

**BEAUFORT MEMORIAL
HOSPITAL AND OTHER
COMBINED ENTITY**

Combined Financial Statements

September 30, 2011 and 2010

(with Independent
Auditors' Report thereon)

**BEAUFORT MEMORIAL HOSPITAL
AND OTHER COMBINED ENTITY**

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Independent Auditors' Report

To the Board of Trustees
Beaufort Memorial Hospital and Other Combined Entity

We have audited the accompanying combined financial statements of Beaufort Memorial Hospital and Other Combined Entity, a public agency, (the "Hospital") and the financial statements of its discretely presented component unit, Beaufort Memorial Hospital Endowment Foundation, (the "Foundation") as of September 30, 2011 and 2010, which comprise the Hospital's and Foundation's basic financial statements, as presented on pages 9 through 32. These combined financial statements are the responsibility of the Hospital's and Foundation's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's and Foundation'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 combined financial statements and includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Beaufort Memorial Hospital and Other Combined Entity and its discretely presented component unit as of September 30, 2011 and 2010, and the results of their operations, changes in net assets, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis on pages 3 through 8 is not a required part of the basic combined financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

To the Board of Trustees
Beaufort Memorial Hospital and Other Combined Entity
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Our audits were conducted for the purpose of forming an opinion on the combined financial statements taken as a whole. The supplementary combining information on pages 33 and 34 is presented only for purposes of additional analysis of the combined financial statements rather than to present the financial position and results of operations of the individual organizations, and is not a required part of the basic combined financial statements. Accordingly, we do not express an opinion on the financial position and results of operations of the individual organizations. However, the supplementary combining information has been subjected to the auditing procedures applied in the audit of the combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

Dixon Hughes Goodman LLP

January 18, 2012

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY

Annual Financial Report

The annual financial report of Beaufort Memorial Hospital (“BMH”) and Other Combined Entity (the “Hospital”) provides an overview of the Hospital’s financial activities for the fiscal years ended September 30, 2011 and 2010. The combined financial statements include the independent auditor’s report, the required combined financial statements, and the accompanying explanatory notes. The required combined financial statements include a combined balance sheet, a combined statement of revenues, expenses and changes in net assets, and a combined statement of cash flows. Management’s discussion and analysis should be read in conjunction with the combined financial statements and notes.

Beaufort Memorial Hospital Endowment Foundation (the “Foundation”) is a legally separate, tax-exempt discretely presented component unit of the Hospital. The Foundation is a South Carolina corporation whose purpose is to support and encourage, through financial and fundraising assistance, the healthcare services and interests of the Hospital. Complete financial statements for the Foundation can be obtained from the Beaufort Memorial Hospital Endowment Foundation.

Management’s Discussion and Analysis

Mission and Organizational Structure

Beaufort Memorial Hospital is a not-for-profit hospital, with a sole community hospital (Medicare) designation, located in Beaufort, South Carolina. The Hospital has 197 licensed beds, of which, 169 are medical/surgical acute, 14 are rehabilitation, and 14 are mental health beds. The mission of the Hospital is to deliver superior healthcare services to our patients and to improve the health of our community. This mission embraces the charitable focus of the organization, which is to provide healthcare services regardless of the patient’s ability to pay. The Hospital continues to be active in the community through its wellness and healthy community efforts. The Hospital’s vision is to exceed expectations for quality and compassionate care.

In addition to the financial statements and operations of Beaufort Memorial Hospital, the “Other Combined Entity” includes the information and accounts of Broad River Healthcare, Inc. (“Broad River”), which is a blended component unit of BMH. Broad River is a private, not-for-profit South Carolina corporation organized to assist BMH meet its mission and operational goals. The Hospital’s related entity company, Broad River, has a non-controlling interest in an outpatient surgery center, managed a mobile PET, and had a 100% interest in Beaufort Medical Imaging, LLC, which was created in 2007. Beaufort Medical Imaging, LLC ceased to operate during fiscal year 2009 due to the State of South Carolina’s Certificate of Need ruling allowing the business elements of this entity to be transferred to Beaufort Memorial Hospital. In addition, the mobile PET was upgraded to a mobile PET CT and this business entity was also transferred to the Hospital during fiscal year 2009.

Financial Highlights

Net assets increased to \$160.0 million in 2011 from \$149.6 million in 2010, a \$10.4 million or 7.0% increase. The Hospital has had sound financial operations over the past seven years, with consistently increasing net assets, primarily due to growing operating income. Inpatient and outpatient activity has increased at a rate of 2.1% and 1.2%, respectively, over the prior year, resulting in a 2011 operating income of \$7.8 million; an increase of \$.49 million from the 2010 operating income of \$7.4 million. Non-operating revenues, net of expenses, decreased from \$2.4 million in 2010 to \$2.1 million in 2011, a 13.0% decline. This decline, which was also evident in 2010, was primarily due to the decline in interest

earnings caused by lower interest rates in 2011. Although interest rates have declined, the Hospital has maintained all investments in instruments that protect the principal. All investments are backed by appropriate collateral.

Required Combined Financial Statements

The required combined financial statements are presented on an “enterprise” basis. Entities accounted for on an enterprise basis are primarily financed by charges for services to their users rather than tax receipts.

The combined balance sheet is a statement of the investments in resources (assets) and obligations to creditors (liabilities) on the last day of the fiscal year. The net asset balance is the value of the Hospital’s assets less its liabilities (net assets). The combined balance sheet classifies assets and liabilities as current and non-current, and can be used to evaluate the Hospital’s liquidity and ability to meet its future financial obligations.

The combined statement of revenues, expenses, and changes in net assets reports the revenue the Hospital generated from providing services to patients and the expenses required providing these services. Enterprise basis financial statements are prepared on an “accrual” basis, in which revenue is recorded for charges not yet received in cash and for obligations to creditors not yet paid in cash. Enterprise accounting requires that a portion of the cost of capital assets be recorded as depreciation expense. The statement also reports the changes in net assets attributable to non-operating activities and from other transactions.

The combined statement of cash flows reports cash inflows and outflows from operations, capital and related financing activities, investing activities, and noncapital financing activities, and their effect on the change in cash from the combined balance sheet.

Analysis of Overall Financial Position and Results of Operations

A summary of the Hospital’s condensed combined balance sheets at September 30 is presented below:

<i>(In thousands of dollars)</i>	2011	2010	2009
Current assets	\$ 119,110	\$ 110,284	\$ 93,453
Capital assets, net	70,948	73,097	73,003
Other non-current assets	3,223	3,267	13,439
Total Assets	<u>193,281</u>	<u>186,648</u>	<u>179,895</u>
Current liabilities	21,693	24,021	26,267
Long-term debt	11,559	13,026	14,411
Total Liabilities	<u>33,252</u>	<u>37,047</u>	<u>40,678</u>
Net Assets			
Invested in capital assets, net of related debt	53,290	52,166	47,672
Restricted for debt service	2,314	2,314	2,314
Expendable for specific operating activities	---	---	425
Unrestricted	104,425	95,121	88,806
Total Net Assets	<u>160,029</u>	<u>149,601</u>	<u>139,217</u>

Current assets, which consist primarily of cash, short-term investments and accounts receivable, totaled \$119.1 million in 2011 and \$110.3 million in 2010, representing an 8.0% increase. The Hospital’s total current assets cover current liabilities 5.5 times in 2011, an improvement from 4.6 times in 2010 and 3.6 times in 2009. This indicates the Hospital’s liquidity continues to improve. Current assets increased \$8.8 million or 8.0% in 2011 compared to 2010, primarily due to increased patient accounts receivable (net of

allowance for uncollectible accounts) and cash and cash equivalents. The Hospital maintains all investments in fully secured instruments, primarily in FDIC insured banks. Certificate of deposits are collateralized and therefore the stock market will have no impact on the Hospital's cash position other than reduction in interest earnings. Cash and short-term investments increased from \$84.8 million in 2010 to \$87.6 million in 2011. The Hospital's day's cash on hand decreased from 208.6 in 2010 to 197.5 days in 2011. Although cash increased \$7.2 million from 2010 to 2011, operating costs (outgoing cash) also increased primarily in the area of labor expenses. These expenses were influenced directly by the employment of physician's and their related labor costs through salaries and bonuses. Current liabilities decreased in 2011 primarily due to reductions in our line of credit and accrued expenses. Long-term debt was reduced due by the annual bond principal payment made in November. Overall, total liabilities decreased \$3.8 million or 10.2% in 2011.

