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

The Audit and Compliance Committee
Grady Memorial Hospital Corporation
Atlanta, Georgia

Ladies and Gentlemen:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the combined financial statements of Grady Memorial Hospital Corporation and affiliate (the System), which comprise the combined balance sheet as of December 31, 2012, and the related combined statement of operations, changes in net assets, and cash flows for the year then ended, and the related notes to the combined financial statements, and have issued our report thereon dated April 29, 2013.

Internal Control over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that were not identified.



The Audit and Compliance Committee
Grady Memorial Hospital Corporation
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Compliance and Other Matters

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

Purpose of this Report

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

KPMG LLP

Atlanta, Georgia
April 29, 2013



GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Combined Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 2000
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Independent Auditors' Report

The Board of Directors
Grady Memorial Hospital Corporation:

Report on the Combined Financial Statements

We have audited the accompanying combined financial statements of Grady Memorial Hospital Corporation and affiliate (the System), which comprise the combined balance sheets as of December 31, 2012 and 2011, and the related combined statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Combined Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement.

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

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



Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Grady Memorial Hospital Corporation and affiliate as of December 31, 2012 and 2011, and the results of their operations, changes in their net assets, and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 29, 2013 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.

KPMG LLP

April 29, 2013

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Combined Balance Sheets

December 31, 2012 and 2011

(In thousands)

Assets	2012	2011
Current assets:		
Cash and cash equivalents	\$ 47,365	60,512
Patient accounts receivable, less allowance for uncollectible accounts of \$124,216 and \$115,493 at December 31, 2012 and 2011, respectively	60,060	55,305
Grants receivable	15,908	12,476
Current portion of pledges receivable	63,066	50,339
Other current assets	73,226	20,396
Total current assets	259,625	199,028
Assets limited as to use	47,323	45,102
Property and equipment, net	311,463	308,531
Beneficial interest in net assets held by others	15,091	14,227
Pledges receivable, excluding current portion	53,876	71,276
Other assets	4,743	5,603
Total assets	\$ 692,121	643,767
Liabilities and Net Assets		
Current liabilities:		
Current portion of capital lease obligations	\$ 1,314	1,361
Current portion of notes payable	3,487	3,275
Accounts payable	19,183	20,463
Current portion of self-insurance reserves	15,505	12,572
Due to third-party payors	29,761	27,553
Due to Medical Schools	16,454	9,322
Other accrued expenses	86,085	70,306
Total current liabilities	171,789	144,852
Capital lease obligations, excluding current portion	36,079	33,369
Notes payable, excluding current portion	11,881	15,369
Self-insurance reserves, excluding current portion	44,919	53,387
Accrued postretirement benefit cost	50,124	51,089
Other long-term liabilities	5,049	10,030
Total liabilities	319,841	308,096
Net assets:		
Unrestricted	204,457	171,017
Temporarily restricted	153,849	151,544
Permanently restricted	13,974	13,110
Total net assets	372,280	335,671
Commitments and contingencies		
Total liabilities and net assets	\$ 692,121	643,767

See accompanying notes to combined financial statements.

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Combined Statements of Operations

Years ended December 31, 2012 and 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Revenue, gains, and other support:		
Net patient service revenue (net of provision for uncollectible accounts of \$263,135 in 2012 and \$215,230 in 2011)	\$ 616,222	509,367
Contributions from Fulton and DeKalb Counties	63,332	64,405
Other revenue	<u>85,729</u>	<u>79,852</u>
Total revenue, gains, and other support	<u>765,283</u>	<u>653,624</u>
Expenses:		
Salaries and benefits	335,276	304,727
Supplies and other expenses	354,410	330,216
Interest	4,716	4,882
Depreciation and amortization	<u>43,648</u>	<u>43,726</u>
Total expenses	<u>738,050</u>	<u>683,551</u>
Operating income (loss)	<u>27,233</u>	<u>(29,927)</u>
Nonoperating gains (losses):		
Investment income, net	73	264
Other	<u>(90)</u>	<u>170</u>
Total nonoperating (losses) gains, net	<u>(17)</u>	<u>434</u>
Revenue, gains, and other support in excess of (less than) expenses and losses	27,216	(29,493)
Accrued postretirement benefit cost adjustments	2,437	(4,103)
Net assets released from restriction used for the purchase of property and equipment	—	19,014
Contributions used for the purchase of property and equipment	<u>3,787</u>	<u>—</u>
Change in unrestricted net assets	<u>\$ 33,440</u>	<u>(14,582)</u>

See accompanying notes to combined financial statements.

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Combined Statements of Changes in Net Assets

Years ended December 31, 2012 and 2011

(In thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Net assets, December 31, 2010	\$ 185,599	172,610	13,472	371,681
Revenue, gains, and other support less than expenses and losses	(29,493)	—	—	(29,493)
Accrued postretirement benefit cost adjustments	(4,103)	—	—	(4,103)
Contributions	—	952	—	952
Net assets released from restriction used for the purchase of property and equipment	19,014	(19,014)	—	—
Net assets released from restriction used for operations	—	(3,004)	—	(3,004)
Net change in beneficial interest in net assets held by others	—	—	(362)	(362)
Change in net assets	<u>(14,582)</u>	<u>(21,066)</u>	<u>(362)</u>	<u>(36,010)</u>
Net assets, December 31, 2011	<u>171,017</u>	<u>151,544</u>	<u>13,110</u>	<u>335,671</u>
Revenue, gains, and other support in excess of expenses and losses	27,216	—	—	27,216
Accrued postretirement benefit cost adjustments	2,437	—	—	2,437
Contributions	—	2,500	—	2,500
Net assets released from restriction used for operations	—	(195)	—	(195)
Contributions used for the purchase of property and equipment	3,787	—	—	3,787
Net change in beneficial interest in net assets held by others	—	—	864	864
Change in net assets	<u>33,440</u>	<u>2,305</u>	<u>864</u>	<u>36,609</u>
Net assets, December 31, 2012	\$ <u>204,457</u>	<u>153,849</u>	<u>13,974</u>	<u>372,280</u>

See accompanying notes to combined financial statements.

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Combined Statements of Cash Flows

Years ended December 31, 2012 and 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Change in net assets	\$ 36,609	(36,010)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	43,648	43,726
Loss on asset disposal	1,882	—
Accrued postretirement benefit cost adjustments	(2,437)	4,103
Net realized and unrealized losses on investments	—	33
Net change in beneficial interest in net assets held by others	(864)	362
Provision for uncollectible accounts	263,135	215,230
Contributions used for the purchase of capital and equipment	(3,787)	(19,014)
Changes in operating assets and liabilities:		
Patient accounts receivable	(267,890)	(196,981)
Grants and pledges receivable	1,241	26,840
Other current assets	(52,830)	49,338
Other assets	(594)	1,039
Accounts payable and other accrued expenses	14,598	(26,919)
Due to third-party payors, net	2,208	5,031
Accrued postretirement benefit cost	720	660
Self-insurance reserves	(5,535)	11,747
Net cash provided by operating activities	<u>30,104</u>	<u>79,185</u>
Cash flows from investing activities:		
Purchase of property and equipment, net	(39,660)	(28,481)
Net change in assets limited as to use	(2,221)	(3,119)
Net cash used in investing activities	<u>(41,881)</u>	<u>(31,600)</u>
Cash flows from financing activities:		
Principal repayments under capital lease obligations	(1,881)	(2,951)
Principal repayments under notes payable	(3,276)	(3,075)
Net change in line of credit	—	(30,000)
Contributions used for the purchase of capital and equipment	3,787	19,014
Net cash used in financing activities	<u>(1,370)</u>	<u>(17,012)</u>
Net change in cash and cash equivalents	(13,147)	30,573
Cash and cash equivalents, beginning of period	<u>60,512</u>	<u>29,939</u>
Cash and cash equivalents, end of period	\$ <u>47,365</u>	\$ <u>60,512</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 3,704	2,854
Noncash disclosure information:		
Liabilities assumed for additions to property and equipment	2,804	—
New capital lease obligations during the period	4,544	—

See accompanying notes to combined financial statements.

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Notes to Combined Financial Statements

December 31, 2012 and 2011

(1) Organization, Business, and Summary of Significant Accounting Policies

Grady Memorial Hospital Corporation (the System) is a 501(c)(3) not-for-profit health system formed on March 17, 2008, which subsequently entered into a Lease and Transfer Agreement (the Agreement) effective June 1, 2008 with The Fulton-DeKalb Hospital Authority (the Authority). The System, located in Atlanta, Georgia, is comprised of Grady Memorial Hospital (one of the largest teaching hospitals in the state, licensed for over 900 beds), Hughes Spalding Children's Hospital, six free-standing primary care clinics, and other significant healthcare facilities and services consistent with an integrated delivery and medical education system serving a major metropolitan area. The System is the principal safety-net healthcare provider for the Atlanta metropolitan area, and maintains the primary Level I trauma center for the region.

