess of amounts previously recorded, removal of allowances previously estimated that are no longer necessary as a result of audits and final settlements, and years that are no longer subject to audits, reviews, and investigations.

Estimated settlements recorded at June 30, 2013 could differ materially from actual settlements based on the results of third-party audits.

(5) Meaningful Use Incentives

The American Recovery and Reinvestment Act of 2009 (ARRA) established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record (EHR) technology. The Medicare incentive payments are paid out to qualifying hospitals and physician groups over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals, and physician groups must meet EHR "meaningful use" criteria that become more stringent over three stages as determined by Centers for Medicare & Medicaid Services (CMS). Medicaid programs and payment schedules vary from state to state.

For fiscal years ending June 30, 2013 and 2012, Wellmont recorded $13,707 and $13,177, respectively, in other operating revenue related to the EHR and meaningful use incentives. These incentives have been recognized following the grant accounting model, recognizing income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria.

Amounts recognized represent management's best estimates for payments ultimately expected to be received based on estimated discharges, charity care, and other input data. Subsequent changes to these estimates will be recognized in other operating revenue in the period in which additional information is available. Such estimates are subject to audit by the federal government or its designee.

(6) Charity Care and Community Services

Wellmont accepts all patients within its primary service area regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies that consider, among other factors, generally recognized poverty income levels.

Wellmont maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone and estimated costs incurred for services and supplies furnished under its charity care policy. Costs incurred are estimated based on the ratio of total operating expenses to gross charges applied to charity care charges. Charges foregone for services and supplies furnished under its charity care policy, the estimated cost of those services, and the equivalent percentage of charity care patients to all patients serviced were $61,802, $15,536, and 2.45%, respectively, for the year ended June 30, 2013 and $61,660, $16,144, and 2.57%, respectively, for the year ended June 30, 2012.

In addition to the charity care services described above, Wellmont provides a number of other services to benefit the indigent for which little or no payment is received. Medicare, Medicaid, and State indigent programs do not cover the full cost of those services. The shortfall between actual receipts from those programs and Wellmont's cost of providing care to those patients totaled $37,999 and $44,432, for the years ended June 30, 2013 and 2012, respectively.

Wellmont also provides services to the community at large for which it receives little or no payment. Health evaluations, screening programs, and specific services for the elderly and homebound are other services supplied. Wellmont also provides public health education, trains new health professionals, and conducts health research.

(7) Investment in Affiliates

Wellmont has investments with other healthcare providers, which include hospital, home care, regional laboratories, and other healthcare-related organizations. Wellmont records its share of equity in the operations of the respective organizations. Equity in earnings of affiliates was approximately $4,594 and $7,233 for the years ended June 30, 2013 and 2012, respectively, and is included in other operating revenue in the consolidated financial statements. Wellmont received distributions of $5,366 and $5,764 during 2013 and 2012, respectively, which reduced Wellmont's overall investment in the affiliates.

(Dollars in thousands)

The following table summarizes the unaudited aggregate financial information of Wellmont's investments in affiliates:

		2013	2012
Total assets	$	135,802	127,206
Total liabilities		40,617	27,732
Total net assets	$	95,185	99,474
Net revenues	$	200,765	228,644
Expenses		186,394	207,806
Revenues in excess of expenses	$	14,371	20,838

Wellmont's investment in these affiliates and its ownership percentage as of June 30, 2013 and 2012 is as follows:

		Amount		Percentage	
		2013	2012	2013	2012
Takoma Regional Hospital	$	11,983	12,350	60%	60%
Holston Valley Imaging Center (HVIC)		8,336	8,818	75	75
Advanced Home Care (AHC)		6,092	6,092	6	6
Lab Group Holdings LLC		3,500	3,500	1	1
Others		1,963	1,886	4%–50%	4%–50%
	$	31,874	32,646		

Although Wellmont's ownership percentage in Takoma Regional Hospital and HVIC is greater than 50%, Wellmont does not consolidate these entities because Wellmont only has a 50% representation on each respective board and does not have control over these entities.

Wellmont provided billing, management, and professional services to some of the affiliates. Income recognized by Wellmont for the services was $971 in 2013 and $929 in 2012 and is included in other revenues.

Included in other receivables are $406 and $374 as of June 30, 2013 and 2012, respectively, of amounts due to Wellmont from these entities.

(Dollars in thousands)

(8) Investments

Long-term investments, including assets limited as to use, at June 30 are reported at fair value and consist of the following:

	2013	2012
Assets limited as to use by Board for capital improvements:		
Stock mutual funds	$ 109,356	88,942
Bond mutual funds	175,594	163,401
Cash and money market funds	3,749	1,492
Real estate funds	16,377	7,157
Alternative investments (private equity, hedge funds, commingled funds, and real estate funds):		
Liquid	10,504	9,616
Illiquid	26,016	27,373
	341,596	297,981
Assets limited as to use under self-insurance agreements:		
Corporate bonds	—	2,673
Cash and money market funds	—	32
	—	2,705
Assets limited as to use under bond indenture agreements:		
Cash and money market funds	39,174	42,716
Less assets limited as to use that are required for current liabilities	5,061	4,372
Assets limited as to use, net of current portion	$ 375,709	339,030
Long-term investments:		
Stock mutual funds	$ 12,228	10,321
Bond mutual funds	13,478	13,926
Preferred equity investment and related options	1,512	11,512
Cash, money market funds, and certificates of deposit	190	189
Real estate funds	1,220	685
Total long-term investments	$ 28,628	36,633

Investments in certain alternative limited partnership investments contain agreements whereby Wellmont is committed to contribute approximately $5,229 as of June 30, 2013 of additional funds to the limited partnerships in the form of capital calls at the discretion of the general partner, of which $117 was paid subsequent to June 30, 2013.

Effective June 27, 2013, Wellmont redeemed its $10,000 in the preferred equity of a regional managed services organization; however, retained its $1,512 on a right of first refusal related to any future sale of this organization. This equity had a guaranteed annual return of at least 6.5% of the outstanding preferred equity balance.

(Dollars in thousands)

Wellmont's investments are concentrated in stock and bond mutual funds. In the event of a downward trend in the stock and bond markets, Wellmont's overall market value of net assets could be adversely affected by a material amount. Investments in alternative investments are generally illiquid investments whose value is determined by the general partner such as hedge funds, private equity, commingled funds, and real estate funds. Distributions are only at the discretion of a voting majority of the general partners.

Wellmont evaluates whether unrealized losses on investment securities indicate other-than-temporary impairment. Based on this evaluation, Wellmont recognized other-than-temporary impairment losses of \$131 and \$265 on investments as of June 30, 2013 and 2012, respectively. Other-than-temporary impairment losses are considered as realized losses and are reported within "investment income" in the consolidated statements of operations and changes in net assets.

Gross unrealized losses on investments for which other-than-temporary impairments have not been recognized and the fair values of those investments, aggregated by the length of time that individual investments have been in a continuous unrealized loss position, at June 30, 2013 and 2012 were as follows:

		Less than 12 months		12 months or more		Total	
		Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
2013:							
Alternative investments	$	478	3,243	—	—	478	3,243
Mutual funds		7,304	181,780	371	3,185	7,675	184,965
	$	7,782	185,023	371	3,185	8,153	188,208

		Less than 12 months		12 months or more		Total	
		Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
2012:							
Alternative investments	$	129	52	—	—	129	52
Mutual funds		2,692	55,142	2,903	15,407	5,595	70,549
	$	2,821	55,194	2,903	15,407	5,724	70,601

Investment income comprises the following for the years ended June 30:

		2013	2012
Interest and dividends, net of amounts capitalized	$	16,044	10,371
Realized gains on investments, net		3,423	6,901
Investment income, net	$	19,467	17,272
Change in net unrealized gains (losses) on investments	$	6,157	(9,534)

(Dollars in thousands)

(9) Land, Buildings, and Equipment

Land, buildings, and equipment at June 30 consist of the following:

		2013	2012
Land	$	49,758	49,397
Buildings and improvements		536,758	526,243
Equipment		384,747	364,973
Buildings and equipment under capital lease obligations		45,102	42,404
		1,016,365	983,017
Less accumulated depreciation		(576,210)	(527,828)
		440,155	455,189
Construction in progress		34,575	2,859
Land, buildings, and equipment	$	474,730	458,048

Depreciation expense for the years ended June 30, 2013 and 2012 was $51,350 and $46,393, respectively. Included in depreciation expense is amortization related to capitalized software and equipment under capital leases. Accumulated amortization for equipment under capitalized software and lease obligations was $18,408 and $17,234 as of June 30, 2013 and 2012, respectively.

(10) Other Long-Term Liabilities

Other long-term liabilities at June 30 consist of the following:

		2013	2012
Workers' compensation liability	$	9,882	9,097
Professional and general liability		11,492	12,535
Postretirement benefit obligation		4,582	7,039
Asset retirement obligation		2,969	2,994
Deferred gain on sale of assets		439	439
Derivative liability		7,425	9,781
Pension benefit liability		10,393	17,290
Other		583	667
		47,765	59,842
Less current portion		(6,198)	(5,782)
Total other long-term liabilities	$	41,567	54,060

(Dollars in thousands)

(11) Debt

(a) *Long-Term Debt*

Long-term debt consists of the following at June 30:

		2013	2012
Hospital Revenue Refunding Bonds, Series 2011	$	76,165	76,165
Hospital Revenue Bonds, Series 2010 (Bank Qualified)		22,836	24,836
Hospital Revenue Bonds, Series 2007A		55,000	55,000
Hospital Revenue Refunding Bonds, Series 2006C		200,000	200,000
Hospital Revenue Refunding Bonds, Series 2005		54,820	57,250
Hospital Revenue Bonds, Series 2003		25,225	29,230
Project Odyssey 2012 Tax-Exempt Master Lease/Sublease		16,150	—
Notes payable		11,968	3,102
Capital lease obligations		21,601	18,514
Other		847	826
		484,612	464,923
Unamortized premium		6,679	7,005
Unamortized discount		(343)	(361)
		490,948	471,567
Less current maturities		(15,002)	(11,913)
	$	475,946	459,654

(b) *Series 2011 Bonds*

On May 5, 2011, Wellmont refunded the Revenue Bonds, Series 2006A, with the proceeds of the Revenue Bonds, Series 2011. The Series 2011 Bonds were issued by Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee on behalf of Wellmont. Under the terms of the bond indenture, the proceeds were used to advance refund the Revenue Bonds, Series 2006A and to pay the costs of issuing the Series 2011 Bonds.

In order to refund the Series 2006A Bonds, Wellmont made a tender offer to the holders of the Series 2006A Bonds. The holders of all outstanding Series 2006A Bonds agreed to tender their Series 2006A Bonds to Wellmont. Proceeds of the Series 2011 Bonds were used to pay the purchase price of Series 2006A Bonds tendered for purchase. All outstanding Series 2006A Bonds were purchased by the Wellmont on the date of issuance of the Bonds and were immediately surrendered to the trustee for the Series 2006A Bonds for retirement and cancellation.

The Series 2011 Bonds were issued with two maturities of $42,385 and $33,780 for 2026 and 2032, respectively. The Series 2011 Bonds maturing September 1, 2026 are subject to mandatory redemption prior to maturity pursuant to the operation of a sinking fund, in part by lot starting on the redemption dates beginning on September 1, 2013 and ending on September 1, 2026 in annual amounts ranging from $865 to $4,680. The Series 2011 Bonds maturing September 1, 2032 are subject to mandatory redemption prior to maturity pursuant to the operation of a sinking fund, in part by lot starting on the redemption dates beginning on September 1, 2027 and ending on September 1, 2032 in annual amounts ranging from $4,980 to $6,300. The Series 2011 Bonds were issued as fixed-rate obligations at 6.0% and 6.5% for the two maturities (2026 and 2032, respectively).

(c) Series 2010 Bank Qualified Bonds

On November 1, 2010, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee (the Board) issued $30,000 Hospital Revenue Bonds, Series 2010 (Bank Qualified). The Series 2010 Bonds were issued and sold pursuant to the Bond Purchase Agreement dated as of November 1, 2010, between the Board and First Tennessee Bank National Association. During the fiscal years ended June 30, 2013 and 2012, Wellmont has received advances on the bonds in the amounts of $0 and $11,368, respectively.

Commencing on January 1, 2011, and continuing on the first day of each fiscal quarter thereafter, Wellmont shall pay accrued interest on the outstanding balance of the loan. Commencing on October 1, 2011 and continuing on the first day of each fiscal quarter thereafter, Wellmont shall also make principal payments equal to $500. The outstanding bonds accrue interest at a rate equal to the product of 65% of the sum of LIBOR plus the applicable margin, which at June 30, 2013 was set at 1.95%.

(d) Series 2007 Bonds

On July 24, 2007, The Virginia Small Business Financing Authority issued, on behalf of Wellmont, $55,000 of Hospital Revenue Bonds, Series 2007A. The Series 2007A Bonds, with other methods of financing, were used to purchase the assets of Mountain View Regional Medical Center and Lee Regional Medical Center.

Principal on outstanding Series 2007A Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $360 to $2,460 commencing on September 1, 2017 through September 1, 2036, with a balloon payment of $29,245 due on September 1, 2037. The outstanding bonds accrue interest at rates ranging from 5.125% to 5.250%.

(e) Series 2006 C

On October 26, 2006, The Health, Educational, and Housing Facilities Board of the County of Sullivan Tennessee issued, on behalf of Wellmont, $200,000 of Hospital Revenue Bonds, Series 2006C. The Series 2006C Bonds were used to finance the costs of acquisition of land for expansion, construction, expansion, equipping, and renovation of HVMC, including the construction of a new patient tower (collectively known as Project Platinum); finance the costs of the construction, expansion, equipping, and renovation of the emergency department at BRMC (the Bristol Emergency Department Project); and finance the costs of construction, expansion, renovation and equipping of an operating room and related facilities at Hawkins County Memorial Hospital.

Principal on outstanding Series 2006C Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $1,605 to $25,330 commencing on September 1, 2017 through September 1, 2036. The outstanding bonds accrue interest at rates ranging from 5.00% to 5.25%.

(f) Series 2005

On December 8, 2005, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $70,620 of Hospital Revenue Refunding Bonds, Series 2005. The Series 2005 Bonds together with other available funds were used to advance refund the previously issued Hospital Revenue Bonds, Series 2002, and to pay certain expenses incurred in connection with the issuance of the Series 2005 Bonds.

Principal on outstanding Series 2005 Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $1,945 to $3,390 commencing on September 1, 2007 through September 1, 2032. The terms of the bonds provide that bondholders may redeem or put the bonds to the remarketing agent on dates that approximate a weekly basis. The remarketing agent is obligated to remarket the redeemed bonds on a "best efforts" basis. Redeemed bonds are repaid to bondholders from the proceeds of the remarketing effort or, in the event of an inability to remarket the bonds, from a letter of credit. This letter secures the bonds in the event of a failed remarketing or liquidity issue. In the event of a liquidity drawing under the letter of credit, Wellmont shall pay the Base Rate equal to the greater of (i) the Prime Rate plus 1.50% per annum, (ii) LIBOR plus 2.50% per annum, or (iii) 7.50% per annum. Wellmont shall repay the liquidity drawing amount in 12 equal quarterly installments, with the first such installment due on the first anniversary of the related liquidity drawing.

Outstanding Series 2005 Bonds are subject to redemption prior to maturity at the option of The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee, upon direction by Wellmont in whole at any time, or in part on any certain specified days at redemption prices of 100%-102% of the principal amount of the Series 2005 Bonds being redeemed, plus accrued interest thereon to the redemption date.

(g) Series 2003

On June 1, 2003, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $59,100 of Hospital Revenue Bonds, Series 2003. The bonds were issued to provide funds necessary to refund Wellmont's Hospital Revenue Bonds, Series 1993 (HVHC), to fund a debt service reserve fund and to pay certain expenses incurred in connection with the issuance of the Series 2003 Bonds.

The Wellmont Series 2003 Bonds consist of $27,460 in fixed-rate serial bonds and $19,280 in fixed-rate term bonds payable through maturity or mandatory sinking fund redemption maturing in annual amounts ranging from $3,230 on September 1, 2007 to $4,140 on September 1, 2019, and carrying interest rates ranging from 2.5% to 5.00%.

(h) Master Trust Indenture

The master trust indentures and loan agreements for the 2011, 2010, 2007, 2006, 2005, and 2003 bonds contain certain requirements regarding deposits to trustee funds, maintenance of rates, maintenance of debt service coverage and liquidity, permitted indebtedness, and permitted disposition of assets. Gross receipts of Wellmont collateralize the bonds. The purpose of the master trust indenture is to provide a mechanism for the efficient and economical issuance of notes by individual members of Wellmont using the collective borrowing capacity and credit rating of Wellmont. The master trust indenture requires individual members of Wellmont to make principal and interest payments on notes issued for their benefit. The master trust indenture also requires Wellmont members to make payments on notes issued by other members of Wellmont if such other members are unable to satisfy their obligations under the master trust indenture. Payments of principal and interest on certain bonds are also insured by bond insurance policies.

Funds held by the trustee related to the various revenue bonds are available for specific purposes. The bond interest and revenue funds may be used only to pay interest and principal on the bonds; the debt service reserve fund may be used to pay interest and principal if sufficient funds are not available in the bond interest and revenue funds. The original issue discount and premium on all Bond Series outstanding are being amortized over the life of the bond issue using the effective-interest method.

(i) Project Odyssey 2012 Tax-Exempt Master Lease/Sublease Financing

On December 1, 2012, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee (as Lessee) and Wellmont (as Sub-Lessee) entered into a Master Equipment Lease and Sublease Agreement with Banc of America Public Capital Corp (the Lessor). The proceeds of this Master Lease are being used to finance an electronic medical records system consisting of an EpicCare Inpatient Clinical System and an EpicCare Ambulatory Electronic Medical Records System inclusive of hardware, software, and implementation services subject to a License and Support agreement between Epic Systems Corporate and Sub-lessees dated September 19, 2012. The Sub-Lessee has authorized the Lessor to take a security interest in the entire System although only certain components of the System are to be funded under this Master Lease with the rest to be funded by Bank of America N.A. and Sub-Lessee. During the fiscal year ended June 30, 2013, Wellmont has received two advances totaling $16,150.

Each Lease Term shall commence and interest shall begin to accrue on the date any funds are advanced by the Lessor. The Lease payments shall be payable on a monthly basis. The first six lease payments under each agreement shall consist only of an interest component and the remaining 78 lease payments shall consist of a principal component and an interest component. Commencing on June 30, 2013, and continuing on the first day of each fiscal quarter thereafter, Wellmont shall pay accrued interest on the outstanding balance of the loan. Each agreement will have an interest component based on a fixed-rate of interest and payable with respect to the amount of funds that the Lessor has advanced. The Leases issued during the fiscal year ended June 30, 2013 as fixed-rate obligations calculated at 0.65% if the Average Life Swap Rate, United States Treasury Swap as of the Request date plus 1.0635% based on Lessor's credit evaluation of Wellmont, which resulted in 1.45% and 1.82% for the two maturities in 2020.

(Dollars in thousands)

(j) ***Notes Payable***

During 2007, Wellmont entered into a five-year $3,000 note payable, which has a fixed interest rate of 7.25% and a termination date of July 2011. In August 2011, Wellmont renewed this note agreement in the amount of $1,760 with a variable interest rate indexed to *The Wall Street Journal* U.S. Prime Rate with a ceiling of 7.75% and a floor of 4.00% and a maturity date of August 2016. At June 30, 2013 and 2012, $1,199 and $1,540, respectively, were outstanding on this note.

During 2009, Wellmont entered into a five-year $2,400 term note payable with a variable interest rate indexed to *The Wall Street Journal* U.S. Prime Rate and a maturity date of October 2013. At June 30, 2013 and 2012, $379 and $640, respectively, were outstanding on this note.

During 2010, Wellmont entered into a $2,767 note payable to finance the purchase of Cardiovascular Associates. The note payable had a fixed interest rate of 5.5% and a termination date of May 2013. At June 30, 2013 and 2012, $0 and $922, respectively, were outstanding on this note.

On October 17, 2012, Wellmont entered into a ten-year $12,500 term note payable with Bank of America, N.A. The proceeds were used for the EpicCare system and its implementation, among other general corporate purposes. The note payable has a fixed interest rate of 3.27% and a maturity date of December 13, 2022. At June 30, 2013, $10,390 was outstanding on this note.

(k) **Capital Lease Obligations**

Assets under capital leases are included in property and equipment and have a net carrying value of $26,695 and $25,170 as of June 30, 2013 and 2012, respectively. Amortization of capital assets is included in depreciation expense. The lease obligations are recorded at the net present value of the minimum lease payments with interest rates from 2.03% to 12.0%.

(l) ***Long-Term Debt Maturities Schedule***

Bond maturities in accordance with the original terms of the Master Trust Indenture and other long-term debt maturities for each of the next five years and in the aggregate at June 30, 2013 are as follows:

2014	$	15,002
2015		14,450
2016		14,124
2017		13,677
2018		16,182
Thereafter		411,177
	$	484,612

(Dollars in thousands)

The following table reflects the required repayment terms for the years ended June 30 of Wellmont's debt obligations in the event that the put options associated with the 2005 bonds were exercised, but not successfully remarketed.

2014	$	12,457
2015		30,064
2016		29,617
2017		29,045
2018		12,766
Thereafter		370,663
	$	484,612

Interest paid for the years ended June 30, 2013 and 2012 was $21,163 and $22,216, respectively, net of amounts capitalized. Interest costs of $299 and $0, net of interest income of $0 and $0 in 2013 and 2012, respectively, were capitalized.

(12) Derivative Transactions

Wellmont is a party to a number of interest rate swap agreements. Such swaps have not been designated as hedges and are valued at estimated fair value in the accompanying consolidated balance sheets. By using derivative financial instruments to hedge exposures to changes in interest rates, Wellmont exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes Wellmont, which creates credit risk for Wellmont. When the fair value of a derivative contract is negative, Wellmont owes the counterparty, and therefore, Wellmont is not exposed to the counterparty's credit risk in those circumstances. Pursuant to the terms of its interest rate swap agreements, Wellmont is required to post collateral with its counterparties under certain specified conditions. Collateral posting requirements are based on the amount of Wellmont's derivative liability and Wellmont's bond rating. As of June 30, 2013 and 2012, Wellmont was not required to post collateral related to its swaps.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

Wellmont has a Total Return Swap on the Series 2011 Bonds with a new counterparty.