Net assets represent the residual interest in the Hospital's assets after liabilities are deducted. Total net assets in 2011 increased \$10.4 million or 7.0% over 2010; 2010 increased \$10.4 million or 7.5% over 2009; and 2009 increased 7.3% over 2008. Beaufort Memorial Hospital continues to show growth in our net assets. Due to the economy and significant changes in the healthcare industry, capital acquisitions and building slowed in 2011. Investments in capital assets (net of related debt) increased from \$52.2 million in 2010 to \$53.3 million in 2011, an increase of 2.2%. However, during the fiscal year major strategic capital plans were put in place for 2012 building expansions and property acquisitions. The Hospital continues to maintain its plant. The average age of plant for the Hospital is 8.0 years in 2011, up from 6.9 years in 2010 and 7.8 years in 2009. The capital budget for 2012 is approximately \$4.7 million, approximately the same as the 2011 capital budget.

The Hospital's current and long-term debt includes Hospital Revenue and Refinancing Bonds, Series 1997 with an outstanding balance of \$13.2 million as of September 30, 2011. Additionally, the line of credit was reduced by \$1.9 million in 2011 leaving the amount outstanding at \$4.5 million in 2011, down from \$6.4 million in 2010. The Hospital's debt service coverage has increased to 9.1 times in 2011, up from 8.3 times in 2010.

The Combined Statement of Revenues, Expenses, and Changes in Net Assets present the Hospital's resulting financial activity for the year. A summary of the Hospital's condensed combined statements of revenues, expenses, and changed in net assets at September 30 is presented below:

<i>(In thousands of dollars)</i>	2011	2010	2009
Operating revenues	\$ 153,887	\$ 148,909	\$ 145,976
Operating expenses	146,040	141,552	139,584
Operating income	<u>7,847</u>	<u>7,357</u>	<u>6,392</u>
Non-operating revenues (net of expenses)	<u>2,073</u>	<u>2,383</u>	<u>2,688</u>
Excess revenues over expenses before capital grants and contributions	9,920	9,740	9,080
Capital grants and contributions	<u>508</u>	<u>644</u>	<u>366</u>
Increase in net assets	10,428	10,384	9,446
Net Assets			
Beginning of year	<u>149,601</u>	<u>139,217</u>	<u>129,771</u>
End of year	<u>\$ 160,029</u>	<u>\$ 149,601</u>	<u>\$ 139,217</u>

Patient service revenues account for 98.6% of the Hospital's operating revenues. Operating revenues for 2011 increased 3.3% over 2010, compared to 2010's increase of 2.0% over the prior 2009. During 2011, contractual adjustments increased by .3% and the Medicaid disproportionate share increased by \$.39

million; the greatest influence on the Hospital's operating revenue growth was the increase in outpatient activity. Although inpatient activity increased at a greater percentage than outpatient, revenues per activity showed a greater increase from outpatient activity than inpatient. The Hospital's average daily census increased 2.0% in 2011 from the prior year while outpatient volumes increased 1.2%. Bad debts increased 62.5% in 2011 compared to 2010 while charity care as a percentage of gross patient charges increased to 5.2% in 2011 from 5.1% in 2010. The primary cause of this material increase in bad debt comes from material increases in uninsured volumes at the Hospital. Both inpatient and outpatient uninsured payer mix increased by 2.0%. Overall, revenue deductions increased slightly from 66.5% in 2010 to 66.6% in 2011.

Total operating expenses increased 3.2%, 1.4%, and 12.3% in 2011, 2010, and 2009, respectively. Labor costs (salaries, benefits and contract labor) accounted for 57.6% of operating expenses during 2011, compared to 56.0% in 2010 and 55.3% in 2009. The Hospital was successful in significantly reducing contract labor during 2010 and maintaining this reduction in 2011. The Hospital incurred only \$307,780 in contract labor expenses in 2011. The Hospital continues to have an active and successful supply chain management program, and focused efforts on reducing supply expenses, resulting in a decrease from \$26.0 million in 2010 to \$25.1 million in 2011. Overall, supply costs as a percentage of net patient revenues decreased to 16.5% in 2011, down from 17.8% in 2010 and from 19.0% in 2009. Non-operating revenues, net of expenses decreased 13.0% during 2011 due mainly to decreases in interest rates.

Excess of revenues over expenses, before capital grants and contributions, increased 1.8% in 2011 compared to an increase of 7.3% in 2010 and an increase of 2.5% in 2009. The Hospital's operating margin for 2011 was 5.1% up from 4.9% in 2010 and 4.4% in 2009.

The Combined Statement of Cash Flows provides additional information about the Hospital's financial results by reporting the major sources and uses of cash. A summary of the Hospital's condensed combined statements of cash flows at September 30 is presented below:

<i>(In thousands of dollars)</i>	2011	2010	2009
Cash Flows			
Operating activities	\$ 11,108	\$ 19,743	\$ 12,740
Capital and related financing activities	(11,102)	(14,651)	(13,182)
Investing activities	6,002	6,986	234
Non-capital financing activities	1,166	1,242	900
Net increase in cash	<u>7,174</u>	<u>13,320</u>	<u>692</u>
Cash and Cash Equivalents			
Beginning of year	<u>42,649</u>	<u>29,329</u>	<u>28,637</u>
End of year	<u>\$ 49,823</u>	<u>\$ 42,649</u>	<u>\$ 29,329</u>

In 2011, the Hospital had cash generated by operating activities of \$11.1 million, a decrease of \$8.6 million from 2010 or 43.7%. From 2010 to 2011, receipts from patients and others decreased \$2.1 million while wages and benefits (payments to employees) increased 9.3% and payments to suppliers increased 1.2%, with a combined total cash flow from operating activities of \$11.1 million.

Budgets

Unlike other government facilities, budgets for entities accounted for on the enterprise basis are not legally binding authorizing documents. The budget for an enterprise fund is a guide for management and the Board in evaluating the success of the institution in meeting its financial goals.

Future Opportunities and Challenges

Beaufort Memorial Hospital's greatest challenge for the upcoming year is in the area of payer mix and insurance payments. Over the past two years we have experienced a major shift in our payer mix, particularly in the uninsured population; resulting in material increases in charity and bad debt write-offs. Additionally, Recovery Audit Contractors (RACs) continue to demand large numbers of medical records for review going back three years since the date of service. These companies are denying claims and requiring hospital's to settle "overpayments" retroactively. While BMH has not seen large recoupments, the labor to meet their demands is tremendous. During the fiscal year the South Carolina Medicaid program reduced its reimbursement by 7% throughout the State. This reduction amounts to nearly \$1.0 million in annualized Medicaid payment reductions for our Hospital. Insurance continue to aggressively challenge hospitals reimbursements. BMH has experienced these challenges and we expect to see more reimbursement reductions in the future.

Our strategic focus remains in the market located south of the Broad River. This area is inclusive of Bluffton, Hardeeville and Hilton Head Island. The Hospital currently has a presence in this market with a primary care clinic and a medical services facility. BMH employs four primary care physicians at this location and also makes available space for numerous independent specialists to see patients from this market. All physicians treating patients at the Bluffton satellite clinic have access to ancillary services available through the Hospital. BMH is in negotiations to purchase approximately 20 acres in this geographic area. It is expected the property will be used for a medical office building and ultimately ancillary services in a multi-stage building project. This capital project will allow BMH to develop and maintain a major presence in this market as the population grows.