The key terms and conditions associated with the Agreement follow:

- The System makes monthly lease payments to the Authority, totaling \$2.5 million in the initial year of the Agreement, and increasing each year by an amount generally measured by inflation in the published Consumer Price Index (CPI), not to exceed 3%, for an initial term of 40 years.
- The System assumed the liabilities of the Authority related to its previous operation of the former Grady Memorial Hospital and related facilities.
- In exchange for the lease payments and assumption of liabilities, the Authority transferred to the System all of the Authority's right, title, and interest in the operating assets of Grady Memorial Hospital and provided to the System the right to use its related facilities.
- The System is the agent for the Authority with respect to pre-existing Operating Agreements among the Authority, Fulton County, and DeKalb County. The Operating Agreements define the obligations of the Authority with respect to (principally) the provision of indigent care to the citizens of Fulton and DeKalb Counties (the Counties), in exchange for related ongoing funding that the Counties provide. The Authority is obligated to remit directly to the System all such funds the Authority receives from the Counties.

Certain assets and obligations of the Authority were excluded from the Agreement. In particular, the Authority retained certain assets and obligations related to (a) its sponsorship of The Fulton-DeKalb Hospital Authority Employee Pension Plan (the Plan – a frozen plan effective May 19, 2008) and (b) pre-existing Authority hospital revenue bond issues.

The Authority has defined obligations within the Agreement related to how it will apply the lease payments to its own obligations. A portion of the lease payments is to be applied to the Authority's ongoing funding of the Plan, and the Agreement requires that the System fund any shortfall between required Plan funding and available funds from the lease payments. Should there be an excess of lease payments over the Authority's bona fide operating costs and pension obligations, such excess must be returned to the System. The Authority may not carry over excess funds from year to year.

The System's acquisition of assets and assumption of liabilities under the Agreement was accounted for as a purchase. The System has recognized a capital lease obligation for the lease payments (excluding any future CPI adjustments), which were discounted at 7.24%, representing management's best estimate of a

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Notes to Combined Financial Statements

December 31, 2012 and 2011

fair value rate that might be available to the System on an unenhanced credit basis. Other acquired assets and assumed liabilities were recognized at their respective fair values.

Because any future funding obligations of the System for the Plan are currently indeterminable, those payments (if any) are accounted for on a "pay-as-you-go" basis and recognized currently in expense as invoiced from the Authority. During the years ended December 31, 2012 and 2011, the System recognized approximately \$6.3 million and \$4.3 million, respectively, in expense associated with its pension funding obligation as described herein. At December 31, 2012 and 2011, the System's accrual for this obligation totaled approximately \$0.6 million and \$0.7 million, respectively, which is included in other accrued expenses in the accompanying combined balance sheets.

The Agreement subjects the System to a number of commercially typical covenants, principally related to continuance of mission as a safety-net hospital system, maintenance of facilities, and financial and other reporting, including the System's obligation to deliver audited financial statements within 120 days of year-end.

The significant accounting policies used by the System in preparing and presenting its combined financial statements are as follows:

(a) Principles of Combination

The accompanying combined financial statements include the accounts of the System and the Henry W. Grady Memorial Foundation, Inc. (the Foundation). All significant intercompany accounts and transactions are eliminated in combination.

(b) Use of Estimates

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

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

(c) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, deposits with banks, and investments in highly liquid debt instruments with original maturities of three months or less, excluding amounts limited as to use.

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Notes to Combined Financial Statements

December 31, 2012 and 2011

(d) *Investments and Investment Income*

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

The System has adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820 – *Fair Value Measurements*. ASC 820 establishes an enhanced framework for measuring fair value and expands disclosures about fair value measurements.

In accordance with ASC 820, the System has categorized its financial instruments, based on the priority of inputs used in related valuation techniques, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets (Level 1) and observable market inputs for similar instruments (Level 2), and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure a specific financial instrument fall within multiple levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

(e) *Assets Limited as to Use*

Assets limited as to use include assets for self-insurance funding arrangements, assets designated under grant agreements, assets designated by the board of directors for capital expansion, and assets restricted by donors.

(f) *Inventories*

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

(g) *Property and Equipment*

Property and equipment transferred to the System under the terms of the Agreement are stated at fair value at the date of transfer. Property and equipment acquired subsequently are stated at cost, with the exception of donated items and the information technology contract, which are stated at fair value at the date of donation and net present value, respectively. Equipment held under capital lease obligations is initially recorded at the present value of minimum lease payments. Provisions for depreciation are computed using the straight-line method based on the estimated useful lives of the assets. Equipment held under capital lease obligations is amortized using the straight-line method over the shorter of the estimated useful life or the lease term, and such amortization is included in depreciation and amortization in the accompanying combined statements of operations.

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

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December 31, 2012 and 2011

A summary of depreciable lives is as follows:

Land improvements	3 – 8 years
Buildings and improvements	5 – 40 years
Machinery, equipment, and vehicles	3 – 20 years
Computer hardware and software	3 – 10 years

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

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

(h) *Temporarily and Permanently Restricted Net Assets*

Temporarily restricted net assets are those whose use by the System is restricted by the donor to a specific time period or purpose. Permanently restricted net assets are those that have been restricted by donors to be maintained in perpetuity. Permanently restricted net assets consist primarily of the System's beneficial interest in indigent care and nursing scholarship funds held by the Authority. All of the earnings of the trust are donor-restricted for the System's use in providing indigent and charity care.

(i) *Net Patient Service Revenue*

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

(j) *Charity Care*

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

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Notes to Combined Financial Statements

December 31, 2012 and 2011

(k) Revenue, Gains, and Other Support in Excess of (Less than) Expenses and Losses

The combined statements of operations include revenue, gains, and other support in excess of (less than) expenses and losses. Changes in unrestricted net assets, which are excluded from revenue, gains, and other support in excess of (less than) expenses and losses (to the extent applicable in any particular year), include certain postretirement benefit plan accounting adjustments and net assets released from restrictions used for purchase of property and equipment.

For purposes of presentation, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as revenue and expenses. Peripheral or incidental transactions are reported as nonoperating gains and losses.

(l) Contributions

Unconditional promises to give cash and other assets to the System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the underlying condition is satisfied by the System or the date the donor's intention to give becomes a promise to give. Gifts are reported as either temporarily or permanently restricted support 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 purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the combined statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying combined financial statements.

(m) Asset Retirement Obligations

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

(n) Impairment of Long-Lived Assets

Long-lived assets, such as property and equipment and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized to the extent that the carrying amount of an asset exceeds its fair value. Assets to be disposed of are separately presented in the combined balance sheet and reported at the lower of the carrying amount or fair value less costs to

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

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December 31, 2012 and 2011

sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held-for-sale are presented separately in the appropriate asset and liability sections of the combined balance sheet. In the period in which the disposal group is sold or classified as held-for-sale, the results of its operations are classified as discontinued operations in the combined statement of operations.

(o) *Income Taxes*

The System has been recognized by the Internal Revenue Service as exempt from federal income tax under Internal Revenue Code Section 501(a) as an organization described in Section 501(c)(3), and therefore, related income is generally not subject to federal or state income taxes. The Foundation has been similarly recognized.

The System applies FASB ASC 740, *Income Taxes* (ASC 740), which addresses the accounting for uncertain income tax positions. ASC 740 provides guidance on when tax positions are recognized in an entity's financial statements and how the values of these positions are determined. There is no impact on the System's combined financial statements as of a result of applying ASC 740.

(p) *Postretirement Benefit Plan*

The System applies the recognition and disclosure provisions of FASB ASC Topic 715, *Compensation – Retirement Benefits* (ASC 715). ASC 715 requires that the System recognize the unfunded status of its postretirement benefit plan on its combined balance sheets. ASC 715 also requires measurement of plan assets and benefit obligations as of the System's fiscal year-end.

(q) *Subsequent Events*

The System has evaluated subsequent events through April 29, 2013, the date the combined financial statements were issued.

(r) *Reclassifications*

Certain 2011 amounts have been reclassified to conform to the 2012 presentation.

(s) *Recently Adopted Accounting Standards*

During fiscal 2012, the System adopted the provisions of FASB Accounting Standards Update (ASU) 2011-07, *Health Care Entities (Topic 954): 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 requires the reclassification of the provision for uncollectible accounts associated with patient service revenue from an operating expense to a deduction from patient service revenue (net of contractual allowances and discounts). ASU 2011-07 also requires enhanced disclosure about healthcare entities' policies for recognizing revenue and assessing uncollectible accounts, and disclosures of patient service revenue and qualitative and quantitative information about changes in the allowance for uncollectible accounts.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (ASU 2011-04). ASU 2011-04 does not extend the use of fair value but provides guidance about how

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December 31, 2012 and 2011

fair value should be applied where it already is required or permitted under International Financial Reporting Standards (IFRS) or U.S. GAAP. Under U.S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS. A nonpublic entity is required to apply the ASU prospectively for annual periods beginning after December 15, 2011. The System's adoption of ASU 2011-04 during 2012 did not have a material impact on the System's combined financial statements.

