

**AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION
OF
LINCOLN COUNTY HEALTH SYSTEM
LINCOLN COUNTY, TENNESSEE
Years Ended June 30, 2008 and 2007**

**LINCOLN COUNTY HEALTH SYSTEM
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Years Ended June 30, 2008 and 2007

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INDEPENDENT AUDITORS' REPORT

To the Health System Committee
Lincoln County Health System
Lincoln County, Tennessee

We have audited the accompanying financial statements of the Lincoln County Health System (as described in Note A to the financial statements) as of and for the years ended June 30, 2008 and 2007. These financial statements are the responsibility of the Lincoln County Health System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note A, the financial statements present only the Lincoln County Health System and do not purport to, and do not, present fairly the financial position of Lincoln County, Tennessee, as of June 30, 2008 and 2007, and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

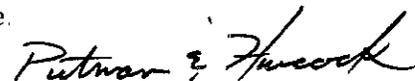
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lincoln County Health System as of June 30, 2008 and 2007, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 29, 2008, on our consideration of Lincoln County Health System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 4 through 8 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying financial information listed as other financial information in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements of the Lincoln County Health System. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly presented, in all material respects, in relation to the financial statements taken as a whole.

October 29, 2008



LINCOLN COUNTY HEALTH SYSTEM
A Component Unit of Lincoln County, State of Tennessee
Management's Discussion and Analysis

Our discussion and analysis of Lincoln County Health System's (the "System") financial performance provides an overview of the System's financial activities for the fiscal years ended June 30, 2008 and 2007. Please read it in conjunction with the System's financial statements, which begin on page 9

Financial Highlights

- The System's net assets decreased in the past year with a \$248,178 or 1.2 percent decrease in 2008 and \$1,500,801 or 6.6 percent decrease in 2007
- The System reported an operating income in 2008 \$22,992 and an operating loss in 2007 (\$1,228,852). Income in 2008 increased by \$1,251,844 or 101.9 percent over the income reported in 2007. Operating income in 2007 decreased by \$1,769,552 or 327.3 percent
- Non-operating revenues decreased by \$15,779 or 5.5 percent in 2008 compared to 2007. Non-operating revenues also decreased in 2007 by \$232,772 or 44.8 percent compared to 2006.

Using This Annual Report

The System's financial statements consist of three statements - a Balance Sheet; a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the System, including resources held by the System but restricted for specific purposes by contributors, grantors, or enabling legislation.

The Balance Sheet and Statement of Revenues, Expenses, and Changes in Net Assets

Our analysis of the System's finances begins on page 5. One of the most important questions asked about the System's finances is, "Is the System as a whole better or worse off as a result of the year's activities?" The Balance sheet and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the System's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the System's net assets and changes in them. You can think of the System's net assets - the difference between assets and liabilities - as one way to measure the System's financial health, or financial position. Over time, increases or decreases in the System's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the System's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the System.

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance during the reporting period?"

The System's Net Assets

The System's net assets are the difference between its assets and liabilities reported in the Balance Sheet on page 9. The System's net assets decreased in 2008 by \$248,178 (1.2 percent) and decreased \$1,500,801 (6.6 percent) in 2007, as you can see from Table 1.

Table 1: Assets, Liabilities, and Net Assets

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Assets:			
Current assets	\$ 7,976,961	\$ 7,582,457	\$ 8,564,638
Capital assets, net	23,782,175	24,572,925	25,465,411
Other non-current assets	8,904,405	10,040,260	8,971,800
Total assets	<u>40,663,541</u>	<u>42,195,642</u>	<u>43,001,849</u>
Liabilities			
Long-term liabilities	16,011,416	16,769,520	17,228,964
Other	3,588,638	4,114,457	2,960,419
Total liabilities	<u>19,600,054</u>	<u>20,883,977</u>	<u>20,189,383</u>
Net assets:			
Invested in capital assets, net of related debt	7,440,455	7,407,380	7,877,197
Restricted bond indenture agreement	1,119,988	1,169,618	1,159,582
Restricted for other purposes	85,262	97,347	83,763
Unrestricted	12,417,782	12,637,320	13,691,924
Total Net Assets	<u>\$ 21,063,487</u>	<u>\$ 21,311,665</u>	<u>\$22,812,466</u>

A significant component of the change in the System's assets is the change in cash and cash equivalents. Cash increased \$311,811 or 12.0 percent in 2008 and decreased \$1,005,196 or 27.8 percent in 2007.

Operating Results and Changes in the System's Net Assets

In 2008, the System's net assets decreased by \$248,178 or 1.2 percent, as shown in Table 2. This decrease is made up of very different components, and it represents a decline compared with the decrease in net assets for 2007 of \$1,500,801.

Table 2: Operating Results and Changes in Net Assets

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Operating Revenues:			
Net patient service revenues	\$ 33,957,397	\$ 31,369,971	\$32,475,473
Other operating revenues	977,021	894,576	1,000,139
Total operating revenues	34,934,418	32,264,547	33,475,612
Operating Expenses			
Salaries and benefits	20,561,997	20,134,600	19,272,689
Fees to individuals and organizations	3,992,188	3,358,611	3,268,371
Medical supplies and drugs	4,053,811	4,028,662	4,692,500
Depreciation	2,162,092	2,126,761	2,141,026
Other operating expenses	4,141,338	3,844,765	3,560,326
Total operating expenses	34,911,426	33,493,399	32,934,912
Operating income (loss)	22,992	(1,228,852)	540,700
Nonoperating Revenues and Expenses			
Investment income	484,445	555,714	370,984
Interest expense	(745,224)	(835,220)	(857,342)
Amortization	(49,562)	(37,727)	(36,647)
Noncapital grants and contributions	39,171	20,725	9,519
Other nonoperating revenues and expenses, net	-	9,559	(6,235)
Total non-operating revenues (expenses)	(271,170)	(286,949)	(519,721)
Excess (deficiency) of revenues over expenses before capital grants, and contributions	(248,178)	(1,515,801)	20,979
Grants and Contributions			
Capital grants and contributions	-	15,000	101,647
Increase (decrease) in net assets	(248,178)	(1,500,801)	122,626
Net assets end of year	\$ 21,063,487	\$ 21,311,665	\$22,812,466

Operating Income

The first component of the overall change in the System's net assets is its operating income - generally, the difference between net patient service revenues and the expenses incurred to perform those services. In the past year, the System has reported an operating income. However, in the previous year, there was an operating loss reported. Income in 2008 increased by \$1,251,844 or 101.9 percent higher than the income reported in 2007. Operating income in 2007 decreased by \$1,769,552 or 327.3 percent

The primary components of these changes in operating incomes are:

- An increase in total operating revenue of \$2,669,871 in 2008 due in part to expanded physician and ancillary services from a decrease in revenue of \$1,211,065 in 2007
- Increases in salary and benefit costs for the System's employees and employed physicians of \$427,397 or 2.1 percent in 2008 from \$861,911 or 4.5 percent in 2007.
- Increases in fees of \$633,577 due in part to new outside therapy service arrangements in 2008 from an increase of \$90,240 in 2007.
- Other expenses increase of \$296,573 in 2008 due in part to employed physicians insurance, utilities and maintenance agreements
- An increase in the level of uncompensated care provided in 2007. These are services provided for which there is no expectation of payment.

The TennCare program in Tennessee dropped thousands of enrollees from the program during 2006. Many of these individuals were not financially able to purchase health insurance. Some have gone untreated for medical conditions and ended up in the emergency room seeking care with no payment method. Others have had services performed and applied for charity care or were unable to pay. This has caused the bad debts expense and charity care to increase.

Employee salary and benefits costs increased in 2007 and again in 2008 based on annual cost of living increases, employing physicians, and upgrading some department salaries to retain staff. The cost of employee insurance programs has continued to increase also.

The rate of healthcare inflation has a direct effect on the cost of services provided by the System. A component of the System's costs is expenses for medical supplies and prescription drugs. Some of the major factors contributing to the increased medical supply and drug costs include the increase of new drugs that cannot be obtained in generic form, and changes in therapeutic mix. Other expense increases include utility costs, physician malpractice insurance and maintenance contract costs for equipment.

