

Annual Financial Report
Claiborne County Hospital
and Nursing Home and Subsidiary
*Years ended June 30, 2011 and 2010
with Report of Independent Auditors*

Claiborne County Hospital and Nursing Home and Subsidiary

Annual Financial Report

Years ended June 30, 2011 and 2010

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Report of Independent Auditors

Board of Directors
Claiborne County Hospital and Nursing Home and Subsidiary

We have audited the accompanying consolidated statements of net position of Claiborne County Hospital and Nursing Home and Subsidiary (the Hospital), a component unit of Claiborne County, Tennessee, as of June 30, 2011 and 2010, and the consolidated statements of revenues, expenses and changes in net position, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audits 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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the net position of Claiborne County Hospital and Nursing Home and Subsidiary as of June 30, 2011 and 2010 and the changes in its net position and its cash flows 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 a report dated December 23, 2011 on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions, laws, regulations, contracts 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 conjunction with this report in considering the results of our audit.

Board of Directors
Claiborne County Hospital and Nursing Home and Subsidiary

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3 through 6 be presented to supplement the consolidated financial statements. Such information, although not a part of the consolidated financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the consolidated financial statements, and other knowledge we obtained during our audit of the consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

The List of Officials on page 26, which is of a nonaccounting nature, has not been subjected to the auditing procedures applied in the audit of the financial statements, and we express no opinion on it.

Coulter & Justus, P. C.

December 23, 2011

Claiborne County Hospital and Nursing Home and Subsidiary
Management's Discussion and Analysis

This section of Claiborne County Hospital and Nursing Home and Subsidiary's annual financial report presents management's discussion and analysis of the Hospital's financial performance during the fiscal years ended June 30, 2011, 2010 and 2009. The information contained herein should be considered in conjunction with the Hospital's accompanying financial statements.

Overview of the Financial Statements

The Hospital is a component unit of Claiborne County, Tennessee, and the accompanying financial statements reflect the Hospital's financial position and activities. These consolidated financial statements consist of statements of net position (formerly balance sheets), statements of revenues, expenses and changes in net position and statements of cash flows. The accompanying notes to the consolidated financial statements are an integral part of the financial statements and are essential to understanding the data contained in the financial statements.

The statements of net position provide descriptions of the Hospital's assets and liabilities and an indication of the Hospital's financial position. The statements of revenue, expenses and changes in net position report the revenues and expenses relate to the Hospital's activities. The statements of cash flows report the cash provided and used by operating, investing, capital, financing and other activities.

Financial Highlights

Condensed financial information as of and for the years June 30, 2011, 2010 and 2009 is provided in the tables below (amounts in thousands):

	2011	2010	2009
Assets:			
Current assets	\$ 8,370	\$ 6,828	\$ 8,305
Capital assets, net	14,265	14,755	15,318
Assets limited as to use	1,895	2,480	1,381
Other	238	201	202
Total assets	\$24,768	\$24,264	\$25,206
Liabilities:			
Current liabilities	\$ 3,922	\$ 4,247	\$ 4,143
Long-term liabilities	6,539	7,083	6,542
Total liabilities	\$10,461	\$11,330	\$10,685
Net assets:			
Invested in capital assets, net of related debt	\$ 8,453	\$ 9,035	\$ 9,290
Unrestricted	5,459	3,491	4,900
Temporarily restricted	395	407	331
Total net assets	\$14,307	\$12,933	\$14,521

Claiborne County Hospital and Nursing Home and Subsidiary

Management's Discussion and Analysis (continued)

Financial Position

Overall, the Hospital's net position declined in 2010 and increased in 2011. This increase in net assets is primarily the result of reduced operating expenses and the sale of the Home Health operation in 2011.

Depreciation decreased the amounts classified as net assets invested in capital assets (net of related debt) in 2011. In 2010, the capital additions resulted in an increase in net assets invested in capital assets (net of related debt), while additional bond issues were offset by principal payments and depreciation.