(1) *Healthcare Industry Environment*

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

Additionally, the general healthcare industry environment is increasingly uncertain, especially with respect to the impacts of federal healthcare reform legislation, which was passed in the spring of 2010 and largely upheld by the U.S. Supreme Court in June 2012. Potential impacts of ongoing healthcare industry transformation include, but are not limited to:

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

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

(2) **Principal Safety Net Healthcare Provider – Implications for the System**

The System's formation was driven by the strategic vision of local business and community leaders who recognized the overriding importance of Grady Memorial Hospital in providing appropriately accessible healthcare for the indigent and other potentially under-served populations in the region. In short, the vision is founded on a deep desire to ensure that the System can both survive and thrive in an increasingly competitive and challenging healthcare industry environment. The System's ability to continue its mission

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on a long-term sustainable basis is a critical benefit to the citizens of both metropolitan Atlanta and the State of Georgia.

As indicated in note 1, the System is the principal safety-net healthcare provider for the Atlanta metropolitan area. Additionally, because the System is the primary Level I trauma center for the region (and for other reasons unique to the System), it also has significant patient volumes from outside of the metropolitan area. Finally, the System is one of the largest medical education platforms in Georgia. Given all of those factors, the System's payor mix is heavily influenced by care to the uninsured and underinsured. The financing of the System's care for this critical population is provided through two key sources:

- Funding from the Counties, as described in note 1, which totaled approximately \$63.3 million and \$64.4 million for the 2012 and 2011 calendar years, respectively.
- Funding from the combined state/federal Medicaid disproportionate share program (referred to in Georgia as the Indigent Care Trust Fund, or ICTF), which totaled approximately \$95.6 million and \$74.2 million for the 2012 and 2011 calendar years, respectively.

The System is largely dependent on the two financing sources described above to provide net cash from operations at levels sufficient to fund the System's operating activities in a fashion consistent with its mission. Any material reduction in funds from these two financing sources would have a materially adverse impact on the System's financial results. Management recognizes the risks inherent in the System's dependence on these financing sources.

As previously noted, the System is the legal agent for the Authority's obligations to the Counties regarding the provision of indigent care to the Counties' citizens, under the terms of continuing Operating Agreements that obligate the Counties to fund the cost of that care according to certain defined criteria. To further clarify Fulton County's obligations (which have historically represented the significant majority of related funding), the Authority and Fulton County entered into a Memorandum of Understanding (the MOU), which effectively further memorializes the financial obligation of Fulton County under the Operating Agreements. System management views the MOU as an important additional level of confirmation ensuring that funding it receives from the Counties will continue at levels reasonably consistent with the services the System provides to the Counties' citizens. Nevertheless, funding under the Operating Agreements (as supplemented by the MOU) is necessarily subject to political and related implications arising from the Counties' budgeting and related processes, and therefore, there are no guarantees regarding future funding amounts beyond the commitments evidenced in the Operating Agreements.

Under the provisions of the ICTF program, the System contributes funds to be used by the state in the Medicaid program that are then supplemented by federal funds, the aggregate of which are often referred to as combination dollars. The combination dollars are returned to the System as additional Medicaid inpatient reimbursement. The state Medicaid program is funded on a state fiscal year basis (the state maintains a June 30 fiscal year-end). As of December 31, 2012 and 2011, the System has been approved to participate in the state fiscal 2013 ICTF program; the state fiscal 2014 ICTF program plan terms have not been finalized. Because of the importance of the ICTF funding to the System, management maintains routine contact with state Medicaid officials and has no reason to believe that the System's participation in the state fiscal 2014 ICTF program will be meaningfully different from the System's historical

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participation. Nevertheless, there can be no assurance that the specific funding levels associated with the System's future participation in this program will be maintained at or near historical levels, or that the program will not ultimately be discontinued or materially modified. Distributions of the annual ICTF funding are generally disbursed in semiannual lump sums, the timing of which varies from year to year. Amounts outstanding for fiscal 2012 totaled \$50.5 million and are included in other current assets in the accompanying combined balance sheets. The fiscal 2012 outstanding amount was received by the System in February 2013.

The System's funding contribution to the ICTF program has historically been facilitated by a specific line-of-credit financing arrangement with a commercial bank. On August 3, 2012, the System obtained an amendment to the commitment letter dated August 3, 2011 from the bank, which is expected to fully enable the System's necessary funding contributions through expiration of the arrangement in August 2013. Management is in discussions with the commercial bank regarding routine renewal of the line, and anticipates such renewal prior to expiration with substantially the same terms and conditions as the existing facility. However, there is currently no commitment to renewal from the bank and such renewal is not assured.

Significant operational improvements have been achieved since the formation of the System and management remains focused on continuing to improve operational efficiencies and growing revenue.

An important goal in the creation of the System was the solicitation of contributions from community donors who had previously not significantly supported Grady Memorial Hospital. To that end, the System has received multiple commitments totaling approximately \$315 million through December 31, 2012 for contributions to support the System's significant need to improve its capital asset base. In particular, The Woodruff Foundation committed \$200 million to the System for capital improvements to be used over an indefinite period as needed. These funds have been, and will be, directed to a number of important capital asset needs, including major clinical equipment upgrades and new information technology systems. These capital asset additions support the System's important strategic goals of improving clinical quality, attracting commercial and other insured patients, giving physicians and other clinicians clinical equipment that is consistent with current standards of care, and creating support systems that optimize effectiveness and efficiency in both clinical and nonclinical information reporting.

The System's ability to continue to pursue its safety net mission in a fashion consistent with otherwise-comparable institutions serving major metropolitan areas is dependent on a number of factors, the most important of which have been described above. A reasonably assured funds flow from the Counties, continued participation in the ICTF program at legacy levels, achievement of continued operational improvement strategies, and enhanced community fund-raising support are all vital to the System's mission. Management believes that the System is well-positioned against the critical dependencies previously described, but also notes that any material variance from the System's expectations in any of these areas would have an associated material adverse effect on financial condition and results of operations.

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(3) Other Current Assets

The composition of other current assets is as follows:

	December 31	
	2012	2011
	(In thousands)	
Prepaid expenses	\$ 8,884	6,496
Inventories	12,037	11,551
Due from state reimbursement programs	50,513	—
Other current assets	1,792	2,349
	<u>\$ 73,226</u>	<u>20,396</u>

(4) Assets Limited as to Use

The composition of assets limited as to use is as follows:

	Fair value hierarchy level	December 31	
		2012	2011
		(In thousands)	
Internally designated for capital acquisition and other uses:			
Cash and cash equivalents	Level 1	\$ 1,439	1,447
Mutual funds	Level 1	2,293	2,283
		<u>3,732</u>	<u>3,730</u>
Held by trustee under escrow agreements:			
Cash and cash equivalents	Level 1	941	866
Held by trustee under self-insurance programs:			
Cash and cash equivalents	Level 1	—	23
U.S. government and agency bonds	Level 1	—	905
		<u>—</u>	<u>928</u>
Insurance guaranty trust fund:			
Cash and cash equivalents	Level 1	7,824	7,808
Limited by donors for specific purposes:			
Cash and cash equivalents	Level 1	32,312	29,300
Mutual funds – proprietary funds	Level 1	313	290
Common collective trust funds	Level 1	2,201	2,180
		<u>34,826</u>	<u>31,770</u>
Totals		<u>\$ 47,323</u>	<u>45,102</u>

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There were no significant transfers between Level 1 and Level 2 during the years ended December 31, 2012 and 2011.

The composition of investment income is as follows:

	Year ended December 31	
	2012	2011
	(In thousands)	
Interest and dividends	\$ 73	297
Realized gains on sales of investments	—	190
Net unrealized losses on investments	—	(223)
	<u>\$ 73</u>	<u>264</u>

(5) Property and Equipment

A summary of property and equipment is as follows:

	December 31	
	2012	2011
	(In thousands)	
Land and land improvements	\$ 2,765	2,714
Buildings, leasehold improvements, and fixtures	231,167	230,083
Equipment	155,760	126,425
Computer hardware and software	68,852	61,920
	<u>458,544</u>	<u>421,142</u>
Less accumulated depreciation and amortization	(164,458)	(123,235)
	294,086	297,907
Construction in progress	17,377	10,624
	<u>\$ 311,463</u>	<u>308,531</u>

Construction in progress at December 31, 2012 and 2011 principally consists of expenditures related to renovation of existing facilities. Current projects in process at December 31, 2012 are largely planned for completion in fiscal 2013 at an estimated total remaining cost to complete of approximately \$24.4 million.

Equipment under capital lease obligations at December 31, 2012 and 2011, exclusive of amounts held under the Agreement, is approximately \$15.6 million and \$11.0 million, respectively. Related accumulated amortization at December 31, 2012 and 2011 is \$9.0 million and \$6.7 million, respectively.