BMH currently employs eighteen physicians. During the fiscal year a number of physicians were hired to compliment the growing need for primary care physicians and specialists. The Hospital hired a female general surgeon to join the existing group of surgeons already employed by the Hospital. As we moved into 2012, additional physician employment contracts are under consideration. The Hospital has negotiated the purchase of a new robotic da Vinci surgical system. This system is primarily used for gynecology procedures, but it is anticipated that urological procedures will be added in 2012. BMH continues to maintain close clinical relationships with Duke Medical University (for cancer and heart services) and Roper Hospital.

The Hospital has begun a number of capital projects and purchases. The expansion of the emergency room is underway after receiving certificate of need approval from the State's Budget and Control Board. This project will increase the size of the emergency room from 9,000 square feet to over 20,000 square feet to help facilitate the growing number of patients. It is anticipated that the Healthcare Reform Act will generate significant patient volumes. It is highly likely these patients will be unable to find a primary care physician and will use the emergency room for their medical care. Additionally, the volumes in the ER have been growing significantly each year and additional space is necessary. In addition to this project, the Hospital is in negotiations to purchase a large tract of land in the Bluffton area to expand its facilities and services. A Women's Imaging Center on the first floor of the medical building next to the Hospital has been completed. This facility provides specialty services such as mammography, stereotactic biopsies and bone density to women in a very private, specialized service. Eventually, this service is planned to grow to include more women's services. Space demands have created the need to build a medical services support building to house numerous support departments as well as the expansion of the Lifefit program. The City of Beaufort has approved the four story building and plans are under way to design and build this facility during 2012. Once completed, flat surface parking will increase on the main campus once departments vacate their old suites/buildings and move into the new building. During the fiscal year the Hospital staff analyzed opportunities to secure approximately \$50.0 million in debt to fund the three major capital projects; ER expansion, property purchase and construction

of the support services building. After a thorough review of public and private bond markets, the Hospital sent out approximately five RFP's for a private placement bond through a commercial bank. After review and consideration, TD Bank was selected and approved by the Board of Trustees to finance the capital projects as well as refinancing the 1997 Series Bonds. Material savings will be obtained with the refinancing of the 1997 Series Bonds totaling \$9.5 million. The Series 1997 Bonds have an interest rate of over 5.0% with a rate of 1.96% for the new Series 2011 A (refinancing). The new money debt will be issued through a second instrument (Series 2011 B) totaling \$36.7 million at a rate of 3.03%. The combined bond issue, Series 2011 A and B are scheduled to close in the first quarter of FY 2012.

The Hospital continues to maintain a financially sound balance sheet and strong financial ratios. The Hospital's operating and cash flow margins are also consistent and above most rating agency's median levels.

Contacting the Hospital's Financial Management

If you have questions about this report or need additional information, please contact the Hospital's Senior Vice President and Chief Financial Officer at Beaufort Memorial Hospital, 955 Ribaut Road, Beaufort, South Carolina 29902.

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY

Combined Balance Sheets

September 30, 2011 and 2010

<u>Assets</u>	<u>2011</u>	<u>2010</u>
Current assets:		
Cash and cash equivalents	\$ 49,823,220	\$ 42,649,532
Short-term investments	37,781,698	42,152,651
Patient accounts receivable, net of allowance for uncollectible accounts of \$21,001,813 in 2011 and \$12,136,014 in 2010	26,329,312	19,200,962
Other receivables	368,813	1,826,793
Physician receivables	8,186	1,000
Drugs and supplies	3,149,435	2,879,303
Prepaid expenses	<u>1,649,373</u>	<u>1,573,852</u>
Total current assets	119,110,037	110,284,093
Assets limited as to use	2,314,000	2,314,000
Investment in joint ventures	865,629	867,358
Capital assets, net	70,947,961	73,097,805
Deferred financing costs	43,021	58,405
Goodwill	<u>-</u>	<u>26,047</u>
Total assets	<u>\$ 193,280,648</u>	<u>\$ 186,647,708</u>
 <u>Liabilities and Net Assets</u>		
Current liabilities:		
Current portion of long-term debt	\$ 1,640,000	\$ 1,560,000
Line of credit	4,501,929	6,403,929
Accounts payable	5,237,237	5,276,807
Accrued expenses	8,295,339	10,268,162
Estimated third-party payor settlements	<u>2,018,479</u>	<u>511,955</u>
Total current liabilities	21,692,984	24,020,853
Long-term debt, less current portion	<u>11,559,015</u>	<u>13,026,130</u>
Total liabilities	<u>33,251,999</u>	<u>37,046,983</u>
Net assets:		
Invested in capital assets, net of related debt	53,290,038	52,166,151
Restricted:		
For debt service	2,314,000	2,314,000
Unrestricted	<u>104,424,611</u>	<u>95,120,574</u>
Total net assets	<u>160,028,649</u>	<u>149,600,725</u>
Total liabilities and net assets	<u>\$ 193,280,648</u>	<u>\$ 186,647,708</u>

The accompanying notes are an integral part of these combined financial statements.

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY
Component Unit - Beaufort Memorial Hospital Endowment Foundation

Statements of Position

September 30, 2011 and 2010

<u>Assets</u>	<u>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 1,061,754	\$ 526,265
Certificates of deposit	1,820,295	1,970,556
Pledges receivable, net	9,073	139,157
Investments	8,329,907	8,884,914
Other assets	<u>26,161</u>	<u>16,005</u>
Total assets	<u>\$ 11,247,190</u>	<u>\$ 11,536,897</u>
<u>Liabilities and Net Assets</u>		
Liabilities:		
Payable to Beaufort Memorial Hospital	\$ 777,128	\$ 748,745
Obligations under gift annuities	<u>23,566</u>	<u>25,128</u>
Total liabilities	<u>800,694</u>	<u>773,873</u>
Net assets:		
Unrestricted	1,894,539	1,695,217
Board designated for endowment	<u>8,249,587</u>	<u>8,697,786</u>
Total unrestricted net assets	10,144,126	10,393,003
Temporarily restricted net assets	<u>302,370</u>	<u>370,021</u>
Total net assets	<u>10,446,496</u>	<u>10,763,024</u>
Total liabilities and net assets	<u>\$ 11,247,190</u>	<u>\$ 11,536,897</u>

The accompanying notes are an integral part of these combined financial statements.

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY

Combined Statements of Revenues, Expenses, and Changes in Net Assets

For the Years Ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Net patient service revenue, net of provision for bad debts of \$25,934,003 in 2011 and \$15,952,978 in 2010	\$ 151,753,537	\$ 146,046,848
Other operating revenue	<u>2,133,844</u>	<u>2,862,110</u>
Total operating revenues	<u>153,887,381</u>	<u>148,908,958</u>
Operating expenses:		
Salaries and wages	66,189,765	61,935,368
Employee benefits	17,677,186	16,971,678
Contract labor	307,780	311,099
Supplies	25,102,054	26,002,252
Purchased services	10,757,221	9,855,721
Physician fees	4,847,349	4,743,149
Depreciation and amortization	10,051,348	10,210,726
Other	<u>11,107,906</u>	<u>11,522,322</u>
Total operating expenses	<u>146,040,609</u>	<u>141,552,315</u>
Operating income	<u>7,846,772</u>	<u>7,356,643</u>
Nonoperating revenues (expenses):		
Interest income	949,515	1,438,137
Interest expense	(722,629)	(966,231)
Share of income of investee, net	680,409	669,596
County apportionment	536,198	643,382
Noncapital gifts and bequests	<u>629,476</u>	<u>598,649</u>
Total nonoperating revenues	<u>2,072,969</u>	<u>2,383,533</u>
Excess of revenues over expenses before capital grants and contributions	9,919,741	9,740,176
Capital grants and contributions	<u>508,183</u>	<u>643,888</u>
Increase in net assets	10,427,924	10,384,064
Net assets, beginning of year	<u>149,600,725</u>	<u>139,216,661</u>
Net assets, end of year	\$ <u><u>160,028,649</u></u>	\$ <u><u>149,600,725</u></u>

The accompanying notes are an integral part of these combined financial statements.