Current assets increased from 2010 to 2011 primarily due to an increase in cash. Assets limited as to use decreased in 2011 due to defeasance of the 2009 bonds. Assets limited as to use consist of debt proceeds restricted for use in completing the Medical Office Building (MOB).

The statements of cash flows and Notes 6, 7 and 8 to the financial statements provide additional information regarding the capital additions, bonds, debt and related cash flows.

Results of Operations

Operating revenues and expenses are as follows for the years ended June 30, 2011, 2010 and 2009 (amounts in thousands):

	2011	Relative %	2010	Relative %	2009	Relative %
Operating revenue:						
Net patient service revenues	\$29,549	96%	\$30,405	96%	\$31,877	97%
Other revenue	1,123	4%	1,160	4%	1,043	3%
Total operating revenues	30,672	100%	31,565	100%	32,920	100%
Operating expenses:						
Salaries and wages	19,068	62%	20,177	64%	21,935	67%
Medical supplies and drugs	3,237	11%	3,242	10%	3,748	11%
Other supplies	761	2%	790	2%	771	2%
Insurance	792	3%	752	2%	631	2%
Depreciation and amortization	1,376	5%	1,415	5%	1,298	4%
Other expenses	6,274	21%	6,628	21%	6,522	20%
Total operating expenses	31,508	103%	33,004	104%	34,905	106%
Operating loss	(836)	3%	(1,439)	(4%)	(1,985)	(6%)
Nonoperating income (expenses):						
Investment income	93	-	131	-	142	-
Interest expense	(325)	1%	(339)	(1%)	(295)	(1%)
Other income	-	-	60	-	-	-
Gain on sale	2,441	8%				
Nonoperating loss	2,209	7%	(148)	(1%)	(153)	(1%)
Excess revenues over expenses (expenses over revenues)	\$ 1,373	4%	\$ (1,587)	(5%)	\$ (2,138)	(7%)

Claiborne County Hospital and Nursing Home and Subsidiary
Management's Discussion and Analysis (continued)

Results of Operations (continued)

Net patient service revenues decreased 3% in 2011 and 5% in 2010 primarily due to lower demand from the economic downturn and resulting loss of medical insurance by residents of the area served by the Hospital. Overall, hospital fees and rates have increased each year but a significant portion of the price increases are not reimbursed by the Hospital's largest third party payors such as Medicare and TennCare. Operating expenses in 2011 decreased due to cost containment efforts by Hospital management and staff, including efforts to purchase supplies and drugs at lower costs and a workforce reduction. In total, operating expenses decreased 5% in both 2011 and 2010. The 2011 operating revenue decline was offset by a decrease in operating expenses, resulting in an operating loss for 2011 of \$836,201. The 2011 operating loss was lower than the 2010 loss of \$1,439,401. The Hospital has operated on a continuation budget for the past two years and management has directed budgetary efforts toward effective cost control.

Other cost containment measures included sale of the Home Health division in March 2011. The Home Health division operation represented approximately \$160,000 and \$250,000 in operating losses for both 2011 (9 months) and 2010, respectively. The sale generated cash of approximately \$2,250,000 and a note receivable from the buyer of \$250,000.

Interest costs in 2011 decreased in relation to the repayment of the 2009 bonds in 2011. Interest expense in 2010 primarily reflects the increases in variable rates paid in connection with the bonds outstanding during this period.

Capital Acquisitions and Construction Activities

Note 6 to the consolidated financial statements summarizes property and equipment by class and changes for the years ended June 30, 2011 and 2010. Additional information regarding accounting policies for capital assets is provided in Note 1 to the financial statements.

Total additions to property and equipment were \$1,631,955 in 2011 and \$827,151 in 2010. Additions in 2011 included completion of the MOB, upgrades to current facilities to house a new digital mammography unit and other routine upgrades and improvements. In 2010, an eight bed Inpatient Rehabilitation Facility (IRF) was also completed. Construction in progress at June 30, 2011 and 2010 consists primarily of costs for the IRF and the renovations necessary for the digital mammography unit. The IRF unit opened July 5, 2010. The digital mammography unit opened July 1, 2011. Due to low census; the IRF unit was closed in December 2010.