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(6) Pledges Receivable

Pledges receivable are due as follows:

	<u>December 31</u>	
	<u>2012</u>	<u>2011</u>
	(In thousands)	
Less than one year	\$ 63,920	50,339
One to five years	<u>58,975</u>	<u>79,319</u>
	122,895	129,658
Less:		
Unamortized discounts ranging from 2.1% to 3.5% at December 31, 2012 and 2011	3,795	5,736
Allowance for doubtful pledges	<u>2,158</u>	<u>2,307</u>
	<u>\$ 116,942</u>	<u>121,615</u>

(7) Other Accrued Expenses

The composition of other accrued expenses is as follows:

	<u>December 31</u>	
	<u>2012</u>	<u>2011</u>
	(In thousands)	
Accrued salaries and benefits	\$ 35,652	30,462
Authority pension plan funding obligation	634	737
Current portion of accrued postretirement benefit cost	1,670	2,422
Due to related party (note 17(a))	11,295	2,628
Other accrued expenses	<u>36,834</u>	<u>34,057</u>
	<u>\$ 86,085</u>	<u>70,306</u>

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(8) Notes Payable

During 2009, the System entered into separate agreements with Emory University and Morehouse School of Medicine to convert certain accounts payable then due under healthcare services contracts (as described further in note 16) to long-term debt. Amounts outstanding are reflected as notes payable in the accompanying combined balance sheets and consist of the following:

	<u>December 31</u>	
	<u>2012</u>	<u>2011</u>
	(In thousands)	
Note payable to Emory University, payable in monthly installments of \$268,000, including imputed interest at approximately 6.3% per annum. Final payment is due on December 31, 2016.	\$ 12,883	16,104
Note payable to the Morehouse School of Medicine, payable in monthly installments of \$95,000, including imputed interest at approximately 6.3% per annum. Final payment is due on December 31, 2016.	<u>4,546</u>	<u>5,683</u>
	17,429	21,787
Less:		
Allowance for interest	2,061	3,143
Current installments	<u>3,487</u>	<u>3,275</u>
Notes payable, less current installments	<u>\$ 11,881</u>	<u>15,369</u>

(9) Self-Insurance Programs

The System is self-insured for its general and professional liability insurance coverages. The System's self-insured retention is \$5 million per claim. Commercial insurance has been obtained to provide for coverage in excess of the System's self-insured retention limits on a claims-made basis.

The general and professional self-insurance reserves included in the accompanying combined balance sheets, totaling \$56.4 million and \$60.4 million at December 31, 2012 and 2011, respectively, include estimates of the ultimate costs for both reported claims and claims incurred but not reported. The System has employed independent actuaries to estimate the ultimate costs of the settlement of such claims. Accrued general and professional liability reserves have been discounted at 1.0% and 3.5% at December 31, 2012 and 2011, respectively.

The System is self-insured for its workers' compensation liability exposures up to limits of \$350,000 per claim. Commercial insurance has been obtained to provide for excess workers' compensation liability coverage. The related amounts recorded by the System in the accompanying combined balance sheets totaled \$4.0 million (discounted at 1.0%) and \$5.6 million (undiscounted) at December 31, 2012 and 2011, respectively.

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The System sponsors a self-insured program for its employee health benefits up to limits of \$250,000 per claim. The System recognized related reserves of approximately \$2.0 million and \$2.5 million in accrued medical benefits (included in other accrued expenses) in the accompanying 2012 and 2011 combined balance sheets, respectively. The reserves include estimates of the ultimate cost for claims incurred but not reported.

In the opinion of management, adequate provision has been made for losses that may occur from the asserted and unasserted claims for each of these self-insurance programs.

(10) Net Patient Service Revenue

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

Medicare – Substantially all acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Certain types of exempt services and other defined payments related to Medicare beneficiaries are paid based upon cost reimbursement or other retroactive-determination methodologies. Payments for cost reimbursable items are made at tentative rates, with final settlement determined after submission of annual cost reports by Grady Memorial Hospital and audits by the Medicare administrative contractors. Grady Memorial Hospital's cost reports have been audited and settled for all fiscal years through 2007. Revenue from the Medicare program accounted for approximately 27% and 28% of the System's net patient service revenue for the years ended December 31, 2012 and 2011, respectively.

Medicaid – Inpatient services rendered to Medicaid program beneficiaries are generally paid based upon prospective reimbursement methodologies established by the State of Georgia. Certain types of exempt services and outpatient services related to Medicaid beneficiaries are paid based upon cost reimbursement or other retroactive-determination methodologies. Payments for cost reimbursable items are made at tentative rates, with final settlement determined after submission of annual cost reports by the System and audits by the Medicaid fiscal intermediary. Grady Memorial Hospital's cost reports have been audited and settled for all fiscal years through 2007. The System also contracts with certain managed care organizations to receive reimbursement for providing services to Medicaid beneficiaries. Payment arrangements with these managed care organizations consist primarily of prospectively determined rates per discharge, discounts from established charges, or prospectively determined per diem rates. Revenue from the Medicaid program accounted for approximately 45% and 46% of the System's net patient service revenue for the years ended December 31, 2012 and 2011, respectively.

As described in note 2, the System participates in the state ICTF program (which for purposes of disclosure here also includes the System's participation in an ancillary program referred to as the Upper Payment Limit program). Net amounts received from the ICTF program are recognized as additional Medicaid inpatient reimbursement and, therefore, are reflected in net patient service revenue. The related net reimbursement benefit recognized by the System for the years ended

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December 31, 2012 and 2011 was approximately \$107.7 million and \$80.6 million, respectively. The fact that the System's fiscal year-end differs from the state fiscal year also drives certain timing differences in terms of ICTF funds both received and to be received. The System's ICTF revenue is subject to retrospective adjustment in future periods based upon audits as required by CMS.

The System has also entered into other reimbursement arrangements providing for payment methodologies, which include prospectively determined rates per discharge, prospectively determined per diem amounts, and discounts from established charges.

With respect to reserves for third-party payor cost report audits and anticipated settlements, the System routinely provides such reserves through initial audit and final settlement of the cost reports. The System has historically provided such reserves in recognition of the complexity of relevant reimbursement regulations and the volatility of related settlement processes. In any event, the System's estimates in this area will differ from actual experience, and those differences may be material.

The composition of net patient service revenue (excluding charity care) is as follows:

	Year ended December 31	
	2012	2011
	(In thousands)	
Gross patient service revenue	\$ 2,091,491	1,811,718
Less provisions for contractual and other adjustments	1,212,134	1,087,121
Less provision for uncollectible accounts	263,135	215,230
Net patient service revenue	<u>\$ 616,222</u>	<u>509,367</u>

As further described in both notes 1 and 2, the System is the principal safety net healthcare provider for the Atlanta metropolitan area. As a result, the System provides significant amounts of healthcare services to a large number of uninsured citizens in the region, the majority of whom do not have the means to pay for the cost of services provided. Consistent with the System's mission, all patients are served without regard to ability to pay and charity care is offered to all in accordance with the System's financial assistance policies. While a significant number of uninsured patients apply and qualify for financial assistance, a large population of uninsured patients that are cared for by the System (especially those provided emergency care) does not qualify for financial assistance, and therefore, the System also incurs significant amounts of bad debt expense related to the charges for services provided.

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The System recognizes patient service revenue associated with services provided to patients with third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for community financial aid, the System recognizes revenue on the basis of its discounted rates for services provided. On the basis of historical experience, a significant portion of the System's uninsured patients are unable or unwilling to pay for the services provided. Thus, the System records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized during the years ended December 31, 2012 and 2011 from these major payor sources, is as follows:

	2012		
	<u>Third-party payors</u>	<u>Self-pay</u> (In thousands)	<u>Total</u>
Patient service revenue, net of contractual adjustments and discounts	\$ 601,784	277,573	879,357

	2011		
	<u>Third-party payors</u>	<u>Self-pay</u> (In thousands)	<u>Total</u>
Patient service revenue, net of contractual adjustments and discounts	\$ 495,119	229,478	724,597

The System provides services to patients who do not have the ability to pay and who qualify for charity services pursuant to established policies of the System. Charity services are defined as those for which patients have the obligation and willingness to pay but do not have the ability to do so. The System does not include charity care in net patient service revenue. The cost of charity care provided totaled \$107.3 million and \$106.9 million for the years ended December 31, 2012 and 2011, respectively. The System estimated these costs by applying a ratio of cost to gross charges to the gross uncompensated charges associated with providing care to charity patients.

The System incurred bad debt expense, valued at established charges, of \$263.1 million and \$215.2 million for the years ended December 31, 2012 and 2011, respectively. In an effort to improve amounts collected from uninsured patients that do not apply and/or qualify for charity assistance, the System offers discounted prices to the uninsured. In addition to charity care and bad debt write-offs, the System provided discounts to the uninsured of \$90.6 million and \$64.7 million (recorded as discounts in net patient service revenue) for the years ended December 31, 2012 and 2011, respectively.

The Health Information Technology for Economic and Clinical Health (HITECH) Act was enacted as part of the American Recovery and Reinvestment Act of 2009 and signed into law in February 2009. In the context of the HITECH Act, the System must implement a certified Electronic Health Records (EHR) technology in an effort to promote the adoption and "meaningful use" of health information technology (HIT). The HITECH Act includes significant monetary incentives and payment penalties meant to

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encourage the adoption of EHR technology. The System anticipates that its current efforts at implementing an enterprise-wide EHR technology will enable its compliance with the meaningful use objectives mandated in the HITECH legislation. During both fiscal 2012 and 2011, the System recognized approximately \$4.1 million in incentive payments under the Georgia Medicaid EHR incentive payment program related to its efforts at implementing a certified EHR technology. During fiscal 2012, the System recognized approximately \$1.8 million in incentive payments under the Medicare EHR incentive payment program. The incentive payments are included as other operating revenue in the accompanying combined statements of operations.