(Dollars in thousands)

Management's primary objective in holding such derivatives is to introduce a fixed or variable rate component into its variable rate debt structure using LIBOR rates. The fair value as of June 30, 2013 and 2012 of approximately $(7,425) and $(9,781), respectively, is included in other long-term liabilities in the consolidated balance sheets. The change in the fair value of the derivative instruments was approximately $2,356 and $1,807, respectively, in 2013 and 2012 and is included in nonoperating gains in the consolidated statements of operations. The terms of the swap agreements allow netting of all amounts due from/to the counterparty. The following is a summary of the interest rate swap information as of June 30, 2013:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2011	$ 76,165	May 5, 2011	September 1, 2032	1.400%	6.222%	$ 1,792
Pay fixed interest rate swap	Series 2005	54,820	December 13, 2005	September 1, 2016	3.548	0.082	(4,738)
Basis swap	Series 2002	58,680	September 1, 2002	September 1, 2032	0.050	0.163	(1,245)
Pay fixed interest rate swap	*	30,295	October 24, 2003	September 1, 2021	3.613	0.082	(3,234)
							$ (7,425)

* Previously designated bond series has been refinanced.

The following is a schedule detailing the swap information as of June 30, 2012:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2011	$ 76,165	May 5, 2011	September 1, 2032	1.530%	6.200%	$ 2,888
Pay fixed interest rate swap	Series 2005	57,250	December 13, 2005	September 1, 2016	3.548	0.165	(6,471)
Basis swap	Series 2002	60,765	September 1, 2002	September 1, 2032	0.180	0.339	(1,662)
Pay fixed interest rate swap	*	32,880	October 24, 2003	September 1, 2021	3.613	0.165	(4,536)
							$ (9,781)

* Previously designated bond series has been refinanced.

In September and October 2008, the counterparty and credit support provider, for four of the swaps held at that time, filed bankruptcy. The bankruptcy process is underway and the ultimate outcome regarding any final settlement cannot be determined at this time.

(13) Pension and Other Postretirement Benefits

Wellmont sponsors a retirement program and defined-contribution retirement plan (Retirement Plan) that covers substantially all employees. This program and the related Retirement Plan were created from amendments, restatements, and mergers of existing defined-contribution plans at BRMC and HVMC. Wellmont makes annual contributions to the Retirement Plan in an amount equal to 3% of each participant's base wages and contributes an additional amount, based on each participant's voluntary contributions, which cannot exceed certain limits established in the Internal Revenue Code, up to 3% of each participant's wages. The total pension expense related to the Retirement Plan was $13,020 and $10,346 for the years ended June 30, 2013 and 2012, respectively.

HVMC sponsored a noncontributory, defined-benefit pension plan covering substantially all its employees. However, effective June 30, 1996, this plan was frozen and no further benefits accrue. LPH also sponsors a defined-benefit pension plan covering substantially all its employees.

HVMC's defined-pension benefits are actuarially determined based on a formula taking into consideration an employee's compensation and years of service. HVMC's funding policy is to make annual contributions to the plan based upon the funding standard developed by the plan actuary. This standard uses the projected unit credit actuarial cost method, including the amortization of prior service costs, over a 20-year period. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The LPH plan contains similar funding and actuarial policies.

On June 30, 2007, the HVMC plan merged into LPH plan and the plan name changed to Wellmont Health System Defined Benefit Plan. At the end of 2008, only a single defined-pension plan exists. Collectively, the two defined-benefit plans are referred to as the "Plans." Effective June 30, 2010, the plan was frozen for all Lonesome Pine Hospital employees and no further benefits will be accrued.

Wellmont recognizes the funded status (i.e., difference between the fair value of plan assets and projected benefit obligations) of its defined-benefit pension plans as an asset or liability in its consolidated balance sheet and recognizes changes in that funded status in the year in which the changes occur as a change in unrestricted net assets. All defined-benefit pension plans use a June 30 measurement date.

(Dollars in thousands)

The following table sets forth the funded status of the combined Plans, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

		2013	2012
Change in benefit obligation:			
Benefit obligation at beginning of year	$	54,081	45,337
Service cost		—	—
Interest cost		2,102	2,422
Actuarial losses		(3,062)	8,614
Benefits paid		(2,372)	(2,292)
Benefit obligation at end of year		50,749	54,081
Change in plan assets:			
Fair value of plan assets at beginning of year		36,791	38,811
Actual return on plan assets		2,521	(304)
Employer contribution		3,417	576
Benefits paid		(2,372)	(2,292)
Fair value of plan assets at end of year		40,357	36,791
Funded status	$	(10,393)	(17,290)
Amounts recognized in the accompanying consolidated balance sheets:			
Pension benefit liability (other long-term liabilities)	$	(10,393)	(17,290)

(Dollars in thousands)

		2013	2012
Amounts not yet reflected in net periodic benefit cost and included as an accumulated charge to unrestricted net assets:			
Unrecognized actuarial loss	$	14,552	19,773
Unrecognized prior service cost		—	—
Net amounts included as an accumulated charge to unrestricted net assets	$	14,552	19,773
Calculation of change in unrestricted net assets:			
Accumulated charge to unrestricted net assets, end of year	$	14,552	19,773
Reversal of accumulated charge to unrestricted net assets, prior year		(19,773)	(8,565)
Change in unrestricted net assets	$	(5,221)	11,208
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Actuarial loss (gain) arising during the year	$	(3,003)	11,577
Amortization of actuarial loss		(2,218)	(369)
Amortization of prior service cost		—	—
Net amounts recognized in unrestricted net assets	$	(5,221)	11,208

(Dollars in thousands)

		2013	2012
Estimate of amounts that will be amortized from unrestricted net assets to net pension cost in 2013:			
Amortization of net loss	$	1,467	2,186
Amortization of prior service cost		—	—
Estimated future benefit payments:			
Fiscal 2013	$	—	2,609
Fiscal 2014		2,590	2,732
Fiscal 2015		2,658	2,821
Fiscal 2016		2,741	2,897
Fiscal 2017		2,828	2,996
Fiscal 2018–2022		18,643	16,054
Weighted average assumptions used to determine benefit obligations:			
Settlement (discount) rate		4.50%	4.00%
Weighted average rate of increase in future compensation levels		N/A	N/A
Components of net periodic benefit cost (benefit):			
Service cost	$	—	—
Interest cost		2,102	2,422
Expected return on plan assets		(2,581)	(2,658)
Amortization of net loss		2,218	369
Net periodic benefit cost	$	1,739	133
Weighted average assumptions used to determine net periodic benefit cost:			
Settlement (discount) rate		4.00%	5.50%
Expected long-term return on plan assets (HVMC)		7.00	7.00
Expected long-term return on plan assets (LPH)		7.00	7.00
Weighted average rate of increase in future compensation levels		N/A	N/A

Wellmont's overall expected long-term rate of return on assets is 7.00%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

Wellmont has developed a plan investment policy, which is reviewed and approved by the board of directors. The policy established goals and objectives of the fund, asset allocations, asset classifications, and manager guidelines. The policy dictates a target asset allocation and an allowable range for such categories based on quarterly investment fluctuations. Investments are managed by independent advisers who are monitored by management and the board of directors.

(Dollars in thousands)

The table below shows the target allocation and actual asset allocations as of June 30, 2013 and 2012:

Asset	Target allocation	2013	2012
Equity securities	65%	48%	47%
Fixed income	28	33	32
Cash	5%–15%	1	2
Other	5%– 5%	18	19

Wellmont monitors the asset allocation and executes required recalibrations of the portfolio allocation on a regular basis in response to fluctuations in market conditions and the overall portfolio composition.

HVMC also participates in a health and welfare plan for its retirees. The plan provides postretirement medical and life insurance benefits to certain employees who meet minimum age and service requirements. Effective January 1, 1995, the death benefit was changed to provide a flat $5 benefit to all future retirees. During 1995, the medical program for retirees was amended to terminate medical benefits for any active employees who would not meet the full eligibility requirements of the program by January 1, 1996. The plan is contributory and contains other cost-sharing features such as deductibles and coinsurance.

The following table sets forth the postretirement plan's funded status, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

	Postretirement benefits	
	2013	2012
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 7,039	7,763
Interest cost	163	298
Plan participants contributions	19	34
Actuarial losses	(2,554)	(975)
Benefits paid	(85)	(81)
Benefit obligation at end of year	4,582	7,039
Change in plan assets:		
Fair value of plan assets at beginning of year	—	—
Employer contribution	66	47
Plan participants contributions	19	34
Benefits paid	(85)	(81)
Fair value of plan assets at end of year	—	—
Funded status	$ 4,582	7,039

(Dollars in thousands)

		Postretirement benefits	
		2013	2012
Amounts recognized in the consolidated balance sheets consist of:			
Noncurrent assets	$	—	—
Current liabilities		—	—
Noncurrent liabilities		(4,582)	(7,039)
Accumulated charge to unrestricted net assets		4,608	2,469
	$	26	(4,570)

Amounts recognized as an accumulated credit to unrestricted net assets consist of the following:

		2013	2012
Net actuarial gain	$	4,608	2,469

Net periodic benefic cost recognized and other changes in plan assets and benefit obligations recognized in unrestricted net assets in 2013 and 2012 were as follows:

		Postretirement benefits	
		2013	2012
Net periodic benefit cost:			
Interest cost	$	163	299
Amortization of net gain		(416)	(262)
Net periodic benefit cost recognized		(253)	37
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Net actuarial loss		(2,554)	(975)
Amortization of net gain		416	262
Total recognized in unrestricted net assets		(2,138)	(713)
Total recognized in net periodic benefit cost and unrestricted net assets	$	(2,391)	(676)

(Continued)

(Dollars in thousands)

The net gain and prior service credit for the defined-benefit postretirement plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year are $(405) and $(168), respectively. Weighted average assumptions used to determine benefit obligations for 2013 and 2012 were as follows:

	2013	2012
Discount rate	4.00%	3.50%
Rate of compensation increase	—	—
Healthcare cost trend rate	5.00	5.00

Weighted average assumptions used to determine net benefit cost for 2013 and 2012 were as follows:

	Postretirement benefits	
	2013	2012
Discount rate	3.50%	5.00%
Expected long-term rate of return on plan assets	N/A	N/A
Rate of compensation increase	N/A	N/A
Healthcare cost trend rate	5.00	5.00

Wellmont's overall expected long-term rate of return on assets is 7%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

For measurement purposes, a 6.50% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2013.

The following table summarizes the effect of one-percentage-point increase/decrease in healthcare costs trends:

		2013	2012
Effect of one-percentage-point increase in healthcare cost trend on:			
Service and interest cost	$	10	21
Accumulated pension benefit obligation		271	533
Effect of one-percentage-point decrease in healthcare cost trend on:			
Service and interest cost	$	(9)	(19)
Accumulated pension benefit obligation		(242)	(473)

(Dollars in thousands)

The asset allocations of Wellmont's pension and postretirement benefits as of June 30, 2013 and 2012, respectively, were as follows:

	Fair value measurement at June 30, 2013 pension benefits – plan assets			
	Total	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets:				
Stock mutual funds	$ 32,750	32,750	—	—
Cash and money market funds	543	543	—	—
Alternative funds	7,064	—	3,674	3,390
Total	$ 40,357	33,293	3,674	3,390

	Fair value measurement at June 30, 2012 pension benefits – plan assets			
	Total	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets:				
Stock mutual funds	$ 29,223	29,223	—	—
Cash and money market funds	578	578	—	—
Alternative funds	6,990	—	3,443	3,547
Total	$ 36,791	29,801	3,443	3,547

(Dollars in thousands)

The following table presents Wellmont's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 820 for the years ended June 30, 2013 and 2013:

		Alternative investments
Balance at June 30, 2011	$	3,588
Net change in value		(29)
Purchases, issuances, and settlements		(12)
Transfers into and/or out of Level 3 (net)		—
Balance at June 30, 2012		3,547
Net change in value		(61)
Purchases, issuances, and settlements		(96)
Transfers into and/or out of Level 3 (net)		—
Balance at June 30, 2013	$	3,390

There were no transfers between any levels during the years ended June 30, 2013 and 2012.

(14) Self-Insurance Programs

Wellmont is self-insured for professional and general liability and workers' compensation liability. Consulting actuaries have been retained to determine funding requirements and estimate claim liability exposures. Wellmont had established revocable self-insurance trust funds to provide for professional and general liability claims and workers' compensation claims and related expenses. Wellmont's contributions to the self-insurance trusts were based upon actuarial determinations by an independent service company. The trust fund requirement for professional and general liability was eliminated in 2013. The professional and general liability self-insurance program is supplemented by umbrella excess liability policies consisting of various layers of coverage with commercial carriers based on policy year. The workers' compensation program is supplemented for Tennessee and Virginia by excess workers' compensation policies, with a commercial carrier for statutory limits per occurrence. Provisions based on actuarial estimates are made for the ultimate cost of claims asserted, as well as estimates of claims incurred but not reported as of the respective consolidated balance sheet dates. Workers' compensation expense under these programs amounted to approximately $3,681 and $4,100 for the years ended June 30, 2013 and 2012, respectively, and are included in salaries and benefits expense in the accompanying consolidated statements of operations and changes in net assets. All other self-insurance expense under these programs amounted to approximately $2,229 and $2,763 for the years ended June 30, 2013 and 2012, respectively, and are included in other expense in the accompanying consolidated statements of operations and changes in net assets.

At June 30, 2013 and 2012, Wellmont was involved in litigation relating to medical malpractice and workers' compensation claims arising in the ordinary course of business. There are also known incidents that occurred through June 30, 2013 that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. Claims have been filed requesting damages in excess of the amount accrued for estimated malpractice costs. Management of Wellmont is of the opinion that estimated professional and general liability amounts accrued at June 30, 2013 are adequate to provide for potential losses resulting from pending or potential litigation. Amounts of claim settlements may be more or less than what has been provided for by management. The ultimate settlement of claims could be different from recorded accruals, with such differences being potentially significant.

(Dollars in thousands)

Wellmont is also self-insured for medical and other healthcare benefits provided to its employees and their families. A provision for estimated incurred but not reported claims has been provided in the consolidated financial statements.

(15) Commitments and Contingencies

Construction in progress at June 30, 2013 and 2012 relates primarily to the completion of certain buildings and renovations. Total costs to complete these and other projects were approximately $15,403 at June 30, 2013. Wellmont has entered into contracts of $15,403 related to these projects.

Wellmont leases certain equipment and office space under operating lease agreements. Total rental expense under cancelable and noncancelable agreements was $18,240 and $19,269 for the years ended June 30, 2013 and 2012, respectively. Minimum future lease payments under noncancelable operating leases with initial or remaining lease terms in excess of one year as of June 30, 2013 are as follows:

2014	$	9,076
2015		8,164
2016		5,749
2017		4,898
2018		4,377
Thereafter		15,251
	$	47,515

Wellmont has entered into contractual employment relationships with physicians to provide services to Wellmont physician practices that are intended to qualify under the employee safe harbor of the Anti-Kickback Statute and the employee exception of the Physician Self-Referral Law. These contracts have terms of varying lengths, guarantee certain base payments, and may provide for additional incentives based upon productivity.

(Dollars in thousands)

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, such matters as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes Wellmont is in compliance with fraud and abuse statutes and other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

(16) Functional Expense Disclosure

Wellmont provides healthcare services to residents within its geographic location. Expenses based upon functional classification related to providing these services during the years ended June 30 are as follows:

		2013	2012
Professional care of patients	$	655,152	612,639
Administrative and general		128,955	152,171
Fund-raising		1,172	1,106
	$	785,279	765,916

(17) Income Taxes

Wellmont, Inc. and its subsidiaries file consolidated federal and separate-company state income tax returns. These companies have combined net operating loss carryforwards for federal income tax purposes of approximately $107,000 at June 30, 2013, which begin expiring in fiscal 2018 and expire through 2032. These net operating losses can be used to offset future consolidated taxable income of Wellmont, Inc. and subsidiaries. Wellmont participates in certain activities that generate unrelated business taxable income. These activities have generated net operating losses in prior years, and Wellmont files a Form 990-T with the Internal Revenue Service to report such activity. Wellmont has net operating loss carryforwards for federal income tax purposes of approximately $1,780 for unrelated business activities. Management believes that it is more likely than not that deferred tax assets arising from net operating loss carryforwards will not be realizable. Accordingly, these are fully reserved at June 30, 2013 and 2012.

(Continued)

(Dollars in thousands)

(18) Concentration of Credit Risk

Wellmont grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2013 and 2012 was as follows:

	2013	2012
Medicare	53%	50%
TennCare	6	5
Medicaid	9	7
Other third-party payors	26	31
Patients	6	7
	100%	100%

(19) Disclosures about Fair Value of Financial Instruments

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer or settle a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820, *Fair Value Measurements and Disclosures*, establishes a three-level fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The classification of an investment within the hierarchy is based upon the pricing transparency or ability to redeem the investment and does not necessarily correspond to the perceived risk of that investment. Inputs are used in applying various valuation techniques that are assumptions, which market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, operating statistics, specific and broad credit data, liquidity statistics, recent transactions, earnings forecasts, future cash flows, market multiples, discount rates and other factors.

Assets and liabilities measured and reported at fair value are classified within the fair value hierarchy as follows:

Level 1 – Valuations based on quoted market prices in active markets.

Level 2 – Investments that trade in markets that are considered to be active, but are based on dealer quotations or alternative pricing sources supported by observable inputs or investments that trade in markets that are not considered to be active, but are valued based on quoted market prices, dealer quotations or alternative pricing sources supported by observable inputs.

Level 3 – Investments classified within Level 3 have significant unobservable inputs, as they trade infrequently or not at all.

(Dollars in thousands)

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2013:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 55,958	—	—	55,958
Assets limited as to use:				
Stock mutual funds	109,356	—	—	109,356
Bond mutual funds	175,594	—	—	175,594
Cash and money market funds	42,923	—	—	42,923
Real estate funds	16,377	—	—	16,377
Alternative investments	—	—	36,520	36,520
Subtotal	400,208	—	36,520	436,728
Long-term investments:				
Stock mutual funds	12,228	—	—	12,228
Bond mutual funds	13,478	—	—	13,478
Cash and money market funds	190	—	—	190
Real estate funds	1,220	—	—	1,220
Subtotal	27,116	—	—	27,116
	$ 427,324	—	36,520	463,844
Liabilities:				
Derivatives liability	$ —	7,425	—	7,425
Total	$ —	7,425	—	7,425

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2012:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 44,930	—	—	44,930
Assets limited as to use:				
Stock mutual funds	88,942	—	—	88,942
Bond mutual funds	163,401	—	—	163,401
Cash and money market funds	44,240	—	—	44,240
Real estate funds	7,157	—	—	7,157
Alternative investments	—	—	36,989	36,989
Corporate bonds	2,673	—	—	2,673
U.S. Treasury bonds	—	—	—	—
Subtotal	351,343	—	36,989	388,332
Long-term investments:				
Stock mutual funds	10,321	—	—	10,321
Bond mutual funds	13,926	—	—	13,926
Cash and money market funds	189	—	—	189
Real estate funds	685	—	—	685
Alternative investments	—	—	—	—
Subtotal	25,121	—	—	25,121
	$ 376,464	—	36,989	413,453
Liabilities:				
Derivatives liability	$ —	9,781	—	9,781
Total	$ —	9,781	—	9,781

The following methods and assumptions were used to estimate fair value of each class of instruments:

- *Cash and Cash Equivalents*

  The carrying amount approximates fair value due to the short maturities of these instruments.

- *Patient Accounts and Other Receivables*

  The net recorded carrying value approximates fair value due to the short maturities of these instruments.

- *Investments and Assets Limited as to Use*

  The fair values of investments and assets limited as to use are based on quoted market prices and quotes obtained from security brokers or, in the case of the limited partnerships, by the general partner.

  Wellmont also applies the measurement provisions of ASU No. 2009-12 to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. This guidance amends the previous guidance and allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent. Net asset value, in many instances may not equal fair value that would be calculated pursuant to ASC 820. The fair value of these investments was $36,520 and $36,989 at June 30, 2013 and 2012, respectively.

- *Accounts Payable and Accrued Expenses*

  The carrying amount approximates fair value due to the short maturities of these liabilities.

- *Estimated Third-Party Payor Settlements, Other Long-Term Liabilities*

  The carrying amount approximates fair market value due to the nature of these liabilities.

- *Long-Term Debt*

  The carrying amount of indebtedness with variable interest rates approximates its fair value because the variable rates reflect current market rates for indebtedness with similar maturities and credit quality. The fair value of indebtedness with fixed interest rates is based on rates assumed to be currently available for indebtedness with similar terms and average maturities. Fair value measurements of indebtedness are based on observable interest rates and maturity schedules that fall within Level 2 of the hierarchy of fair value inputs. The estimated fair value of revenue bonds, using current market rates, was estimated at $436,832 and $436,634 for the years ended June 30, 2013 and 2012, respectively. The carrying amount of other long-term debt reported in Note 11 and on the consolidated balance sheet approximates the related fair value.

(Dollars in thousands)

The following table presents additional information about Level 3 assets measured at fair value. Both observable and unobservable inputs may be used to determine the fair value of positions that the Health System has classified within the Level 3 category. As a result, the unrealized gains and losses for assets within the Level 3 category in the table below may include changes in fair value that were attributable to both observable and unobservable inputs.

		Alternative investments
Balance at June 30, 2011	$	37,778
Total realized and unrealized gains (losses):		
Included in revenues and gains in excess of expenses and losses		264
Included in changes in net assets		(420)
Purchases, issuances, and settlements		(633)
Transfers into and/or out of Level 3 (net)		—
Balance at June 30, 2012		36,989
Total realized and unrealized gains (losses):		
Included in revenues and gains in excess of expenses and losses		(69)
Included in changes in net assets		1,113
Purchases, issuances, and settlements		(1,513)
Transfers into and/or out of Level 3 (net)		—
Balance at June 30, 2013	$	36,520

There were no transfers between any of the levels during the years ended June 30, 2013 and 2012.

(20) Subsequent Events

Effective October 1, 2013, Wellmont closed Lee Regional Medical Center in Pennington Gap, Virginia.