Claiborne County Hospital and Nursing Home and Subsidiary
Management's Discussion and Analysis (continued)

Long-Term Debt Activity

Principal payments on the 1997, 1998 and 2009 bond issues were approximately \$5,036,000 for 2010. The majority of the payments were funded with 2010 refunding bond proceeds. Balances outstanding at June 30, 2011 and 2010 were \$5,975,000 and \$6,190,000 respectively (before bond premiums, discounts, and deferred refunding loss).

Requests for Information

The annual financial report is designed to provide an overview of the Hospital's financial position and activity. Questions concerning the information provided herein or requests for additional information should be directed to the CEO/Administrator of Claiborne County Hospital and Nursing Home, Inc.

Respectfully submitted,



Timothy S. Brown
CEO/Administrator
Claiborne County Hospital and Nursing Home, Inc.

Claiborne County Hospital and Nursing Home and Subsidiary
Consolidated Statements of Net Position

	June 30	
	2011	2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,852,773	\$ 856,749
Patient accounts receivable, less allowances for uncollectible accounts of approximately \$2,500,000 in 2011 and \$2,400,000 in 2010	4,367,488	4,859,080
Other receivables	411,512	246,571
Inventories	588,160	553,298
Prepaid expenses	150,529	230,945
Estimated amounts due from third-party payors	-	81,387
Total current assets	8,370,462	6,828,030
Assets limited as to use:		
For construction of capital assets	487,576	1,000,000
Foundation	395,142	407,394
Under bond agreements--held by trustee	1,012,571	1,072,131
	1,895,289	2,479,525
Property and equipment, net	14,264,988	14,755,178
Bond issuance costs, net	12,658	22,454
Other assets	224,358	178,358
Total assets	\$ 24,767,755	\$ 24,263,545

	June 30	
	2011	2010
Liabilities and net position		
Current liabilities:		
Accounts payable and accrued expenses	\$ 1,468,553	\$ 1,772,565
Accrued payroll and withholdings	792,432	894,473
Accrued compensated absences	815,211	826,248
Deferred revenue	-	3,869
Estimated amounts due to third-party payors	72,526	-
Current portion of notes payable and capital leases	377,857	535,152
Current portion of bonds payable	395,000	215,000
Total current liabilities	<u>3,921,579</u>	<u>4,247,307</u>
Long-term debt:		
Notes payable and capital leases, less current portion	795,894	1,011,514
Bonds payable, less current portion	5,743,440	6,071,179
Total long-term debt	<u>6,539,334</u>	<u>7,082,693</u>
Total liabilities	<u>10,460,913</u>	<u>11,330,000</u>
Net position:		
Invested in capital assets, net of related debt	8,452,944	9,035,009
Unrestricted	5,458,756	3,491,142
Temporarily restricted	395,142	407,394
Total net position	<u>14,306,842</u>	<u>12,933,545</u>
Total liabilities and net position	<u><u>\$ 24,767,755</u></u>	<u><u>\$ 24,263,545</u></u>

See accompanying Notes to Consolidated Financial Statements.

Claiborne County Hospital and Nursing Home and Subsidiary
Consolidated Statements of Revenues, Expenses and Changes in Net Position

	Year ended June 30	
	2011	2010
Operative revenues:		
Net patient service revenue	\$ 29,549,337	\$ 30,404,853
Other revenue	1,122,846	1,159,840
Total operating revenues	30,672,183	31,564,693
Operating expenses:		
Salaries, wages, and benefits	19,068,353	20,177,124
Medical supplies and drugs	3,236,919	3,242,384
Other supplies	760,917	789,756
Insurance	792,450	752,135
Depreciation and amortization	1,375,519	1,415,082
Other expenses	6,274,226	6,627,613
Total operating expenses	31,508,384	33,004,094
Operating loss	(836,201)	(1,439,401)
Nonoperating income (expenses):		
Investment income	93,579	131,453
Interest expense	(324,660)	(339,417)
Other income	-	60,000
Gain on sale of Claiborne Home Health Care	2,440,579	-
Net nonoperating income (expenses)	2,209,498	(147,964)
Excess of revenues over expenses (expenses over revenues)	1,373,297	(1,587,365)
Net position at beginning of year	12,933,545	14,520,910
Net position at end of year	\$ 14,306,842	\$ 12,933,545

See accompanying Notes to Consolidated Financial Statements.