(11) Employee Benefits Plans

(a) Postretirement Medical Plan

The System provides retiree medical benefits covering all employees of the System who previously retired at age 55 or older with at least 10 years of service. In fiscal 2008, the System amended this plan to limit availability of retiree medical benefits to current employees aged 50 or older on September 4, 2008 and who retire at age 62 or older with at least 10 years of service. The cost of providing most of these benefits is shared with the retirees. The plan is unfunded, and therefore, the System's participation is on a "pay-as-you-go" basis.

The changes in the accumulated postretirement benefit obligation (APBO) during the years ended December 31, 2012 and 2011 are as follows:

	December 31	
	2012	2011
	(In thousands)	
APBO, beginning of year	\$ 53,511	48,748
Service cost	1,528	1,454
Interest cost	2,014	2,470
Plan participant contributions	1,209	1,295
Benefits paid	(2,312)	(2,548)
Actuarial (gain) loss	(4,156)	2,092
APBO, end of year	<u>\$ 51,794</u>	<u>53,511</u>

The amounts recognized in the accompanying combined balance sheets are as follows:

	December 31	
	2012	2011
	(In thousands)	
Current liabilities	\$ 1,670	2,422
Long-term liabilities	<u>50,124</u>	<u>51,089</u>
Net amount recognized	<u>\$ 51,794</u>	<u>53,511</u>

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The amounts accumulated in unrestricted net assets are as follows:

	December 31	
	2012	2011
	(In thousands)	
Prior service credit	\$ (11,397)	(13,409)
Net loss	289	4,430
	<u>\$ (11,108)</u>	<u>(8,979)</u>

The total amount of prior service credit and actuarial net loss expected to be amortized into net periodic postretirement benefit cost in 2013 is a net credit of \$2.0 million.

Weighted average assumptions used to determine benefit obligations in the accompanying combined balance sheets are as follows:

	December 31	
	2012	2011
Discount rate	3.80%	4.60%
Rate of compensation increases	N/A	N/A

The components of net periodic postretirement benefit cost, which is included in salaries and benefits, are as follows:

	Year ended December 31	
	2012	2011
	(In thousands)	
Service cost	\$ 1,528	1,454
Interest cost	2,014	2,470
Amortization of prior service credit	(2,011)	(2,011)
Amortization of net gain	(14)	—
Net periodic postretirement benefit cost	<u>\$ 1,517</u>	<u>1,913</u>

Weighted average assumptions used to determine net periodic postretirement benefit cost are as follows:

	Year ended December 31	
	2012	2011
Discount rate	4.60%	5.40%
Expected long-term rate of return on plan assets	N/A	N/A
Rate of compensation increases	N/A	N/A

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Assumed healthcare cost trend rates are as follows:

2013		7.50%
2014		7.30
2015		7.10
2016		7.00
2017		6.80
2018 – 2027	Reduce by 0.20% per year	
2028 and thereafter		4.50

Assumed healthcare cost trend rates can have a significant effect on amounts reported for postretirement healthcare benefits. A 1% increase in the healthcare cost trend rate would increase the APBO by approximately \$7.4 million and increase interest and service cost by approximately \$573,000. A 1% decrease in the healthcare cost trend rate would decrease the APBO by approximately \$6.1 million and reduce interest and service cost by approximately \$472,000.

Expected Future Benefit Payments

The following benefit payments are expected to be paid (in thousands):

2013	\$	1,670
2014		1,824
2015		1,926
2016		2,139
2017		2,359
2018 – 2022		14,230

(b) *Defined Contribution Savings Plan*

The System sponsors a defined contribution savings plan, which covers substantially all of its employees. Total matching contributions made and accrued under the savings plan totaled approximately \$4.3 million and \$3.6 million for the years ended December 31, 2012 and 2011, respectively.

Beginning January 1, 2009, the deferred retirement savings program changed from the previous 403(b) plan sponsored by the Authority to a 401(k) Plan sponsored by the System. The System matches employee contributions dollar for dollar up to 4% of eligible employees' base compensation after completion of one year of eligible service. Employees are immediately fully vested in matching contributions. Under the new plan, an employer discretionary nonelective provision exists whereby the System also may contribute at its discretion up to 2% of the eligible employees' annual based compensation. Eligible employees are not obligated to have made voluntary contributions to be eligible for the nonelective discretionary 2% contribution. Eligible employees vest in the 2% nonelective contributions at a rate of 20% per year over five years of service to attain 100% vesting after completion of year five, including credit for service rendered prior to December 31, 2008.

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(12) Leases

As previously described in note 1, the Agreement was determined to be a capital lease obligation under relevant accounting literature. Additionally, the System has also entered into certain other noncancelable medical equipment leases, determined to be capital lease obligations under relevant accounting literature, which expire at various dates through 2019. Future minimum payments under these capital lease obligations at December 31, 2012 are as follows (in thousands):

	<u>The Agreement</u>	<u>Other</u>
Payable in fiscal year:		
2013	\$ 2,500	1,331
2014	2,500	778
2015	2,500	778
2016	2,500	663
2017	2,500	663
Thereafter	<u>76,042</u>	<u>774</u>
	88,542	4,987
Less:		
Interest cost	55,718	418
Current portion	<u>218</u>	<u>1,096</u>
	<u>\$ 32,606</u>	<u>3,473</u>

The System has also entered into certain noncancelable leases for office space and office equipment, determined to be operating leases under relevant accounting literature, which expire at various dates through 2025. Total rent expense recognized for the years ended December 31, 2012 and 2011 was approximately \$5.2 million and \$4.3 million, respectively, principally for building and equipment rentals.

Future minimum payments due under noncancelable operating leases as of December 31, 2012 are as follows (in thousands):

Payable in fiscal year:	
2013	\$ 1,756
2014	1,771
2015	1,601
2016	1,641
2017	1,590
Thereafter	<u>3,224</u>
	<u>\$ 11,583</u>

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(13) Temporarily Restricted Net Assets

Temporarily restricted net assets as of December 31, 2012 and 2011 are restricted by donors for the following purposes:

	December 31	
	2012	2011
	(In thousands)	
Capital improvements	\$ 148,129	145,580
Fund-raising and other programs	5,720	5,964
	<u>\$ 153,849</u>	<u>151,544</u>

(14) Business and Credit Concentrations

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

The composition of the System's net accounts receivable balance by payor type is as follows:

	December 31	
	2012	2011
Medicare	21%	22%
Medicaid	33	30
Commercial and other third-party payors	44	45
Patients	2	3
	<u>100%</u>	<u>100%</u>

(15) Fair Value of Financial Instruments

The carrying amounts of all applicable financial instruments reported in the accompanying combined balance sheets approximate their estimated fair values, in all significant respects, at December 31, 2012 and 2011. Fair value of a financial instrument is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurements date.

(16) Affiliation with Medical Schools

The System serves as one of the largest teaching hospitals in the state of Georgia. In that respect, the System has contracts with both Emory University (Emory) and the Morehouse School of Medicine (Morehouse) (collectively, the Medical Schools), wherein practicing interns and residents of the Medical Schools receive clinical training at the System. The teaching services provided to the interns and residents

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Notes to Combined Financial Statements

December 31, 2012 and 2011

are provided primarily by faculty members of the Medical Schools in addition to other clinical and administrative services, which they provide to the System. The Medical Schools are compensated for the costs of interns and residents effectively at cost. The Medical Schools are compensated for the faculty teaching, administrative, and clinical services based on certain formulas that consider the number of interns and residents taught, time spent performing administrative services and otherwise unreimbursed clinical services, and consider fair market value of compensation rates by specialty and ranking. Additionally, the System has agreed to fund other costs specifically associated with the ongoing provision of physician services by the Medical Schools, including the cost of professional liability exposures and the funding of intergovernmental transfers to enable the receipt of related Medicaid program supplemental payments for physician services billed by the Medical Schools. The current contracts expire on June 30, 2013 for Emory (renewal expected in May 2013) and January 15, 2018 for Morehouse. Total expense for direct physician services under these contracts totaled approximately \$89.4 million and \$82.5 million for the years ended December 31, 2012 and 2011, respectively, and is reported in supplies and other expenses in the accompanying combined statements of operations.

The System has historically provided significant support to Morehouse to fund its operations and associated residency programs. Support payments of \$11.4 million and \$16.2 million were provided to Morehouse in 2012 and 2011, respectively, in addition to other contractual support for professional services. As a result of the System's unique relationship with Morehouse, the System receives supplemental Medicaid payments from the State. Supplemental Medicaid payments received by the System were \$14.2 million and \$28.9 million in 2012 and 2011, respectively.