Wellmont has evaluated subsequent events from the balance sheet date through October 23, 2013, the date at which the consolidated financial statements were issued. No other material subsequent events were identified for recognition.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Financial Statements

June 30, 2014 and 2013

(With Independent Auditors' Report Thereon)

WELLMONT HEALTH SYSTEM AND AFFILIATES

Table of Contents

KPMG LLP
Suite 1000
401 Commerce Street
Nashville, TN 37219-2422

Independent Auditors' Report

The Board of Directors
Wellmont Health System:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Wellmont Health System and affiliates, which comprise the consolidated balance sheets as of June 30, 2014 and 2013, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Wellmont Health System and affiliates as of June 30, 2014 and 2013, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Nashville, Tennessee
October 24, 2014

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Balance Sheets

June 30, 2014 and 2013

(Dollars in thousands)

Assets		**2014**	**2013**
Current assets:			
Cash and cash equivalents	$	30,674	55,958
Assets limited as to use, required for current liabilities		3,233	5,061
Patient accounts receivable, less allowance for uncollectible accounts of approximately $38,007 and $25,991 in 2014 and 2013, respectively		117,265	107,029
Other receivables		14,685	17,995
Inventories		18,684	18,361
Prepaid expenses and other current assets		10,337	8,949
Total current assets		194,878	213,353
Assets limited as to use, net of current portion		425,740	375,709
Land, buildings, and equipment, net		492,581	474,730
Other assets:			
Long-term investments		32,521	28,628
Investments in affiliates		18,221	31,874
Deferred debt expense, net		4,226	5,178
Goodwill		51,649	15,096
Other		520	547
		107,137	81,323
Total assets	$	1,220,336	1,145,115
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	18,015	15,002
Accounts payable and accrued expenses		90,547	84,300
Estimated third-party payor settlements		8,425	7,157
Current portion of other long-term liabilities		6,510	6,198
Other current liabilities		11,700	—
Total current liabilities		135,197	112,657
Long-term debt, less current portion		490,443	475,946
Other long-term liabilities, less current portion		43,866	41,567
Total liabilities		669,506	630,170
Net assets:			
Unrestricted		538,607	503,934
Temporarily restricted		8,214	6,927
Permanently restricted		1,319	1,311
Total net assets attributable to Wellmont		548,140	512,172
Noncontrolling interests		2,690	2,773
Total net assets		550,830	514,945
Commitments and contingencies			
Total liabilities and net assets	$	1,220,336	1,145,115

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2014 and 2013

(Dollars in thousands)

		2014	2013
Revenue:			
Patient service revenue	$	788,910	791,230
Provision for bad debt		(45,644)	(53,251)
Net patient revenue less provision for bad debt		743,266	737,979
Other revenues		29,441	42,127
Total revenue		772,707	780,106
Expenses:			
Salaries and benefits		374,309	373,150
Medical supplies and drugs		166,676	162,604
Purchased services		73,674	77,716
Interest		18,350	20,292
Depreciation and amortization		50,058	49,465
Maintenance and utilities		36,978	36,830
Lease and rental		15,506	17,892
Other		32,312	26,745
Total expenses		767,863	764,694
Income from operations		4,844	15,412
Nonoperating gains:			
Investment income		14,749	19,316
Derivative valuation adjustments		1,307	2,356
Loss on refinancing		(1,133)	—
Gain on revaluation of equity method investment		14,744	—
Nonoperating gains, net		29,667	21,672
Revenue and gains in excess of expenses and losses before discontinued operations		34,511	37,084
Discontinued operations		(26,639)	(4,484)
Revenue and gains in excess of expenses and losses		7,872	32,600
Income attributable to noncontrolling interests		(1,540)	(1,228)
Revenues and gains in excess of expenses and losses attributable to Wellmont		6,332	31,372
Other changes in unrestricted net assets:			
Change in net unrealized gains (losses) on investments		28,333	6,157
Net assets released from restrictions for additions to land, buildings, and equipment		901	828
Change in the funded status of benefit plans and other		(893)	7,359
Increase in unrestricted net assets		34,673	45,716
Changes in temporarily restricted net assets:			
Contributions		2,707	2,977
Net assets released from temporary restrictions		(1,420)	(1,789)
Increase in temporarily restricted net assets		1,287	1,188
Changes in permanently restricted net assets – investment income		8	7
Changes in noncontrolling interests:			
Income attributable to noncontrolling interests		1,540	1,228
Distributions to noncontrolling interests		(1,623)	(1,220)
Change in noncontrolling interests		(83)	8
Change in net assets		35,885	46,919
Net assets, beginning of year		514,945	468,026
Net assets, end of year	$	550,830	514,945

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2014 and 2013

(Dollars in thousands)

		2014	2013
Cash flows from operating activities:			
Change in net assets	$	35,885	46,919
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		50,526	51,392
(Gain) loss on disposal of land, buildings, and equipment		(78)	211
Equity in earnings of affiliated organizations		(1,764)	(4,594)
Distributions from affiliated organizations		3,484	5,366
Amortization of deferred financing costs		426	486
Net realized and unrealized gain on investments		(31,302)	(9,580)
Provision for bad debts		40,237	55,029
Change in fair value of derivative instruments		(1,307)	(2,356)
Loss on refinancing		1,133	—
Gain on revaluation of equity method investment		(14,744)	—
Loss on impairment		22,456	2,007
Changes in assets and liabilities, net of acquisitions:			
Patient accounts receivable		(44,839)	(53,793)
Other current assets		(1,711)	(1,986)
Other assets		3,297	5,872
Accounts payable and accrued expenses		5,474	(2,532)
Estimated third-party payor settlements		1,268	(8,378)
Other current liabilities		11,358	416
Other liabilities		2,998	(10,137)
Net cash provided by operating activities		82,797	74,342
Cash flows from investing activities:			
Proceeds from sales and maturities of investments		123,193	115,439
Purchase of investments		(141,095)	(135,222)
Purchase of land, buildings, and equipment		(86,879)	(57,747)
Proceeds from the sale of buildings and equipment		2,434	355
Cash paid for acquisitions		(22,637)	(13)
Net cash used in investing activities		(124,984)	(77,188)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt		128,623	28,908
Payments on long-term debt		(111,092)	(14,789)
Payment of debt issuance costs		(628)	(245)
Net cash provided by financing activities		16,903	13,874
Net (decrease) increase in cash and cash equivalents		(25,284)	11,028
Cash and cash equivalents, beginning of year		55,958	44,930
Cash and cash equivalents, end of year	$	30,674	55,958

Supplemental disclosures of noncash items:

Wellmont entered into capital lease obligations for buildings and equipment in the amount of $1,345 and $5,262 in 2014 and 2013, respectively.

Additions to property and equipment financed through current liabilities of $3,770 and $5,589 in 2014 and 2013, respectively.

See accompanying notes to consolidated financial statements.

(1) Operations and Basis of Presentation

Wellmont Health System (Wellmont), a Tennessee not-for-profit corporation, currently operates six acute care hospitals in Tennessee and Virginia that include Bristol Regional Medical Center in Bristol, Tennessee, Holston Valley Medical Center in Kingsport, Tennessee, Lonesome Pine Hospital in Big Stone Gap, Virginia, Hawkins County Memorial Hospital in Rogersville, Tennessee, Hancock County Hospital in Sneedville, Tennessee, and Mountain View Regional Medical Center in Norton, Virginia.

The consolidated financial statements also include the operations of:

- Wellmont Cardiology Services and Wellmont Medical Associates, which operate physician practices.
- Wellmont Madison House and Wellmont Wexford House, which operate assisted living, adult day care, and skilled nursing facilities.
- Wellmont Foundation, which conducts fund-raising activities for the benefit of Wellmont.
- Wellmont Integrated Network, LLC, which is an accountable care organization.
- Wellmont Insurance Company SPC, Ltd, which is a captive insurance company.
- Wellmont, Inc., a wholly owned taxable subsidiary of Wellmont, formed as the holding company of various other taxable subsidiaries that provide medical collection services, provide other healthcare-related services, and invest in affiliates and other activities.

All significant intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

Wellmont's continuing operations consist primarily of the delivery of healthcare services in northeast Tennessee and southwest Virginia.

The following are included in discontinued operations:

- As of October 1, 2013, Wellmont closed Lee Regional Medical Center in Pennington Gap, Virginia. The losses of $26,091 and $2,317, including an impairment loss of $22,456 and $0, for the years ended June 30, 2014 and 2013, respectively, are included in discontinued operations
- As of May 17, 2013, a subsidiary of Wellmont ceased operating its sleep labs, which were managed by a third party. The losses of $292 and $2,302, including an impairment loss of $0 and $2,007, for the years ended June 30, 2014 and 2013, respectively, are included in discontinued operations.
- As of September 23, 2010, Wellmont sold the majority of its retail pharmacy's assets to a national pharmacy company. The gains (losses) of $45 and ($131) for the years ended June 30, 2014 and 2013, respectively, are included in discontinued operations.
- As of April 30, 2009, Wellmont closed Jenkins Community Hospital in Jenkins, Kentucky. The gains (losses) of ($301) and $266 for the years ended June 30, 2014 and 2013, respectively, are included in discontinued operations.

(2) Significant Accounting Policies

A summary of significant accounting policies is as follows:

(a) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Significant estimates include allowances for contractual adjustments and bad debts; third-party payor settlements; valuation of investments, land, buildings, equipment, and goodwill; and self-insurance and other liabilities. Actual results could differ from these estimates.

(b) Cash and Cash Equivalents

Wellmont considers all highly liquid investments with a maturity of three months or less when purchased, excluding amounts whose use is limited by board of directors' designation or other arrangements under trust agreements, to be cash equivalents.

(c) Investments

Marketable equity securities and debt securities are recorded at fair value and classified as other than trading. Fair value is determined primarily using quoted prices (unadjusted) in active markets for identical assets or liabilities that Wellmont has the ability to access at the measurement date. However, Wellmont also uses observable and unobservable inputs for investments without quoted market prices to determine the fair value of certain investments at the measurement date. Investments in limited partnerships are recorded at fair value as determined by the partnership using net asset value. Wellmont has adopted the measurement provisions of Accounting Standards Update (ASU) No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. Investments in affiliates in which Wellmont has significant influence but does not control are reported on the equity method of accounting, which represents Wellmont's equity in the underlying net book value. Long-term investments include those investments that have not been designated by the board of directors for specific purposes and are also not intended to be used for the liquidation of current liabilities. Investment income is recognized when earned.

Realized gains and losses are determined on the specific-identification method and included in investment income with interest and dividends. Investment income is reported net of related investment fees. Unrealized gains and losses are included in other changes in unrestricted net assets except for losses determined to be other than temporary, which are considered realized losses and included in investment income.

(d) Assets Limited as to Use

Assets limited as to use primarily include designated assets set aside by the board of directors for future capital improvements, over which the board of directors retains control and may, at its discretion, subsequently use for other purposes, and assets held by trustees under bond indenture and self-insurance arrangements. Amounts required to meet current liabilities of Wellmont have been reclassified to current assets in the accompanying consolidated balance sheets.

(e) Inventories

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

(f) Land, Buildings, and Equipment

Land, buildings, and equipment are stated at cost, if purchased, or fair value at date of donation. Depreciation is computed using the straight-line method based on the estimated useful life of the asset, ranging from 3 to 40 years. Buildings and equipment held under capital leases are recorded at net present value of future lease payments and are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. Costs of maintenance and repairs are expensed as incurred. Upon sale or retirement of land, buildings, or equipment, the cost and related accumulated depreciation are eliminated from the respective accounts and the resulting gain or loss, if any, is included in other revenues on the consolidated statements of operations and changes in net assets. Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

Wellmont evaluates long-lived assets for impairment on annual basis. Long-lived assets are considered to be impaired whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable from future cash flows. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of an asset to future cash flows expected to be generated by the asset. When such assets are considered to be impaired, the impairment loss recognized is measured by the amount by which the carrying value of the asset exceeds the fair value of the asset.

(g) Goodwill

Wellmont adopted ASU No. 2010-07, *Not for Profit Entities: Mergers and Acquisitions*, which in part requires healthcare entities to follow Accounting Standards Codification (ASC) Topic 350-20-35, *Intangibles – Goodwill and Other* along with ASU 2011-08, *Testing Goodwill for Impairment*, effective July 1, 2012. ASC Topic 350-20-35 requires goodwill of not-for-profit entities to be evaluated for impairment at least annually. An entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. The more-likely than-not threshold is defined as having a likelihood of more than 50%. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount (including goodwill) of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss. Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. The annual impairment test is performed as of June 30.

(h) Deferred Debt Expense

Deferred debt expense is amortized over the life of the related bond issues using the effective-interest method.

(i) Derivative Financial Instruments

As further described in note 12, Wellmont is a party to interest rate swap and other derivative agreements. These financial instruments are not designated as hedges and are presented at estimated fair market value in the accompanying consolidated balance sheets. These fair values are based on the estimated amount Wellmont would receive, or be required to pay, to enter into equivalent agreements with a third party at the valuation date. Due to the nature of these financial instruments, such estimates are subject to significant change in the near term. Wellmont recognizes changes in the fair values of derivatives as nonoperating gains or losses in the consolidated statements of operations and changes in net assets. The cash settlements resulting from these interest rate swaps are reported as interest expense in the consolidated statements of operations and changes in net assets.

(j) Asset Retirement Obligations

Asset retirement obligations (AROs) are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value, and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, Wellmont records period-to-period changes in the ARO liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. Wellmont derecognizes ARO liabilities when the related obligations are settled.

(k) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Wellmont has been limited by donors to a specific-time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by Wellmont in perpetuity. Generally, donors of permanently restricted assets permit use of all or part of the income earned on related investments for general or specific purposes.

Temporarily restricted net assets relate primarily to amounts held by the Foundation and include amounts restricted for future capital expenditures and for operations of such areas as children's healthcare services, hospice, and cancer care.

Net assets are released from restrictions by Wellmont incurring expenses that satisfy the restricted purposes. Such net assets released during 2014 and 2013 primarily included amounts related to the purchase of equipment for pediatrics, cancer, and other healthcare operations.

Wellmont has adopted guidance issued by Financial Accounting Standards Board (FASB), which provides guidance on the net asset classification of donor-restricted endowment funds for a tax-exempt organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). Effective July 1, 2007, the State of Tennessee adopted legislation that incorporates the provisions outlined in UPMIFA. Wellmont's endowments consist solely of donor-restricted endowment funds. Wellmont's endowments consist of five individual funds established for a variety of purposes.

Wellmont has interpreted UPMIFA 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. As a result of this interpretation, Wellmont classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are approved for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Wellmont considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the organization and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the organization; and (7) the investment policies of the organization.

(l) Net Patient Service Revenue and Accounts Receivable

Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts expected to be collected. Net patient service revenue includes amounts estimated by management to be reimbursable by patients and various third-party payors under provisions of reimbursement formulas in effect, including retroactive adjustments under reimbursement agreements. Estimated retroactive adjustments are accrued in the period related services are rendered and adjusted in future periods as final and other settlements are determined. On the basis of historical experience, a significant portion of Wellmont's uninsured patients will be unable or unwilling to pay for the services provided. Therefore, Wellmont records a significant provision for bad debts related to uninsured patients in the period the services are provided. This provision for bad debts is presented on the statements of operations as a component of net patient revenue. Wellmont provides care to patients who meet criteria under its charity care policy without charge or at amounts less than its established rates. Because Wellmont does not pursue collection of amounts determined to qualify as charity care, they are not included in net patient service revenue.

Patient accounts receivable are reported net of both an allowance for contractual adjustments and an allowance for uncollectible accounts. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, TennCare, Medicaid, and other third-party payment programs. Wellmont's policy does not require collateral or other security for patient accounts receivable. Wellmont routinely obtains assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans, or policies.

(m) Revenue and Gains in Excess of Expenses and Losses

The consolidated statements of operations and changes in net assets include revenue and gains in excess of expenses and losses. Changes in unrestricted net assets that are excluded from revenue and gains in excess of expenses and losses, consistent with industry practice, include changes in net unrealized gains (losses) on investments other than trading securities, changes in the funded status of Wellmont's defined-benefit plan, contributions of long-lived assets, including assets acquired using contributions that, by donor restriction, were to be used for the purposes of acquiring such assets, and cumulative effects of changes in accounting principles.

For purposes of financial statement display, those activities directly associated with Wellmont's mission of providing healthcare services are considered to be operating activities. Nonoperating activities primarily include investment and related activities. Other operating revenues primarily include cafeteria, rental, meaningful use incentives, and income from affiliates.

(n) Contributed Resources

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted contributions, and are excluded from revenue and gains 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 contributions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expiration of donor restrictions is reported when the donated or acquired long-lived assets are placed in service.

Unconditional promises to give cash or other assets are reported at fair value at the date the promise is received. Gifts are reported as either a temporarily or permanently restricted contribution if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are recorded as unrestricted contributions. Unrestricted contributions are included in other revenues.

(o) Federal Income Taxes

The Wellmont entities are primarily classified as organizations exempt from federal income taxes under Section 501(a) as entities described in Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes has been included for these entities in the consolidated financial statements. The operations of Wellmont, Inc. are subject to state and federal income taxes, which are accounted for in accordance with ASC Topic 740, *Income Taxes*; however, such amounts are not material.

(p) Recently Adopted Accounting Standards

The FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, in May 2011. This ASU requires the reason for the fair value measurement to be disclosed, a description of the valuation techniques, and descriptions of the inputs used for all Level 2 and Level 3 fair value measurements. It also requires all transfers between levels of the fair value hierarchy to be separately reported and described. Wellmont adopted ASU 2011-04 as of July 1, 2012.

(q) Reclassifications

Certain 2013 amounts have been reclassified to conform to the 2014 consolidated financial statement presentation. The reclassifications had no impact on total assets or changes in net assets.

(3) Business Combinations and Goodwill

On November 30, 2013, Wellmont purchased 100% of the membership interest in Wexford House from Residential Healthcare Affiliates. Wexford House is a skilled nursing facility, which serves residents of Sullivan County, Tennessee and the surrounding communities. The facility provides short- and long-term medical and rehabilitation care. In addition, on March 31, 2014, Wellmont purchased the remaining 25% interest in Holston Valley Imaging Center (HVIC), which included the remaining 50% governance interest from Blue Ridge Radiology Investment. The assets acquired and liabilities assumed under each acquisition were recorded at their estimated fair value in accordance with ASC 805.

(Dollars in thousands)

The following table summarizes the consideration paid and the estimated fair value of the assets acquired and liabilities assumed at the business combination date:

		Wexford	HVIC
Consideration:			
Cash	$	14,770	7,867
Fair value of Wellmont's equity interest in HVIC held before acquisition		—	23,601
	$	14,770	31,468
Recognized amounts of identifiable assets acquired and liabilities assumed:			
Current assets	$	2,976	2,474
Other assets		5,277	241
Current liabilities		(564)	(863)
Long-term liabilities		(608)	—
Total identifiable net assets		7,081	1,852
Goodwill		7,689	29,616
	$	14,770	31,468

Wellmont recognized a gain of $14,744 as a result of remeasuring to fair value its 75% equity interest in HVIC held before the business combination. The gain is included in nonoperating gains (losses) on the consolidated statement of operations for the year ended June 30, 2014.

A summary of goodwill for the years ended June 30 is as follows:

		2013	Additions	Decreases	2014
Goodwill	$	15,096	37,305	(752)	51,649

		2012	Additions	Decreases	2013
Goodwill	$	17,090	13	(2,007)	15,096

(Dollars in thousands)

(4) Net Patient Service Revenue

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations and changes in net assets is as follows for the years ended June 30:

		2014	2013
Gross patient service revenue	$	2,683,891	2,452,561
Less:			
Contractual adjustments and other discounts		(1,838,900)	(1,605,045)
Charity care		(56,081)	(56,286)
Net patient service revenue before provision for bad debts		788,910	791,230
Less provision for bad debts		(45,644)	(53,251)
Net patient service revenue	$	743,266	737,979

Wellmont's allowance for doubtful accounts is predominantly for self-pay patients and patient balances remaining after third-party payments. The provision for bad debts decreased $7,607 from fiscal 2013 to fiscal 2014 and the net write-offs decreased $19,262 from fiscal 2013 to fiscal 2014. The decrease in the provision for bad debts was primarily offset by an increase of $6,594 in self-pay discounts. The decrease in write-offs was due to the above item and the implementation of a new billing system in the last quarter of the fiscal year. Wellmont has not changed its charity care or uninsured discount policies during fiscal 2014. Wellmont does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

(5) Third-Party Reimbursement Arrangements

Wellmont renders services to patients under contractual arrangements with the Medicare and Medicaid programs. The Medicaid programs in Tennessee and Virginia are contracted by each state to commercial managed care contractors to cover Medicaid eligible enrollees. Amounts earned under these contractual arrangements are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Management believes that adequate provision has been made for any adjustments that may result from such reviews. Participation in these programs subjects Wellmont to significant rules and regulations; failure to adhere to such could result in fines, penalties, or expulsion from the programs.

Wellmont contracts with various managed care organizations under the Medicaid programs. Reimbursement for both inpatient and outpatient services is based upon prospectively determined rates, including diagnostic-related group assignments, fee schedules, and per diem amounts. Reimbursement under the Medicaid program is also based upon prospectively determined amounts.

The Medicare program pays for the costs of inpatient services on a prospective basis. Payments are based upon diagnostic-related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. Wellmont receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid-eligible and other low-income patients. Outpatient services are also reimbursed primarily on a prospectively determined basis.

(Dollars in thousands)

Net patient service revenue in 2014 and 2013 related to Medicare and TennCare/Medicaid and net patient accounts receivable at June 30, 2014 and 2013 from Medicare and TennCare/Medicaid were as follows:

		2014	2013
Net patient service revenue:			
Medicare	$	304,713	313,429
TennCare/Medicaid		37,216	39,515
Net patient accounts receivable:			
Medicare	$	44,480	38,102
TennCare/Medicaid		6,817	6,146

Wellmont has filed cost reports with Medicare and Medicaid. The cost reports are subject to final settlement after audits by the fiscal intermediary. The Medicare and Medicaid cost reports have been audited and final settled by the intermediary through June 30, 2010 and audit adjustments have been received and considered for certain hospitals and year-ends through June 30, 2012.