The System sometimes provides care for patients who have little or no health insurance or other means of repayment. As discussed, this service to the community is consistent with the goals established for the System when it was established in 1917. The amount of charges foregone for services supplied under the System's charity care policy totaled \$383,994 in 2007 and \$231,571 in 2008. Because there is no expectation of repayment, charity care is not reported as patient service revenues of the System.

Non-operating Revenues and Expenses

Non-operating revenues consist primarily of interest revenue and investment earnings.

Grants and Contributions

The System receives grants and contributions from various state and federal agencies for specific programs. These are discussed in detail in Note A to the financial statements.

The System also receives proceeds from an endowment that is to aid indigent patients.

The System's Cash Flow

Changes in the System's cash flows are consistent with changes in operating incomes and non-operating revenues and expenses, discussed earlier. The System generated cash flows from operating activities in 2008 of \$1,885,494 or 7.5 percent less than in 2007. In 2007 the System generated \$2,038,461 or 24.3 percent less in cash flows from operating activities than in 2006.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2008, the System had \$23,782,175 invested in capital assets, net of accumulated depreciation, as detailed in Note G to the financial statements. In 2008, the System purchased new equipment costing \$481,787, exclusive of building and land additions. \$666,114 was spent to acquire new equipment in 2007. The System spent \$1,712,598 for new equipment in 2006.

Debt

At year-end, the System had \$17,118,865 in revenue bonds, adjustable rate pooled financing revenue bonds and notes payable obligations outstanding as detailed in Note H to the financial statements. The System's formal debt issuances - revenue notes - cannot be issued without approval of the Lincoln County Board of Commissioners. The amount of debt issued is subject to limitations that apply to the County and its component units as a whole. There have been no changes in the System's debt ratings in the past two years.

Other Economic Factors

Payment methodologies and reimbursement in the future are subject to ever changing regulations and laws which will have an impact on the system's financial position and results of operations.

AmeriChoice and AmeriGroup are the two new Managed Care Organizations for TennCare. They replaced Blue Cross TennCare Select in our part of the state.

Likewise the System is continuing to actively recruit physicians of general and specialty for the success of its operations. An orthopedic surgeon has recently been added and a search for a family practice physician has begun.

Another factor is the System is also presently evaluating the replacement of its Lincoln Care Center with a new facility in the future.

Contacting the System's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the System's finances and to show the System's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Chief Financial Officer, at Lincoln County Health System, 106 Medical Center Blvd., Fayetteville, TN 37334.

LINCOLN COUNTY HEALTH SYSTEM
BALANCE SHEETS
June 30, 2008 and 2007

ASSETS

	<u>2008</u>	<u>2007</u>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 2,919,552	\$ 2,607,741
Restricted cash	37,010	32,134
Accounts receivable, net of allowance for doubtful accounts of \$3,101,822 (2008) \$3,008,461 (2007)	3,806,757	3,829,092
Estimated third-party payor settlements receivable	110,670	220,043
Supplies, at cost	711,293	651,269
Prepaid expenses	262,035	175,156
Other assets	<u>129,644</u>	<u>67,022</u>
Total Current Assets	<u>7,976,961</u>	<u>7,582,457</u>
NONCURRENT ASSETS:		
Restricted investments	8,078,539	8,949,354
Capital assets, net of accumulated depreciation	23,782,175	24,572,925
Other assets:		
Investment in insurance fund	125,808	131,868
Notes receivable, net	256,769	489,039
Deferred financing costs	<u>443,289</u>	<u>469,999</u>
Total Noncurrent Assets	<u>32,686,580</u>	<u>34,613,185</u>
TOTAL ASSETS	<u>\$ 40,663,541</u>	<u>\$ 42,195,642</u>

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 773,593	\$ 866,024
Accounts payable	852,955	865,287
Accrued expenses:		
Salaries and payroll taxes	483,207	437,115
Compensated absences	801,065	827,479
Interest	114,138	108,022
Other	221,792	293,697
Estimated third-party payor settlements payable	304,878	684,699
Patient trust funds	<u>37,010</u>	<u>32,134</u>
Total Current Liabilities	<u>3,588,638</u>	<u>4,114,457</u>
NONCURRENT LIABILITIES:		
Long-term debt, net of current maturities	<u>16,011,416</u>	<u>16,769,520</u>
TOTAL LIABILITIES	<u>19,600,054</u>	<u>20,883,977</u>
NET ASSETS:		
Invested in capital assets, net of related debt	7,440,455	7,407,380
Restricted for:		
Bond indenture agreement	1,119,988	1,169,618
Other purposes	85,262	97,347
Unrestricted assets	<u>12,417,782</u>	<u>12,637,320</u>
TOTAL NET ASSETS	<u>21,063,487</u>	<u>21,311,665</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 40,663,541</u>	<u>\$ 42,195,642</u>

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

LINCOLN COUNTY HEALTH SYSTEM
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
OPERATING REVENUES:		
Net patient service revenue, net of provision for bad debts of \$3,661,409 in 2008 and \$3,271,943 in 2007	\$ 33,957,397	\$ 31,369,971
Other operating revenue	977,021	894,576
Total Operating Revenues	34,934,418	32,264,547
OPERATING EXPENSES:		
Employee compensation and benefits	20,561,997	20,134,600
Fees to individuals and organizations	3,992,188	3,358,611
Supplies	4,053,811	4,028,662
Other expenses	4,141,338	3,844,765
Depreciation	2,162,092	2,126,761
Total Operating Expenses	34,911,426	33,493,399
INCOME (LOSS) FROM OPERATIONS	22,992	(1,228,852)
NONOPERATING REVENUES AND (EXPENSES):		
Investment income	484,445	555,714
Interest expense	(745,224)	(835,220)
Amortization	(49,562)	(37,727)
Noncapital grants and contributions	39,171	20,725
Gain on disposal of capital assets	-	9,559
Nonoperating Revenues and (Expenses), net	(271,170)	(286,949)
DEFICIENCY OF REVENUES OVER EXPENSES	(248,178)	(1,515,801)
Capital contributions	-	15,000
DECREASE IN NET ASSETS	(248,178)	(1,500,801)
Net Assets Balance, beginning of year	21,311,665	22,812,466
Net Assets Balance, end of year	\$ 21,063,487	\$ 21,311,665

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

**LINCOLN COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS**

Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	\$ 33,987,183	\$ 32,304,769
Other operating cash receipts	1,754,119	2,052,113
Cash paid to employees	(20,627,020)	(20,114,381)
Cash paid to suppliers for goods and services	(13,228,788)	(12,204,040)
Net Cash Provided by Operating Activities	<u>1,885,494</u>	<u>2,038,461</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Noncapital grants and contributions	<u>39,171</u>	<u>20,725</u>
Net Cash Provided by Noncapital Financing Activities	<u>39,171</u>	<u>20,725</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Additions to capital assets, net	(1,372,275)	(924,806)
Proceeds from disposal of capital assets	934	88
Capital contributions	-	15,000
Principal paid on long-term debt	(876,024)	(760,395)
Interest paid on long-term debt, net	(739,108)	(860,455)
Net Cash Used by Capital and Related Financing Activities	<u>(2,986,473)</u>	<u>(2,530,568)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest received	478,485	553,145
(Increase) Decrease in restricted investments	<u>895,134</u>	<u>(1,086,959)</u>
Net Cash Provided (Used) by Investing Activities	<u>1,373,619</u>	<u>(533,814)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	311,811	(1,005,196)
CASH AND CASH EQUIVALENTS, beginning of year	<u>2,607,741</u>	<u>3,612,937</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 2,919,552</u>	<u>\$ 2,607,741</u>

RECONCILIATION OF OPERATING INCOME TO NET

CASH FLOWS FROM OPERATING ACTIVITIES:

Income (Loss) from operations	\$ 22,992	\$ (1,228,852)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,162,092	2,126,761
Provision for bad debts	3,661,409	3,271,943
Payments received on notes receivable arrangements	20,231	-
Provision for note receivable arrangements	226,585	266,419
Advances under note receivable arrangements, net	(14,546)	(158,706)
Investment in insurance funds, net	6,060	(20,360)
Changes in operating assets and liabilities:		
(Increase) in accounts receivable	(3,639,074)	(3,529,402)
(Increase) Decrease in estimated third-party payor settlements	(270,448)	910,946
(Increase) in supplies	(60,024)	(4,005)
(Increase) Decrease in prepaid expenses	(86,879)	52,928
(Increase) in other assets	(78,345)	(42,331)
Increase (Decrease) in accounts payable	(12,332)	242,162
Increase (Decrease) in accrued expenses	<u>(52,227)</u>	<u>150,958</u>
Net Cash Provided by Operating Activities	<u>\$ 1,885,494</u>	<u>\$ 2,038,461</u>