(17) Related Party Transactions

(a) *HSOC, Inc.*

With the execution of the Agreement (note 1), HSOC, Inc. (HSOC) committed to a total of \$15 million of donated capital for capital improvements to Hughes Spalding Children's Hospital (Hughes Spalding). The System has a contract with HSOC, a nonprofit affiliate of Children's Healthcare of Atlanta (CHOA), whereby HSOC provides certain management, administrative, and related services to Hughes Spalding for an initial term of 15 years beginning in February 2006. The contract requires that Hughes Spalding operate under the name "Children's Healthcare of Atlanta at Hughes Spalding." HSOC is responsible for the costs of operating Hughes Spalding. The System has a commitment of \$2 million of specific annual support for the operation of Hughes Spalding and CHOA has a matching support commitment of \$2 million annually. Additionally, the System is responsible for 50% of the Hughes Spalding "Excess/Deficit" (as defined) up to a total of \$2 million annually, not to exceed \$4 million in any successive rolling three-year period. The System maintains ownership of Hughes Spalding, including ownership of Hughes Spalding's certificate of need, licensure, and provider agreements. The System provided support for Hughes Spalding totaling \$2.3 million and \$3.2 million during the years ended December 31, 2012 and 2011, respectively, in fulfilling its annual support commitment. Hughes Spalding also received \$2.3 million and \$3.2 million from CHOA during the years ended December 31, 2012 and 2011, respectively, related to its annual support commitment. Amounts due to HSOC were \$11.3M and \$2.6M as of December 31, 2012 and 2011, respectively, and are included in other accrued expenses in the accompanying combined balance sheets.

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Notes to Combined Financial Statements

December 31, 2012 and 2011

The management agreement also gives CHOA the right to acquire Hughes Spalding, subject to a lease/purchase negotiation with the System and other terms and conditions. Any such option, if elected, contemplates a reversionary interest on the part of the System and other System involvement in HSOC's potential ownership of Hughes Spalding, which would be subject to additional negotiation as well. The agreement also contemplates that, given the \$15 million in original donations by HSOC and other ongoing consideration under the agreement as described above, there would be no further economic consideration required in the exercise of the HSOC option. Given the significant uncertainties associated with the potential future exercise of the HSOC option, there is no current recognition of the option in the System's combined financial statements.

(b) *Fulton-DeKalb Hospital Authority*

During both the years ended December 31, 2012 and 2011, \$2.5 million of lease payments were provided to the Authority in accordance with the Agreement. As required by the Agreement, at the conclusion of the "lease years" ended May 31, 2012 and 2011, no excess funds were applied toward the Authority's pension obligation and excess funds in the amount of \$659,000 and \$200,000 had yet to be applied as of December 31, 2012 and 2011, respectively.

(18) Line of Credit

The System has historically maintained a line-of-credit facility with a commercial bank, which serves as bridge financing for the System's intergovernmental transfer (IGT) funding requirements for the ICTF program (notes 2 and 10) and as a general revolving working capital facility. On August 3, 2012, the System executed an amendment to its prior commitment letter dated August 3, 2011 with the bank for renewal of the facility for the upcoming annual ICTF program cycle, and therefore, the new facility currently expires on August 2, 2013. The working capital component generally provides a range of \$10 million to \$50 million of non-IGT funding capacity, while the ICTF program component generally flexes with the required amount of IGT funding. In total, the facility is currently estimated at \$50 million.

The ICTF program component is repaid with the receipt of related program funds by the System, and reduces to zero as the System's IGT funding requirements for the current program year are met. Amounts outstanding under the working capital and ICTF program components accrue interest at LIBOR plus 220 basis points and 150 basis points, respectively. The working capital component carries a 20 basis point commitment fee on the unused line, while the ICTF program component carries a commitment fee of 10 basis points against each associated draw. The facility matures 364 days from closing. No amounts were outstanding under the facility at both December 31, 2012 and 2011.

GRADY MEMORIAL HOSPITAL CORPORATION AND AFFILIATE

Notes to Combined Financial Statements

December 31, 2012 and 2011

(19) Information Technology Contract

The System has entered into a software and services agreement with a major information technology vendor. The agreement generally commits the System to the purchase of a variety of information technology products and services from this vendor for a defined payment stream over the term of the contract. Certain software license and support fees and related implicit maintenance costs (totaling approximately \$13.8 million) were capitalized during fiscal 2010 with recognition of an associated liability related to the System's acquisition of these intangible assets. Implied maintenance costs of approximately \$6.5 million are being amortized over the estimated useful life of the implicit maintenance period of five years. Such costs are included in computer software and other assets in the accompanying combined balance sheets. Other contract costs are evaluated for capitalization or expense recognition under relevant accounting literature as associated products and/or services are provided.

The following table summarizes the future payment commitments by year under the contract as of December 31, 2012:

	Capitalized software and implicit maintenance costs obligation
	<u>(In thousands)</u>
Payable in fiscal year:	
2013	\$ 3,732
2014	2,218
	<u>5,950</u>
Less:	
Interest cost	235
Current portion (included in other accrued expenses)	<u>3,538</u>
Long-term obligation (included in other long-term liabilities)	\$ <u><u>2,177</u></u>

Interest expense incurred under the agreement in fiscal 2012 and 2011 was approximately \$343,000 and \$490,000, respectively.





KPMG LLP
Suite 2000
303 Peachtree Street, N.E.
Atlanta, GA 30308-3210

April 29, 2013

Audit and Compliance Committee
Grady Memorial Hospital Corporation and affiliate
Atlanta, Georgia

Ladies and Gentlemen:

In planning and performing our audit of the combined financial statements of Grady Memorial Hospital Corporation and affiliate (the System), as of and for the year ended December 31, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the System's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the combined financial statements but not for the purpose of expressing an opinion on the effectiveness of the System's internal control. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

Annual Financial Reporting Process

We continue to note that marked improvements and progress have been made by the System relative to its financial accounting and reporting function and commend the System relative to its efforts to remediate many of the financial reporting matters raised in prior years, including accounting for property, plant and equipment and the significant enhancements being applied to its asset management system.



Audit and Compliance Committee
Grady Memorial Hospital Corporation
April 29, 2013
Page 2 of 4

The following were noted as remaining focus areas for management as the System works to achieve a more streamlined annual financial reporting process:

- We recommend that the System continue to work toward its goal of a 45-60 day annual financial close period. While the System eliminated the need for any “post-closing” adjustments during 2012 which had typically occurred during prior financial reporting periods, an elongated closing period inherently results in inefficiencies within the accounting and finance function and adds timing pressure to the annual financial reporting process. We would expect the financial close timing to improve as key positions are staffed within the finance function going forward.
- We recommend that the System work with third-party specialists and affiliates to ensure that the timing of the information provided for inclusion in the combined financial statements allows for adequate time to identify and properly present current assets and liabilities for financial reporting purposes.

Management's Response

Management agrees. We will streamline internal and external processes and address staffing vacancies with a goal of producing high quality results in a 45-60 day period for the 2013 year-end process.

Lease and Transfer Agreement

In connection with its establishment as a 501(c)(3) organized not-for-profit health system during 2008, the System entered into a Lease and Transfer Agreement (the Agreement) with The Fulton-DeKalb Hospital Authority (the Authority) which set forth the terms of the initial and continuing relationship between the System and the Authority. Included in the Agreement are the terms of assets transferred to and leased by the System, the liabilities assumed by the System, as well as those assets and obligations of the Authority excluded from the Agreement. The Agreement also governs the lease payments between the two entities as well as how the Authority may apply the lease payments to certain of its own obligations.

As both the System's operations and relationship with the Authority have evolved over the subsequent five years, we recommend that the System review the Agreement to ensure that its key terms continue to be relevant to its organization and operations. Further, we recommend that the System undertake to cure any ambiguities or ‘gaps’ that have been identified during the term of the Agreement relative to transactions or circumstances which may not have been fully contemplated at the outset of the term of the Agreement.

Management's Response

Management acknowledges that over the past few years several ambiguities have been identified related to the Lease and Transfer Agreement, in particular, issues related to the handling of



Audit and Compliance Committee
Grady Memorial Hospital Corporation
April 29, 2013
Page 3 of 4

assets under the Lease. Legal will provide the senior executive team with an overview of the key terms and provisions of the agreement. We will continue to resolve issues as they arise and seek to establish protocols or sub-agreements with the Lessor that address these matters in advance of an issue arising.

* * * * *

Marketplace Transformation and Healthcare Reform

Marketplace transformation within the context of the current healthcare ecosystem involves a new way of thinking about how participants in various healthcare sectors react and engage to maximize their results and meet their financial and operating objectives within what is certain to become a much more value (vs. volume) driven reimbursement model. Developing integrated healthcare delivery networks and building scale and expanding geographic reach to improve efficiency and reduce costs are just a few ways market participants are positioning themselves for a new normal. While the institutionalized uncertainty of healthcare reform and related regulations forms part of the backdrop of this fluid and difficult environment, several requirements are certain:

- Do better with less to improve quality and to manage margins on less revenue;
- Increase size and scale to improve efficiencies, manage population health, and achieve true clinical integration;
- Manage compliance with ever-increasing enforcement activities and the on-going implementation of un(der)funded mandates; and
- Address costs in view of impending liabilities for Medicare and Social Security given the current unsustainability of the total cost of U.S. healthcare.

Preparing for payment reform, achieving economies of scale and accessing additional capital, considering potential partnerships and collaboration opportunities, expanding IT infrastructure and use of sophisticated data analytics, and modeling to address competitive and disruptive actions in their local markets are all 'next-generation' strategies that we would expect leading healthcare organizations to address on some level. Equally important, organizations should lead change from the top and ensure that their people understand and embrace the coming transformation. Further, key business processes and technology should fully support collaboration, consensus and clear decision making.