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY
Component Unit - Beaufort Memorial Hospital Endowment Foundation

Statements of Activities and Changes in Net Assets

For the Years Ended September 30, 2011 and 2010

	<u>Year Ended September 30, 2011</u>			<u>Year Ended September 30, 2010</u>		
	<u>Total</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>	<u>Unrestricted</u>	<u>Temporarily Restricted</u>
Support and revenue:						
Interest, dividends, and other	\$ 178,754	\$ 178,754	\$ -	\$ 215,182	\$ 215,182	\$ -
Net gains (losses) on investments	(263,976)	(263,976)	-	738,892	738,892	-
Donations, gifts and bequests	900,550	790,590	109,960	792,754	698,918	93,836
Fundraising income	83,842	83,842	-	89,660	89,660	-
Satisfaction of program restrictions	-	177,611	(177,611)	-	210,214	(210,214)
Total support and revenue	899,170	966,821	(67,651)	1,836,488	1,952,866	(116,378)
Expenses:						
Fundraising events	72,958	72,958	-	58,212	58,212	-
General and administrative	161,716	161,716	-	28,447	28,447	-
Grants to Beaufort Memorial Hospital	981,024	981,024	-	1,386,966	1,386,966	-
Total expenses	1,215,698	1,215,698	-	1,473,625	1,473,625	-
Increase (decrease) in net assets	(316,528)	(248,877)	(67,651)	362,863	479,241	(116,378)
Net assets, beginning of year	10,763,024	10,393,003	370,021	10,400,161	9,913,762	486,399
Net assets, end of year	\$ 10,446,496	\$ 10,144,126	\$ 302,370	\$ 10,763,024	\$ 10,393,003	\$ 370,021

The accompanying notes are an integral part of these combined financial statements.

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY

Combined Statements of Cash Flows

For the Years Ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 146,131,711	\$ 148,243,207
Other receipts and payments, net	(7,523,898)	(8,775,723)
Payments to employees	(85,813,774)	(78,519,407)
Payments to suppliers	<u>(41,686,319)</u>	<u>(41,205,091)</u>
Net cash provided by operating activities	<u>11,107,720</u>	<u>19,742,986</u>
Cash flows from capital and related financing activities:		
Principal paid on long-term debt	(1,560,000)	(1,490,000)
Payments on line of credit	(1,902,000)	(3,102,000)
Interest paid on long-term debt and line of credit	(748,629)	(717,481)
Purchases of capital assets	(7,400,496)	(10,068,435)
Proceeds from sale of capital assets	630	83,264
Capital grants and contributions	<u>508,183</u>	<u>643,888</u>
Net cash used in capital and related financing activities	<u>(11,102,312)</u>	<u>(14,650,764)</u>
Cash flows from investing activities:		
Decrease in investments, net of earnings	5,322,197	6,316,705
Share of income of investee, net	<u>680,409</u>	<u>669,596</u>
Net cash provided by investing activities	<u>6,002,606</u>	<u>6,986,301</u>
Cash flows from noncapital financing activities:		
Noncapital gifts and bequests	629,476	598,649
County apportionment	<u>536,198</u>	<u>643,382</u>
Net cash provided by noncapital financing activities	<u>1,165,674</u>	<u>1,242,031</u>
Net increase in cash and cash equivalents	7,173,688	13,320,554
Cash and cash equivalents, beginning of year	<u>42,649,532</u>	<u>29,328,978</u>
Cash and cash equivalents, end of year	<u>\$ 49,823,220</u>	<u>\$ 42,649,532</u>

(continued)

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY

Combined Statements of Cash Flows, Continued

For the Years Ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 7,846,772	\$ 7,356,643
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	10,051,348	10,210,726
Provision for bad debts	25,934,003	15,952,978
Gain on disposal of capital assets	(630)	(83,264)
Changes in assets and liabilities:		
Patient accounts receivable, net	(33,062,353)	(13,998,895)
Other receivables and physician receivables	1,450,794	(32,247)
Prepaid expenses and drugs and supplies	(345,653)	(199,741)
Accounts payable	(326,262)	(93,129)
Accrued expenses and estimated third-party payor settlements	<u>(440,299)</u>	<u>629,915</u>
Net cash provided by operating activities	\$ <u>11,107,720</u>	\$ <u>19,742,986</u>
<u>Schedule of non-cash investing and financing activities</u>		
Purchase of capital assets through accounts payable	\$ <u>286,692</u>	\$ <u>-</u>

The accompanying notes are an integral part of these combined financial statements.

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY
Component Unit - Beaufort Memorial Hospital Endowment Foundation

Statements of Cash Flows

For the Years Ended September 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ (316,528)	\$ 362,863
Adjustments to reconcile to net cash provided by (used in) operating activities:		
Net, unrealized and realized (gains) losses on investments	263,976	(738,892)
Changes in assets and liabilities:		
Other assets	(10,156)	14,263
Pledges receivable, net	130,084	28,650
Payable to Beaufort Memorial Hospital	28,383	263,857
Obligations under gift annuities	<u>(1,562)</u>	<u>18,079</u>
Net cash provided by (used in) operating activities	<u>94,197</u>	<u>(51,180)</u>
Cash flows from investing activities:		
Decrease (increase) in certificates of deposit	150,261	(379,576)
Decrease (increase) in investments, net of earnings	<u>291,031</u>	<u>(299,425)</u>
Net cash provided by (used in) investing activities	<u>441,292</u>	<u>(679,001)</u>
Net increase (decrease) in cash and cash equivalents	535,489	(730,181)
Cash and cash equivalents, beginning of year	<u>526,265</u>	<u>1,256,446</u>
Cash and cash equivalents, end of year	<u>\$ 1,061,754</u>	<u>\$ 526,265</u>

The accompanying notes are an integral part of these combined financial statements.

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY

Notes to Combined Financial Statements

September 30, 2011 and 2010

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

Reporting Entity - The combined financial statements of Beaufort Memorial Hospital (“BMH”) and Other Combined Entity (the “Hospital”) include the accounts of Broad River Healthcare, Inc. (“Broad River”), which is a blended component unit of BMH. Broad River has a non-controlling interest in limited liability companies (“LLC’s”). The Hospital’s combined financial statements are prepared using the accrual basis of accounting. All significant intercompany accounts have been eliminated.

Beaufort Memorial Hospital Endowment Foundation (the “Foundation”) is a legally separate, tax-exempt component unit of the Hospital. The Foundation is a South Carolina corporation, the purpose of which is to support and encourage, through financial and fundraising assistance, the health care services and interests of the Hospital. The Foundation is governed by a self-perpetuating board of trustees. Although the Hospital does not control the timing or amount of receipts from the Foundation, a significant amount of the resources, or income thereon that the Foundation holds and invests are restricted to the activities of the Hospital by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the Hospital, the Foundation is considered a component unit of the Hospital and is discretely presented in the Hospital’s combined financial statements.

Beaufort Memorial Hospital, Other Combined Entity, and Beaufort Memorial Hospital Endowment Foundation are collectively referred to as the “Organizations” throughout the notes to the combined financial statements.

Organization - The Hospital is a not-for-profit healthcare facility which owns and operates a 197-bed acute care community hospital, a 14-bed rehabilitation facility and 14 mental health beds located in Beaufort, South Carolina. The Hospital is governed by a nine member Board of Trustees (the “Board”), whose members are appointed by the County Council of Beaufort County. The Board appoints the board of directors for Broad River, which is a supporting organization for BMH. The Hospital is a public agency as defined in Title 44, Chapter 7, of the Code of Laws of South Carolina, 1976, as amended, and is not included in the financial statements of Beaufort County.

Basis of Presentation - The Hospital utilizes enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Pursuant to Governmental Accounting Standards Board (“GASB”) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (“FASB”), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

The Foundation is a private nonprofit organization that reports under the Not-for-Profit Entities Topic of the FASB Accounting Standards Codification. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation standards.

Use of Estimates - The preparation of combined financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include allowances for uncollectible accounts, contractual allowances, estimated useful lives of capital assets, settlements with third party payors, and risk retention areas such as estimates for incurred but not reported employee medical claims.

Cash and Cash Equivalents - Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less.