SCHEDULE OF NONCASH FINANCING AND INVESTING ACTIVITIES:

Note payable issued to purchase assets	\$ 300,000
LMC Series 1998 bonds refunded	(4,835,000)
LMC Series 2007 bond proceeds used to refund 1998 bonds	4,960,000
LMC Series 2001 bond refunded	(1,820,000)
LMC Series 2007 bond proceeds used to refund 2001 bonds	1,905,000
Issue costs paid by LMC Series 2007 refunding bonds	(90,786)

The accompanying notes are an integral part of these financial statements

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Lincoln County Health System is owned by Lincoln County, Tennessee, ("the County" and "Primary Government") with interest vested in the Lincoln County Board of Commissioners. The Health System is not a legal entity separate and apart from the Primary Government and accordingly, it is blended as an enterprise fund as part of the financial statements of the Primary Government. The Health System is governed by the Health System Committee ("the Committee"), consisting of four members appointed from the Lincoln County Board of Commissioners and a physician appointed from the medical staff of Lincoln Medical Center. Each committee member serves a three-year term.

Principles of Departmental Combination

The Health System's financial statements include the following financial activities also referred to herein as "departments": Lincoln Medical Center (the "Medical Center"), Lincoln Medical Center EMS (the "Ambulance Service"), Hospital Home Health and Hospice (the "Home Health Care"), Patrick Rehab-Wellness Center (the "Wellness Center") and Lincoln and Donalson Care Centers (the "Care Centers"). All significant interdepartmental transactions have been eliminated.

The Medical Center provides general acute health care services for Lincoln County and surrounding areas. It is licensed for 49 beds and 10 Geropsych beds, which were placed in service July 08. The Ambulance Service provides emergency medical transportation services. The Home Health Care provides skilled nursing, therapy and personal care services. The Patrick Rehab-Wellness Center provides centralized rehabilitation, health education, therapy and other related programs and services to other departments of the Health System and to local businesses, industries and residents. The Lincoln Care Center and Donalson Care Center provide long-term health care services. They are licensed for 153 intermediate-level and 125 skilled-level care beds. The Donalson Care Center is also licensed for 24 beds (decreased from 42 beds effective June 2007) for assisted living services.

The Medical Center's financial statements include Lincoln Medical Center Auxiliary Gift Shop (the "Auxiliary"). The Auxiliary is not a separate legal entity and it is subject to financial accountability to the Committee. As of and for the year ended June 30, 2008, the Auxiliary's total assets, current assets, and net assets totaled \$85,262 that are reported as restricted for other purposes in the balance sheet. Their excess of revenues over expenses for the year ended 2008 totaled \$15,300. The Auxiliary made noncapital contributions totaling \$24,420 to the Medical Center during 2008.

Basis of Accounting

The Health System uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Accordingly, revenues are recognized when earned, and expenses are recognized when incurred.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the Health System enterprise fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board (GASB). Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Health System has elected not to follow subsequent private-sector guidance.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Deposits

The Health System's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition, excluding restricted cash held for patient trust funds. State statutes authorize the Health System to invest in obligations of the U.S. Treasury, bank certificates of deposit, State approved repurchase agreements and pooled investment funds, consisting of State or local bonds, rated A or higher by a nationally recognized rating service.

Investments

Investments consist of restricted cash by contributors and investments (primarily bank certificates of deposit and money market mutual funds) held for internally designated purposes by the Health System, and funds legally restricted for debt service requirements and held by a trustee under an indenture agreement.

Supplies

Supplies are stated at cost (first-in, first-out method) that approximates the lower of cost or market.

Capital Assets

Capital assets are stated at cost, less accumulated depreciation that is computed on the straight-line method over the estimated useful life of the asset. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. There was no interest cost capitalized on borrowed funds for the years ended June 30, 2008 and 2007, respectively.

Contributed capital assets are reported at their estimated fair value at the time of their donation.

Major expenditures for property and those that substantially increase useful lives are capitalized. Maintenance, repairs and minor renewals are expensed as incurred.

Grants and Contributions

From time to time, the Health System receives grants and contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted either for specific operating purposes or for capital purposes. When both restricted and unrestricted resources are available for use, the Health System uses the restricted resources first, then the unrestricted resources as they are needed. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Absences

The Health System's employees earn paid time off ("PTO") benefits for vacation, sick, and holiday leave at varying rates that may accumulate up to a specified maximum depending on years of service. In the event of termination, an eligible employee is paid for accumulated PTO benefits. The estimated amount of PTO payable is accrued when earned and reported as a current liability in the accompanying financial statements.

Deferred Financing Costs

Financing costs incurred for issuance of bonds are amortized over the term of the respective bond issue using the straight-line method. Amortization expense was \$49,562 and \$37,727 for the years ended June 30, 2008 and 2007, respectively.

Charity Care

The Health 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 Health System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Income Taxes

The Health System, as an instrumentality of Lincoln County, Tennessee, is exempt from income taxes.

Risk Management

The Health System is exposed to various risks of losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. The Health System maintains commercial insurance coverage for claims arising from such matters. Settled claims in the past three years have not exceeded insurance coverage. There were no significant reductions in coverage compared to the prior year.

Net Assets

Net assets of the Health System are classified in the following components. *Net assets invested in capital assets, net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable net assets* are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Health System, including amounts deposited with trustees as required by revenue bond indentures, as discussed in Note E. *Restricted nonexpendable net assets* equal the principal portion of permanent endowments of which the Health System has none. *Unrestricted net assets* are remaining net assets that do not meet the definition of the other components.

Operating Revenues and Expenses

The Health System's statement of revenues, expenses and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing patient health care services—the Health System's principal activity. Therefore, no additional segment financial information or disclosures are presented.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Patient service revenue is recorded at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Settlements under reimbursement agreements with third-party payors are estimated and recorded in the period the related services are rendered and are adjusted in future periods as adjustments become known or as years are no longer subject to audit, review or investigation. Laws governing the third-party programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Other operating revenues include charges for sale of medical and pharmaceutical supplies, medical transcripts, cafeteria sales, educational training services, etc.

Nonexchange revenues, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues.

Operating expenses are all expenses incurred to provide health care services, other than financing costs.

The Health System receives payments on a periodic basis from an endowment fund for the benefit of eligible patients. The endowment fund is legally separate from the Health System and under the control of an independent trustee. Therefore, it is not included in the Health System's financial statements.

NOTE B: DESIGNATED NET ASSETS

Unrestricted net assets include designated net assets by the Health System totaling \$6,883,948 and \$7,692,191 as of June 30, 2008 and 2007, respectively, for specific purposes such as future capital improvements, insurance and debt service. The designated funds remain under the control of the Health System which may at its discretion later use the funds for other purposes.

NOTE C: CHARITY CARE

Charges foregone for services and supplies furnished under the Health System's charity care policy totaled \$231,571 and \$383,994 and for the years ended June 30, 2008 and 2007, respectively.

NOTE D: NET PATIENT SERVICE REVENUE

A summary of the payment arrangements with major third-party payors follows:

Medicare - Medical Center inpatient care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Medical Center outpatient services to Medicare beneficiaries are paid based on a prospective payment system based on the patient's ambulatory patient classification group. Geropsych services, ambulance services, and rehab services related to Medicare beneficiaries are paid based upon a cost/fee screen reimbursement methodology.

Care Center skilled nursing care services and Home Health Care services to Medicare beneficiaries are paid based on prospective payment arrangements. Care Center Medicare payments are based on a blend of the Care Center's specific cost and a regional prospective payment rate. The rate varies according to a patient classification system that is based on patient clinical, diagnostic, and other factors. Home Health Care payments for services to Medicare beneficiaries are based on the patient's resource group classification for patient clinical, functional, and service level factors.