Transformation and change is nothing new to the healthcare industry; however, the current scope and pace of transformation today is unprecedented and requires close attention to internal operations and external factors, as well as a nimbleness around planning and change.

* * * * *



Audit and Compliance Committee
Grady Memorial Hospital Corporation
April 29, 2013
Page 4 of 4

Our audit procedures are designed primarily to enable us to form an opinion on the combined financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the System's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

The System's written response to our comments and recommendations has not been subjected to the auditing procedures applied in the audit of the combined financial statements and, accordingly, we express no opinion on it.

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

Very truly yours,

KPMG LLP

THE FULTON-DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM

Information Required Under the Single Audit Act and
Office of Management and Budget's Circular A-133
For the Year Ended December 31, 2012
With Independent Auditors' Reports Thereon

**THE FULTON-DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM**

December 31, 2012

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THE FULTON-DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM

Schedule of Findings and Questioned Costs
Year Ended December 31, 2012

Section I – Summary of Auditors’ Results

On May 20, 2008, The Fulton-DeKalb Hospital Authority (the “Authority”) entered into a lease and transfer agreement with the Grady Memorial Hospital Corporation (GMHC), a non-profit corporation organized under the laws of the State of Georgia, to lease the Authority’s health system facilities. The agreement transfers the operating assets and existing operations, as well as the performance and discharge of all other obligations for consideration of annual rent of \$2,500,000. The Authority assigns, transfers, and conveys right, title, and interest in and to all assets to the GMHC. The entities are collectively referred to in this report as the “Hospital”.

This report has been previously submitted under the name Fulton-DeKalb Hospital Authority; however, pursuant to the above paragraph, it is now submitted under the name Grady Memorial Hospital Corporation.

Financial Statements

The audit of the basic financial statements of the GMHC was performed by other auditors. The report by the auditor of the GMHC on financial statements as of and for the year then ended December 31, 2012, dated April 29, 2013, expressed an unqualified opinion on those statements.

In connection with the audit of the basic financial statements of the GMHC, the other auditors did not disclosed any significant deficiencies and no material weaknesses which are disclosed in their report issued under separate cover and dated April 29, 2013.

Federal Awards

We issued an unqualified opinion on the compliance for major programs for the Hospital for the year ended December 31, 2012.

We noted no significant deficiencies or material weaknesses involving the internal control over major programs.

We noted no findings that we are required to report in accordance with Circular A-133, Section .510.

Identification of Major Programs:

The following programs were audited as major programs:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Women Infants and Children Supplemental Nutrition Program	10.552
Ryan White Part D	93.153
Poison Control Center State	93.283
Cancer Control	93.283
Ryan White/ Non MAI	93.917
Ryan White/MA	93.917
Mental Health and Addictive Diseases Adult Care	93.958
Temporary Assistance for Needy Families	93.558

We used a threshold of \$1,019,963 expended to distinguish between Type A and Type B programs.

The Hospital is considered a high-risk auditee.

To the Board of Trustees
The Fulton-DeKalb Hospital Authority

The Board of Directors
Grady Memorial Hospital Corporation:

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Report on Compliance for Each Major Federal Program

We have audited The Fulton-DeKalb Hospital Authority d/b/a Grady Health System (the "Hospital") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Hospital's major federal programs for the year ended December 31, 2012. The Hospital's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Hospital's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Hospital's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.



To the Board of Trustees
The Fulton-DeKalb Hospital Authority

The Board of Directors
Grady Memorial Hospital Corporation

Page Two

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Hospital's compliance.

Opinion on Each Major Federal Program

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

Report on Internal Control Over Compliance

Management of the Hospital is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Hospital's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.



To the Board of Trustees
The Fulton-DeKalb Hospital Authority

The Board of Directors
Grady Memorial Hospital Corporation

Page Three

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Schedule of Federal and State Contractual Assistance

We have audited the accompanying Schedule of Federal and State Contractual Assistance of the Hospital. The schedule is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations and the “Standards for Audits of DHR Agencies and Programs Conducted by Independent Auditors Under Contract” as described in the second paragraph of this report, and is not a required part of the basic financial statements of GMHC. The basic financial statements of GMHC, as of and the year ended December 31, 2012, were audited by other auditors whose report dated April 29, 2013, expressed an unqualified opinion on those statements.

The information in the Schedule of Federal and State Contractual Assistance is the responsibility of management and as derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

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

Banks, Finley, White & Co.
June 10, 2013

**THE FULTON-DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM**

Schedule of Findings and Questioned Costs
For the Year Ended December 31, 2012

Section II - Federal Awards

No current year findings

THE FULTON-DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM

Schedule of Federal and State Contractual Assistance
as of December 31, 2012

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>CFDA Number</u>	<u>Grantor's Number</u>	<u>Award or Amount</u>	<u>Program Revenues</u>	<u>Total Expenditures</u>
U.S. Department of Health and Human Services					
Passed through the Georgia Department of Behavioral Health: and Developmental Disabilities					
*Mental Health and Addictive Diseases Adult Core Services Block Grant:					
Fiscal 2012	93.150/93.958/93.959	441-93-1233O46	\$ 5,909,613	\$ 2,876,356	\$ 2,876,356
Fiscal 2013	93.150/93.958/93.959	441-93-1333ABI	5,774,121	2,887,069	2,887,069
Substance Abuse and Mental Health Services Administration					
Georgia BASICS Initiative					
Fiscal 2012	93.243	44100-906-0000014041	1,096,282	227,683	227,683
Fiscal 2013	93.243	44100-906-0000027501	797,288	319,540	319,540
Subtotal			<u>13,577,304</u>	<u>6,310,648</u>	<u>6,310,648</u>
U.S. Department of Health and Human Services					
HIV Care and Emergency Relief Formula Grants					
Passed through the Georgia Department of Community Health					
AIDS State Clinic:					
Fiscal 2012	93.914	41900-044-12110275	3,733,878	2,004,379	2,004,379
Fiscal 2013	93.914	40500-044-13110275	3,733,878	1,747,829	1,747,829
Pediatric AIDS					
Fiscal 2012	93.994	41900-044-12110254	162,743	66,232	66,232
Subtotal			<u>7,630,499</u>	<u>3,818,439</u>	<u>3,818,439</u>
U.S. Department of Health and Human Services					
Ryan White Care Act					
Direct Program					
Ryan White (Part D):					
Fiscal 2012	93.153	5 H12HA03378-08-00	720,080	405,963	405,963
Fiscal 2013	93.153	1 H2HA24799-01-00	713,678	277,194	277,194
Subtotal			<u>1,433,758</u>	<u>683,157</u>	<u>683,157</u>
U.S. Department of Health and Human Services					
*Ryan White Care Act Health and Human Services:					
Passed through Fulton County:					
Ryan White Part A Non-MAI Supplemental:					
Fiscal 2012	93.917	PO 118 79274C-BL	7,798,487	2,663,757	2,663,757
Fiscal 2013	93.917	PO 118-128SC84664B-TR	7,887,945	4,966,378	4,966,378
Ryan White Part A MAI Supplemental:					
Fiscal 2012		P0 118 12SC82799B-TR-1	1,000,000	848,731	848,731
Ryan White Children (Part B):					
Fiscal 2012	93.917	41900-044-11100179	85,704	-	-
Fiscal 2013	93.917	40500-044-12100179	164,567	124,775	124,775
Subtotal			<u>16,936,702</u>	<u>8,603,641</u>	<u>8,603,641</u>
Maternal and Child Health Services Block Grants:					
Passed through the Georgia Department of Community Health					
Sickle Cell Legislative:					
Fiscal 2012	93.994	40500-039-12110255	948,403	470,575	470,575
Fiscal 2013	93.994	40500-039-13110255	948,403	533,352	533,352
Intensive Infant Care:					
Fiscal 2012	93.994	40500-039-12110242	1,046,755	524,321	524,321
Maternal and Infant Care:					
Fiscal 2012	93.994	40500-039-12110243	945,203	479,572	479,572
Fiscal 2013	93.994	41900-039-11110242	943,406	409,202	409,202
Subtotal			<u>4,832,171</u>	<u>2,417,022</u>	<u>2,417,022</u>
U.S. Department of Health and Human Services					
Passed through the Georgia Department of Community Health					
Poison Control Stabilization and Enhancement (FED)					
Fiscal 2012	93.253	6H4BHS15495-03-01	626,480	241,735	241,735
Fiscal 2013	93.253	5H4BHS15495-04-00	523,484	161,939	161,939
Subtotal			<u>1,149,964</u>	<u>403,675</u>	<u>403,675</u>