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

Net patient service revenue is reported at the net amounts billed to patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Estimated retroactive adjustments are accrued in the period the related services are rendered and adjusted in future periods as changes in estimated provisions and final settlements are determined. Net patient service revenue increased approximately $3,334 and $6,605 in 2014 and 2013, respectively, due to final settlements and revised estimates in excess of amounts previously recorded, removal of allowances previously estimated that are no longer necessary as a result of audits and final settlements, and years that are no longer subject to audits, reviews, and investigations.

Estimated settlements recorded at June 30, 2014 could differ materially from actual settlements based on the results of third-party audits.

(6) Meaningful Use Incentives

The American Recovery and Reinvestment Act of 2009 (ARRA) established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record (EHR) technology. The Medicare incentive payments are paid out to qualifying hospitals and physician groups over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals, and physician groups must meet EHR “meaningful use” criteria that become more stringent over three stages as determined by Centers for Medicare & Medicaid Services (CMS). Medicaid programs and payment schedules vary from state to state.

For fiscal years ended June 30, 2014 and 2013, Wellmont recorded $7,211 and $12,267, respectively, in other operating revenue related to the EHR and meaningful use incentives. These incentives have been recognized following the grant accounting model, recognizing income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria.

Amounts recognized represent management's best estimates for payments ultimately expected to be received based on estimated discharges, charity care, and other input data. Subsequent changes to these estimates will be recognized in other operating revenue in the period in which additional information is available. Such estimates are subject to audit by the federal government or its designee.

(7) Charity Care and Community Services

Wellmont accepts all patients within its primary service area regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies that consider, among other factors, generally recognized poverty income levels.

Wellmont maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone and estimated costs incurred for services and supplies furnished under its charity care policy. Costs incurred are estimated based on the ratio of total operating expenses to gross charges applied to charity care charges. Charges foregone for services and supplies furnished under its charity care policy, the estimated cost of those services, and the equivalent percentage of charity care patients to all patients serviced were $56,081, $14,567, and 2.39%, respectively, for the year ended June 30, 2014 and $56,286, $15,735, and 2.57%, respectively, for the year ended June 30, 2013.

In addition to the charity care services described above, Wellmont provides a number of other services to benefit the indigent for which little or no payment is received. Medicare, Medicaid, and state indigent programs do not cover the full cost of those services. The shortfall between actual receipts from those programs and Wellmont's cost of providing care to those patients totaled $37,432 and $45,056 for the years ended June 30, 2014 and 2013, respectively.

Wellmont also provides services to the community at large for which it receives little or no payment. Health evaluations, screening programs, and specific services for the elderly and homebound are other services supplied. Wellmont also provides public health education, trains new health professionals, and conducts health research.

(8) Investment in Affiliates

Wellmont has investments with other healthcare providers, which include hospital, home care, regional laboratories, and other healthcare-related organizations. Wellmont records its share of equity in the operations of the respective organizations. Equity in earnings of affiliates was approximately $1,764 and $4,594 for the years ended June 30, 2014 and 2013, respectively, and is included in other operating revenue in the consolidated financial statements. Wellmont received distributions of $3,484 and $5,366 during 2014 and 2013, respectively, which reduced Wellmont's overall investment in the affiliates.

(Dollars in thousands)

The following table summarizes the unaudited aggregate financial information of Wellmont's investments in affiliates:

		2014	2013
Total assets	$	136,824	135,802
Total liabilities		38,396	40,617
Total net assets	$	98,428	95,185
Net revenues	$	201,639	200,765
Expenses		191,023	186,394
Revenues in excess of expenses	$	10,616	14,371

Wellmont's investment in these affiliates and its ownership percentage as of June 30, 2014 and 2013 is as follows:

		Amount		Percentages	
		2014	2013	2014	2013
Takoma Regional Hospital	$	10,763	11,983	60%	60%
Holston Valley Imaging Center (HVIC)		—	8,336	—	75
Advanced Home Care (AHO)		6,092	6,092	6	6
Lab Group Holdings, LLC		—	3,500	—	1
Others		1,366	1,963	25%–50%	25%–50%
	$	18,221	31,874		

As of March 31, 2014, Wellmont purchased the remaining 25% interest in HVIC and included HVIC in the consolidated financial statements from that date.

Prior to this transaction and although Wellmont's ownership percentage in Takoma Regional Hospital and HVIC was greater than 50%, Wellmont did not consolidate these entities because Wellmont only had a 50% representation on each respective board and did not have control over these entities. Also, during the fiscal year ended June 30, 2014, Lab Group Holdings, LLC was purchased by another entity, which also purchased all of Wellmont's share in this entity.

Wellmont provided billing, management, and professional services to some of the affiliates. Income recognized by Wellmont for the services was $173 in 2014 and $971 in 2013 and is included in other revenues. Included in other receivables are $242 and $406 as of June 30, 2014 and 2013, respectively, of amounts due to Wellmont from these entities.

(Dollars in thousands)

(9) Investments

Long-term investments, including assets limited as to use, at June 30 are reported at fair value and consist of the following:

		2014	2013
Assets limited as to use by Board for capital improvements:			
Stock mutual funds	$	148,453	109,356
Bond mutual funds		167,156	175,594
Cash and money market funds		5,904	3,749
Real estate funds		21,381	16,377
Alternative investments (private equity, hedge funds, commingled funds, and real estate funds):			
Liquid		14,215	10,504
Illiquid		26,852	26,016
		383,961	341,596
Assets limited as to use under self-insurance agreements:			
Cash and money market funds		16,051	—
Assets limited as to use under bond indenture agreements:			
Cash and money market funds		28,961	39,174
Less assets limited as to use that are required for current liabilities		3,233	5,061
Assets limited as to use, net of current portion	$	425,740	375,709
Long-term investments:			
Stock mutual funds	$	17,741	12,228
Bond mutual funds		11,420	13,478
Preferred equity investment and related options		1,512	1,512
Cash, money market funds, and certificates of deposit		230	190
Real estate funds		1,618	1,220
Total long-term investments	$	32,521	28,628

Investments in certain alternative limited partnership investments contain agreements whereby Wellmont is committed to contribute approximately $10,162 as of June 30, 2014 of additional funds to the limited partnerships in the form of capital calls at the discretion of the general partner, of which $567 was paid subsequent to June 30, 2014.

Effective June 27, 2013, Wellmont redeemed its $10,000 in the preferred equity of a regional managed services organization; however, retained its $1,512 on a right of first refusal related to any future sale of this organization. This equity had a guaranteed annual return of at least 6.5% of the outstanding preferred equity balance.

Wellmont's investments are concentrated in stock and bond mutual funds. In the event of a downward trend in the stock and bond markets, Wellmont's overall market value of net assets could be adversely affected by a material amount. Investments in alternative investments are generally illiquid investments whose value is determined by the general partner such as hedge funds, private equity, commingled funds, and real estate funds. Distributions are only at the discretion of a voting majority of the general partners.

(Dollars in thousands)

Wellmont evaluates whether unrealized losses on investment securities indicate other-than-temporary impairment. Based on this evaluation, Wellmont recognized other-than-temporary impairment losses of $0 and $131 on investments as of June 30, 2014 and 2013, respectively. Other-than-temporary impairment losses are considered as realized losses and are reported within "investment income" in the consolidated statements of operations and changes in net assets.

Gross unrealized losses on investments for which other-than-temporary impairments have not been recognized and the fair values of those investments, aggregated by the length of time that individual investments have been in a continuous unrealized loss position, at June 30, 2014 and 2013 were as follows:

		Less than 12 months		12 months or more		Total	
		Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
2014:							
Alternative investments	$	—	—	647	878	647	878
Mutual funds		16	1,655	3,632	119,716	3,648	121,371
	$	16	1,655	4,279	120,594	4,295	122,249

		Less than 12 months		12 months or more		Total	
		Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
2013:							
Alternative investments	$	478	3,243	—	—	478	3,243
Mutual funds		7,304	181,780	371	3,185	7,675	184,965
	$	7,782	185,023	371	3,185	8,153	188,208

Investment income is comprised of the following for the years ended June 30:

		2014	2013
Interest and dividends, net of amounts capitalized	$	11,780	15,893
Realized gains on investments, net		2,969	3,423
Investment income, net	$	14,749	19,316
Change in net unrealized gains on investment	$	28,333	6,157

(Dollars in thousands)

(10) Land, Buildings, and Equipment

Land, buildings, and equipment at June 30 consist of the following:

		2014	2013
Land	$	49,825	49,758
Buildings and improvements		523,069	536,758
Equipment		490,805	384,747
Buildings and equipment under capital lease obligations		46,031	45,102
		1,109,730	1,016,365
Less accumulated depreciation		(623,930)	(576,210)
		485,800	440,155
Construction in progress		6,781	34,575
Land, buildings, and equipment	$	492,581	474,730

Depreciation expense for the years ended June 30, 2014 and 2013 was $50,058 and $49,465, respectively. Included in depreciation expense is amortization related to capitalized software and equipment under capital leases. Accumulated amortization for equipment under capitalized software and lease obligations was $21,789 and $18,408 as of June 30, 2014 and 2013, respectively.

(11) Other Long-Term Liabilities

Other long-term liabilities at June 30 consist of the following:

		2014	2013
Workers’ compensation liability	$	11,096	9,882
Professional and general liability		15,940	11,492
Postretirement benefit obligation		2,633	4,582
Asset retirement obligation		3,139	2,969
Deferred gain on sale of assets		409	439
Derivative liability		6,118	7,425
Pension benefit liability		11,041	10,393
Other		—	583
		50,376	47,765
Less current portion		(6,510)	(6,198)
Total other long-term liabilities	$	43,866	41,567

(Dollars in thousands)

(12) Debt

(a) Long-Term Debt

Long-term debt consists of the following at June 30:

	2014	2013
Hospital Refunding Bonds, Series 2014A	$ 14,242	—
Hospital Refunding Bonds, Series 2014B	52,275	—
Hospital Refunding Bonds, Series 2014C	20,836	—
Hospital Revenue Bonds, Series 2014D	13,575	—
Hospital Revenue Refunding Bonds, Series 2011	75,300	76,165
Hospital Revenue Bonds, Series 2010 (Bank Qualified)	—	22,836
Hospital Revenue Bonds, Series 2007A	55,000	55,000
Hospital Revenue Refunding Bonds, Series 2006C	200,000	200,000
Hospital Revenue Refunding Bonds, Series 2005	—	54,820
Hospital Revenue Bonds, Series 2003	—	25,225
Project Odyssey 2012 Tax-Exempt Master Lease/Sublease Financing	40,589	16,150
Notes payable	10,232	11,968
Capital lease obligations	19,749	21,601
Other	674	847
	502,472	484,612
Unamortized premium	5,986	6,679
Unamortized discount	—	(343)
	508,458	490,948
Less current maturities	(18,015)	(15,002)
	$ 490,443	475,946

(b) Series 2014 Bonds

On June 25, 2014, Wellmont (a) refunded the Revenue Bonds, Series 2003, the Revenue Refunding Bonds, Series 2005, and the Revenue Bonds, Series 2010 (Bank Qualified), with the proceeds of the Hospital Revenue Refunding Bonds, Series 2014A, Series 2014B, and Series 2014C and (b) issued Series 2014D. The Series 2014A through Series 2014D Bonds were issued by Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee on behalf of Wellmont. Under the terms of the bond indenture, the proceeds were used to advance refund the Revenue Bonds, Series 2003, the Revenue Refunding Bonds, Series 2005, and the Revenue Bonds, Series 2010 (Bank Qualified) and to issue new debt in the amount of $13,575 to reimburse Wellmont for the purchase price of Wellmont Wexford House and to pay closing costs of issuing the Series 2014D Bonds. All of the Series 2014 Bonds were issued as tax-exempt and were issued in accordance with the Master Trust Indenture dated May 1, 1991.

The Series 2014 Bonds were issued with four maturities; Series 2014A for $14,242, maturing September, 1, 2019, Series 2014B for $52,275, maturing September 1, 2032, Series 2014C for $20,836, maturing September 1, 2024, and Series 2014D for $13,575, maturing September 1, 2040. Principal and interest will be paid annually, except there will be interest only paid on the Series 2014D through September 2030. Principal payments will begin on September 1, 2031.

Interest on the Series 2014 Bonds is 100% of LIBOR plus a quotient of applicable spread divided by 67%. Accrued interest is paid monthly in arrears. Interest rates on the 2014A, 2014B, 2014C, and 2014D Bonds were 0.92%, 1.02%, 0.85%, and 0.85%, respectively, as of June 30, 2014.

The Series 2014C and Series 2014D Bonds can be called by the bondholders June 1, 2021 and each successive year after that until they mature.

(c) Project Odyssey 2012 Tax-Exempt Master Lease/Sublease Financing

On December 1, 2012, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee (as Lessee) and Wellmont (as Sub-Lessee) entered into a Master Equipment Lease and Sublease Agreement with Banc of America Public Capital Corp (the Lessor). The proceeds of this Master Lease were used to finance an electronic medical records system consisting of an EpicCare Inpatient Clinical System and an EpicCare Ambulatory Electronic Medical Records System inclusive of hardware, software, and implementation services. The Sub-Lessee authorized the Lessor to take a security interest in the entire System although only certain components of the System were funded under this Master Lease with the rest funded by Bank of America N.A. and Sub-Lessee. During the fiscal year ended June 30, 2013, Wellmont received two draws totaling $16,150. During the fiscal year ended June 30, 2014, Wellmont received two additional draws totaling $26,349.

Each lease term shall commence and interest shall begin to accrue on the date any funds are advanced by Wellmont. The first six lease payments under each agreement consist only of an interest component and the remaining 78 lease payments consist of a principal component and an interest component. Commencing on June 30, 2013, and continuing on the first day of each fiscal quarter thereafter, Wellmont shall pay accrued interest on the outstanding balance of the loan. Each agreement will have an interest component based on a fixed rate of interest and payable with respect to the amount of funds that the Lessor has advanced. The rates of interest are 1.79% and 1.97% for the two draws in the fiscal year ended June 30, 2014 and 1.45% and 1.82% for the two draws in the fiscal year ended June 30, 2013.

(d) Series 2011 Bonds

On May 5, 2011, Wellmont refunded the Revenue Bonds, Series 2006A, with the proceeds of the Revenue Bonds, Series 2011. The Series 2011 Bonds were issued by Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee on behalf of Wellmont. Under the terms of the bond indenture, the proceeds were used to advance refund the Revenue Bonds, Series 2006A and to pay the costs of issuing the Series 2011 Bonds.

In order to refund the Series 2006A Bonds, Wellmont made a tender offer to the holders of the Series 2006A Bonds. The holders of all outstanding Series 2006A Bonds agreed to tender their Series 2006A Bonds to Wellmont. Proceeds of the Series 2011 Bonds were used to pay the purchase price of Series 2006A Bonds tendered for purchase. All outstanding Series 2006A Bonds were purchased by the Wellmont on the date of issuance of the Bonds and were immediately surrendered to the trustee for the Series 2006A Bonds for retirement and cancellation.

The Series 2011 Bonds were issued with two maturities of $42,385 and $33,780 for 2026 and 2032, respectively. The Series 2011 Bonds maturing September 1, 2026 are subject to mandatory redemption prior to maturity pursuant to the operation of a sinking fund, in part by lot starting on the redemption dates beginning on September 1, 2013 and ending on September 1, 2026 in annual amounts ranging from $865 to $4,680. The Series 2011 Bonds maturing September 1, 2032 are subject to mandatory redemption prior to maturity pursuant to the operation of a sinking fund, in part by lot starting on the redemption dates beginning on September 1, 2027 and ending on September 1, 2032 in annual amounts ranging from $4,980 to $6,300. The Series 2011 Bonds were issued as fixed-rate obligations at 6.0% and 6.5% for the two maturities (2026 and 2032, respectively).

(e) Series 2010 Bank Qualified Bonds

On November 1, 2010, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee (the Board) issued $30,000 Hospital Revenue Bonds, Series 2010 (Bank Qualified). The Series 2010 Bonds were issued and sold pursuant to the Bond Purchase Agreement dated as of November 1, 2010, between the Board and First Tennessee Bank National Association. Commencing on January 1, 2011, and continuing on the first day of each fiscal quarter thereafter, Wellmont shall pay accrued interest on the outstanding balance of the loan. Commencing on October 1, 2011 and continuing on the first day of each fiscal quarter thereafter, Wellmont shall also make principal payments equal to $500. The outstanding bonds accrue interest at a rate equal to the product of 65% of the sum of LIBOR plus the applicable margin; however, the Series 2010 Bonds were redeemed upon the issuance of the Series 2014C Bonds.

(f) Series 2007 Bonds

On July 24, 2007, The Virginia Small Business Financing Authority issued, on behalf of Wellmont, $55,000 of Hospital Revenue Bonds, Series 2007A. The Series 2007A Bonds, with other methods of financing, were used to purchase the assets of Mountain View Regional Medical Center and Lee Regional Medical Center.

Principal on outstanding Series 2007A Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $360 to $2,460 commencing on September 1, 2017 through September 1, 2036, with a balloon payment of $29,245 due on September 1, 2037. The outstanding bonds accrue interest at rates ranging from 5.125% to 5.250%.

(g) Series 2006 C

On October 26, 2006, The Health, Educational, and Housing Facilities Board of the County of Sullivan Tennessee issued, on behalf of Wellmont, $200,000 of Hospital Revenue Bonds, Series 2006C. The Series 2006C Bonds were used to finance the costs of acquisition of land for expansion, construction, expansion, equipping, and renovation of HVMC, including the construction of a new patient tower (collectively known as Project Platinum); finance the costs of the construction, expansion, equipping, and renovation of the emergency department at BRMC (the Bristol Emergency Department Project); and finance the costs of construction, expansion, renovation, and equipping of an operating room and related facilities at Hawkins County Memorial Hospital.

Principal on outstanding Series 2006C Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $1,605 to $25,330 commencing on September 1, 2017 through September 1, 2036. The outstanding bonds accrue interest at rates ranging from 5.00% to 5.25%.

(h) Series 2005

On December 8, 2005, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $70,620 of Hospital Revenue Refunding Bonds, Series 2005. The Series 2005 Bonds together with other available funds were used to advance refund the previously issued Hospital Revenue Bonds, Series 2002, and to pay certain expenses incurred in connection with the issuance of the Series 2005 Bonds. Principal on outstanding Series 2005 Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $1,945 to $3,390 commencing on September 1, 2007 through September 1, 2032; however, the Series 2005 Bonds were redeemed upon the issuance of the Series 2014B Bonds.

(i) Series 2003

On June 1, 2003, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee, issued, on behalf of Wellmont, $59,100 of Hospital Revenue Bonds, Series 2003. The bonds were issued to provide funds necessary to refund Wellmont's Hospital Revenue Bonds, Series 1993 (HVHC), to fund a debt service reserve fund and to pay certain expenses incurred in connection with the issuance of the Series 2003 Bonds.

The Wellmont Series 2003 Bonds consist of $27,460 in fixed-rate serial bonds and $19,280 in fixed-rate term bonds payable through maturity or mandatory sinking fund redemption maturing in annual amounts ranging from $3,230 on September 1, 2007 to $4,140 on September 1, 2019; however, the Series 2003 Bonds were redeemed upon the issuance of the Series 2014A Bonds.

(j) Master Trust Indenture

The master trust indentures and loan agreements for the 2014, 2011, 2007, and 2006 bonds contain certain requirements regarding deposits to trustee funds, maintenance of rates, maintenance of debt service coverage and liquidity, permitted indebtedness, and permitted disposition of assets. Gross receipts of Wellmont collateralize the bonds. The purpose of the master trust indenture is to provide a mechanism for the efficient and economical issuance of notes by individual members of Wellmont using the collective borrowing capacity and credit rating of Wellmont. The master trust indenture requires individual members of Wellmont to make principal and interest payments on notes issued for their benefit. The master trust indenture also requires Wellmont members to make payments on notes issued by other members of Wellmont if such other members are unable to satisfy their obligations under the master trust indenture. Payments of principal and interest on certain bonds are also insured by bond insurance policies.

Funds held by the trustee related to the various revenue bonds are available for specific purposes. The bond interest and revenue funds may be used only to pay interest and principal on the bonds; the debt service reserve fund may be used to pay interest and principal if sufficient funds are not available in the bond interest and revenue funds. The original issue discount and premium on all bond series outstanding are being amortized over the life of the bond issue using the effective-interest method.

(k) Notes Payable

During 2007, Wellmont entered into a five-year $3,000 note payable, which has a fixed interest rate of 7.25% and a termination date of July 2011. In August 2011, Wellmont renewed this note agreement in the amount of $1,760 with a variable interest rate indexed to *The Wall Street Journal* U.S. Prime Rate with a ceiling of 7.75% and a floor of 4.00% and a maturity date of August 2016. At June 30, 2014 and 2013, $828 and $1,199, respectively, were outstanding on this note.

During 2009, Wellmont entered into a five-year $2,400 term note payable with a variable interest rate indexed to *The Wall Street Journal* U.S. Prime Rate and a maturity date of October 2014. At June 30, 2014 and 2013, $150 and $379, respectively, were outstanding on this note.

On October 17, 2012, Wellmont entered into a 10-year $12,500 term note payable with Bank of America, N.A. The proceeds were used for the EpicCare system and its implementation, among other general corporate purposes. The note payable has a fixed interest rate of 3.27% and a maturity date of December 13, 2022. At June 30, 2014, $9,254 and $10,390 was outstanding on this note.

(l) Capital Lease Obligations

Assets under capital leases are included in property and equipment and have a net carrying value of $24,242 and $26,695 as of June 30, 2014 and 2013, respectively. Amortization of capital assets is included in depreciation expense. The lease obligations are recorded at the net present value of the minimum lease payments with interest rates from 2.1% to 12.0%.

(Dollars in thousands)

(m) Long-Term Debt Maturities Schedule

Bond maturities in accordance with the original terms of the Master Trust Indenture and other long-term debt maturities for each of the next five years and in the aggregate at June 30, 2014 are as follows:

2015	$ 18,015
2016	17,318
2017	16,405
2018	18,912
2019	19,638
Thereafter	412,184
	$ 502,472

Interest paid for the years ended June 30, 2014 and 2013 was $18,899 and $19,622, respectively, net of amounts capitalized. Interest costs of $1,444 and $299 were capitalized in 2014 and 2013, respectively.