Each department is reimbursed at a tentative rate with final settlement determined after submission of an annual cost report by the department and audit thereof by the Medicare fiscal intermediary. The Health System's Medicare cost reports have been audited by the fiscal intermediary through June 30, 2006.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE D: NET PATIENT SERVICE REVENUE (CONTINUED)

Medicaid – The Medicaid program for acute care services was replaced by a waiver program, TennCare, as approved by the Health Care Financing Administration (“HCFA”) in 1994. Services to program beneficiaries are provided under contract with a managed care organization through the State of Tennessee TennCare program. Payments for Medical Center inpatient services are paid based either upon a prospective per diem rate or per discharge rate. Payments for Hospital outpatient, Ambulance, Wellness Center, and Home Health Care services are paid based upon a percentage of charges or per diem.

Care Center services rendered to Medicaid program beneficiaries are reimbursed at per diem rates determined by the State of Tennessee Comptroller’s Office. The rates for both intermediate care (level I) and skilled care (level II) program beneficiaries are paid on a prospective per diem basis subject to a statewide ceiling for each rate.

Others - The Medical Center, Ambulance Service, and Wellness Center have entered into payment agreements with certain commercial insurance carriers and managed care health plans. The basis for reimbursement under these agreements includes discounts from established charges and per diem payments.

For the years ended June 30, 2008 and 2007, the Medical Center received \$7,874 and \$10,041, respectively, for patient care from an endowment fund that is included in net patient service revenue.

NOTE E: DEPOSITS AND INVESTMENTS

The Health System’s carrying amount of deposits was \$2,919,552 and \$2,607,741 and the bank balance was \$2,944,178 and \$2,716,264 as of June 30, 2008 and 2007, respectively. The Health System’s carrying amount for restricted cash and investments, excluding amount held under indenture agreement, was \$6,995,561 and \$7,811,870 and the bank balance was \$6,911,238 and \$7,753,075 as of June 30, 2008 and 2007, respectively. The bank balances totaling \$9,855,416 are either insured by the Federal Deposit Insurance Corporation or Tennessee Bank Collateral Pool. The bank balances are not subject to custodial credit risk.

Interest Rate Risk

For an investment, this is the risk that a change in interest rates will affect the fair market value of investments held. The Health System has established a debt service reserve fund under an indenture agreement for repayment of the Series 1998 bonds. The reserve fund consists of a money market fund that normally invests at least 80% of its assets in U. S. Treasury securities and repurchase agreements for those securities. Its value as of June 30, 2008 was \$1,119,988. Generally, these investments maintain a dollar weighted average at 60 days or less. These investments are exposed to declines in fair values due to interest rate changes. The Health System’s exposure is mitigated through the limited maturities of the investments.

The Health System currently has no formal policy addressing interest rate or custodial credit risks.

**LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS**

June 30, 2008 and 2007

NOTE E: DEPOSITS AND INVESTMENTS (CONTINUED)

Restricted investments are held as follows as of June 30:

	<u>2008</u>	<u>2007</u>
Internally designated for capital improvements, insurance and debt service:	\$ 6,883,948	\$ 7,692,191
Restricted by contributors	74,603	87,545
Held under an indenture agreement	1,119,988	1,169,618
Held under patient trust fund arrangements - cash	<u>37,010</u>	<u>32,134</u>
	8,115,549	8,981,488
Less amounts reclassified to meet current liabilities	<u>37,010</u>	<u>32,134</u>
	<u>\$ 8,078,539</u>	<u>\$ 8,949,354</u>

NOTE F: NOTES RECEIVABLE ARRANGEMENTS

The Medical Center has advanced money to physicians to assist in the establishment of their medical professional practices. Advances are to be repaid by cash payment or continuation of the physicians' medical practices for a certain period based upon the terms of these arrangements. Net advances to physicians totaled \$14,546 and \$158,706 for the years ended June 30, 2008 and 2007, respectively. Net repayments from physicians totaled \$20,231 for the year ended June 30, 2008. The Health System provided provisions for continuation of the medical practices under these arrangements totaling \$226,585 and \$266,419 for 2008 and 2007, respectively. As of June 30, 2008 and 2007, net advances totaling \$256,769 and \$489,039, respectively, were due under these arrangements. As of June 30, 2008, no commitments remain outstanding.

NOTE G: CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2008 was as follows:

	<u>June 30, 2007</u>	<u>Additions</u>	<u>Retirements</u>	<u>June 30, 2008</u>
Capital assets, not being depreciated:				
Land	\$ 1,073,754	\$ -	\$ -	\$ 1,073,754
Construction in progress	<u>81,195</u>	<u>-</u>	<u>(81,195)</u>	<u>-</u>
Total capital assets, not being depreciated	1,154,949	-	(81,195)	1,073,754
Capital assets, being depreciated:				
Ground improvements	2,258,292	-	-	2,258,292
Building & improvements	25,866,986	971,683	-	26,838,669
Equipment	<u>11,885,729</u>	<u>481,787</u>	<u>(129,366)</u>	<u>12,238,150</u>
Total capital assets being depreciated	40,011,007	1,453,470	(129,366)	41,335,111
Less accumulated depreciation for:				
Ground improvements	(460,729)	(84,729)	-	(545,458)
Buildings and improvements	(9,204,128)	(1,001,438)	-	(10,205,566)
Equipment	<u>(6,928,174)</u>	<u>(1,075,926)</u>	<u>128,433</u>	<u>(7,875,667)</u>
Total accumulated depreciation	<u>(16,593,031)</u>	<u>(2,162,092)</u>	<u>128,433</u>	<u>(18,626,691)</u>
Capital assets, net	<u>\$ 24,572,925</u>	<u>\$ (708,622)</u>	<u>\$ (82,128)</u>	<u>\$ 23,782,175</u>

Capital asset activity for the year ended June 30, 2007 is presented on the next page.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE G: CAPITAL ASSETS (CONTINUED)

	June 30, <u>2006</u>	<u>Additions</u>	<u>Retirements</u>	June 30, <u>2007</u>
Capital assets, not being depreciated:				
Land	\$ 773,754	\$ 300,000	\$ -	\$ 1,073,754
Total capital assets, not being depreciated	<u>-</u>	<u>81,195</u>	<u>-</u>	<u>81,195</u>
	773,754	381,195	-	1,154,949
Capital assets, being depreciated:				
Ground improvements				
Building & improvements	2,196,444	62,536	(688)	2,258,292
Equipment	25,744,334	124,461	(1,809)	25,866,986
Total capital assets being depreciated	<u>11,558,085</u>	<u>666,114</u>	<u>(338,470)</u>	<u>11,885,729</u>
	39,498,863	853,111	(340,967)	40,011,007
Less accumulated depreciation for:				
Ground improvements				
Buildings and improvements	(380,114)	(81,303)	688	(460,729)
Equipment	(8,256,080)	(949,857)	1,809	(9,204,128)
Total accumulated depreciation	<u>(6,171,012)</u>	<u>(1,095,601)</u>	<u>338,439</u>	<u>(6,928,174)</u>
Capital assets, net	<u>(14,807,206)</u>	<u>(2,126,761)</u>	<u>340,936</u>	<u>(16,593,031)</u>
	<u>\$ 25,465,411</u>	<u>\$ (892,455)</u>	<u>\$ (31)</u>	<u>\$ 24,572,925</u>

The general depreciation rates based on the useful lives for depreciable capital assets is 5% for ground improvements, 2.5% to 5% for building and improvements, and 5% to 20% for equipment. Depreciation expense for the years ended June 30, 2008 and 2007 totaled \$2,162,092 and \$2,126,761, respectively.

**LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS**

June 30, 2008 and 2007

NOTE H: LONG-TERM DEBT

The following is a schedule of long-term debt activity for the year ended June 30, 2008:

	June 30, <u>2007</u>	<u>Additions</u>	<u>Reductions</u>	June 30, <u>2008</u>	Due Within <u>One Year</u>
Series 1998, due in installments of \$410,000 to \$495,000 through May 2013, interest rates ranging from 5.00% to 5.125%	\$ 2,650,000	\$ -	\$ (390,000)	\$ 2,260,000	\$ 410,000
Series 2001, due in installments of \$130,000 to \$140,000 through May 2011, at interest rates ranging from 4.1% to 4.45%	530,000	-	(125,000)	405,000	130,000
Series 2002, Adjustable Rate Pooled Financing Revenue Bonds	112,000	-	(112,000)	-	-
Series 2004, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of \$40,000 to \$800,000 through May 2023, at an interest rate of 3.875%	7,045,000	-	(40,000)	7,005,000	40,000
Note Payable, General Electric Capital Corporation, due in monthly installments of \$13,560 through October 2010, at an interest rate of 4.28%	492,889	-	(144,436)	348,453	150,741
Series 2007, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of \$10,000 to \$1,040,000 through May 2028, at an interest rate of 4.2%	4,960,000	-	(25,000)	4,935,000	10,000
Series 2007, General Obligation Refunding Bonds, due in monthly installments of \$10,000 to \$220,000 through May 2021, at an interest rate of 3.93%	1,905,000	-	(15,000)	1,890,000	10,000
Capital Lease Obligation, due in monthly installments of \$3,561 through April 2017, at an interest rate of 7.5%	300,000	-	(24,588)	275,412	22,852
Total long-term debt	17,994,889	\$ -	\$ (876,024)	17,118,865	\$ 773,593
Less current maturities of long-term debt	(866,024)			(773,593)	
Less Series 2004 deferred refunding costs	(281,171)			(263,505)	
Less Series 2007 deferred refunding costs	(119,214)			(109,521)	
Add unamortized bond premium	41,040			39,170	
Total noncurrent liabilities	<u>\$ 16,769,520</u>			<u>\$ 16,011,416</u>	

A schedule of long-term debt for the year ended June 30, 2007 is presented on the next page.

**LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS**

June 30, 2008 and 2007

NOTE H: LONG-TERM DEBT (CONTINUED)

	June 30, <u>2006</u>	<u>Additions</u>	<u>Reductions</u>	June 30, <u>2007</u>	Due Within <u>One Year</u>
Series 1998, due in installments of \$390,000 to \$495,000 through May 2013, interest rates ranging from 5.00% to 5.125%	\$ 7,855,000	\$ -	\$ (5,205,000)	\$ 2,650,000	\$ 390,000
Series 2001, due in installments of \$125,000 to \$140,000 through May 2011, at interest rates ranging from 4.1% to 4.45%	2,470,000	-	(1,940,000)	530,000	125,000
Series 2002, Adjustable Rate Pooled Financing Revenue Bonds, due in installments of \$10,000 to \$102,000 through May 2009, at adjustable interest rates (currently 3.89%) subject to fixed rate conversion	209,000	-	(97,000)	112,000	102,000
Series 2004, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of \$40,000 to \$800,000 through May 2023, at an interest rate of 3.875%	7,080,000	-	(35,000)	7,045,000	40,000
Note Payable, General Electric Capital Corporation, due in monthly installments of \$13,560 through October 2010, at an interest rate of 4.28%	631,284	-	(138,395)	492,889	144,436
Series 2007, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of \$10,000 to \$1,040,000 through May 2028, at an interest rate of 4.2%		4,960,000	-	4,960,000	25,000
Series 2007, General Obligation Refunding Bonds, due in monthly installments of \$10,000 to \$220,000 through May 2021, at an interest rate of 3.93%		1,905,000	-	1,905,000	15,000
Capital Lease Obligation, due in monthly installments of \$3,561 through April 2017, at an interest rate of 7.5%	-	300,000	-	300,000	24,588
Total long-term debt	18,245,284	<u>\$ 7,165,000</u>	<u>\$ (7,415,395)</u>	17,994,889	<u>\$ 866,024</u>
Less current maturities of long-term debt	(760,395)			(866,024)	
Less Series 2004 deferred refunding costs	(298,836)			(281,171)	
Less Series 2007 deferred refunding costs	-			(119,214)	
Add unamortized bond premium	42,911			41,040	
Total noncurrent liabilities	<u>\$ 17,228,964</u>			<u>\$ 16,769,520</u>	

The unamortized bond premium is being amortized over the life of the related indebtedness using a method that approximates the interest method.

**LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS**

June 30, 2008 and 2007

NOTE H: LONG-TERM DEBT (CONTINUED)

The annual requirements to amortize all long-term debt outstanding as of June 30, 2008 are as follows:

Year Ending <u>June 30,</u>	<u>Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2009	\$ 773,593	\$ 723,814
2010	847,338	687,359
2011	676,537	650,024
2012	713,598	616,871
2013	740,818	582,054
2014-2018	4,166,981	2,402,202
2019-2023	4,415,000	1,506,122
2024-2028	<u>4,785,000</u>	<u>619,710</u>
	<u>\$ 17,118,865</u>	<u>\$ 7,788,156</u>

Series 1998

The Series 1998 Hospital Facility Lease Revenue and Tax Bonds were issued in the total amount of \$15,000,000 to construct and purchase equipment for the new Medical Center built in 2001. The bonds are the ultimate obligation of Lincoln County, Tennessee. The Series 1998 bond agreement contains various covenants, including the establishment of a Debt Service Reserve Fund for repayment of the bonds, and maintenance of a certain debt service coverage ratio. For the year ended June 30, 2008, the Health System complied with the restrictive covenants including the required debt service covenant ratio.

The bonds maturing May 1, 2009 through May 1, 2013 are not subject to optional redemption. The bonds maturing on or after May 1, 2014 have been redeemed by advance refunding in August 2004 and June 2007. See Series 2004 and Series 2007 bonds below for further information.

Series 2001

The Series 2001 General Obligation Refunding and Public Improvement Bonds were issued in the total amount of \$4,060,000 to purchase furniture and equipment for the Medical Center and to refund \$1,010,000 of existing Wellness Center and Care Centers' debt. The bonds are the ultimate obligation of Lincoln County, Tennessee. The bonds maturing May 1, 2009 through May 1, 2011 will mature without the option of prior redemption. Bonds maturing on or after May 1, 2012 have been redeemed by advance refunding in June 2007. See Series 2007 bonds below for further information.

Series 2004

In a prior year, the Health System defeased a portion of the Series 1998 bonds by issuance of \$7,115,000 Series 2004 Hospital Facility Lease Revenue and Tax Refunding Bonds and placing the proceeds of the bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Health System's financial statements. At June 30, 2008, \$6,625,000 of the bonds outstanding are considered defeased.

The Series 2004 bonds are the ultimate obligation of Lincoln County, Tennessee. The bonds maturing May 1, 2009 through May 1, 2013 are not subject to redemption prior to maturity. The bonds maturing May 1, 2014 and thereafter are subject to redemption on or after May 1, 2013 and thereafter, as a whole or in part, at any time, at the redemption price plus interest accrued to the redemption date. The Series 2004 bond agreement contains various covenants, including the maintenance of a certain debt service coverage ratio. For the year ended June 30, 2008, the Medical Center did comply with the debt service coverage ratio.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

June 30, 2008 and 2007

NOTE H: LONG-TERM DEBT (CONTINUED)

Series 2007

In 2007, the Health System defeased \$4,835,000 of the Series 1998 bonds and \$1,820,000 of the Series 2001 bonds by issuance of \$4,960,000 Series 2007 Hospital Facility Lease Revenue and Tax Refunding Bonds and \$1,905,000 Series 2007 General Obligation Refunding Bonds and placing the proceeds of the bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Health System's financial statements. At June 30, 2008, \$6,655,000 of the bonds outstanding are considered defeased.

Both Series 2007 bonds are the ultimate obligation of Lincoln County, Tennessee. Both Series 2007 bonds are subject to redemption prior to maturity, as a whole or in part, at any time, at the redemption price plus interest accrued to the redemption date for bonds maturing after May 1, 2017. The Series 2007 bonds contain various covenants, including the maintenance of a certain debt service coverage ratio. The unrefunded Series 1998 and Series 2004 bonds are on a parity lien with the Series 2007 bonds. For the year ended June 30, 2008, the Medical Center did comply with the debt service coverage ratio.

Other Debt

The note payable and capital lease obligation are secured by the related equipment and property, respectively. The capital lease obligation property cost was \$300,000.

NOTE I: PENSION PLAN

Medical Center, Ambulance Service, Home Health Care, and Wellness Center

Employees of the Medical Center, Ambulance Service, Home Health Care, and Wellness Center are included in the Lincoln County Courthouse Employees' Pension Plan.