Claiborne County Hospital and Nursing Home and Subsidiary

Consolidated Statements of Cash Flows

	Year ended June 30	
	2011	2010
Cash flows from operating activities		
Cash received from patients and third-party payors	\$ 30,194,842	\$ 31,789,481
Other operating cash receipts	1,122,846	1,159,840
Cash payments to suppliers for good and services	(14,497,643)	(14,878,528)
Cash payments to employees for services	(15,952,006)	(16,996,904)
Net cash provided by operating activities	868,039	1,073,889
Cash flows from capital and related financing activities		
Acquisition and construction of capital assets	(809,532)	(673,700)
Proceeds from sale of home health	2,191,840	-
Principal paid on long-term debt	(1,225,750)	(5,760,000)
Proceeds from issuance of long-term debt	637,835	6,189,984
Interest paid on long-term debt	(335,900)	(297,481)
Bond premiums, discounts and issuance costs	-	132,996
Net cash provided by (used in) capital and related financing activities	458,493	(408,201)
Cash flows from investing activities		
Interest received	93,579	131,453
Net increase in restricted and unrestricted cash	1,420,111	797,141
Cash and cash equivalents at beginning of year	3,292,745	2,495,604
Cash and cash equivalents at end of year	\$ 4,712,856	\$ 3,292,745
Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents in current assets	\$ 2,852,773	\$ 856,749
Cash and cash equivalents included in assets limited as to use	1,860,083	2,435,996
Total cash and cash equivalents	\$ 4,712,856	\$ 3,292,745

Claiborne County Hospital and Nursing Home and Subsidiary

Consolidated Statements of Cash Flows (continued)

	Year ended June 30	
	2011	2010
Reconciliation of operating loss to net cash provided by operating activities		
Operating loss	(836,201)	\$ (1,439,401)
Adjustments to reconcile operating loss to net cash flows provided by operating activities:		
Depreciation expense	1,299,722	1,380,354
Amortization of bond issuance costs and bond premium	75,797	34,738
Provision for bad debts	3,757,715	4,145,360
Changes in operating assets and liabilities:		
Patient accounts receivable	(3,266,123)	(2,791,471)
Inventories, prepaid expenses and other current assets	212,000	(100,429)
Restricted assets	8,323	(33,579)
Other assets	(46,000)	(62,416)
Accounts payable and accrued expenses	(292,773)	(94,406)
Accrued payroll and withholdings	(102,041)	38,227
Accrued compensated absences	(11,037)	(1,549)
Other liabilities	68,657	(1,529)
Net cash provided by operating activities	\$ 868,039	\$ 1,073,899
 Supplemental disclosure		
Noncash investment in equipment through capital lease	\$ -	\$ 149,692
Promissory note received from sale of Claiborne Home Health Care	250,000	-

See accompanying Notes to Consolidated Financial Statements.

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2011

1. Description of Reporting Entity and Significant Accounting Policies

Reporting Entity

Claiborne County Hospital and Nursing Home (CCH) is an acute and general short-term healthcare provider and nursing home formed to provide services to Claiborne County and the surrounding communities. CCH is the sole shareholder of Multi-Specialty Medical, P.C., a for-profit physicians' office, whose financial statements are consolidated with those of CCH. In addition, CCH is the primary beneficiary of the fundraising activities of Claiborne County Healthcare Foundation, Inc. (the Foundation). As such, the financial activity of the Foundation is included (blended) in the consolidated financial statements of CCH and its subsidiary. CCH, the for-profit subsidiary and the Foundation are collectively referred to as the Hospital.