(13) Derivative Transactions

Wellmont is a party to a number of interest rate swap agreements. Such swaps have not been designated as hedges and are valued at estimated fair value in the accompanying consolidated balance sheets. By using derivative financial instruments to hedge exposures to changes in interest rates, Wellmont exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes Wellmont, which creates credit risk for Wellmont. When the fair value of a derivative contract is negative, Wellmont owes the counterparty, and therefore, Wellmont is not exposed to the counterparty's credit risk in those circumstances. Pursuant to the terms of its interest rate swap agreements, Wellmont is required to postcollateral with its counterparties under certain specified conditions. Collateral posting requirements are based on the amount of Wellmont's derivative liability and Wellmont's bond rating. As of June 30, 2014 and 2013, Wellmont was not required to postcollateral related to its swaps.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

(Dollars in thousands)

Management's primary objective in holding such derivatives is to introduce a fixed or variable rate component into its variable rate debt structure using LIBOR rates. The fair value as of June 30, 2014 and 2013 of approximately $(6,118) and $(7,425), respectively, is included in other long-term liabilities in the consolidated balance sheets. The change in the fair value of the derivative instruments was approximately $1,307 and $2,356, respectively, in 2014 and 2013 and is included in nonoperating gains in the consolidated statements of operations. The terms of the swap agreements allow netting of all amounts due from/to the counterparty. The following is a summary of the interest rate swap information as of June 30, 2014:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2011	$ 75,300	May 5, 2011	September 1, 2032	1.410%	6.222%	$ 987
Pay fixed interest rate swap	*	52,275	December 13, 2005	September 1, 2016	3.548	0.101	(3,323)
Basis swap	*	56,465	September 1, 2002	September 1, 2032	0.060	0.173	(1,127)
Pay fixed interest rate swap	*	27,575	October 24, 2003	September 1, 2021	3.613	0.104	(2,655)
							$ (6,118)

* Previously designated bond series has been refinanced.

The following is a schedule detailing the swap information as of June 30, 2013:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2011	$ 76,165	May 5, 2011	September 1, 2032	1.400%	6.222%	$ 1,792
Pay fixed interest rate swap	Series 2005	54,820	December 13, 2005	September 1, 2016	3.548	0.082	(4,738)
Basis swap	*	58,680	September 1, 2002	September 1, 2032	0.050	0.163	(1,245)
Pay fixed interest rate swap	*	30,295	October 24, 2003	September 1, 2021	3.613	0.082	(3,234)
							$ (7,425)

* Previously designated bond series has been refinanced.

In September and October 2008, the counterparty and credit support provider, for four of the swaps held at that time, filed bankruptcy. The bankruptcy process is underway and the ultimate outcome regarding any final settlement cannot be determined at this time.

(14) Pension and Other Postretirement Benefits

Wellmont sponsors a retirement program and defined-contribution retirement plan (Retirement Plan) that covers substantially all employees. Wellmont makes annual contributions to the Retirement Plan in an amount equal to 2% (after October 1, 2013) and 3% (before October 1, 2013) of each participant's base wages and contributes an additional amount, based on each participant's voluntary contributions, which cannot exceed certain limits established in the Internal Revenue Code, up to 2.4% (after October 1, 2013) and 3% (before October 1, 2013) of each participant's wages. The total pension expense related to the Retirement Plan was $10,687 and $12,765 for the years ended June 30, 2014 and 2013, respectively.

A predecessor to Wellmont sponsored a noncontributory, defined-benefit pension plan covering, substantially all its employees. However, effective June 30, 1996, this plan was frozen and no further benefits accrue. One of Wellmont's acquired hospitals also sponsored a defined-benefit pension plan covering substantially all its employees, but the two plans were merged on June 30, 2007 and effective June 30, 2010, the plan was frozen for all employees and no further benefits accrue.

The defined-pension benefits are actuarially determined based on a formula taking into consideration an employee's compensation and years of service. The funding policy is to make annual contributions to the plan based upon the funding standard developed by the plan actuary. This standard uses the projected unit credit actuarial cost method, including the amortization of prior service costs, over a 20-year period. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. Wellmont recognizes the funded status (i.e., difference between the fair value of plan assets and projected benefit obligations) of its defined-benefit pension plans as an asset or liability in its consolidated balance sheet and recognizes changes in that funded status in the year in which the changes occur as a change in unrestricted net assets. The defined-benefit pension plans use a June 30 measurement date.

(Dollars in thousands)

The following table sets forth the funded status of the Plans, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

		2014	2013
Change in benefit obligation:			
Benefit obligation at beginning of year	$	50,749	54,081
Service cost		—	—
Interest cost		2,196	2,102
Actuarial loss(gain)		5,815	(3,062)
Benefits paid		(2,469)	(2,372)
Benefit obligation at end of year		56,291	50,749
Change in plan assets:			
Fair value of plan assets at beginning of year		40,357	36,791
Actual return on plan assets		4,960	2,521
Employer contribution		2,402	3,417
Benefits paid		(2,469)	(2,372)
Fair value of plan assets at end of year		45,250	40,357
Funded status	$	(11,041)	(10,393)
Amounts recognized in the accompanying consolidated balance sheets:			
Pension benefit liability (other long-term liabilities)	$	(11,041)	(10,393)

(Dollars in thousands)

		2014	2013
Amounts not yet reflected in net periodic benefit cost and included as an accumulated charge to unrestricted net assets:			
Unrecognized actuarial loss	$	16,777	14,552
Unrecognized prior service cost		—	—
Net amounts included as an accumulated charge to unrestricted net assets	$	16,777	14,552
Calculation of change in unrestricted net assets:			
Accumulated charge to unrestricted net assets, end of year	$	16,777	14,552
Reversal of accumulated charge to unrestricted net assets, prior year		(14,552)	(19,773)
Change in unrestricted net assets	$	2,225	(5,221)
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Actuarial loss (gain) arising during the year	$	3,665	(3,003)
Amortization of actuarial loss		(1,440)	(2,218)
Amortization of prior service cost		—	—
Net amounts recognized in unrestricted net assets	$	2,225	(5,221)

(Dollars in thousands)

		2014	2013
Estimate of amounts that will be amortized from unrestricted net assets to net pension cost in 2013:			
Amortization of net loss	$	1,810	1,467
Amortization of prior service cost		—	—
Estimated future benefit payments:			
Fiscal 2014	$	—	2,590
Fiscal 2015		2,804	2,658
Fiscal 2016		2,894	2,741
Fiscal 2017		3,004	2,828
Fiscal 2018		3,093	2,907
Fiscal 2019–2023		19,937	15,736
Weighted average assumptions used to determine benefit obligations:			
Settlement (discount) rate		4.00%	4.50%
Weighted average rate of increase in future compensation levels		N/A	N/A
Components of net periodic benefit cost (benefit):			
Service cost	$	—	—
Interest cost		2,196	2,102
Expected return on plan assets		(2,810)	(2,581)
Amortization of net loss		1,440	2,218
Net periodic benefit cost	$	826	1,739
Weighted average assumptions used to determine net periodic benefit cost:			
Settlement (discount) rate		4.50%	4.00%
Expected long-term return on plan assets (HVMC)		7.00	7.00
Expected long-term return on plan assets (LPH)		7.00	7.00
Weighted average rate of increase in future compensation levels		N/A	N/A

Wellmont's overall expected long-term rate of return on assets is 7%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

Wellmont has developed a plan investment policy, which is reviewed and approved by the board of directors. The policy established goals and objectives of the fund, asset allocations, asset classifications, and manager guidelines. The policy dictates a target asset allocation and an allowable range for such categories based on quarterly investment fluctuations. Investments are managed by independent advisers who are monitored by management and the board of directors.

(Dollars in thousands)

The table below shows the target allocation and actual asset allocations as of June 30, 2014 and 2013:

Asset	Target allocation	2014	2013
Equity securities	47%	48%	48%
Fixed income	41	33	33
Cash	—	3	1
Other	12	16	18

Wellmont monitors the asset allocation and executes required recalibrations of the portfolio allocation on a regular basis in response to fluctuations in market conditions and the overall portfolio composition.

A predecessor to Wellmont also participates in a health and welfare plan for its retirees. The plan provides postretirement medical and life insurance benefits to certain employees who meet minimum age and service requirements. Effective January 1, 1995, the death benefit was changed to provide a flat $5 benefit to all future retirees. During 1995, the medical program for retirees was amended to terminate medical benefits for any active employees who would not meet the full eligibility requirements of the program by January 1, 1996. The plan is contributory and contains other cost-sharing features such as deductibles and coinsurance.

The following table sets forth the postretirement plan's funded status, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

	Postretirement benefits	
	2014	2013
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 4,582	7,039
Interest cost	96	163
Plan participants contributions	17	19
Actuarial losses	(1,978)	(2,554)
Benefits paid	(84)	(85)
Benefit obligation at end of year	2,633	4,582
Change in plan assets:		
Fair value of plan assets at beginning of year	—	—
Employer contribution	66	66
Plan participants contributions	17	19
Benefits paid	(83)	(85)
Fair value of plan assets at end of year	—	—
Funded status	$ (2,633)	(4,582)

(Dollars in thousands)

	Postretirement benefits	
	2014	2013
Amounts recognized in the consolidated balance sheets consist of:		
Noncurrent assets	$ —	—
Current liabilities	—	—
Noncurrent liabilities	(2,633)	(4,582)
Accumulated charge to unrestricted net assets	5,939	4,608
	$ 3,306	26

Amounts recognized as an accumulated credit to unrestricted net assets consist of the following:

	2014	2013
Net actuarial gain	$ 5,939	4,608

Net periodic benefic cost recognized and other changes in plan assets and benefit obligations recognized in unrestricted net assets in 2014 and 2013 were as follows:

	Postretirement benefits	
	2014	2013
Net periodic benefit cost:		
Interest cost	$ 95	163
Amortization of net gain	(646)	(416)
Net periodic benefit recognized	(551)	(253)
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:		
Net actuarial loss	(1,978)	(2,554)
Amortization of net gain	646	416
Total recognized in unrestricted net assets	(1,332)	(2,138)
Total recognized in net periodic benefit cost and unrestricted net assets	$ (1,883)	(2,391)

(Dollars in thousands)

The net gain and prior service credit for the defined-benefit postretirement plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year are $(646) and $(416), respectively. Weighted average assumptions used to determine benefit obligations for 2014 and 2013 were as follows:

	2014	2013
Discount rate	3.50%	4.00%
Rate of compensation increase	—	—
Healthcare cost trend rate	5.00	5.00

Weighted average assumptions used to determine net benefit cost for 2014 and 2013 were as follows:

	Postretirement benefits	
	2014	2013
Discount rate	4.00%	4.00%
Expected long-term rate of return on plan assets	N/A	N/A
Rate of compensation increase	N/A	N/A
Healthcare cost trend rate	5.00	5.00

Wellmont's overall expected long-term rate of return on assets is 7%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

For measurement purposes, a 6.7% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2014.

The following table summarizes the effect of one-percentage-point increase/decrease in healthcare costs trends:

		2014	2013
Effect of one-percentage-point increase in healthcare cost trend on:			
Service and interest cost	$	4	10
Accumulated pension benefit obligation		132	271
Effect of one-percentage-point decrease in healthcare cost trend on:			
Service and interest cost	$	(3)	(9)
Accumulated pension benefit obligation		(116)	(242)

(Dollars in thousands)

The asset allocations of Wellmont's pension and postretirement benefits as of June 30, 2014 and 2013, respectively, were as follows:

	Fair value measurement at June 30, 2014 pension benefits – plan assets			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Stock mutual funds	$ 36,546	36,546	—	—
Cash and money market funds	1,416	1,416	—	—
Alternative funds	7,425	—	3,935	3,490
Total	$ 45,387	37,962	3,935	3,490

	Fair value measurement at June 30, 2013 pension benefits – plan assets			
	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets:				
Stock mutual funds	$ 32,750	32,750	—	—
Cash and money market funds	543	543	—	—
Alternative funds	7,064	—	3,674	3,390
Total	$ 40,357	33,293	3,674	3,390

(Dollars in thousands)

The following table presents Wellmont's activity for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as defined in ASC 820 for the years ended June 30, 2014 and 2013:

		Alternative investments
Balance at June 30, 2012	$	3,547
Net change in value		(61)
Purchases, issuances, and settlements		(96)
Transfers into and/or out of Level 3 (net)		—
Balance at June 30, 2013		3,390
Net change in value		232
Purchases, issuances, and settlements		(132)
Transfers into and/or out of Level 3 (net)		—
Balance at June 30, 2014	$	3,490

There were no transfers between any levels during the years ended June 30, 2014 and 2013.

(15) Self-Insurance Programs

Wellmont is self-insured for professional and general liability and workers' compensation liability. Consulting actuaries have been retained to determine funding requirements and estimate claim liability exposures. Wellmont had established revocable self-insurance trust funds to provide for professional and general liability claims and workers' compensation claims and related expenses. Wellmont's contributions to the self-insurance trusts were based upon actuarial determinations by an independent service company. The trust fund requirement for professional and general liability was eliminated in fiscal year 2013.

Wellmont Insurance Company SPC, Ltd (the captive) was formed in 2014 as a wholly owned captive insurance company in the Cayman Islands. The captive holds Wellmont's self-insurance liabilities for professional and general liability and is funded by transfers from Wellmont Health System. These funds are included in assets limited as to use.

The professional and general liability self-insurance program is supplemented by umbrella excess liability policies consisting of various layers of coverage with commercial carriers based on policy year. The workers' compensation program is supplemented for Tennessee and Virginia by excess workers' compensation policies, with a commercial carrier for statutory limits per occurrence. Provisions based on actuarial estimates are made for the ultimate cost of claims asserted, as well as estimates of claims incurred but not reported as of the respective consolidated balance sheet dates. Workers' compensation expense under these programs amounted to approximately $3,695 and $3,588 for the years ended June 30, 2014 and 2013, respectively, and are included in salaries and benefits expense in the accompanying consolidated statements of operations and changes in net assets. All other self-insurance expense under these programs amounted to approximately $5,707 and $2,229 for the years ended June 30, 2014 and 2013, respectively, and are included in other expense in the accompanying consolidated statements of operations and changes in net assets.

(Dollars in thousands)

At June 30, 2014 and 2013, Wellmont was involved in litigation relating to medical malpractice and workers' compensation claims arising in the ordinary course of business. There are also known incidents that occurred through June 30, 2014 that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. Claims have been filed requesting damages in excess of the amount accrued for estimated malpractice costs. Management of Wellmont is of the opinion that estimated professional and general liability amounts accrued at June 30, 2014 are adequate to provide for potential losses resulting from pending or potential litigation. Amounts of claim settlements may be more or less than what has been provided for by management. The ultimate settlement of claims could be different from recorded accruals, with such differences being potentially significant.

Wellmont is also self-insured for medical and other healthcare benefits provided to its employees and their families. A provision for estimated incurred but not reported claims has been provided in the consolidated financial statements.

(16) Commitments and Contingencies

Construction in progress at June 30, 2014 and 2013 relates primarily to the completion of certain buildings and renovations. Total costs to complete these and other projects were approximately $24,685 at June 30, 2014. Wellmont has entered into contracts of $24,685 related to these projects.

Wellmont leases certain equipment and office space under operating lease agreements. Total rental expense under cancelable and noncancelable agreements was $15,506 and $17,892 for the years ended June 30, 2014 and 2013, respectively. Minimum future lease payments under noncancelable operating leases with initial or remaining lease terms in excess of one year as of June 30, 2014 are as follows:

2015	$ 11,222
2016	8,117
2017	7,210
2018	6,439
2019	6,167
Thereafter	20,423
	$ 59,578

Wellmont has entered into contractual employment relationships with physicians to provide services to Wellmont physician practices that are intended to qualify under the employee safe harbor of the Anti-Kickback Statute and the employee exception of the Physician Self-Referral Law. These contracts have terms of varying lengths, guarantee certain base payments, and may provide for additional incentives based upon productivity.

(Dollars in thousands)

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, such matters as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes Wellmont is in compliance with fraud and abuse statutes and other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

(17) Functional Expense Disclosure

Wellmont provides healthcare services to residents within its geographic location. Expenses based upon functional classification related to providing these services during the years ended June 30 are as follows:

		2014	2013
Professional care of patients	$	610,162	613,277
Administrative and general		156,647	150,245
Fund-raising		1,054	1,172
	$	767,863	764,694

(18) Income Taxes

Wellmont, Inc. and its subsidiaries file consolidated federal and separate-company state income tax returns. These companies have combined net operating loss carryforwards for federal income tax purposes of approximately $111,000 at June 30, 2014, which begin expiring in fiscal 2019 and expire through 2033. These net operating losses can be used to offset future consolidated taxable income of Wellmont, Inc. and subsidiaries. Wellmont participates in certain activities that generate unrelated business taxable income. These activities have generated net operating losses in prior years, and Wellmont files a Form 990-T with the Internal Revenue Service to report such activity. Wellmont has net operating loss carryforwards for federal income tax purposes of approximately $1,796 for unrelated business activities. Management believes that it is more likely than not that deferred tax assets arising from net operating loss carryforwards will not be realizable. Accordingly, these are fully reserved at June 30, 2014 and 2013.

(Dollars in thousands)

(19) Concentration of Credit Risk

Wellmont grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2014 and 2013 was as follows:

	2014	2013
Medicare	48%	53%
TennCare/Medicaid	13	14
Other third-party payors	31	27
Patients	8	6
	100%	100%

(20) Disclosures about Fair Value of Financial Instruments

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer or settle a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820, *Fair Value Measurements*, establishes a three-level fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The classification of an investment within the hierarchy is based upon the pricing transparency or ability to redeem the investment and does not necessarily correspond to the perceived risk of that investment. Inputs are used in applying various valuation techniques that are assumptions, which market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, operating statistics, specific and broad credit data, liquidity statistics, recent transactions, earnings forecasts, future cash flows, market multiples, discount rates, and other factors.

Assets and liabilities measured and reported at fair value are classified within the fair value hierarchy as follows:

Level 1 – Valuations based on quoted market prices in active markets.

Level 2 – Investments that trade in markets that are considered to be active, but are based on dealer quotations or alternative pricing sources supported by observable inputs or investments that trade in markets that are not considered to be active, but are valued based on quoted market prices, dealer quotations, or alternative pricing sources supported by observable inputs.

Level 3 – Investments classified within Level 3 have significant unobservable inputs, as they trade infrequently or not at all.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2014:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 30,674	—	—	30,674
Assets limited as to use:				
Stock mutual funds	148,453	—	—	148,453
Bond mutual funds	167,156	—	—	167,156
Cash and money market funds	50,916	—	—	50,916
Real estate funds	21,381	—	—	21,381
Alternative investments	—	—	41,067	41,067
Subtotal	418,580	—	41,067	459,647
Long-term investments:				
Stock mutual funds	17,741	—	—	17,741
Bond mutual funds	11,420	—	—	11,420
Cash and money market funds	230	—	—	230
Real estate funds	1,618	—	—	1,618
Subtotal	31,009	—	—	31,009
	$ 449,589	—	41,067	490,656
Liabilities:				
Derivatives liability	$ —	6,118	—	6,118
Total	$ —	6,118	—	6,118

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2013:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 55,958	—	—	55,958
Assets limited as to use:				
Stock mutual funds	109,356	—	—	109,356
Bond mutual funds	175,594	—	—	175,594
Cash and money market funds	42,923	—	—	42,923
Real estate funds	16,377	—	—	16,377
Alternative investments	—	—	36,520	36,520
Subtotal	400,208	—	36,520	436,728
Long-term investments:				
Stock mutual funds	12,228	—	—	12,228
Bond mutual funds	13,478	—	—	13,478
Cash and money market funds	190	—	—	190
Real estate funds	1,220	—	—	1,220
Subtotal	27,116	—	—	27,116
	$ 427,324	—	36,520	463,844
Liabilities:				
Derivatives liability	$ —	7,425	—	7,425
Total	$ —	7,425	—	7,425

The following methods and assumptions were used to estimate fair value of each class of instruments:

- *Cash and Cash Equivalents*

  The carrying amount approximates fair value due to the short maturities of these instruments.

- *Patient Accounts and Other Receivables*

  The net recorded carrying value approximates fair value due to the short maturities of these instruments.

- *Investments and Assets Limited as to Use*

  The fair values of investments and assets limited as to use are based on quoted market prices and quotes obtained from security brokers or, in the case of the limited partnerships, by the general partner.

(Dollars in thousands)

Wellmont also applies the measurement provisions of ASU No. 2009-12 to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. This guidance amends the previous guidance and allows for the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent. Net asset value, in many instances may not equal fair value that would be calculated pursuant to ASC 820. The fair value of these investments was $41,067 and $36,520 at June 30, 2014 and 2013, respectively.

- *Accounts Payable and Accrued Expenses*

  The carrying amount approximates fair value due to the short maturities of these liabilities.

- *Estimated Third-Party Payor Settlements, Other Long-Term Liabilities*

  The carrying amount approximates fair market value due to the nature of these liabilities.

- *Long-Term Debt*

  The carrying amount of indebtedness with variable interest rates approximates its fair value because the variable rates reflect current market rates for indebtedness with similar maturities and credit quality. The fair value of indebtedness with fixed interest rates is based on rates assumed to be currently available for indebtedness with similar terms and average maturities. Fair value measurements of indebtedness are based on observable interest rates and maturity schedules that fall within Level 2 of the hierarchy of fair value inputs. The estimated fair value of revenue bonds, using current market rates, was estimated at $444,106 and $436,832 for the years ended June 30, 2014 and 2013, respectively. The carrying amount of other long-term debt reported in note 11 and on the consolidated balance sheet approximates the related fair value.

The following table presents additional information about Level 3 assets measured at fair value. Both observable and unobservable inputs may be used to determine the fair value of positions that the Health System has classified within the Level 3 category. As a result, the unrealized gains and losses for assets within the Level 3 category in the table below may include changes in fair value that were attributable to both observable and unobservable inputs.

		Alternative investments
Balance at June 30, 2012	$	36,989
Total realized and unrealized gains (losses):		
Included in revenues and gains in excess of expenses and losses		(69)
Included in changes in net assets		1,113
Purchases, issuances, and settlements		(1,513)
Transfers into and/or out of Level 3 (net)		—
Balance at June 30, 2013		36,520

(Dollars in thousands)

		Alternative investments
Total realized and unrealized gains (losses):		
Included in revenues and gains in excess of expenses and losses	$	(3,161)
Included in changes in net assets		1,898
Purchases, issuances, and settlements		5,810
Transfers into and/or out of Level 3 (net)		—
Balance at June 30, 2014	$	41,067

There were no transfers between any of the levels during the years ended June 30, 2014 and 2013.