Plan Description

Employees of Lincoln County Courthouse Employees' Plan are members of the Political Subdivision Pension Plan (PSPP), an agent multiple-employer defined benefit pension plan (the "Plan") administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement benefits as well as death and disability benefits. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with 5 years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members at the age of 55. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the system after July 1, 1979, become vested after 5 years of service and members joining prior to July 1, 1979, were vested after 4 years of service. Benefit provisions are established in state statute found in Title 8, Chapter 34-37 of the Tennessee Code Annotated (TCA). State statutes are amended by the Tennessee General Assembly. Political subdivisions such as Lincoln County Courthouse Employees participate in the TCRS as individual entities and are liable for all costs associated with the operation and administration of their plan. Benefit improvements are not applicable to a political subdivision unless approved by the chief governing body.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for the PSPP. That report may be obtained by writing to Tennessee Treasury Department, Consolidated Retirement System, 10th Floor Andrew Jackson Building; Nashville, Tennessee 37243-0230 or can be accessed at www.treasury.state.tn.us. Copies of footnotes in PDF format can be accessed at www.treasury.state.tn.us/tcrs/PS.

**LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS**

June 30, 2008 and 2007

NOTE I: PENSION PLAN (CONTINUED)

Funding Policy

Lincoln County Courthouse Employees' Plan requires employees to contribute 5.0 percent of earnable compensation

Plan members are required to contribute at an actuarially determined rate. The current rate is 5.48% of annual covered payroll. The contribution requirement of plan members is set by state statute. The contribution requirement for Lincoln County Courthouse Employees Plan is established and may be amended by the ICRS Board of Trustees. The Health System contributions for participating departments for the years ending June 30, 2008, 2007, and 2006 were \$441,309, \$437,319, and \$276,835, respectively, equal to the required contributions for each year.

Care Centers

The Care Centers adopted a defined contribution pension plan effective October 1, 2002, under sections 401(a) and 457 of the Internal Revenue Code, covering all employees who are 21 years of age and have completed 1,000 hours of service. Participants become fully vested after six years (20% after 2 years plus 20% for each subsequent year). Participants become eligible to retire at the age of 60 or completion of 5 years of service, whichever is later. The plan provides for early retirement at the age of 55 and the completion of 30 years of service. Eligible participants may contribute a portion of their salary, up to the legal limit established by the Internal Revenue Code. The Care Centers will match up to 50% of the employee's contribution up to the first 3% of gross pay. Employer contributions under this plan totaled \$31,909 and \$29,518 for the years ended June 30, 2008 and 2007, respectively.

NOTE J: RISK MANAGEMENT

The Health System contracts with Blue Cross of Tennessee to provide a self-insured group health insurance plan to eligible employees and their eligible dependents, as defined in the contract. The Health System has also purchased reinsurance for claims paid in any one-contract year, in excess of \$90,000 per member, which includes employees and their eligible dependents. Claims are paid on a monthly basis by Blue Cross with a settlement at the end of each quarter for the excess or deficit of premiums paid by the Health System over or under claims paid by Blue Cross.

Claims expense and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported (claims lag).

As of June 30, 2008 and 2007, the Health System accrued \$144,674 and \$181,794 respectively, for an estimated claims lag. Changes in the reported liability for 2007 and 2006 resulted from the following:

	<u>2008</u>	<u>2007</u>
Balance, beginning of year	\$ 181,794	\$ 159,756
Current year claims and settlements	1,851,936	1,674,889
Claim payments	<u>(1,889,056)</u>	<u>(1,652,851)</u>
Balance, end of year	<u>\$ 144,674</u>	<u>\$ 181,794</u>

The Committee has internally designated cash to use for payment of future insurance premiums. As of June 30, 2008, this internally designated cash, including interest earned, totaled \$161,727

**LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS**

June 30, 2008 and 2007

NOTE K: CONCENTRATIONS OF CREDIT RISK

The Health System grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements and managed care health plans. The following is a summary of the mix of accounts receivable from third-party payors and patients as of June 30:

	<u>2008</u>	<u>2007</u>
Medicare	29%	28%
Medicaid	13%	18%
Other third-party payors	26%	23%
Patients	<u>32%</u>	<u>31%</u>
	<u>100%</u>	<u>100%</u>

NOTE L: MANAGEMENT AGREEMENT

The Health System has an agreement with Quorum Health Resources, LLC, ("QHR"), to provide management services and certain key personnel for a five year period ending June 30, 2010. Management fees are subject to annual adjustment by an inflation factor as defined in the agreement. Management fees paid for 2008 and 2007 were \$592,459 and \$594,610, respectively. Total payments to QHR for 2008 and 2007 were \$601,966 and \$602,148, respectively, which includes reimbursement for travel, dues, and key personnel who provide services to the Health System.

NOTE M: CONTINGENCIES AND COMMITMENTS

The Health System is involved in litigation arising in the ordinary course of business. The ultimate outcome of the litigation is unknown at the present time. Accordingly, no provision for any liability that might result has been made in the accompanying financial statements. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Health System's financial position or results of operations.

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. The Health System leases various equipment and property under operating leases that can be canceled under terms less than one year. The following is a schedule by year of future minimum noncancelable lease payments as of June 30, 2008:

Year Ending <u>June 30,</u>	
2009	\$ 28,257
2010	18,840
2011	17,240
2012	15,000
2013	15,000
Later Years	<u>75,000</u>
	<u>\$ 169,337</u>

**LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS**

June 30, 2008 and 2007

NOTE M: CONTINGENCIES AND COMMITMENTS (CONTINUED)

Rental expense under all operating leases for 2008 and 2007 totaled \$290,408 and \$227,290, respectively.

The Health System leases office space in its medical office building to physicians primarily under three-year lease terms and also leases office space at Lincoln Care Center. The following is a schedule by year of future minimum rentals under noncancelable leases that expire under existing terms through 2010:

Year Ending	
<u>June 30,</u>	
2009	\$ 150,850
2010	<u>102,304</u>
	<u>\$ 253,154</u>

Rental income received for 2008 and 2007 totaled \$196,651 and \$200,331, respectively. Rental income is included in other operating revenue in the accompanying financial statements. The cost and accumulated depreciation related to the medical office building is included in property and equipment as follows:

Cost	\$ 3,499,649
Accumulated depreciation	<u>630,024</u>
Net Book Value	<u>\$ 2,869,625</u>

NOTE N: LINCOLN COUNTY HEALTH SYSTEM FOUNDATION

The Lincoln County Health System Foundation ("Foundation") is a legally separate, tax-exempt supporting organization to the Health System and a component unit of Lincoln County, Tennessee. The Health System does not control the timing or amount of receipts from the Foundation. Accordingly, the net assets of the Foundation are not reported by the Health System. However, for informational purposes only, a summary of the Foundation's assets, liabilities, net assets, results of operations, and changes in net assets follows as of June 30, 2008.

Assets, cash and cash equivalents	<u>\$ 62,684</u>
Liabilities	<u>-</u>
Unrestricted net assets	<u>\$ 62,684</u>
Support and revenue	\$ 32,884
Expenses	<u>(9,818)</u>
Excess of support and revenue over expenses	23,066
Unrestricted net assets, beginning of year	<u>39,618</u>
Unrestricted net assets, end of year	<u>\$ 62,684</u>

NOTE O - PLEDGED REVENUES

The Health System has pledged revenues to secure certain revenue bonds as described in Note H. The current year revenues, debt service, and future pledge commitment are as follows:

Operating Revenues	Current Year Principal and Interest Paid on Revenue Bonds	Percent of Current Revenue	Remaining Pledge based on future Principal and Interest Requirements	Commitment Period through Fiscal Year
<u>\$ 34,672,565</u>	<u>\$ 1,405,805</u>	<u>4.1%</u>	<u>\$ 21,113,387</u>	2028