The Organizations maintain bank accounts at various financial institutions covered by the FDIC. At times throughout the year, the Organizations may maintain bank account balances in excess of the FDIC insured limit. It is management’s opinion that these financial institutions are financially sound and that the Organizations are not exposed to any significant credit risk related to cash.

Patient Accounts Receivable - Allowances for uncollectible accounts are computed based on historical collection experience and a review of the current status of existing accounts receivable. The Hospital grants credit to patients without collateral, substantially all of whom are from the surrounding area.

Drugs and Supplies - Drugs and supplies are stated at the lower of cost (first-in, first-out) or market.

Investments - The Hospital’s investments consist primarily of interest earning investment contracts and certificates of deposit. Non-participating investment contracts and certificates of

deposit are carried at cost. All other investments are carried at fair value except investments in debt securities with maturities less than one year at the time of purchase. These investments are carried at amortized cost, which approximates fair value. Investment income including realized and unrealized gains and losses are reported as nonoperating revenues (expenses).

The Foundation's investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the Statements of Position. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in support and revenues on the Statements of Activities and Changes in Net Assets. Securities or other investments donated are recorded at their market value at the date of the gift.

Investment in Joint Ventures - The Hospital records its interest in investments where the Hospital has a twenty to fifty percent interest in a corporation under the equity method of accounting. Under the equity method, original investments are recorded at cost and adjusted for the Hospital's share of undistributed earnings or losses and distributions.

Assets Limited as to Use - Assets limited as to use include assets held by bond trustees under bond indenture agreements.

Capital Assets - Capital assets are recorded at cost or, in the case of donated property, at fair market value at the time of donation. Assets are depreciated using the straight-line method based on the estimated useful lives of the assets, which range from three to forty years. Additions and improvements are capitalized and depreciated over the estimated remaining lives of the related assets.

Land improvements	15 to 20 years
Buildings	20 to 40 years
Equipment	3 to 7 years

Deferred Financing Costs - Deferred financing costs are amortized over the period the related obligation is outstanding. Accumulated amortization for deferred financing costs was \$357,293 and \$341,909 for September 30, 2011 and 2010, respectively. Losses on early extinguishment of debt are deferred and amortized over the remaining life of the old debt or the new debt, whichever is shorter.

Physician Receivable - The Hospital enters into loans to physicians as a method of recruiting certain physician specialties that are considered underserved in the community. If the physician complies with the provisions of the contract, the loan is forgiven by the Hospital over the term of the loan. The Hospital amortizes the amount of the loan forgiven over the remaining life of the contracts. The remaining contract life is one year at September 30, 2011. Physician loans outstanding totaled \$8,186 and \$1,000 at September 30, 2011 and 2010, respectively.

Net Assets - Net assets of the Hospital are classified in three components. Net assets invested in capital assets, net of related debt consist of capital assets net of accumulated depreciation and deferred financing costs reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets include amounts held by bond trustees as required by revenue bond indenture agreements. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Net assets of the Foundation are classified in three components. Temporarily restricted net assets are those whose use has been limited by donors to a specific time period or purpose. Temporarily restricted net assets are transferred to unrestricted net assets when donor restrictions as to time and purpose have been met and are shown as satisfaction of program restrictions on the accompanying Statements of Activities and Changes in Net Assets. Board designated net assets are those whose use has been limited by the Board of Trustees. Unrestricted net assets are remaining net assets that do not meet the definition of temporarily restricted net assets or board designated net assets.

Net Patient Service Revenue - Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Third-party contractual revenue adjustments are accrued on an estimated basis in the period the related services are rendered. Such amounts are subject to audit by governmental agencies. Adjustments, if any, are included in contractual revenue adjustments in the year of determination. In compliance with GASB 34, net patient service revenue has been reduced by the amount of bad debt expense incurred by the Hospital.

The Hospital's policy does not require collateral or other security for patient accounts receivable. The Hospital routinely accepts assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans or policies such as those related to Medicare, Medicaid, Blue Cross, health maintenance organizations and commercial insurance carriers.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. Partial payments to which the Hospital is entitled from public assistance on behalf of patients that meet the Hospital's charity care criteria are reported as net patient service revenue.

Recognition of Revenue by Component Unit Foundation - Contributions are recognized as revenue when they are received or unconditionally pledged and are measured at their fair value and are reported as an increase in net assets.

Operating Revenues and Expenses - The combined statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, the Hospital's principal activity. Nonexchange revenues, including grants and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Grants and Contributions - From time to time, the Hospital receives grants and contributions from individuals and private organizations. Revenues from grants and contributions are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

Under the Not-for-Profit Entities Topic of the FASB Accounting Standards Codification, the Foundation records contribution expense and a payable to the Hospital when the Foundation's board approves the future payment of funds to the Hospital for specified purposes. The Foundation considers these restricted contributions to the Hospital because the funds must be spent for the purposes specified by the Foundation. In accordance with GASB Statement No. 33, *Accounting and Reporting for Non-exchange Transactions*, the Hospital records contribution revenue when the funds are spent for the specified purpose, that is, when the reimbursable costs have been incurred. As a result of the different accounting treatment required under the FASB Accounting Standards Codification and GASB No. 33, the Foundation has recorded a payable of approximately \$777,000 and \$749,000 as of September 30, 2011 and 2010, respectively, for which a corresponding receivable has not been recorded by the Hospital.

Compensated Absences - The Hospital's employees earn paid days off ("PDO") at varying rates depending on years of service. Accumulated PDO time may be carried over each year up to a maximum of 480 hours. The employee may elect to use PDOs or cash in PDO hours at that time.

If an employee has given proper notice, upon termination, the employee will receive pay at the regular hourly rate for all unused PDO, providing the employee has completed three months of service.

All full-time employees must use a minimum of 40 PDO hours each calendar year and part time employees must use a minimum of 20 PDO hours. Failure to use these mandatory PDO hours will result in the forfeiture of these hours.

The estimated amount of the PDO payable is reported as a current accrued expense in both the 2011 and 2010 years.

Restricted Resources - When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

Income Taxes - Beaufort Memorial Hospital, Broad River Healthcare, Inc., and Beaufort Memorial Hospital Endowment Foundation are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code; accordingly, the accompanying combined financial statements do not reflect a provision or liability for federal and state income taxes. The Organizations have determined that they do not have any material unrecognized tax benefits or obligations as of September 30, 2011. Fiscal years ending on or after September 30, 2008 remain subject to examination by federal and state tax authorities.

Risk Management - The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice claims and judgments; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. The Hospital is self-insured for amounts up to a specified level for health and medical coverage for its employees. The estimated liability is the total estimated amount to be paid for all known claims or incidents and a reserve for incurred but not reported claims. The Hospital purchases professional and general liability insurance to cover medical malpractice claims. Claims under such coverage are covered based on the date of occurrence.

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

As required by state statutes, all of the Hospital's cash and cash equivalents and investments, which consist principally of certificates of deposit, overnight repurchase agreements and interest earning investment contracts, are covered by federal depository insurance, invested in U.S. Government obligations, or collateralized by U.S. governmental obligations held in the Hospital's name by a custodial bank.

The bond trustee invests in a non-participating interest earning investment contract in which the Hospital receives a guaranteed interest rate of return. As such, this investment is reported at cost at September 30, 2011 and 2010.

Investments at September 30 consist of the following:

	<u>2011</u>	<u>2010</u>
Certificates of deposit maturing within one year	\$ 37,781,698	\$ 42,152,651
Guaranteed investment contract, held by trustee	<u>2,314,000</u>	<u>2,314,000</u>
	<u><u>\$ 40,095,698</u></u>	<u><u>\$ 44,466,651</u></u>

Custodial credit risk for investments is the risk that, in the event of failure of the counterparty, the Hospital will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. Investments held with third party banks are invested primarily in certificates of deposit. Investments held by a trustee are invested in a guaranteed investment contract. Investments with third party banks and investments held by a trustee are fully collateralized and insured as of September 30, 2011 and 2010 with securities maintained by an outside party.