(21) Subsequent Events

On July 1, 2014, Wellmont sold its 60% interest in Takoma Regional Hospital to Adventist Health System (which also owned the other 40%). Cash in the amount of $11,700 was received prior to July 1, 2014 and is included in current liabilities.

On September 24, 2014, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee issued, on behalf of Wellmont, $21,335 of Hospital Revenue Refunding Bonds, Series 2014E. Under the terms of the bond indenture, the proceeds were used to establish a fund to advance refund $19,580 of the Hospital Revenue Bonds, Series 2006C upon their call date in 2016. The Series 2014E Bonds were issued as tax-exempt and were issued in accordance with the Master Trust Indenture dated May 1, 1991. Upon the issuance of the Series 2014E Bonds, a new Master Trust Indenture was implemented and replaced the one dated May 1, 1991.

Wellmont has evaluated subsequent events from the balance sheet date through October 24, 2014, the date at which the consolidated financial statements were issued. No other material subsequent events were identified for recognition and disclosed.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Financial Statements

June 30, 2015 and 2014

(With Independent Auditors' Report Thereon)

WELLMONT HEALTH SYSTEM AND AFFILIATES

Table of Contents

KPMG LLP
Suite 1000
401 Commerce Street
Nashville, TN 37219-2422

Independent Auditors' Report

The Board of Directors
Wellmont Health System:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Wellmont Health System and affiliates, which comprise the consolidated balance sheets as of June 30, 2015 and 2014, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Wellmont Health System and affiliates as of June 30, 2015 and 2014, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Nashville, Tennessee
October 27, 2015

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Balance Sheets

June 30, 2015 and 2014

(Dollars in thousands)

Assets		**2015**	**2014**
Current assets:			
Cash and cash equivalents	$	48,866	30,674
Assets limited as to use, required for current liabilities		3,651	4,066
Patient accounts receivable, less allowance for uncollectible accounts of approximately $33,297 and $38,007 in 2015 and 2014, respectively		112,299	117,265
Other receivables		11,238	14,685
Inventories		19,981	18,684
Prepaid expenses and other current assets		9,979	10,337
Total current assets		206,014	195,711
Assets limited as to use, net of current portion		424,864	424,907
Land, buildings, and equipment, net		484,569	492,581
Other assets:			
Long-term investments		27,964	32,521
Investments in affiliates		7,214	18,221
Deferred debt expense, net		4,217	4,226
Goodwill		51,583	51,649
Other		525	520
		91,503	107,137
Total assets	$	1,206,950	1,220,336
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	$	18,626	18,015
Accounts payable and accrued expenses		101,871	90,547
Estimated third-party payor settlements		12,987	8,425
Current portion of other long-term liabilities		7,660	6,510
Other current liabilities		—	11,700
Total current liabilities		141,144	135,197
Long-term debt, less current portion		480,187	490,443
Other long-term liabilities, less current portion		39,097	43,866
Total liabilities		660,428	669,506
Net assets:			
Unrestricted		535,632	538,607
Temporarily restricted		6,960	8,214
Permanently restricted		1,323	1,319
Total net assets attributable to Wellmont		543,915	548,140
Noncontrolling interests		2,607	2,690
Total net assets		546,522	550,830
Commitments and contingencies			
Total liabilities and net assets	$	1,206,950	1,220,336

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Operations and Changes in Net Assets

Years ended June 30, 2015 and 2014

(Dollars in thousands)

		2015	2014
Revenue:			
Patient service revenue	$	838,277	788,910
Provision for bad debts		(47,307)	(45,644)
Net patient revenue less provision for bad debts		790,970	743,266
Other revenues		21,759	29,441
Total revenue		812,729	772,707
Expenses:			
Salaries and benefits		399,955	374,309
Medical supplies and drugs		168,678	166,676
Purchased services		75,749	73,674
Interest		17,757	18,350
Depreciation and amortization		58,569	50,058
Maintenance and utilities		39,764	36,978
Lease and rental		15,435	15,506
Other		30,128	32,312
Total expenses		806,035	767,863
Income from operations		6,694	4,844
Nonoperating gains (losses):			
Investment income		14,207	14,749
Derivative valuation adjustments		(563)	1,307
Loss on refinancing		(1,389)	(1,133)
Gain on revaluation of equity method investmen		—	14,744
Nonoperating gains, net		12,255	29,667
Revenue and gains in excess of expenses and losses before discontinued operations		18,949	34,511
Discontinued operations		(2,720)	(26,639)
Revenue and gains in excess of expenses and losses		16,229	7,872
Income attributable to noncontrolling interests		(866)	(1,540)
Revenues and gains in excess of expenses and losses attributable to Wellmont		15,363	6,332
Other changes in unrestricted net assets:			
Change in net unrealized (losses) gains on investments		(18,555)	28,333
Net assets released from restrictions for additions to land, buildings, and equipment		2,712	901
Change in the funded status of benefit plans		(2,495)	(893)
(Decrease) increase in unrestricted net assets		(2,975)	34,673
Changes in temporarily restricted net assets:			
Contributions		2,545	2,707
Net assets released from temporary restrictions		(3,799)	(1,420)
(Decrease) increase in temporarily restricted net assets		(1,254)	1,287
Changes in permanently restricted net assets – investment income		4	8
Changes in noncontrolling interests:			
Income attributable to noncontrolling interests		866	1,540
Distributions to noncontrolling interests		(949)	(1,623)
Change in noncontrolling interests		(83)	(83)
Change in net assets		(4,308)	35,885
Net assets, beginning of year		550,830	514,945
Net assets, end of year	$	546,522	550,830

See accompanying notes to consolidated financial statements.

WELLMONT HEALTH SYSTEM AND AFFILIATES

Consolidated Statements of Cash Flows

Years ended June 30, 2015 and 2014

(Dollars in thousands)

		2015	2014
Cash flows from operating activities:			
Change in net assets	$	(4,308)	35,885
Adjustments to reconcile change in net assets to net cash provided by operating activities:			
Depreciation and amortization		58,569	50,526
Gain on disposal of land, buildings, and equipment		(569)	(78)
Equity in earnings of affiliated organizations		(405)	(1,764)
Distributions from affiliated organizations		231	3,484
Amortization of deferred financing costs		534	426
Net realized and unrealized loss (gain) on investments		18,182	(31,302)
Provision for bad debts		47,307	40,237
Change in fair value of derivative instruments		1,637	(1,307)
Loss on refinancing		1,389	1,133
Gain on revaluation of equity method investment		—	(14,744)
Loss on impairment		66	22,456
Changes in assets and liabilities, net of acquisitions:			
Patient accounts receivable		(42,341)	(44,839)
Other current assets		(939)	(1,711)
Other assets		3,442	3,297
Accounts payable and accrued expenses		6,240	5,474
Estimated third-party payor settlements		4,562	1,268
Other current liabilities		(10,550)	11,358
Other liabilities		(6,925)	2,998
Net cash provided by operating activities		76,122	82,797
Cash flows from investing activities:			
Proceeds from sales and maturities of investments		100,324	123,193
Purchase of investments		(101,791)	(141,095)
Purchase of land, buildings, and equipment		(39,044)	(86,879)
Proceeds from the sale of buildings and equipment		2,424	2,434
Cash paid for acquisitions		—	(22,637)
Net cash used in investing activities		(38,087)	(124,984)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt		21,335	128,623
Payments on long-term debt		(40,746)	(111,092)
Payment of debt issuance costs		(432)	(628)
Net cash (used in) provided by financing activities		(19,843)	16,903
Net increase (decrease) increase in cash and cash equivalents		18,192	(25,284)
Cash and cash equivalents, beginning of year		30,674	55,958
Cash and cash equivalents, end of year	$	48,866	30,674

Supplemental disclosures of noncash items:

Wellmont entered into capital lease obligations for buildings and equipment in the amount of $8,284 and $1,345 in 2015 and 2014, respectively.

Additions to property and equipment financed through current liabilities of $5,084 and $3,770 in 2015 and 2014, respectively.

See accompanying notes to consolidated financial statements.

(1) Operations and Basis of Presentation

Wellmont Health System (Wellmont), a Tennessee not-for-profit corporation, currently operates six acute care hospitals in Tennessee and Virginia that include Bristol Regional Medical Center in Bristol, Tennessee, Holston Valley Medical Center in Kingsport, Tennessee, Lonesome Pine Hospital in Big Stone Gap, Virginia, Hawkins County Memorial Hospital in Rogersville, Tennessee, Hancock County Hospital in Sneedville, Tennessee, and Mountain View Regional Medical Center in Norton, Virginia.

The consolidated financial statements also include the operations of:

- Wellmont Cardiology Services and Wellmont Medical Associates, which operate physician practices.
- Wellmont Madison House and Wellmont Wexford House, which operate assisted living, adult day care, and skilled nursing facilities.
- Wellmont Foundation, which conducts fund-raising activities for the benefit of Wellmont.
- Wellmont Integrated Network, LLC, which is an accountable care organization.
- Wellmont Insurance Company SPC, Ltd, which is a captive insurance company.
- Wellmont, Inc., a wholly owned taxable subsidiary of Wellmont, formed as the holding company of various other taxable subsidiaries that provide medical collection services, provide other healthcare-related services, and invest in affiliates and other activities.

All significant intercompany accounts and transactions have been eliminated in the accompanying consolidated financial statements.

Wellmont's continuing operations consist primarily of the delivery of healthcare services in northeast Tennessee and southwest Virginia.

The following are included in discontinued operations:

- As of October 1, 2013, Wellmont closed Lee Regional Medical Center in Pennington Gap, Virginia. The losses of $2,717 and $26,091, for the years ended June 30, 2015 and 2014, respectively, including an impairment loss of $22,456, for the year ended June 30, 2014, are included in discontinued operations
- As of May 17, 2013, a subsidiary of Wellmont ceased operating its sleep labs, which were managed by a third party. The gains (losses) of $3 and ($292) for the years ended June 30, 2015 and 2014, respectively, are included in discontinued operations.
- As of September 23, 2010, Wellmont sold the majority of its retail pharmacy's assets to a national pharmacy company. The gains (losses) of ($6) and $45 for the years ended June 30, 2015 and 2014, respectively, are included in discontinued operations.
- As of April 30, 2009, Wellmont closed Jenkins Community Hospital in Jenkins, Kentucky. The gains (losses) of $0 and ($301) for the years ended June 30, 2015 and 2014, respectively, are included in discontinued operations.

(Continued)

(2) Significant Accounting Policies

A summary of significant accounting policies is as follows:

(a) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Significant estimates include allowances for contractual adjustments and bad debts; third-party payor settlements; valuation of investments, land, buildings, equipment, and goodwill; and self-insurance and other liabilities. Actual results could differ from these estimates.

(b) Cash and Cash Equivalents

Wellmont considers all highly liquid investments with a maturity of three months or less when purchased, excluding amounts whose use is limited by board of directors' designation or other arrangements under trust agreements, to be cash equivalents.

(c) Investments

Marketable equity securities and debt securities are recorded at fair value and classified as other than trading. Fair value is determined primarily using quoted prices (unadjusted) in active markets for identical assets or liabilities that Wellmont has the ability to access at the measurement date. However, Wellmont also uses observable and unobservable inputs for investments without quoted market prices to determine the fair value of certain investments at the measurement date. Investments in limited partnerships are recorded at net asset value as determined by the partnership. Wellmont has adopted the measurement provisions of Accounting Standards Update (ASU) No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, to certain investments in funds that do not have readily determinable fair values including private investments, hedge funds, real estate, and other funds. Investments in affiliates in which Wellmont has significant influence but does not control are reported on the equity method of accounting, which represents Wellmont's equity in the underlying net book value. Long-term investments include those investments that have not been designated by the board of directors for specific purposes and are also not intended to be used for the liquidation of current liabilities. Investment income is recognized when earned.

Realized gains and losses are determined on the specific-identification method and included in investment income with interest and dividends. Investment income is reported net of related investment fees. Unrealized gains and losses are included in other changes in unrestricted net assets except for losses determined to be other than temporary, which are considered realized losses and included in investment income.

(d) Assets Limited as to Use

Assets limited as to use primarily include designated assets set aside by the board of directors for future capital improvements, over which the board of directors retains control and may, at its discretion, subsequently use for other purposes, and assets held by trustees under bond indenture and self-insurance arrangements. Amounts required to meet current liabilities of Wellmont have been reclassified to current assets in the accompanying consolidated balance sheets.

(e) Inventories

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

(f) Land, Buildings, and Equipment

Land, buildings, and equipment are stated at cost, if purchased, or fair value at date of donation. Depreciation is computed using the straight-line method based on the estimated useful life of the asset, ranging from 3 to 40 years. Buildings and equipment held under capital leases are recorded at net present value of future lease payments and are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset. Costs of maintenance and repairs are expensed as incurred. Upon sale or retirement of land, buildings, or equipment, the cost and related accumulated depreciation are eliminated from the respective accounts and the resulting gain or loss, if any, is included in other revenues on the consolidated statements of operations and changes in net assets. Interest costs incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The amount capitalized is net of investment earnings on assets limited as to use derived from borrowings designated for capital assets. Renewals and betterments are capitalized and depreciated over their useful life, whereas costs of maintenance and repairs are expensed as incurred.

Wellmont evaluates long-lived assets for impairment on annual basis. Long-lived assets are considered to be impaired whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable from future cash flows. Recoverability of long-lived assets to be held and used is measured by a comparison of the carrying amount of an asset to future cash flows expected to be generated by the asset. When such assets are considered to be impaired, the impairment loss recognized is measured by the amount by which the carrying value of the asset exceeds the fair value of the asset.

(g) Goodwill

Wellmont follows ASU No. 2010-07, *Not for Profit Entities: Mergers and Acquisitions*, which in part requires healthcare entities to follow Accounting Standards Codification (ASC) Topic 350-20-35, *Intangibles – Goodwill and Other* along with ASU 2011-08, *Testing Goodwill for Impairment*. ASC Topic 350-20-35 requires goodwill of not-for-profit entities to be evaluated for impairment at least annually. An entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. The more-likely than-not threshold is defined as having a likelihood of more than 50%. However, if an entity concludes otherwise, then it is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing the fair value with the carrying amount (including goodwill) of the reporting unit. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss. Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. The annual impairment test is performed as of June 30.

(h) Deferred Debt Expense

Deferred debt expense is amortized over the life of the related bond issues using the effective-interest method.

(i) Derivative Financial Instruments

As further described in note 13, Wellmont is a party to interest rate swap and other derivative agreements. These financial instruments are not designated as hedges and are presented at estimated fair market value in the accompanying consolidated balance sheets. These fair values are based on the estimated amount Wellmont would receive, or be required to pay, to enter into equivalent agreements with a third party at the valuation date. Due to the nature of these financial instruments, such estimates are subject to significant change in the near term. Wellmont recognizes changes in the fair values of derivatives as nonoperating gains or losses in the consolidated statements of operations and changes in net assets. The cash settlements resulting from these interest rate swaps are reported as interest expense in the consolidated statements of operations and changes in net assets.

(j) Asset Retirement Obligations

Asset retirement obligations (AROs) are legal obligations associated with the retirement of long-lived assets. These liabilities are initially recorded at fair value, and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, Wellmont records period-to-period changes in the ARO liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. Wellmont derecognizes ARO liabilities when the related obligations are settled.

(k) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by Wellmont has been limited by donors to a specific-time period or purpose. Permanently restricted net assets have been restricted by donors to be

(Continued)

maintained by Wellmont in perpetuity. Generally, donors of permanently restricted assets permit use of all or part of the income earned on related investments for general or specific purposes.

Temporarily restricted net assets relate primarily to amounts held by the Foundation and include amounts restricted for future capital expenditures and for operations of such areas as children's healthcare services, hospice, and cancer care.

Net assets are released from restrictions by Wellmont incurring expenses that satisfy the restricted purposes. Such net assets released during 2015 and 2014 primarily included amounts related to the purchase of equipment for pediatrics, cancer, and other healthcare operations.

Wellmont has adopted guidance issued by Financial Accounting Standards Board (FASB), which provides guidance on the net asset classification of donor-restricted endowment funds for a tax-exempt organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). Effective July 1, 2007, the State of Tennessee adopted legislation that incorporates the provisions outlined in UPMIFA. Wellmont's endowments consist solely of donor-restricted endowment funds. Wellmont's endowments consist of five individual funds established for a variety of purposes.

Wellmont has interpreted UPMIFA 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. As a result of this interpretation, Wellmont classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are approved for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Wellmont considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the organization and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the organization; and (7) the investment policies of the organization.

(l) Net Patient Service Revenue and Accounts Receivable

Net patient service revenue is reported on the accrual basis in the period in which services are provided at the estimated net realizable amounts expected to be collected. Net patient service revenue includes amounts estimated by management to be reimbursable by patients and various third-party payors under provisions of reimbursement formulas in effect, including retroactive adjustments under reimbursement agreements. Estimated retroactive adjustments are accrued in the period related services are rendered and adjusted in future periods as final and other settlements are determined. On the basis of historical experience, a significant portion of Wellmont's uninsured patients will be unable or unwilling to pay for the services provided. Therefore, Wellmont records a significant provision for bad debts related to uninsured patients in the period the services are provided. This provision for bad debts is presented on the statements of operations as a component of net patient revenue. Wellmont provides care to patients who meet criteria under its charity care policy without charge or at amounts less than its established rates. Because Wellmont does not pursue collection of amounts determined to qualify as charity care, they are not included in net patient service revenue.

Patient accounts receivable are reported net of both an allowance for contractual adjustments and an allowance for uncollectible accounts. The contractual allowance represents the difference between established billing rates and estimated reimbursement from Medicare, TennCare, Medicaid, and other third-party payment programs. Wellmont's policy does not require collateral or other security for patient accounts receivable. Wellmont routinely obtains assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans, or policies.

(m) Revenue and Gains in Excess of Expenses and Losses

The consolidated statements of operations and changes in net assets include revenue and gains in excess of expenses and losses. Changes in unrestricted net assets that are excluded from revenue and gains in excess of expenses and losses, consistent with industry practice, include changes in net unrealized gains (losses) on investments other than trading securities, changes in the funded status of Wellmont's defined-benefit plan, contributions of long-lived assets, including assets acquired using contributions that, by donor restriction, were to be used for the purposes of acquiring such assets, and cumulative effects of changes in accounting principles.

For purposes of financial statement display, those activities directly associated with Wellmont's mission of providing healthcare services are considered to be operating activities. Nonoperating activities primarily include investment and related activities. Other operating revenues primarily include cafeteria, rental, meaningful use incentives, and income from affiliates.

(n) Contributed Resources

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted contributions, and are excluded from revenue and gains 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 contributions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expiration of donor restrictions is reported when the donated or acquired long-lived assets are placed in service.

Unconditional promises to give cash or other assets are reported at fair value at the date the promise is received. Gifts are reported as either a temporarily or permanently restricted contribution if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or a purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are recorded as unrestricted contributions. Unrestricted contributions are included in other revenues.

(o) Federal Income Taxes

The Wellmont entities are primarily classified as organizations exempt from federal income taxes under Section 501(a) as entities described in Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes has been included for these entities in the consolidated financial statements. The operations of Wellmont, Inc. are subject to state and federal income taxes, which are accounted for in accordance with ASC Topic 740, *Income Taxes*; however, such amounts are not material.

(p) Recently Adopted Accounting Standards

In May 2015, the FASB issued ASU No. 2015-07, *Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent)*. This ASU removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendments also remove the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using the practical expedient. Adoption of this standard should be applied on a retrospective basis. Wellmont early implemented the provisions of ASU 2015-07 during fiscal year 2015, retrospectively effective July 1, 2014.

(q) Reclassifications

Certain 2014 amounts have been reclassified to conform to the 2015 consolidated financial statement presentation. The reclassifications had no impact on total assets or changes in net assets.

(3) Business Combinations and Goodwill

On November 30, 2013, Wellmont purchased 100% of the membership interest in Wexford House from Residential Healthcare Affiliates. Wexford House is a skilled nursing facility, which serves residents of Sullivan County, Tennessee and the surrounding communities. The facility provides short- and long-term medical and rehabilitation care. In addition, on March 31, 2014, Wellmont purchased the remaining 25% interest in Holston Valley Imaging Center (HVIC), which included the remaining 50% governance interest from Blue Ridge Radiology Investment. The assets acquired and liabilities assumed under each acquisition were recorded at their estimated fair value in accordance with ASC 805.

(Dollars in thousands)

The following table summarizes the consideration paid and the estimated fair value of the assets acquired and liabilities assumed at the business combination date:

		Wexford	HVIC
Consideration:			
Cash	$	14,770	7,867
Fair value of Wellmont's equity interest in HVIC held before acquisition		—	23,601
	$	14,770	31,468
Recognized amounts of identifiable assets acquired and liabilities assumed:			
Current assets	$	2,976	2,474
Other assets		5,277	241
Current liabilities		(564)	(863)
Long-term liabilities		(608)	—
Total identifiable net assets		7,081	1,852
Goodwill		7,689	29,616
	$	14,770	31,468

Wellmont recognized a gain of $14,744 as a result of remeasuring to fair value its 75% equity interest in HVIC held before the business combination. The gain is included in nonoperating gains (losses) on the consolidated statement of operations for the year ended June 30, 2014.