OTHER FINANCIAL INFORMATION

**LINCOLN COUNTY HEALTH SYSTEM
DEPARTMENTAL BALANCE SHEET**

June 30, 2008

	<u>Lincoln Medical Center</u>	<u>Lincoln Medical Center EMS</u>	<u>Home Health Care</u>	<u>Patrick Rehab- Wellness Center</u>	<u>Lincoln & Donalson Care Centers</u>	<u>Total</u>
ASSETS						
CURRENT ASSETS:						
Cash and cash equivalents	\$ 885,170	\$ -	\$ 45,081	\$ 8,944	\$ 1,980,357	\$ 2,919,552
Restricted cash	-	-	-	-	37,010	37,010
Accounts receivable - net	2,784,732	-	260,371	-	761,654	3,806,757
Estimated third-party payor settlements receivable	-	-	-	-	110,670	110,670
Supplies, at cost	656,869	-	-	-	54,424	711,293
Prepaid expenses	183,689	-	500	35	77,811	262,035
Due from (to) departments	(1,306,087)	-	-	-	1,306,087	-
Other assets	129,644	-	-	-	-	129,644
Total Current Assets	<u>3,334,017</u>	<u>-</u>	<u>305,952</u>	<u>8,979</u>	<u>4,328,013</u>	<u>7,976,961</u>
NONCURRENT ASSETS:						
Restricted investments	1,298,743	-	-	-	6,779,796	8,078,539
CAPITAL ASSETS, net of accumulated depreciation	<u>17,726,672</u>	<u>441,663</u>	<u>133,710</u>	<u>1,215,697</u>	<u>4,264,433</u>	<u>23,782,175</u>
Other assets:						
Investment in insurance fund	80,367	-	-	-	45,441	125,808
Notes receivable, net	256,769	-	-	-	-	256,769
Deferred financing costs	443,289	-	-	-	-	443,289
Total Noncurrent Assets	<u>19,805,840</u>	<u>441,663</u>	<u>133,710</u>	<u>1,215,697</u>	<u>11,089,670</u>	<u>32,686,580</u>
TOTAL ASSETS	<u>\$ 23,139,857</u>	<u>\$ 441,663</u>	<u>\$ 439,662</u>	<u>\$ 1,224,676</u>	<u>\$ 15,417,683</u>	<u>\$ 40,663,541</u>
LIABILITIES AND NET ASSETS						
CURRENT LIABILITIES:						
Current maturities of long-term debt	\$ 750,741	\$ -	\$ -	\$ 22,852	\$ -	\$ 773,593
Accounts payable	524,523	6,539	7,412	15,849	298,632	852,955
Accrued expenses:						
Salaries and payroll taxes	267,859	19,766	12,743	23,104	159,735	483,207
Compensated absences	462,683	25,195	10,800	40,953	261,434	801,065
Interest	114,138	-	-	-	-	114,138
Other	141,811	-	-	71	79,910	221,792
Estimated third-party payor settlements payable	304,878	-	-	-	-	304,878
Patient trust funds	-	-	-	-	37,010	37,010
Total Current Liabilities	<u>2,566,633</u>	<u>51,500</u>	<u>30,955</u>	<u>102,829</u>	<u>836,721</u>	<u>3,588,638</u>
NONCURRENT LIABILITIES:						
Long-term debt, net of current maturities	<u>15,758,856</u>	<u>-</u>	<u>-</u>	<u>252,560</u>	<u>-</u>	<u>16,011,416</u>
TOTAL LIABILITIES	<u>18,325,489</u>	<u>51,500</u>	<u>30,955</u>	<u>355,389</u>	<u>836,721</u>	<u>19,600,054</u>
NET ASSETS:						
Invested in capital assets, net of related debt	1,660,364	441,663	133,710	940,285	4,264,433	7,440,455
Restricted for:						
Bond indenture agreement	1,119,988	-	-	-	-	1,119,988
Other purposes	85,262	-	-	-	-	85,262
Unrestricted assets (deficit)	<u>1,948,754</u>	<u>(51,500)</u>	<u>274,997</u>	<u>(70,998)</u>	<u>10,316,529</u>	<u>12,417,782</u>
TOTAL NET ASSETS	<u>4,814,368</u>	<u>390,163</u>	<u>408,707</u>	<u>869,287</u>	<u>14,580,962</u>	<u>21,063,487</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 23,139,857</u>	<u>\$ 441,663</u>	<u>\$ 439,662</u>	<u>\$ 1,224,676</u>	<u>\$ 15,417,683</u>	<u>\$ 40,663,541</u>

**LINCOLN COUNTY HEALTH SYSTEM
DEPARTMENTAL STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**

Year Ended June 30, 2008

	Lincoln Medical Center	Lincoln Medical Center EMS	Home Health Care	Patrick Rehab- Wellness Center	Lincoln & Donalson Care Centers	Eliminations DR/(CR)	Total
OPERATING REVENUES:							
Net patient service revenue	\$ 18,113,174	\$ 1,210,667	\$ 1,046,142	\$ 1,130,938	\$ 12,734,375	\$ 277,899	\$ 33,957,397
Other operating revenue	1,234,874	-	198	531,452	65,940	855,443	977,021
Total Operating Revenues	<u>19,348,048</u>	<u>1,210,667</u>	<u>1,046,340</u>	<u>1,662,390</u>	<u>12,800,315</u>	<u>1,133,342</u>	<u>34,934,418</u>
OPERATING EXPENSES:							
Employee compensation and benefits	10,532,035	863,078	654,135	1,148,659	7,454,851	(90,761)	20,561,997
Fees to individuals and organizations	3,034,535	58,717	221,117	43,009	1,204,588	(569,778)	3,992,188
Supplies	2,743,986	42,918	58,519	52,734	1,536,650	(380,996)	4,053,811
Other expenses	2,167,123	111,663	113,831	216,685	1,623,843	(91,807)	4,141,338
Depreciation	1,641,725	84,934	16,219	84,517	334,697	-	2,162,092
Total Operating Expenses	<u>20,119,404</u>	<u>1,161,310</u>	<u>1,063,821</u>	<u>1,545,604</u>	<u>12,154,629</u>	<u>(1,133,342)</u>	<u>34,911,426</u>
INCOME (LOSS) FROM OPERATIONS	<u>(771,356)</u>	<u>49,357</u>	<u>(17,481)</u>	<u>116,786</u>	<u>645,686</u>	<u>-</u>	<u>22,992</u>
NONOPERATING REVENUES AND (EXPENSES):							
Investment income	110,222	-	1,438	326	372,459	-	484,445
Interest expense	(719,957)	-	-	(25,267)	-	-	(745,224)
Amortization	(49,562)	-	-	-	-	-	(49,562)
Noncapital grants and contributions	32,535	3,040	3,516	-	80	-	39,171
Nonoperating Revenues and (Expenses), net	<u>(626,762)</u>	<u>3,040</u>	<u>4,954</u>	<u>(24,941)</u>	<u>372,539</u>	<u>-</u>	<u>(271,170)</u>
Excess (Deficiency) Revenues over Expenses	(1,398,118)	52,397	(12,527)	91,845	1,018,225	-	(248,178)
Operating transfers from (to) departments	696,222	(40,793)	(497,070)	(158,359)	-	-	-
INCREASE/(DECREASE) IN NET ASSETS	<u>(701,896)</u>	<u>11,604</u>	<u>(509,597)</u>	<u>(66,514)</u>	<u>1,018,225</u>	<u>-</u>	<u>(248,178)</u>
Net Assets, beginning of year	5,516,264	378,559	918,304	935,801	13,562,737	-	21,311,665
Net Assets, end of year	<u>\$ 4,814,368</u>	<u>\$ 390,163</u>	<u>\$ 408,707</u>	<u>\$ 869,287</u>	<u>\$ 14,580,962</u>	<u>\$ -</u>	<u>\$ 21,063,487</u>