Concentration of credit risk is the risk of loss attributed to the magnitude of the Hospital's investments in a single issuer. As of September 30, 2011, the Hospital's investments and assets limited as to use consist of approximately 34% of certificates of deposit held with one financial institution, approximately 60% of certificates of deposit held with another financial institution, and approximately 6% of a guaranteed investment contract. As of September 30, 2010, the Hospital's investments and assets limited as to use consist of approximately 95% of certificates of deposit and approximately 5% of a guaranteed investment contract.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Hospital minimizes their interest rate risk by investing in certificates of deposit with maturities of two years or less and a guaranteed investment contract.

The carrying values of cash and cash equivalents and investments are included in the combined balance sheets as follows:

	<u>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 49,823,220	\$ 42,649,532
Short-term investments	37,781,698	42,152,651
Assets limited as to use	<u>2,314,000</u>	<u>2,314,000</u>
	<u><u>\$ 89,918,918</u></u>	<u><u>\$ 87,116,183</u></u>

3. **Accounts Receivable and Payable**

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the Hospital at September 30, 2011 and 2010 consisted of the following amounts:

	<u>2011</u>	<u>2010</u>
<u>Patient Accounts Receivable</u>		
Receivable from patients	\$ 32,803,466	\$ 19,716,896
Receivable from third-party payors and other	4,216,255	4,950,985
Receivable from Medicare	7,347,275	4,367,563
Receivable from Medicaid	2,964,129	2,301,532
Total patient accounts receivable	47,331,125	31,336,976
Less: allowance for uncollectible accounts	(21,001,813)	(12,136,014)
Net patient accounts receivable	<u>\$ 26,329,312</u>	<u>\$ 19,200,962</u>
<u>Accounts Payable and Accrued Expenses</u>		
Payable to suppliers	\$ 6,615,087	\$ 6,454,596
Payable to employees (including payroll taxes)	6,694,739	8,841,623
Accrued interest payable	222,750	248,750
Total accounts payable and accrued expenses	<u>\$ 13,532,576</u>	<u>\$ 15,544,969</u>

4. **Foundation Pledges Receivable**

Foundation pledges receivable consist of the following at September 30:

	<u>2011</u>	<u>2010</u>
Receivable in less than one year	\$ 143,873	\$ 108,750
Receivable in one to five years	250,000	200,000
Receivable after five years	350,000	450,000
Discounts to present value	(14,184)	(16,528)
Allowance for uncollectible pledges	(720,616)	(603,065)
Net pledges receivable	<u>\$ 9,073</u>	<u>\$ 139,157</u>

Pledges have been discounted at a 0.37% and 0.45% annual rate of interest at September 30, 2011 and 2010, respectively.

5. Foundation Investments

The fair market values of investments of the Foundation at September 30 are as follows:

	<u>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 1,858,881	\$ 2,124,099
Mutual funds	6,056,251	6,193,969
Equity	2,235,070	2,537,402
	<u>\$ 10,150,202</u>	<u>\$ 10,855,470</u>

Investment income (loss) is comprised of the following at September 30:

	<u>2011</u>	<u>2010</u>
Investment income (loss):		
Interest and dividends	\$ 178,754	\$ 215,182
Net unrealized gains (losses)	(298,823)	667,002
Net realized gains	34,847	71,890
Total investment income (loss)	<u>\$ (85,222)</u>	<u>\$ 954,074</u>

6. Capital Assets

Capital asset additions, retirements, transfers, and balances for the years ended September 30 are as follows:

	<u>September 30, 2010</u>	<u>Additions</u>	<u>Retirements & Transfers</u>	<u>September 30, 2011</u>
Land	\$ 18,876,296	\$ -	\$ -	\$ 18,876,296
Land improvements	1,518,837	-	-	1,518,837
Buildings	65,204,626	23,999	3,357,497	68,586,122
Equipment	53,058,299	3,114,538	3,850,720	60,023,557
Construction in progress	5,171,514	4,548,651	(7,299,092)	2,421,073
Total at historical cost	<u>143,829,572</u>	<u>7,687,188</u>	<u>(90,875)</u>	<u>151,425,885</u>
Less accumulated depreciation:				
Land improvements	1,062,855	110,763	-	1,173,618
Buildings	33,665,952	3,213,584	-	36,879,536
Equipment	36,002,960	6,512,685	(90,875)	42,424,770
Total accumulated depreciation	<u>70,731,767</u>	<u>9,837,032</u>	<u>(90,875)</u>	<u>80,477,924</u>
Capital assets, net	<u>\$ 73,097,805</u>	<u>\$ (2,149,844)</u>	<u>\$ -</u>	<u>\$ 70,947,961</u>

**BEAUFORT MEMORIAL HOSPITAL AND
OTHER COMBINED ENTITY**

Notes to Combined Financial Statements, continued

	September 30, 2009	Additions	Retirements & Transfers	September 30, 2010
Land	\$ 17,870,884	\$ 1,005,412	\$ -	\$ 18,876,296
Land improvements	1,511,743	14,593	(7,499)	1,518,837
Buildings	64,256,596	403,772	544,258	65,204,626
Equipment	63,769,316	5,389,987	(16,101,004)	53,058,299
Construction in progress	732,775	3,255,909	1,182,830	5,171,514
Total at historical cost	<u>148,141,314</u>	<u>10,069,673</u>	<u>(14,381,415)</u>	<u>143,829,572</u>
Less accumulated depreciation:				
Land improvements	949,025	113,830	-	1,062,855
Buildings	30,510,181	3,369,768	(213,997)	33,665,952
Equipment	43,679,448	6,490,930	(14,167,418)	36,002,960
Total accumulated depreciation	<u>75,138,654</u>	<u>9,974,528</u>	<u>(14,381,415)</u>	<u>70,731,767</u>
Capital assets, net	<u>\$ 73,002,660</u>	<u>\$ 95,145</u>	<u>\$ -</u>	<u>\$ 73,097,805</u>

The Hospital has outstanding commitments of approximately \$11,731,000 at September 30, 2011 for various projects included in construction in progress and purchase of equipment. The projects are expected to be completed in November 2012.

7. Investment in Joint Ventures

The Hospital's ownership percentage and investments at September 30, 2011 and 2010 for entities recorded under the equity method are as follows:

	Ownership Percentage		Investment		Share of Income	
	2011	2010	2011	2010	2011	2010
The Surgery Center of Beaufort, LLC	40%	40%	\$ <u>865,629</u>	\$ <u>867,358</u>	\$ <u>680,409</u>	\$ <u>669,596</u>

Summarized unaudited financial information of The Surgery Center of Beaufort, LLC as of and for the years ended September 30, 2011 and 2010 is as follows:

	2011	2010
Total assets	\$ 3,259,567	\$ 3,444,604
Total liabilities	1,087,694	1,272,368
Equity	2,171,873	2,172,236
Revenue	5,793,651	5,873,346
Expenses	4,092,629	4,198,682
Net income	1,701,022	1,674,664

8. Long-term Debt

At September 30, long-term debt included the following:

	September 30, 2010	Additions	Reductions	September 30, 2011	Amounts due within one year
Revenue bonds	\$ 14,925,000	\$ -	\$ (1,560,000)	\$ 13,365,000	\$ 1,640,000
Less unamortized discount and deferred loss on re-financing	<u>338,870</u>	<u>-</u>	<u>(172,885)</u>	<u>165,985</u>	<u>-</u>
Total long-term debt	<u>\$ 14,586,130</u>	<u>\$ -</u>	<u>\$ (1,387,115)</u>	<u>\$ 13,199,015</u>	<u>\$ 1,640,000</u>
	September 30, 2009	Additions	Reductions	September 30, 2010	Amounts due within one year
Revenue bonds	\$ 16,415,000	\$ -	\$ (1,490,000)	\$ 14,925,000	\$ 1,560,000
Less unamortized discount and deferred loss on re-financing	<u>514,363</u>	<u>-</u>	<u>(175,493)</u>	<u>338,870</u>	<u>-</u>
Total long-term debt	<u>\$ 15,900,637</u>	<u>\$ -</u>	<u>\$ (1,314,507)</u>	<u>\$ 14,586,130</u>	<u>\$ 1,560,000</u>

On November 13, 1997, BMH issued \$28,740,000 of Series 1997 Bonds. Net proceeds of \$26,093,971 were used (i) to advance refund outstanding principal amounts for the Series 1977 Bonds and Series 1990 Bonds amounting to \$1,190,000 and \$19,580,000, respectively, (ii) to provide \$5,670,086 for the cost of acquiring construction, improving, and equipping an expansion of the Hospital, and (iii) to fund a debt service reserve account and to pay certain expenses associated with Series 1997 Bonds. The Series 1997 Bonds are secured by revenues of the Hospital. Interest is payable each May and November at rates ranging from 3.90% to 5.25%. BMH is the sole member of the obligated group.