A summary of goodwill for the years ended June 30 is as follows:

	2014	Additions	Decreases	2015
Goodwill	$ 51,649		(66)	51,583

	2013	Additions	Decreases	2014
Goodwill	$ 15,096	37,305	(752)	51,649

(Dollars in thousands)

(4) Net Patient Service Revenue

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the consolidated statements of operations and changes in net assets is as follows for the years ended June 30:

		2015	2014
Gross patient service revenue	$	2,973,219	2,683,891
Less:			
Contractual adjustments and other discounts		(2,069,377)	(1,838,900)
Charity care		(65,565)	(56,081)
Net patient service revenue before provision for bad debts		838,277	788,910
Less provision for bad debts		(47,307)	(45,644)
Net patient service revenue	$	790,970	743,266

Wellmont's allowance for doubtful accounts is predominantly for self-pay patients and patient balances remaining after third-party payments. The provision for bad debts increased $1,663 from fiscal 2014 to fiscal 2015 and the net write-offs increased $30,169 from fiscal 2014 to fiscal 2015. The increase in write-offs was due to the implementation of a new billing system in the last quarter of fiscal 2014, which then caused a catch up on write-offs in fiscal 2015. Wellmont has not changed its charity care or uninsured discount policies during fiscal 2015. Wellmont does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

(5) Third-Party Reimbursement Arrangements

Wellmont renders services to patients under contractual arrangements with the Medicare and Medicaid programs. The Medicaid programs in Tennessee and Virginia are contracted by each state to commercial managed care contractors to cover Medicaid eligible enrollees. Amounts earned under these contractual arrangements are subject to review and final determination by fiscal intermediaries and other appropriate governmental authorities or their agents. Management believes that adequate provision has been made for any adjustments that may result from such reviews. Participation in these programs subjects Wellmont to significant rules and regulations; failure to adhere to such could result in fines, penalties, or expulsion from the programs.

Wellmont contracts with various managed care organizations under the Medicaid programs. Reimbursement for both inpatient and outpatient services is based upon prospectively determined rates, including diagnostic-related group assignments, fee schedules, and per diem amounts. Reimbursement under the Medicaid program is also based upon prospectively determined amounts.

The Medicare program pays for the costs of inpatient services on a prospective basis. Payments are based upon diagnostic-related group assignments, which are determined by the patient's clinical diagnosis and medical procedures utilized. Wellmont receives additional payments from Medicare based on the provision of services to a disproportionate share of Medicaid-eligible and other low-income patients. Outpatient services are also reimbursed primarily on a prospectively determined basis.

(Dollars in thousands)

Net patient service revenue in 2015 and 2014 related to Medicare and TennCare/Medicaid and net patient accounts receivable at June 30, 2015 and 2014 from Medicare and TennCare/Medicaid were as follows:

		2015	2014
Net patient service revenue:			
Medicare	$	337,813	304,713
TennCare/Medicaid		49,883	37,216
Net patient accounts receivable:			
Medicare	$	33,101	44,480
TennCare/Medicaid		6,474	6,817

Wellmont has filed cost reports with Medicare and Medicaid. The cost reports are subject to final settlement after audits by the fiscal intermediary. The Medicare and Medicaid cost reports have been audited and final settled by the intermediary through June 30, 2011 and audit adjustments have been received and considered for certain hospitals and year-ends through June 30, 2013.

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

Net patient service revenue is reported at the net amounts billed to patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Estimated retroactive adjustments are accrued in the period the related services are rendered and adjusted in future periods as changes in estimated provisions and final settlements are determined. Net patient service revenue increased approximately $2,735 and $3,334 in 2015 and 2014, respectively, due to final settlements and revised estimates in excess of amounts previously recorded, removal of allowances previously estimated that are no longer necessary as a result of audits and final settlements, and years that are no longer subject to audits, reviews, and investigations.

Estimated settlements recorded at June 30, 2015 could differ materially from actual settlements based on the results of third-party audits.

(6) Meaningful Use Incentives

The American Recovery and Reinvestment Act of 2009 (ARRA) established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record (EHR) technology. The Medicare incentive payments are paid out to qualifying hospitals and physician groups over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals, and physician groups must meet EHR “meaningful use” criteria that become more stringent over three stages as determined by Centers for Medicare & Medicaid Services (CMS). Medicaid programs and payment schedules vary from state to state.

For fiscal years ended June 30, 2015 and 2014, Wellmont recorded $3,233 and $7,211, respectively, in other operating revenue related to the EHR and meaningful use incentives. These incentives have been recognized following the grant accounting model, recognizing income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria.

Amounts recognized represent management's best estimates for payments ultimately expected to be received based on estimated discharges, charity care, and other input data. Subsequent changes to these estimates will be recognized in other operating revenue in the period in which additional information is available. Such estimates are subject to audit by the federal government or its designee.

(7) Charity Care and Community Services

Wellmont accepts all patients within its primary service area regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies that consider, among other factors, generally recognized poverty income levels.

Wellmont maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone and estimated costs incurred for services and supplies furnished under its charity care policy. Costs incurred are estimated based on the ratio of total operating expenses to gross charges applied to charity care charges. Charges foregone for services and supplies furnished under its charity care policy, the estimated cost of those services, and the equivalent percentage of charity care patients to all patients serviced were $69,565 and $17,254, and 2.66%, respectively, for the year ended June 30, 2015 and $56,081, $14,567, and 2.39%, respectively, for the year ended June 30, 2014.

In addition to the charity care services described above, Wellmont provides a number of other services to benefit the indigent for which little or no payment is received. Medicare, Medicaid, and state indigent programs do not cover the full cost of those services. The shortfall between actual receipts from those programs and Wellmont's cost of providing care to those patients totaled $37,818 and $37,432 for the years ended June 30, 2015 and 2014, respectively.

Wellmont also provides services to the community at large for which it receives little or no payment. Health evaluations, screening programs, and specific services for the elderly and homebound are other services supplied. Wellmont also provides public health education, trains new health professionals, and conducts health research.

(8) Investment in Affiliates

Wellmont has investments with other healthcare providers, which include home care, regional laboratories, and other healthcare-related organizations. Wellmont records its share of equity in the operations of the respective organizations. Equity in earnings of affiliates was approximately $405 and $1,764 for the years ended June 30, 2015 and 2014, respectively, and is included in other operating revenue in the consolidated financial statements. Wellmont received distributions of $231 and $3,484 during 2015 and 2014, respectively, which reduced Wellmont's overall investment in the affiliates.

(Dollars in thousands)

The following table summarizes the unaudited aggregate financial information of Wellmont's investments in affiliates:

		2015	2014
Total assets	$	116,359	136,824
Total liabilities		28,284	38,396
Total net assets	$	88,075	98,428
Net revenues	$	150,253	201,639
Expenses		141,825	191,023
Revenues in excess of expenses	$	8,428	10,616

Wellmont's investment in these affiliates and its ownership percentage as of June 30, 2015 and 2014 is as follows:

		Amount		Percentages	
		2015	2014	2015	2014
Takoma Regional Hospital	$	—	10,763	0%	60%
Advanced Home Care (AHO)		6,092	6,092	6	6
Others		1,122	1,366	4%-50%	25%–50%
	$	7,214	18,221		

As of July 1, 2014, Wellmont sold the 60% ownership in Takoma Regional Hospital. Prior to this transaction and although Wellmont's ownership percentage in Takoma Regional Hospital was greater than 50%, Wellmont did not consolidate this entity because Wellmont only had a 50% representation on the board and did not have control over the entity. Wellmont provides billing, management, and professional services to some of the affiliates. Income recognized by Wellmont for the services was $173 in 2014 and is included in other revenues. Included in other receivables are $86 and $242 as of June 30, 2015 and 2014, respectively, of amounts due to Wellmont from these entities.

(Dollars in thousands)

(9) Investments

Long-term investments, including assets limited as to use, at June 30 are reported at fair value and consist of the following:

		2015	2014
Assets limited as to use by Board for capital improvements:			
Stock mutual funds	$	155,165	148,453
Bond mutual funds		157,091	167,156
Cash and money market funds		9,530	5,904
Real estate funds		17,967	21,381
Alternative investments (private equity, hedge funds, commingled funds, and real estate funds):			
Liquid		14,911	14,215
Illiquid		28,012	26,852
		382,676	383,961
Assets limited as to use under self-insurance agreements:			
Cash and money market funds		16,992	16,051
Assets limited as to use under bond indenture agreements:			
Cash and money market funds		28,847	28,961
Less assets limited as to use that are required for current liabilities		3,651	4,066
Assets limited as to use, net of current portion	$	424,864	424,907
Long-term investments:			
Stock mutual funds	$	15,627	17,741
Bond mutual funds		9,535	11,420
Right of first refusal		1,512	1,512
Cash, money market funds, and certificates of deposit		242	230
Real estate funds		1,048	1,618
Total long-term investments	$	27,964	32,521

Investments in certain alternative limited partnership investments contain agreements whereby Wellmont is committed to contribute approximately $15,917 as of June 30, 2015 of additional funds to the limited partnerships in the form of capital calls at the discretion of the general partner, of which $1,053 was paid subsequent to June 30, 2015.

Wellmont's investments are concentrated in stock and bond mutual funds. In the event of a downward trend in the stock and bond markets, Wellmont's overall market value of net assets could be adversely affected by a material amount. Investments in alternative investments are generally illiquid investments whose value is determined by the general partner such as hedge funds, private equity, commingled funds, and real estate funds. Distributions are only at the discretion of a voting majority of the general partners.

(Dollars in thousands)

Wellmont evaluates whether unrealized losses on investment securities indicate other-than-temporary impairment. Based on this evaluation, Wellmont recognized other-than-temporary impairment losses of $845 and $0 on investments as of June 30, 2015 and 2014, respectively. Other-than-temporary impairment losses are considered as realized losses and are reported within "investment income" in the consolidated statements of operations and changes in net assets.

Gross unrealized losses on investments for which other-than-temporary impairments have not been recognized and the fair values of those investments, aggregated by the length of time that individual investments have been in a continuous unrealized loss position, at June 30, 2015 and 2014 were as follows:

		Less than 12 months		12 months or more		Total	
		Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
2015:							
Alternative investments	$	396	2,975	12	459	408	3,434
Mutual funds		3,282	128,081	8,508	72,699	11,790	200,780
	$	3,678	131,056	8,520	73,158	12,198	204,214

		Less than 12 months		12 months or more		Total	
		Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
2014:							
Alternative investments	$	—	—	647	878	647	878
Mutual funds		16	1,655	3,632	119,716	3,648	121,371
	$	16	1,655	4,279	120,594	4,295	122,249

Investment income is comprised of the following for the years ended June 30:

		2015	2014
Interest and dividends, net of amounts capitalized	$	13,677	11,780
Realized gains on investments, net		530	2,969
Investment income, net	$	14,207	14,749
Change in net unrealized gains on investment	$	(18,555)	28,333

(Dollars in thousands)

(10) Land, Buildings, and Equipment

Land, buildings, and equipment at June 30 consist of the following:

		2015	2014
Land	$	49,536	49,825
Buildings and improvements		530,904	523,069
Equipment		517,990	490,805
Buildings and equipment under capital lease obligations		54,316	46,031
		1,152,746	1,109,730
Less accumulated depreciation		(674,587)	(623,930)
		478,159	485,800
Construction in progress		6,410	6,781
Land, buildings, and equipment	$	484,569	492,581

Depreciation expense for the years ended June 30, 2015 and 2014 was $58,569 and $50,058, respectively. Included in depreciation expense is amortization related to capitalized software and equipment under capital leases. Accumulated amortization for equipment under capitalized software and lease obligations was $26,168 and $21,789 as of June 30, 2015 and 2014, respectively.

(11) Other Long-Term Liabilities

Other long-term liabilities at June 30 consist of the following:

		2015	2014
Workers' compensation liability	$	12,195	11,096
Professional and general liability		15,465	15,940
Postretirement benefit obligation		2,487	2,633
Asset retirement obligation		3,353	3,139
Deferred gain on sale of assets		1,327	409
Derivative liability		(90)	6,118
Pension benefit liability		12,020	11,041
		46,757	50,376
Less current portion		(7,660)	(6,510)
Total other long-term liabilities	$	39,097	43,866

(Dollars in thousands)

(12) Debt

(a) Long-Term Debt

Long-term debt consists of the following at June 30:

		2015	2014
Hospital Refunding Bonds, Series 2014A	$	12,137	14,242
Hospital Refunding Bonds, Series 2014B		49,615	52,275
Hospital Refunding Bonds, Series 2014C		18,836	20,836
Hospital Revenue Bonds, Series 2014D		13,575	13,575
Hospital Revenue Bonds, Series 2014E		21,335	—
Hospital Revenue Refunding Bonds, Series 2011		74,410	75,300
Hospital Revenue Bonds, Series 2007A		55,000	55,000
Hospital Revenue Refunding Bonds, Series 2006C		180,420	200,000
Project Odyssey 2012 Tax-Exempt Master Lease/Sublease Financing		34,341	40,589
Notes payable		9,771	10,232
Capital lease obligations		23,864	19,749
Other		308	674
		493,612	502,472
Unamortized premium		5,201	5,986
		498,813	508,458
Less current maturities		(18,626)	(18,015)
	$	480,187	490,443

(b) Series 2014 Bonds

On June 25, 2014, Wellmont (a) refunded the Revenue Bonds, Series 2003, the Revenue Refunding Bonds, Series 2005, and the Revenue Bonds, Series 2010 (Bank Qualified), with the proceeds of the Hospital Revenue Refunding Bonds, Series 2014A, Series 2014B, and Series 2014C and (b) issued Series 2014D. The Series 2014A through Series 2014E Bonds were issued by Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee on behalf of Wellmont. Under the terms of the bond indenture, the proceeds were used to advance refund the Revenue Bonds, Series 2003, the Revenue Refunding Bonds, Series 2005, a portion of the Revenue Refunding Bonds, Series 2006C, and the Revenue Bonds, Series 2010 (Bank Qualified) and to issue new debt in the amount of $13,575 to reimburse Wellmont for the purchase price of Wellmont Wexford House and to pay closing costs of issuing the Series 2014D Bonds. On September 1, 2014, the 2014E Bonds were issued by The Health, Educational, and Housing Facilities board of the County of Sullivan, Tennessee on behalf of Wellmont. All of the Series 2014 Bonds were issued as tax-exempt and were issued in accordance with the Amended and Restated Master Trust Indenture dated September 1, 2014.

The Series 2014 Bonds were issued with four maturities; Series 2014A for $14,242, maturing September, 1, 2019, Series 2014B for $52,275, maturing September 1, 2032, Series 2014C for $20,836, maturing September 1, 2024, Series 2014D for $13,575, maturing September 1, 2040, and Series 2014E for $21,335, maturing September 1, 2022. Principal and interest will be paid annually, except there will be interest only paid on the Series 2014D through September 2030 with principal payments beginning on September 1, 2031 and on the Series 2014E through September 2016 with principal payments beginning September 1, 2017.

Interest on the Series 2014 Bonds is 100% of LIBOR plus a quotient of applicable spread divided by 67%. Accrued interest is paid monthly in arrears. Interest rates on the 2014A, 2014B, 2014C, 2014D and 2014E Bonds were .89%, .99%, .97%, .97% and .97%, respectively, as of June 30, 2015.

The Series 2014C and Series 2014D Bonds can be called by the bondholders June 1, 2021 and each successive year after that until they mature. The Series 2014E Bonds can be called by the bondholders September 1, 2021 and on June 1 each successive year after that until they mature.

(c) Project Odyssey 2012 Tax-Exempt Master Lease/Sublease Financing

On December 1, 2012, The Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee (as Lessee) and Wellmont (as Sub-Lessee) entered into a Master Equipment Lease and Sublease Agreement with Banc of America Public Capital Corp (the Lessor). The proceeds of this Master Lease were used to finance an electronic medical records system consisting of an EpicCare Inpatient Clinical System and an EpicCare Ambulatory Electronic Medical Records System inclusive of hardware, software, and implementation services. The Sub-Lessee authorized the Lessor to take a security interest in the entire System although only certain components of the System were funded under this Master Lease with the rest funded by Bank of America N.A. and Sub-Lessee. During the fiscal year ended June 30, 2014, Wellmont received two draws totaling $26,349. Each lease term shall commence and interest shall begin to accrue on the date any funds are advanced by Wellmont. The first six lease payments under each agreement consist only of an interest component and the remaining 78 lease payments consist of a principal component and an interest component. Commencing on June 30, 2013, and continuing on the first day of each fiscal quarter thereafter, Wellmont shall pay accrued interest on the outstanding balance of the loan. Each agreement will have an interest component based on a fixed rate of interest and payable with respect to the amount of funds that the Lessor has advanced. The rates of interest range from 1.45% to 1.97%.

(d) Series 2011 Bonds

On May 5, 2011, Wellmont refunded the Revenue Bonds, Series 2006A, with the proceeds of the Revenue Bonds, Series 2011. The Series 2011 Bonds were issued by Health, Educational, and Housing Facilities Board of the County of Sullivan, Tennessee on behalf of Wellmont. Under the terms of the bond indenture, the proceeds were used to advance refund the Revenue Bonds, Series 2006A and to pay the costs of issuing the Series 2011 Bonds.

In order to refund the Series 2006A Bonds, Wellmont made a tender offer to the holders of the Series 2006A Bonds. The holders of all outstanding Series 2006A Bonds agreed to tender their Series 2006A Bonds to Wellmont. Proceeds of the Series 2011 Bonds were used to pay the purchase price of Series 2006A Bonds tendered for purchase. All outstanding Series 2006A Bonds were purchased by the Wellmont on the date of issuance of the Bonds and were immediately surrendered to the trustee for the Series 2006A Bonds for retirement and cancellation.

The Series 2011 Bonds were issued with two maturities of $42,385 and $33,780 for 2026 and 2032, respectively. The Series 2011 Bonds maturing September 1, 2026 are subject to mandatory redemption prior to maturity pursuant to the operation of a sinking fund, in part by lot starting on the redemption dates beginning on September 1, 2013 and ending on September 1, 2026 in annual amounts ranging from $865 to $4,680. The Series 2011 Bonds maturing September 1, 2032 are subject to mandatory redemption prior to maturity pursuant to the operation of a sinking fund, in part by lot starting on the redemption dates beginning on September 1, 2027 and ending on September 1, 2032 in annual amounts ranging from $4,980 to $6,300. The Series 2011 Bonds were issued as fixed-rate obligations at 6.0% and 6.5% for the two maturities (2026 and 2032, respectively).

(e) Series 2007 Bonds

On July 24, 2007, The Virginia Small Business Financing Authority issued, on behalf of Wellmont, $55,000 of Hospital Revenue Bonds, Series 2007A. The Series 2007A Bonds, with other methods of financing, were used to purchase the assets of Mountain View Regional Medical Center and Lee Regional Medical Center.

Principal on outstanding Series 2007A Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $360 to $2,460 commencing on September 1, 2017 through September 1, 2036, with a balloon payment of $29,245 due on September 1, 2037. The outstanding bonds accrue interest at rates ranging from 5.125% to 5.250%.

(f) Series 2006 C

On October 26, 2006, The Health, Educational, and Housing Facilities Board of the County of Sullivan Tennessee issued, on behalf of Wellmont, $200,000 of Hospital Revenue Bonds, Series 2006C. The Series 2006C Bonds were used to finance the costs of acquisition of land for expansion, construction, expansion, equipping, and renovation of HVMC, including the construction of a new patient tower (collectively known as Project Platinum); finance the costs of the construction, expansion, equipping, and renovation of the emergency department at BRMC (the Bristol Emergency Department Project); and finance the costs of construction, expansion, renovation, and equipping of an operating room and related facilities at Hawkins County Memorial Hospital.

Principal on outstanding Series 2006C Bonds is payable through maturity or mandatory sinking fund redemption in annual amounts ranging from $1,605 to $25,330 commencing on September 1, 2017 through September 1, 2036. The outstanding bonds accrue interest at rates ranging from 5.00% to 5.25%.

(g) Master Trust Indenture

The master trust indenture and loan agreements for the 2014, 2011, 2007, and 2006 bonds contain certain requirements regarding deposits to trustee funds, maintenance of rates, maintenance of debt service coverage and liquidity, permitted indebtedness, and permitted disposition of assets. Gross receipts of Wellmont collateralize the bonds. The purpose of the master trust indenture is to provide a mechanism for the efficient and economical issuance of notes by individual members of Wellmont using the collective borrowing capacity and credit rating of Wellmont. The master trust indenture requires individual members of Wellmont to make principal and interest payments on notes issued for their benefit. The master trust indenture also requires Wellmont members to make payments on notes issued by other members of Wellmont if such other members are unable to satisfy their obligations under the master trust indenture. Payments of principal and interest on certain bonds are also insured by bond insurance policies.

Funds held by the trustee related to the various revenue bonds are available for specific purposes. The bond interest and revenue funds may be used only to pay interest and principal on the bonds; the debt service reserve fund may be used to pay interest and principal if sufficient funds are not available in the bond interest and revenue funds. The original issue premium on all bond series outstanding are being amortized over the life of the bond issue using the effective-interest method.

(h) Notes Payable

In August 2011, Wellmont entered into a note agreement in the amount of $1,760 with a variable interest rate indexed to *The Wall Street Journal* U.S. Prime Rate with a ceiling of 7.75% and a floor of 4.00% and a maturity date of August 2016. At June 30, 2015 and 2014, $446 and $828, respectively, were outstanding on this note.

On October 17, 2012, Wellmont entered into a 10-year $12,500 term note payable with Bank of America, N.A. The proceeds were used for the EpicCare system and its implementation, among other general corporate purposes. The note payable has a fixed interest rate of 3.27% and a maturity date of December 13, 2022. At June 30, 2015 and 2014, $9,254 and $9,254, respectively, were outstanding on this note.

On January 4, 2013, Wellmont entered into a three-year $193 term note payable with a variable interest rate indexed to *The Wall Street Journal* U.S. Prime Rate and a maturity date of December 2015. At June 30, 2015 and 2014, $45 and $107, respectively, were outstanding on this note.

On March 25, 2013, Wellmont entered into a three-year $47 term note payable with a variable interest rate indexed to *The Wall Street Journal* U.S. Prime Rate and a maturity date of August 2016. At June 30, 2015 and 2014, $26 and $43, respectively, were outstanding on this note.

(Dollars in thousands)

(i) Capital Lease Obligations

Assets under capital leases are included in property and equipment and have a net carrying value of $28,148 and $24,242 as of June 30, 2015 and 2014, respectively. Amortization of capital assets is included in depreciation expense. The lease obligations are recorded at the net present value of the minimum lease payments with interest rates from 2.1% to 12.0%.

(j) Long-Term Debt Maturities Schedule

Bond maturities in accordance with the terms of the Master Trust Indenture and other long-term debt maturities for each of the next five years and in the aggregate at June 30, 2015 are as follows:

2016	$	18,626
2017		17,722
2018		20,059
2019		20,027
2020		20,505
Thereafter		396,673
	$	493,612

Interest paid for the years ended June 30, 2015 and 2014 was $19,881 and $18,899, respectively, net of amounts capitalized. Interest costs of $210 and $1,444 were capitalized in 2015 and 2014, respectively.