**LINCOLN COUNTY HEALTH SYSTEM
DEPARTMENTAL STATEMENT OF CASH FLOWS**

Year Ended June 30, 2008

	Lincoln Medical Center	Lincoln Medical Center EMS	Home Health Care	Patrick Rehab- Wellness Center	Lincoln & Donalson Care Centers	Total
CASH FLOWS FROM OPERATING ACTIVITIES:						
Cash received from patients and third party payors	\$ 17,615,433	\$ 1,210,667	\$ 1,590,966	\$ 1,130,938	\$ 12,439,179	\$ 33,987,183
Other operating cash receipts	1,156,529	-	198	531,452	65,940	1,754,119
Cash paid to employees	(10,508,146)	(860,851)	(659,034)	(1,158,157)	(7,440,832)	(20,627,020)
Cash paid to suppliers for goods and services	(8,018,143)	(218,063)	(394,979)	(321,660)	(4,275,943)	(13,228,788)
Net Cash Provided by Operating Activities	<u>245,673</u>	<u>131,753</u>	<u>537,151</u>	<u>182,573</u>	<u>788,344</u>	<u>1,885,494</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:						
Noncapital grants and contributions	32,535	3,040	3,516	-	80	39,171
Operating transfers in (out)	696,222	(40,793)	(497,070)	(158,359)	-	-
Advances from (to) departments	(15,164)	-	-	29,040	(13,876)	-
Net Cash Provided (Used) by Noncapital Financing Activities	<u>713,593</u>	<u>(37,753)</u>	<u>(493,554)</u>	<u>(129,319)</u>	<u>(13,796)</u>	<u>39,171</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:						
Additions to capital assets, net	(488,514)	(94,934)	-	-	(788,827)	(1,372,275)
Proceeds from disposal of capital assets	-	934	-	-	-	934
Principal paid on long-term debt	(851,436)	-	-	(24,588)	-	(876,024)
Interest paid on long-term debt, net	(713,841)	-	-	(25,267)	-	(739,108)
Net Cash Used by Capital and Related Financing Activities	<u>(2,053,791)</u>	<u>(94,000)</u>	<u>-</u>	<u>(49,855)</u>	<u>(788,827)</u>	<u>(2,986,473)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:						
Interest received	128,582	-	1,438	326	348,139	478,485
(Increase) Decrease in restricted investments	1,176,584	-	-	-	(281,450)	895,134
Net Cash Provided by Investing Activities	<u>1,305,166</u>	<u>-</u>	<u>1,438</u>	<u>326</u>	<u>66,689</u>	<u>1,373,619</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS						
CASH AND CASH EQUIVALENTS, beginning of year	210,641	-	45,035	3,725	52,410	311,811
CASH AND CASH EQUIVALENTS, end of year	<u>674,529</u>	<u>-</u>	<u>46</u>	<u>5,219</u>	<u>1,927,947</u>	<u>2,607,741</u>
	<u>\$ 885,170</u>	<u>\$ -</u>	<u>\$ 45,081</u>	<u>\$ 8,944</u>	<u>\$ 1,980,357</u>	<u>\$ 2,919,552</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH FLOWS FROM OPERATING ACTIVITIES:						
Income (Loss) from operations	\$ (771,356)	\$ 49,357	\$ (17,481)	\$ 116,786	\$ 645,686	\$ 22,992
Adjustments to reconcile operating income (loss) to net cash provided by operating activities -						
Depreciation	1,641,725	84,934	16,219	84,517	334,697	2,162,092
Provision for bad debts	3,176,284	186,869	14,649	134,922	148,685	3,661,409
Payments received on notes receivable arrangements	20,231	-	-	-	-	20,231
Provision for note receivable arrangements	226,585	-	-	-	-	226,585
Advances under note receivable arrangements, net	(14,546)	-	-	-	-	(14,546)
Investment in insurance funds, net	6,291	-	-	-	(231)	6,060
Changes in operating assets and liabilities -						
Accounts receivable	(3,389,566)	(186,869)	530,175	(134,922)	(457,892)	(3,639,074)
Estimated third-party payor settlements	(284,459)	-	-	-	14,011	(270,448)
Supplies	(70,166)	-	-	-	10,142	(60,024)
Prepaid expenses	(96,410)	-	(125)	2,100	7,556	(86,879)
Other assets	(78,345)	-	-	-	-	(78,345)
Accounts payable	(96,464)	(4,765)	(1,387)	(11,288)	101,572	(12,332)
Accrued expenses	(24,131)	2,227	(4,899)	(9,542)	(15,882)	(52,227)
Net Cash Provided by Operating Activities	<u>\$ 245,673</u>	<u>\$ 131,753</u>	<u>\$ 537,151</u>	<u>\$ 182,573</u>	<u>\$ 788,344</u>	<u>\$ 1,885,494</u>

LINCOLN COUNTY HEALTH FACILITIES
SCHEDULE OF LONG-TERM DEBT PRINCIPAL AND INTEREST REQUIREMENTS

June 30, 2008

Year Ending June 30,	Lincoln Medical Center Series 1998		Lincoln Medical Center Series 2001		Lincoln Medical Center Series 2004		Lincoln Medical Center Series 2007 Gen Oblig. Refg. Interest		Lincoln Medical Center Series 2007 Refg. Rev. Interest		Lincoln Medical Center Note Payable		Lincoln Medical Center Capital Lease Obligation		Total
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	
2009	\$ 410,000	\$ 114,212	\$ 130,000	\$ 17,628	\$ 40,000	\$ 271,444	\$ 10,000	\$ 74,277	\$ 10,000	\$ 207,270	\$ 150,741	\$ 11,980	\$ 22,852	\$ 27,003	\$ 1,497,407
2010	430,000	93,712	135,000	12,102	40,000	269,894	10,000	73,884	10,000	206,850	197,712	5,688	24,626	25,229	1,534,697
2011	450,000	72,212	140,000	6,230	40,000	268,344	10,000	73,491	10,000	206,430	-	-	26,537	23,317	1,326,561
2012	475,000	49,712	-	-	45,000	266,794	155,000	73,098	10,000	206,010	-	-	28,598	21,257	1,330,469
2013	495,000	25,371	-	-	45,000	265,050	160,000	67,006	10,000	205,590	-	-	30,818	19,037	1,322,872
2014	-	-	-	-	565,000	263,306	170,000	60,718	10,000	205,170	-	-	33,210	16,645	1,324,049
2015	-	-	-	-	595,000	241,413	170,000	54,037	10,000	204,750	-	-	35,788	14,066	1,325,054
2016	-	-	-	-	610,000	218,356	180,000	47,356	10,000	204,330	-	-	38,567	11,288	1,319,897
2017	-	-	-	-	635,000	194,719	190,000	40,282	10,000	203,910	-	-	34,416	15,438	1,323,765
2018	-	-	-	-	665,000	170,113	195,000	32,815	10,000	203,490	-	-	-	-	1,276,418
2019	-	-	-	-	685,000	144,344	205,000	25,152	10,000	203,070	-	-	-	-	1,272,566
2020	-	-	-	-	720,000	117,800	215,000	17,095	10,000	202,650	-	-	-	-	1,282,545
2021	-	-	-	-	745,000	89,900	220,000	8,650	10,000	202,230	-	-	-	-	1,275,780
2022	-	-	-	-	775,000	61,031	-	-	10,000	201,810	-	-	-	-	1,047,841
2023	-	-	-	-	800,000	31,000	-	-	10,000	201,390	-	-	-	-	1,042,390
2024	-	-	-	-	-	-	-	-	880,000	200,970	-	-	-	-	1,080,970
2025	-	-	-	-	-	-	-	-	915,000	164,010	-	-	-	-	1,079,010
2026	-	-	-	-	-	-	-	-	955,000	125,580	-	-	-	-	1,080,580
2027	-	-	-	-	-	-	-	-	995,000	85,470	-	-	-	-	1,080,470
2028	-	-	-	-	-	-	-	-	1,040,000	43,680	-	-	-	-	1,083,680
	<u>\$ 2,260,000</u>	<u>\$ 355,219</u>	<u>\$ 405,000</u>	<u>\$ 35,960</u>	<u>\$ 7,005,000</u>	<u>\$ 2,873,508</u>	<u>\$ 1,890,000</u>	<u>\$ 647,861</u>	<u>\$ 4,935,000</u>	<u>\$ 3,684,660</u>	<u>\$ 348,453</u>	<u>\$ 17,668</u>	<u>\$ 275,412</u>	<u>\$ 173,280</u>	<u>\$ 24,907,021</u>

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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**

To the Health System Committee
Lincoln County Health System
Lincoln County, Tennessee

We have audited the financial statements of the Lincoln County Health System (as described in Note A to the financial statements) as of and for the year ended June 30, 2008, and have issued our report thereon, dated October 29, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Health System's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Health System's financial statements that is more than inconsequential will not be prevented or detected by the Health System's internal control.

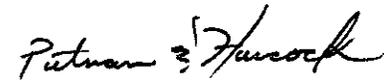
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Health System's internal control.

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

Compliance and Other Matters

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

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

A handwritten signature in black ink, appearing to read "Putnam & Hancock". The signature is written in a cursive style with a large, stylized initial "P" and "H".

October 29, 2008