The advance refunding resulted in an economic gain (the difference between the reacquisition price and the net carrying amount of the old and new debt service payments) of approximately \$1,300,000. The difference between the reacquisition price and the net carrying amount of the old debt, including unamortized financing costs was approximately \$2,200,000 and is reported as a reduction in the new debt and amortized to operations through the year 2012.

On December 1, 2011, BMH issued \$9,480,000 of Series 2011A Bonds. The net proceeds were used to (i) refund, with the Series 1997 Debt Service Reserve Fund, \$11,725,000 of the outstanding Series 1997 Bonds for interest cost savings and (ii) pay all of the expenses associated with the issuance of the Series 2011A Bonds. The Series 2011A Bonds are secured by revenues of the Hospital. Interest is payable monthly at 1.96% and principal is payable annually through December 2017.

Future payments under the Hospital's long-term debt agreements are:

Year Ending September 30,	<u>Principal</u>	<u>Interest</u>
2012	\$ 1,640,000	\$ 810,187
2013	1,395,000	167,578
2014	1,465,000	138,812
2015	1,535,000	108,655
2016	1,615,000	77,147
2017 to 2018	3,470,000	52,565
	<u>11,120,000</u>	<u>1,354,944</u>
Principal paid with the Series 1997 Debt Service Reserve Fund	<u>2,245,000</u>	<u>-</u>
	<u>\$ 13,365,000</u>	<u>\$ 1,354,944</u>

On December 1, 2011, BMH issued \$36,700,000 of Series 2011B Bonds. The net proceeds, which will be drawn over the 15-month construction and acquisition period, will be used to (i) finance land acquisition, site improvements, construction of an administrative building, and emergency room renovations for BMH, (ii) fund interest payments on a portion of the Series 2011B Bonds during the 15-month construction and acquisition period, and (iii) pay all of the expenses associated with the issuance of the 2011B Bonds. The Series 2011B Bonds are secured by revenues of the Hospital. Interest is payable monthly at 3.03% and principal is payable annually starting in December 2018 through December 2042.

The financing arrangements contain several covenants, the most restrictive of which requires the Hospital to maintain certain debt service coverage ratios.

9. Line of Credit

BMH has a line of credit in the amount of \$6,000,000 which bears interest at LIBOR plus 110 basis points, 1.32% at September 30, 2011. Outstanding borrowings against the line of credit totaled \$4,501,929 and \$6,403,929 for the years ended September 30, 2011 and 2010, respectively. The line of credit expires in May 2012.

10. Endowment Funds

The Foundation's board designated net assets consist of three board designated endowment funds. The endowments are to be used at the discretion of the Foundation Board of Trustees for the benefit of the Hospital.

Return Objectives and Risk Parameters

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets.

Strategies Employed for Achieving Objectives

To satisfy its long-term rate-of-return objectives, the Foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

Spending Policy

The Foundation has a policy of requesting annual withdrawals of 4.5% of the three year running average of the fiscal year end total value of the endowment unless otherwise approved by the Foundation Board of Trustees.

Changes in Endowment Net Assets for the Years Ended September 30, 2011 and 2010 are as follows:

	<u>Unrestricted</u>
Board designated endowment net assets, September 30, 2009	\$ 8,000,807
Investment return	903,105
Contributions	101,467
Amounts appropriated for expenditure	<u>(307,593)</u>
Board designated endowment net assets, September 30, 2010	8,697,786
Investment return	(121,324)
Contributions	37,135
Amounts appropriated for expenditure	<u>(364,010)</u>
Board designated endowment net assets, September 30, 2011	<u>\$ 8,249,587</u>

11. **Net Patient Service Revenue**

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

Medicare - Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services are reimbursed under a prospective payment system called the Ambulatory Payment Classification System ("APCs"). Inpatient non-acute services and defined capital and medical education costs related to Medicare beneficiaries are paid based a cost reimbursement methodology. The Hospital is reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through September 30, 2006.

Medicaid - Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Outpatient services are reimbursed at prospectively determined rates per procedures. The Hospital's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through September 30, 2003.

Revenue from Medicare and Medicaid programs accounted for approximately 40% and 12%, respectively, of the Hospital's net patient revenue for the year ended September 30, 2011, and 36% and 10%, respectively, of the Hospital's net patient service revenue, for the year ended September 30, 2010. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term as a result of third party reviews. The 2011 and 2010 net patient service revenue did not change significantly due to changes in the allowances previously estimated for tentative cost report settlements.

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

Net patient service revenue is comprised of the following at September 30:

	<u>2011</u>	<u>2010</u>
Gross patient charges at established rates	\$ 444,792,960	\$ 427,296,359
Medicaid disproportionate share	3,099,248	2,710,656
Contractual adjustments	(247,117,908)	(246,408,960)
Provision for bad debts	(25,934,003)	(15,952,978)
Charity care	<u>(23,086,760)</u>	<u>(21,598,229)</u>
Net patient service revenue	<u>\$ 151,753,537</u>	<u>\$ 146,046,848</u>

12. Professional Liability Insurance

The Hospital purchases professional medical liability insurance with coverage up to \$300,000 per individual and an aggregate of \$600,000 on an occurrence basis. The coverage for physicians employed by the facility is \$1,200,000 per occurrence. Management believes that any pending claims or unasserted claims would be settled within the limits of coverage and is not aware of any potential claims not filed with the carrier as of September 30, 2011. Should this policy lapse and not be replaced with equivalent coverage, claims based upon occurrence during its term, but reported subsequent thereto, will be uninsured.

The laws of the state limit the amount that can be recovered from certain governmental medical facilities, including the Hospital, for damages for medical services rendered by the facility or the facility's employees to \$300,000 per individual and an aggregate of \$600,000 per occurrence and \$1,200,000 for physicians employed by the facility.

There is no litigation pending, or to the knowledge of management of the Hospital threatened, which if decided adversely to the Hospital would have a material adverse effect on the business operations, financial position or operations of the Hospital. Furthermore, there is no litigation pending, or to management's knowledge threatened, involving professional liability claims in which the amount sought by the plaintiff exceeds applicable professional liability or excess insurance policy coverage limits.

13. Workers Compensation

In 2006, the Hospital obtained commercial worker's compensation insurance subject to a deductible provision of \$100,000. The Hospital is responsible for all costs associated with each incident until the deductible limit is reached. The estimated accrual for identified claims and unreported but incurred claims was approximately \$480,000 and \$579,000 at September 30, 2011 and 2010, respectively.

14. Retirement Plans

The Hospital contributes to the South Carolina Retirement System (“SCRS”). SCRS is a cost-sharing multiple-employer defined benefit pension plan administered by South Carolina Retirement Systems, a Division of the State Budget and Control Board. The payroll for all Hospital employees was \$66,189,765 and \$61,935,368 respectively, for the years ended September 30, 2011 and 2010. The payroll for Hospital employees covered by the SCRS for the years ended September 30, 2011 and 2010 was \$46,388,976 and \$41,569,173, respectively, or 70% and 67% of total Hospital payroll in 2011 and 2010, respectively. The contribution from the Hospital for the years ended September 30, 2011 and 2010 was \$4,303,437 and \$3,840,992, respectively. The Hospital’s 2011 and 2010 contributions represented less than 1% of total contributions to SCRS.