(13) Derivative Transactions

Wellmont is and has been a party to a number of interest rate swap agreements. Such swaps have not been designated as hedges and are valued at estimated fair value in the accompanying consolidated balance sheets. By using derivative financial instruments to hedge exposures to changes in interest rates, Wellmont exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes Wellmont, which creates credit risk for Wellmont. When the fair value of a derivative contract is negative, Wellmont owes the counterparty, and therefore, Wellmont is not exposed to the counterparty's credit risk in those circumstances. Pursuant to the terms of its interest rate swap agreements, Wellmont is required to postcollateral with its counterparties under certain specified conditions. Collateral posting requirements are based on the amount of Wellmont's derivative liability and Wellmont's bond rating. As of June 30, 2015 and 2014, Wellmont was not required to postcollateral related to its swaps.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates. The market risk associated with interest-rate contracts is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

Management's primary objective in holding such derivatives is to introduce a fixed or variable rate component into its variable rate debt structure using LIBOR rates. The fair value as of June 30, 2015 and 2014 of approximately $90 and $(6,118), respectively, is included in other long-term liabilities in the consolidated balance sheets. The change in the fair value of the derivative instruments was approximately $1,637 and $1,307, respectively, in 2015 and 2014 and is included in nonoperating gains in the consolidated statements of operations. The terms of the swap agreements allow netting of all amounts due from/to the counterparty. Effective May 28, 2015, Wellmont terminated and settled three of the interest rate swaps resulting in a loss of $2,200 included in Nonoperating gains (losses) in the consolidated statements of operations and changes in net assets. The following is a summary of the interest rate swap information as of June 30, 2015:

(Dollars in thousands)

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2011	$ 75,300	May 5, 2011	September 1, 2032	1.220%	6.249%	$ 90
							$ 90

The following is a schedule detailing the swap information as of June 30, 2014:

Type of interest swap	Debt hedging	Notional amount	Effective date	Maturity date	Rate paid	Rate received	Swap fair value asset (liability)
Total return swap	Series 2011	$ 75,300	May 5, 2011	September 1, 2032	1.410%	6.222%	$ 987
Pay fixed interest rate swap	*	52,275	December 13, 2005	September 1, 2016	3.548	0.101	(3,323)
Basis swap	*	56,465	September 1, 2002	September 1, 2032	0.060	0.173	(1,127)
Pay fixed interest rate swap	*	27,575	October 24, 2003	September 1, 2021	3.613	0.104	(2,655)
							$ (6,118)

* Previously designated bond series has been refinanced.

(14) Pension and Other Postretirement Benefits

Wellmont sponsors a retirement program and defined-contribution retirement plan (Retirement Plan) that covers substantially all employees. Wellmont makes annual contributions to the Retirement Plan in an amount equal to 2% (after October 1, 2013) and 3% (before October 1, 2013) of each participant's base wages and contributes an additional amount, based on each participant's voluntary contributions, which cannot exceed certain limits established in the Internal Revenue Code, up to 2.4% (after October 1, 2013) and 3% (before October 1, 2013) of each participant's wages. The total pension expense related to the Retirement Plan was $8,841 and $10,687 for the years ended June 30, 2015 and 2014, respectively.

A predecessor to Wellmont sponsored a noncontributory, defined-benefit pension plan covering, substantially all its employees. However, effective June 30, 1996, this plan was frozen and no further benefits accrue. One of Wellmont's acquired hospitals also sponsored a defined-benefit pension plan covering substantially all its employees, but the two plans were merged on June 30, 2007 and effective June 30, 2010, the plan was frozen for all employees and no further benefits accrue.

(Dollars in thousands)

The defined-pension benefits are actuarially determined based on a formula taking into consideration an employee's compensation and years of service. The funding policy is to make annual contributions to the plan based upon the funding standard developed by the plan actuary. This standard uses the projected unit credit actuarial cost method, including the amortization of prior service costs, over a 20-year period. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. Wellmont recognizes the funded status (i.e., difference between the fair value of plan assets and projected benefit obligations) of its defined-benefit pension plans as an asset or liability in its consolidated balance sheet and recognizes changes in that funded status in the year in which the changes occur as a change in unrestricted net assets. The defined-benefit pension plans use a June 30 measurement date.

The following table sets forth the funded status of the Plans, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

		2015	2014
Change in benefit obligation:			
Benefit obligation at beginning of year	$	56,291	50,749
Service cost		—	—
Interest cost		2,176	2,196
Actuarial loss(gain)		(886)	5,815
Benefits paid		(2,501)	(2,469)
Benefit obligation at end of year		55,080	56,291
Change in plan assets:			
Fair value of plan assets at beginning of year		45,250	40,357
Actual return on plan assets		(1,591)	4,960
Employer contribution		1,902	2,402
Benefits paid		(2,501)	(2,469)
Fair value of plan assets at end of year		43,060	45,250
Funded status	$	(12,020)	(11,041)
Amounts recognized in the accompanying consolidated balance sheets:			
Pension benefit liability (other long-term liabilities)	$	(12,020)	(11,041)

(Dollars in thousands)

		2015	2014
Amounts not yet reflected in net periodic benefit cost and included as an accumulated charge to unrestricted net assets:			
Unrecognized actuarial loss	$	18,901	16,777
Unrecognized prior service cost		—	—
Net amounts included as an accumulated charge to unrestricted net assets	$	18,901	16,777
Calculation of change in unrestricted net assets:			
Accumulated charge to unrestricted net assets, end of year	$	18,901	16,777
Reversal of accumulated charge to unrestricted net assets, prior year		(16,777)	(14,552)
Change in unrestricted net assets	$	2,124	2,225
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Actuarial loss (gain) arising during the year	$	3,869	3,665
Amortization of actuarial loss		(1,745)	(1,440)
Amortization of prior service cost		—	—
Net amounts recognized in unrestricted net assets	$	2,124	2,225

(Continued)

(Dollars in thousands)

		2015	2014
Estimate of amounts that will be amortized from unrestricted net assets to net pension cost in 2014:			
Amortization of net loss	$	2,200	1,810
Amortization of prior service cost		—	—
Estimated future benefit payments:			
Fiscal 2015		—	2,804
Fiscal 2016		2,882	2,894
Fiscal 2017		2,987	3,004
Fiscal 2018		3,079	3,093
Fiscal 2019		3,162	3,178
Fiscal 2020–2023		20,295	16,759
Weighted average assumptions used to determine benefit obligations:			
Settlement (discount) rate		4.25%	4.00%
Weighted average rate of increase in future compensation levels		N/A	N/A
Components of net periodic benefit cost (benefit):			
Service cost	$	—	—
Interest cost		2,176	2,196
Expected return on plan assets		(3,164)	(2,810)
Amortization of net loss		1,745	1,440
Net periodic benefit cost	$	757	826
Weighted average assumptions used to determine net periodic benefit cost:			
Settlement (discount) rate		4.00%	4.50%
Expected long-term return on plan assets (HVMC)		7.00	7.00
Expected long-term return on plan assets (LPH)		7.00	7.00
Weighted average rate of increase in future compensation levels		N/A	N/A

Wellmont's overall expected long-term rate of return on assets is 7%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

Wellmont has developed a plan investment policy, which is reviewed and approved by the board of directors. The policy established goals and objectives of the fund, asset allocations, asset classifications, and manager guidelines. The policy dictates a target asset allocation and an allowable range for such categories based on quarterly investment fluctuations. Investments are managed by independent advisers who are monitored by management and the board of directors.

(Dollars in thousands)

The table below shows the target allocation and actual asset allocations as of June 30, 2015 and 2014:

Asset	Target allocation	2015	2014
Equity securities	47%	47%	48%
Fixed income	41	33	33
Cash	—	3	3
Other	12	17	16

Wellmont monitors the asset allocation and executes required recalibrations of the portfolio allocation on a regular basis in response to fluctuations in market conditions and the overall portfolio composition.

A predecessor to Wellmont also participates in a health and welfare plan for its retirees. The plan provides postretirement medical and life insurance benefits to certain employees who meet minimum age and service requirements. Effective January 1, 1995, the death benefit was changed to provide a flat $5 benefit to all future retirees. During 1995, the medical program for retirees was amended to terminate medical benefits for any active employees who would not meet the full eligibility requirements of the program by January 1, 1996. The plan is contributory and contains other cost-sharing features such as deductibles and coinsurance.

The following table sets forth the postretirement plan's funded status, amounts recognized in the accompanying consolidated financial statements, and assumptions at June 30:

		Postretirement benefits	
		2015	2014
Change in benefit obligation:			
Benefit obligation at beginning of year	$	2,633	4,582
Interest cost		86	96
Plan participants contributions		16	17
Actuarial losses		(172)	(1,978)
Benefits paid		(76)	(84)
Benefit obligation at end of year		2,487	2,633
Change in plan assets:			
Fair value of plan assets at beginning of year		—	—
Employer contribution		60	66
Plan participants contributions		16	17
Benefits paid		(76)	(83)
Fair value of plan assets at end of year		—	—
Funded status	$	(2,487)	(2,633)

(Dollars in thousands)

		Postretirement benefits	
		2015	**2014**
Amounts recognized in the consolidated balance sheets consist of:			
Noncurrent assets	$	—	—
Current liabilities		(179)	—
Noncurrent liabilities		(2,308)	(2,633)
Accumulated charge to unrestricted net assets		5,568	5,939
	$	3,081	3,306

Amounts recognized as an accumulated credit to unrestricted net assets consist of the following:

		2015	**2014**
Net actuarial gain	$	5,568	5,939

Net periodic benefic cost recognized and other changes in plan assets and benefit obligations recognized in unrestricted net assets in 2015 and 2014 were as follows:

		Postretirement benefits	
		2015	**2014**
Net periodic benefit cost:			
Interest cost	$	86	95
Amortization of net gain		(544)	(646)
Net periodic benefit recognized		(458)	(551)
Other changes in plan assets and benefit obligations recognized in unrestricted net assets:			
Net actuarial loss		(173)	(1,978)
Amortization of net gain		544	646
Total recognized in unrestricted net assets		371	(1,332)
Total recognized in net periodic benefit cost and unrestricted net assets	$	(87)	(1,883)

The net gain and prior service credit for the defined-benefit postretirement plan that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year are $(544) and $(646), respectively. Weighted average assumptions used to determine benefit obligations for 2015 and 2014 were as follows:

(Dollars in thousands)

	2015	2014
Discount rate	3.75%	3.50%
Rate of compensation increase	—	—
Healthcare cost trend rate	5.00	5.00

Weighted average assumptions used to determine net benefit cost for 2015 and 2014 were as follows:

	Postretirement benefits	
	2015	2014
Discount rate	3.50%	4.00%
Expected long-term rate of return on plan assets	N/A	N/A
Rate of compensation increase	N/A	N/A
Healthcare cost trend rate	5.00	5.00

Wellmont's overall expected long-term rate of return on assets is 7%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

For measurement purposes, a 7.25% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for 2015.

The following table summarizes the effect of one-percentage-point increase/decrease in healthcare costs trends:

		2015	2014
Effect of one-percentage-point increase in healthcare cost trend on:			
Service and interest cost	$	5	4
Accumulated pension benefit obligation		143	132
Effect of one-percentage-point decrease in healthcare cost trend on:			
Service and interest cost	$	(5)	(3)
Accumulated pension benefit obligation		(124)	(116)

(Dollars in thousands)

The asset allocations of Wellmont's pension and postretirement benefits as of June 30, 2015 and 2014, respectively, were as follows:

		Fair value measurement at June 30, 2015 pension benefits – plan assets		
	Total	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets:				
Stock mutual funds	$ 34,625	34,625	—	—
Cash and money market funds	1,121	1,121	—	—
Fixed income fund	3,721	—	3,721	—
	39,467	35,746	3,721	—
Alternative funds - recorded at net asset value	3,593			
Total	$ 43,060			

		Fair value measurement at June 30, 2014 pension benefits – plan assets		
	Total	**Quoted prices in active markets for identical assets (Level 1)**	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**
Assets:				
Stock mutual funds	$ 36,546	36,546	—	—
Cash and money market funds	1,279	1,279	—	—
Fixed income fund	3,935	—	3,935	—
	41,760	37,825	3,935	—
Alternative funds - recorded at net asset value	3,490			
Total	$ 45,250			

(15) Self-Insurance Programs

Wellmont is self-insured for professional and general liability and workers' compensation liability. Consulting actuaries have been retained to determine funding requirements and estimate claim liability exposures. Wellmont Insurance Company SPC, Ltd (the captive) was formed in 2014 as a wholly owned captive insurance company in the Cayman Islands. The captive holds Wellmont's self-insurance liabilities for professional and general liability and is funded by transfers from Wellmont Health System. These funds are included in assets limited as to use.

The professional and general liability self-insurance program is supplemented by umbrella excess liability policies consisting of various layers of coverage with commercial carriers based on policy year. The workers' compensation program is supplemented for Tennessee and Virginia by excess workers' compensation policies, with a commercial carrier for statutory limits per occurrence. Provisions based on actuarial estimates are made for the ultimate cost of claims asserted, as well as estimates of claims incurred but not reported as of the respective consolidated balance sheet dates. Workers' compensation expense under these programs amounted to approximately $4,612 and $3,695 for the years ended June 30, 2015 and 2014, respectively, and are included in salaries and benefits expense in the accompanying consolidated statements of operations and changes in net assets. All other self-insurance expense under these programs amounted to approximately $1,568 and $5,707 for the years ended June 30, 2015 and 2014, respectively, and are included in other expense in the accompanying consolidated statements of operations and changes in net assets.

At June 30, 2015 and 2014, Wellmont was involved in litigation relating to medical malpractice, workers' compensation and other claims arising in the ordinary course of business. There are also known incidents that occurred through June 30, 2015 that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past. Claims have been filed requesting damages in excess of the amount accrued for estimated malpractice costs. Management of Wellmont is of the opinion that estimated professional and general liability amounts accrued at June 30, 2015 are adequate to provide for potential losses resulting from pending or potential litigation. Amounts of claim settlements may be more or less than what has been provided for by management. The ultimate settlement of claims could be different from recorded accruals, with such differences being potentially significant.

Wellmont is also self-insured for medical and other healthcare benefits provided to its employees and their families. A provision for estimated incurred but not reported claims has been provided in the consolidated financial statements.

(16) Commitments and Contingencies

Construction in progress at June 30, 2015 and 2014 relates primarily to the completion of certain buildings and renovations. Total costs to complete these and other projects were approximately $5,191 at June 30, 2015. Wellmont has entered into contracts of $5,191 related to these projects.

Wellmont leases certain equipment and office space under operating lease agreements. Total rental expense under cancelable and noncancelable agreements was $15,453 and $15,506 for the years ended June 30, 2015 and 2014, respectively. Minimum future lease payments under noncancelable operating leases with initial or remaining lease terms in excess of one year as of June 30, 2015 are as follows:

(Dollars in thousands)

2016	$	10,018
2017		8,046
2018		6,692
2019		5,908
2020		5,062
Thereafter		13,822
	$	49,548

Wellmont has entered into contractual employment relationships with physicians to provide services to Wellmont physician practices that are intended to qualify under the employee safe harbor of the Anti-Kickback Statute and the employee exception of the Physician Self-Referral Law. These contracts have terms of varying lengths, guarantee certain base payments, and may provide for additional incentives based upon productivity.

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, such matters as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes Wellmont is in compliance with fraud and abuse statutes and other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

(17) Functional Expense Disclosure

Wellmont provides healthcare services to residents within its geographic location. Expenses based upon functional classification related to providing these services during the years ended June 30 are as follows:

		2015	2014
Professional care of patients	$	652,458	643,618
Administrative and general		152,549	123,191
Fund-raising		1,028	1,054
	$	806,035	767,863

(Dollars in thousands)

(18) Income Taxes

Wellmont, Inc. and its subsidiaries file consolidated federal and separate-company state income tax returns. These companies have combined net operating loss carryforwards for federal income tax purposes of approximately $111,000 at June 30, 2015, which begin expiring in fiscal 2019 and expire through 2033. These net operating losses can be used to offset future consolidated taxable income of Wellmont, Inc. and subsidiaries. Wellmont participates in certain activities that generate unrelated business taxable income. These activities have generated net operating losses in prior years, and Wellmont files a Form 990-T with the Internal Revenue Service to report such activity. Wellmont has net operating loss carryforwards for federal income tax purposes of approximately $1,860 for unrelated business activities. Management believes that it is more likely than not that deferred tax assets arising from net operating loss carryforwards will not be realizable. Accordingly, these are fully reserved at June 30, 2015 and 2014.

(19) Concentration of Credit Risk

Wellmont grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2015 and 2014 was as follows:

	2015	2014
Medicare	43%	48%
TennCare/Medicaid	12	13
Other third-party payors	32	31
Patients	13	8
	100%	100%

(20) Disclosures about Fair Value of Financial Instruments

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer or settle a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820, *Fair Value Measurements*, establishes a three-level fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The classification of an investment within the hierarchy is based upon the pricing transparency or ability to redeem the investment and does not necessarily correspond to the perceived risk of that investment. Inputs are used in applying various valuation techniques that are assumptions, which market participants use to make valuation decisions, including assumptions about risk. Inputs may include price information, volatility statistics, operating statistics, specific and broad credit data, liquidity statistics, recent transactions, earnings forecasts, future cash flows, market multiples, discount rates, and other factors. ASC Topic 820 permits, as a practical expedient, for the estimation of the fair value of investment in investment companies for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent. Net asset value in many instance may not equal fair value that would be calculated pursuant to ASC Topic 820. In accordance with ASC Topic 820, investments measured using net asset value as a

(Continued)

practical expedient are not categorized within the fair value hierarchy, however, the amount measured is included to permit reconciliation of the fair value of investments included in the fair value hierarchy to the line items presented in the consolidated statement of operations and changes in net assets.

Assets and liabilities measured and reported at fair value are classified within the fair value hierarchy as follows:

Level 1 – Valuations based on quoted market prices in active markets.

Level 2 – Investments that trade in markets that are considered to be active, but are based on dealer quotations or alternative pricing sources supported by observable inputs or investments that trade in markets that are not considered to be active, but are valued based on quoted market prices, dealer quotations, or alternative pricing sources supported by observable inputs.

Level 3 – Investments classified within Level 3 have significant unobservable inputs, as they trade infrequently or not at all.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2015:

		Level 1	Level 2	Level 3	Total
Assets:					
Cash and cash equivalents	$	48,866	—	—	48,866
Assets limited as to use:					
Stock mutual funds		155,165	—	—	155,165
Bond mutual funds		157,091	—	—	157,091
Cash and money market funds		55,369	—	—	55,369
Real estate funds		17,967	—	—	17,967
		434,458	—	—	434,458
Alternative investments - recorded at net asset vaue					42,923
Subtotal					477,381
Long-term investments:					
Stock mutual funds		15,627	—	—	15,627
Bond mutual funds		9,535	—	—	9,535
Cash and money market funds		242	—	—	242
Real estate funds		1,049	—	—	1,049
Subtotal		26,453	—	—	26,453
	$	460,911	—	—	503,834
Liabilities:					
Derivatives asset	$	—	90	—	90
Total	$	—	90	—	90

(Dollars in thousands)

The following table presents assets and liabilities that are measured at fair value on recurring basis at June 30, 2014:

	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	$ 30,674	—	—	30,674
Assets limited as to use:				
Stock mutual funds	148,453	—	—	148,453
Bond mutual funds	167,156	—	—	167,156
Cash and money market funds	50,916	—	—	50,916
Real estate funds	21,381	—	—	21,381
	418,580	—	—	418,580
Alternative investments - recorded at net asset value				41,067
Subtotal				459,647
Long-term investments:				
Stock mutual funds	17,741	—	—	17,741
Bond mutual funds	11,420	—	—	11,420
Cash and money market funds	230	—	—	230
Real estate funds	1,618	—	—	1,618
Subtotal	31,009	—	—	31,009
	$ 449,589	—	—	490,656
Liabilities:				
Derivatives liability	$ —	6,118	—	6,118
Total	$ —	6,118	—	6,118

The following methods and assumptions were used to estimate fair value of each class of instruments:

- *Cash and Cash Equivalents*

  The carrying amount approximates fair value due to the short maturities of these instruments.

- *Patient Accounts and Other Receivables*

  The net recorded carrying value approximates fair value due to the short maturities of these instruments.

- *Investments and Assets Limited as to Use*

  The fair values of investments and assets limited as to use are based on quoted market prices and quotes obtained from security brokers or, in the case of the limited partnerships, by the general partner.

Alternative investments are not categorized within the fair value hierarchy because fair value is measured using the net asset (NAV) per share practical expedient. Wellmont's alternative investments' prices are obtained from the fund manager. For Wellmont'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 managers evaluate 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 of the underlying securities traded on active markets, and the professional reputation and standing of the investee fund's auditor.

- *Accounts Payable and Accrued Expenses*

  The carrying amount approximates fair value due to the short maturities of these liabilities.

- *Estimated Third-Party Payor Settlements, Other Long-Term Liabilities*

  The carrying amount approximates fair market value due to the nature of these liabilities.

- *Long-Term Debt*

  The carrying amount of indebtedness with variable interest rates approximates its fair value because the variable rates reflect current market rates for indebtedness with similar maturities and credit quality. The fair value of indebtedness with fixed interest rates is based on rates assumed to be currently available for indebtedness with similar terms and average maturities. Fair value measurements of indebtedness are based on observable interest rates and maturity schedules that fall within Level 2 of the hierarchy of fair value inputs. The estimated fair value of revenue bonds, using current market rates, was estimated at $455,650 and $444,106 for the years ended June 30, 2015 and 2014, respectively. The carrying amount of other long-term debt reported in note 12 and on the consolidated balance sheet approximates the related fair value.

(21) Subsequent Events

On July 1, 2014, Wellmont sold its 60% interest in Takoma Regional Hospital to Adventist Health System (which also owned the other 40%). Cash in the amount of $11,700 was received prior to July 1, 2014 and is included in current liabilities as of June 30, 2014. Subsequently, during 2015, Adventist Health System and Wellmont have agreed in principle that Wellmont will repurchase Takoma in fiscal year 2016. Wellmont has evaluated subsequent events from the balance sheet date through October 27, 2015 the date at which the consolidated financial statements were issued. No other material subsequent events were identified for recognition or disclosure.