THE FULTON-DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM

Schedule of Federal and State Contractual Assistance
as of December 31, 2012

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>CFDA Number</u>	<u>Grantor's Number</u>	<u>Award or Amount</u>	<u>Program Revenues</u>	<u>Total Expenditures</u>
U.S. Department of Health and Human Services					
Passed through the Department of Community Health					
Poison Control Center (State):					
Fiscal 2012	92.283	40500-036-12110286	3,003,544	1,354,960	1,354,960
Fiscal 2013	92.283	40500-036-13110286	3,003,544	1,510,900	1,510,900
Poison Control - Training Courses for GA Healthcare Providers					
Fiscal 2011	93.889	41900-033-11110436	742,000	324,500	324,500
Fiscal 2013	93.889		324,500	82,870	82,870
Poison Control - BT Hotline					
Fiscal 2012	93.069	40500-033-12091314	300,000	175,000	175,000
Fiscal 2013	93.069	40500-033-13091314	267,123	16,867	16,867
Family Planning Program:					
Fiscal 2012	93.558	40500-043-12110272	723,943	328,447	328,447
Fiscal 2013	93.558	40500-041-13110272	723,943	359,622	359,622
Preventive Health and Health Services Block Grant:					
Rape Crisis Center - VAWA Victim Services:					
Fiscal 2012	16.575	W11-8-032	60,106	60,106	60,106
Grady Rape Crisis Center					
Fiscal 2012	93.991	SA12-007	33,630	15,037	15,037
Fiscal 2013	93.991	SA13-007	33,630	10,497	10,497
Passed through the Georgia Department of Community Health					
Tuberculosis Detection:					
Fiscal 2012	93.116	41900-046-11100209	77,576	19,394	19,394
Fiscal 2013	93.116	40500-044-1210209	77,576	58,182	58,182
Test, Educate, Support, Treat - T.E.S.T Georgia					
Expanded Access HIV Testing Grant (ARTAS)					
Fiscal 2011	93.940	PH201179G	162,500	45,295	45,295
Cancer Control					
Fiscal 2012	93.283	41900-032-11110312	114,550	42,938	42,938
Fiscal 2013	93.283	40500-032-13110312	114,550	41,352	41,352
Subtotal			<u>9,762,715</u>	<u>4,445,968</u>	<u>4,445,968</u>
U.S. Department of Agriculture					
Passed through the Georgia Department of Community Health:					
Special Supplemental Food Program for Women, Infants, and Children:					
WIC Supplemental Nutrition Program:					
Fiscal 2012	10.572	41900-041-12110409	703,424	435,169	435,169
Fiscal 2013	10.572	40500-041-13110409	405,297	93,101	93,101
Subtotal			<u>1,108,721</u>	<u>528,270</u>	<u>528,270</u>
WIC Supplemental Nutrition Program:(Non-Cash Vouchers)					
Fiscal 2012	10.572	41900-041-12110409	6,539,780	6,539,780	6,539,780
Subtotal			<u>6,539,780</u>	<u>6,539,780</u>	<u>6,539,780</u>
UAB National Institutes of Health					
Fiscal 2012	93.701	00388021-002	290,452	102,711	102,711
			<u>290,452</u>	<u>102,711</u>	<u>102,711</u>
U.S. Department of Education					
Student Financial Assistance Programs:					
Pell Grants Radiologic Technology:					
Fiscal 2013	84.063	P063P122499	101,800	54,492	54,492
			<u>101,800</u>	<u>54,492</u>	<u>54,492</u>

THE FULTON-DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM

Schedule of Federal and State Contractual Assistance
as of December 31, 2012

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>CFDA Number</u>	<u>Grantor's Number</u>	<u>Award or Amount</u>	<u>Program Revenues</u>	<u>Total Expenditures</u>
U.S. Department of Defense					
Electronic Patient Tracking					
Emergency Department and Information Systems	12.420	W81XWH-09-2-0145	1,357,000	28,987	28,987
Subtotal			64,750,226	33,966,151	33,966,151
Consumer Product Safety Commission					
NEISS Surveillance Report and Special Survey	NA	CFSC-N-12-0033	212,088	40,836	40,836
Georgia Department of Community Health					
Statewide Tuberculosis:					
Fiscal 2012	NA	41900-046-12110261	216,242	108,121	108,121
Fiscal 2013	NA	40500-044-13110261	216,242	108,122	108,122
Forensics Psychiatric Evaluation:					
Fiscal 2012	Not Applicable	44100-016-0000008645	139,900	69,950	69,950
Fiscal 2013	Not Applicable	44100-018-0000020627	139,900	69,950	69,950
Trauma Collection, Monitoring and Reporting Registry:					
Fiscal 2012	NA	41900-046-11100209	77,576	19,394	19,394
Fiscal 2013	NA	40500-044-12100209	77,576	58,182	58,182
Georgia Hemoglobinopathies Surveillance Project					
Fiscal 2012	NA	PH201184G	125,000	125,000	125,000
Assertive Community Treatment (ACT)					
Fiscal 2012	NA	441-93-11110321-00	2,167,000	1,201,874	1,201,874
Fiscal 2013	NA	441-93-11110321-01	1,495,000	755,045	755,045
Fiscal 2013	NA	44100-026-0000027801	650,000	102,140	102,140
SAMHSA Atlanta Collaborative HIV/AIDS Network for Growth					
Fiscal 2012	NA	40500-044-12120593	428,522	414,611	414,611
Trauma Readiness Services					
Fiscal 2012	NA	GTC_Grady 2012.2	2,407,658	2,298,708	2,298,708
Fiscal 2013	NA	GTC_Grady 2013.1	1,900,979	1,637,306	1,637,306
D Regional Coordinating Hospital					
Fiscal 2012	NA	176-07100612	85,000	39,846	39,846
Subtotal			10,338,683	7,049,084	7,049,084
Georgia Board for Physician Workforce					
Residency Capitation					
Fiscal 2012	Unknown	Unknown	1,791,833	1,791,833	1,791,833
Fiscal 2013	Unknown	Unknown	844,236	844,236	844,236
			2,636,069	2,636,069	2,636,069
Total			12,974,752	9,685,152	9,685,152
Grand Total			\$ 77,724,978	\$ 43,651,303	\$ 43,651,303

THE FULTON DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM

Notes to the Schedule of Federal and State
Contractual Assistance
December 31, 2012

1. General:

On May 20, 2008, The Fulton-DeKalb Hospital Authority (the "Authority") entered into a lease and transfer agreement with the Grady Memorial Hospital Corporation (GMHC), a non-profit corporation organized under the laws of the State of Georgia, to lease the Authority's health system facilities. The agreement transfers the operating assets and existing operations, as well as the performance and discharge of all other obligations for consideration of annual rent of \$2,500,000. The Authority assigned, transferred, and conveyed right, title, and interest in and to all assets to the GMHC.

The accompanying Schedule of Federal and State Contractual Assistance presents the combined activity of Federal and State assistance programs of the Authority and GMHC. Contractual assistance received directly from Federal grantor agencies, as well as contractual assistance passed through other government agencies, and direct state of Georgia contractual assistance are included on the accompanying schedule.

2. Accounting Principles:

- a. The accompanying Schedule of Federal and State Contractual Assistance is presented using the accrual basis of accounting.
- b. All Federal and State Contractual Assistance Programs are accounted for on the reimbursement basis.

Indirect costs charged to federal programs were as follows:

Poison Control	\$206,544
Supplemental Nutrition for Women Infant and Children	<u>30,227</u>
Total Indirect Costs	<u>\$236,771</u>

THE FULTON DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM

Notes to the Schedule of Federal and State
Contractual Assistance
December 31, 2012

3. Voucher Distributions

The Authority is the pass-through recipient of federal grant funds from the U. S. Department of Agriculture's Special Supplemental Food for Women, Infants and Children (WIC) Program through Georgia Department of Community Health (the "State"). The Authority identifies eligible program participants and the State issues non-cash food vouchers. According to the State's records, the Authority's WIC program participants received 259,444 vouchers for program year 2012 and redeemed 236,956 vouchers valued at \$ 6,539,780 for program year 2012.

4. Relationship to Basic Financial Statements and Federal Financial Reports:

Federal and State Contractual Assistance revenues are reported in the GMHC's basic financial statements as follows:

Federal Contractual assistance	\$33,966,151
State Contractual assistance	<u>9,685,152</u>
Total per Schedule of Federal & State Contractual Assistance	43,651,303
Restricted fund and other revenues, net of WIC Vouchers & Pell Grants	<u>(6,946,560)</u>
Total revenues in GMHC's basic financial statements	<u>\$36,704,743</u>

5. Pass Through Cost:

Sickle Cell Foundation, which is included with Sickle Cell Legislative Service, is the only program with (pass-through) cost of \$87,759.

**THE FULTON DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM**

Notes to the Schedule of Federal and State
Contractual Assistance
December 31, 2012

6. Subsequent Event:

On June 18, 2013, a federal grand jury indicted a former employee of the Hospital relating to theft from an “organization receiving federal funds” during the period January 2008 through June 2011 in the amount of approximately \$450,000. The matter involved embezzlement of funds through the manipulation of payroll accounts of terminated employees. The indictment did not identify any specific federal funds and at this time the Hospital is unable to identify the source of the funds embezzled. The Hospital does believe, however, that a substantial portion of the funds embezzled will be recovered through its fidelity bond insurance coverage.

**THE FULTON-DEKALB HOSPITAL AUTHORITY
d/b/a GRADY HEALTH SYSTEM**

Status of Prior Audit Findings and Questioned Costs
For the Year Ended December 31, 2012

None