Under SCRS, employees who retire at or after age sixty-five (65) or have twenty eight (28) years of service are entitled to an annual retirement benefit, payable monthly for life equal to 1.82% of their final compensation times years of credited service. Benefits are fully vested on reaching five (5) years of earned service. Vested employees may retire at or after age sixty (60) and receive reduced retirement benefits. SCRS also provides death and disability benefits. Benefits are established by state statute. A Comprehensive Annual Financial Report containing financial statements and required supplementary information of SCRS is issued and publicly available by writing the South Carolina Retirement System, P.O. Box 11960, Columbia, SC 29211-1960 or at www.retirementsc.gov.

The employee and employer contribution rates are actuarially determined for SCRS. Covered employees are required by state statute to contribute 6.5% of their total earnings. The Hospital is required to contribute 9.24% of earnable compensation. In addition, the Hospital is required by the same statute to contribute an additional .15% in both 2011 and 2010 for group life insurance coverage.

The accrued liability is a standardized disclosure measure of the actuarial present value of the projected benefits of each individual allocated on a level basis over the earnings or service of the individual between entry age and assumed exit age(s). The measure is intended to help users assess SCRS’s funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems. SCRS does not make separate measurements of assets and benefits payable for individual employers. The unfunded accrued liability at July 1, 2010, the most recent valuation date for retired and active members, determined through an actuarial valuation performed as of that date, was approximately \$13.4 billion. The ten-year historical trend information showing SCRS’s progress in accumulating sufficient assets to pay benefits when due is presented in the June 30, 2011 Component Unit Comprehensive Annual Financial Report issued by the SCRS.

15. **Commitments Under Noncancelable Operating Leases**

The Hospital leases certain equipment under operating leases, which expire over the next six years. Rent expense was approximately \$1,926,000 and \$1,774,000 for the years ended September 30, 2011 and 2010, respectively.

The Hospital has committed to lease approximately one-third of a medical office building for Hospital operations and has also agreed to lease any unused space remaining in the building under a fifteen year master lease agreement commencing in October 2003. The Hospital has no annual contingent commitment based upon occupancy levels at September 30, 2011 and 2010.

At September 30, 2011, future minimum lease payments under the non-cancelable operating leases are as follows:

2012	\$	1,998,438
2013		1,670,216
2014		1,501,585
2015		1,211,637
2016		196,824
2017		147,618
		<hr/>
	\$	6,726,318

16. **Related Party Transactions**

The Foundation has a banking relationship with a financial institution that employs a member of the Foundation's Board of Trustees.

17. **Subsequent Event**

Subsequent events have been evaluated through January 18, 2012, which is the date the combined financial statements were available to be issued.

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY

Combining Balance Sheet

September 30, 2011

<u>Assets</u>	<u>Beaufort</u>	<u>Broad River</u>	<u>Eliminations</u>	<u>Combined</u>
Current assets:				
Cash and cash equivalents	\$ 48,871,632	\$ 951,588	\$ -	\$ 49,823,220
Short-term investments	37,781,698	-	-	37,781,698
Patient accounts receivable, net of allowance for uncollectible accounts of \$21,001,813	26,329,312	-	-	26,329,312
Other receivables	368,813	-	-	368,813
Physician receivable	8,186	-	-	8,186
Drugs and supplies	3,149,435	-	-	3,149,435
Prepaid expenses	1,641,873	7,500	-	1,649,373
Due from affiliate	2,758	-	(2,758)	-
Total current assets	<u>118,153,707</u>	<u>959,088</u>	<u>(2,758)</u>	<u>119,110,037</u>
Assets limited as to use	2,314,000	-	-	2,314,000
Investment in joint ventures	-	865,629	-	865,629
Capital assets, net	70,947,413	548	-	70,947,961
Deferred financing costs	43,021	-	-	43,021
Total assets	<u>\$ 191,458,141</u>	<u>\$ 1,825,265</u>	<u>\$ (2,758)</u>	<u>\$ 193,280,648</u>
<u>Liabilities and Net Assets</u>				
Current liabilities:				
Current portion of long-term debt	\$ 1,640,000	\$ -	\$ -	\$ 1,640,000
Line of credit	4,501,929	-	-	4,501,929
Accounts payable	5,211,093	26,144	-	5,237,237
Accrued expenses	8,295,339	-	-	8,295,339
Due to affiliate	-	2,758	(2,758)	-
Estimated third-party payor settlements	2,018,479	-	-	2,018,479
Total current liabilities	<u>21,666,840</u>	<u>28,902</u>	<u>(2,758)</u>	<u>21,692,984</u>
Long-term debt, less current portion	<u>11,559,015</u>	<u>-</u>	<u>-</u>	<u>11,559,015</u>
Total liabilities	<u>33,225,855</u>	<u>28,902</u>	<u>(2,758)</u>	<u>33,251,999</u>
Net assets:				
Invested in capital assets, net of related debt	53,289,490	548	-	53,290,038
Restricted:				
For debt service	2,314,000	-	-	2,314,000
Unrestricted	<u>102,628,796</u>	<u>1,795,815</u>	<u>-</u>	<u>104,424,611</u>
Total net assets	<u>158,232,286</u>	<u>1,796,363</u>	<u>-</u>	<u>160,028,649</u>
Total liabilities and net assets	<u>\$ 191,458,141</u>	<u>\$ 1,825,265</u>	<u>\$ (2,758)</u>	<u>\$ 193,280,648</u>

See Independent Auditors' Report.

BEAUFORT MEMORIAL HOSPITAL AND OTHER COMBINED ENTITY

Combining Statement of Revenues, Expenses, and Changes in Net Assets

For the year ended September 30, 2011

	<u>Beaufort</u>	<u>Broad River</u>	<u>Eliminations</u>	<u>Combined</u>
Operating revenues:				
Net patient service revenue, net of provision for bad debts of \$25,934,003	\$ 151,753,537	\$ -	\$ -	\$ 151,753,537
Other operating revenue	<u>2,133,844</u>	<u>-</u>	<u>-</u>	<u>2,133,844</u>
Total operating revenues	<u>153,887,381</u>	<u>-</u>	<u>-</u>	<u>153,887,381</u>
Operating expenses:				
Salaries and wages	66,189,765	-	-	66,189,765
Employee benefits	17,677,186	-	-	17,677,186
Contract labor	307,780	-	-	307,780
Supplies	25,102,054	-	-	25,102,054
Purchased services	10,757,221	-	-	10,757,221
Physician fees	4,847,349	-	-	4,847,349
Depreciation and amortization	10,051,348	-	-	10,051,348
Other	<u>11,092,886</u>	<u>15,020</u>	<u>-</u>	<u>11,107,906</u>
Total operating expenses	<u>146,025,589</u>	<u>15,020</u>	<u>-</u>	<u>146,040,609</u>
Operating income (loss)	<u>7,861,792</u>	<u>(15,020)</u>	<u>-</u>	<u>7,846,772</u>
Nonoperating revenues (expenses):				
Investment income	949,515	-	-	949,515
Interest expense	(722,629)	-	-	(722,629)
Share of income of investees, net	-	680,409	-	680,409
County apportionment	536,198	-	-	536,198
Noncapital gifts and bequests	<u>629,476</u>	<u>-</u>	<u>-</u>	<u>629,476</u>
Total nonoperating revenues	<u>1,392,560</u>	<u>680,409</u>	<u>-</u>	<u>2,072,969</u>
Excess of revenues over expenses before capital grants and contributions	9,254,352	665,389	-	9,919,741
Capital grants and contributions	<u>508,183</u>	<u>-</u>	<u>-</u>	<u>508,183</u>
Increase in net assets	9,762,535	665,389	-	10,427,924
Net assets, beginning of year	<u>148,469,751</u>	<u>1,130,974</u>	<u>-</u>	<u>149,600,725</u>
Net assets, end of year	\$ <u>158,232,286</u>	\$ <u>1,796,363</u>	\$ <u>-</u>	\$ <u>160,028,649</u>

See Independent Auditors' Report.