Effective March 31, 2011, the Hospital sold its interest in Claiborne Home Health Care, a for-profit home health agency for \$2,550,000. The sale included equipment with a net book value of approximately \$1,000 and a non-compete agreement. The Hospital received \$2,191,840 in cash, net of \$108,160 in transaction costs and a promissory note for \$250,000 from the buyer. The gain on the transaction was approximately \$2,440,000 and is reflected in the Hospital's statement of revenues, expenses and changes in net position. Revenues and expenses of Claiborne Home Health Care through the effective date of the sale are also included in the Hospital's statement of revenues, expenses and changes in net position for the years ended June 30, 2011 and 2010.

The Hospital is a component unit of the County of Claiborne, Tennessee (the County), which issues debt on the Hospital's behalf (*Note 7*). The Hospital's board members are appointed by the Board of Commissioners of Claiborne County. The Hospital is included as a discretely presented component unit in the financial statements of the County.

Basis of Presentation

The Hospital's financial statements are presented on the accrual basis of accounting in accordance with Governmental Accounting Standards Board (GASB), which establishes standards for external financial reporting for all state and local governmental entities. GASB requires the classification of net position into three components which are defined as follows:

Invested in capital assets, net of related debt - This component of net position consists of property and equipment, net of accumulated depreciation, and unamortized debt expense reduced by the outstanding balances of bonds and other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction or improvement of those assets or related debt are also included in this component of net position. If there are significant unspent related debt proceeds or deferred inflows of resources at year-end, the portion of the debt or deferred inflows of resources attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt or deferred inflow of resources is included in the same net position component as the unspent proceeds.

Claiborne County Hospital and Nursing Home and Subsidiary
Notes to Consolidated Financial Statements (continued)

1. Description of Reporting Entity and Significant Accounting Policies (continued)

Basis of Presentation (continued)

Restricted - This component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.

Unrestricted - This component of net position consists of the net amounts of assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination invested in capital assets, net of related debt or restricted components of net position.

Principles of Consolidation

The consolidated financial statements include the accounts of CCH, its for-profit subsidiary and the Foundation after elimination of all significant intercompany accounts and transactions.

Cash and Cash Equivalents

The Hospital considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Patient Accounts Receivable

Accounts receivable from patients and third-party payors (*Note 4*) are recorded on the accrual basis in the period in which services are rendered. The Hospital does not require collateral on accounts receivable. Accounts are charged to bad debt expense as they are determined to be uncollectible based upon a review of aging and collections. The Hospital establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific patients, historical trends and other information.

Inventories

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

Claiborne County Hospital and Nursing Home and Subsidiary
Notes to Consolidated Financial Statements (continued)

1. Description of Reporting Entity and Significant Accounting Policies (continued)

Property and Equipment

Land, buildings and equipment are stated on the basis of cost or fair value at date of donation. Although title to certain land and buildings rests with the County, these assets have been recorded by the Hospital as the County has authorized their use by the Hospital. Repairs and maintenance costs are expensed as incurred while significant asset purchases and improvements are capitalized. Depreciation of property and equipment is computed by the straight-line method over the estimated useful lives of the assets. The estimated useful lives are based on guidelines established for the healthcare industry, which are summarized as follows:

Land improvements	8 to 25 years
Buildings, improvements and fixed equipment	10 to 40 years
Equipment	3 to 15 years

Bond Issuance Costs

Bond issuance costs are being amortized by the straight-line method over the life of the related bond obligations (*Note 7*).

Accrued Compensated Absences

The Hospital recognizes an expense and accrues a liability for compensated future employee absences in the period in which employees' rights to such compensated absences are earned.

Operating Revenues and Expenses

Revenue and expenses associated with the Hospital's mission of providing healthcare services are considered to be operating activities. Nonoperating revenue consists primarily of investment income, including interest income and income from rental of Medical Office Building (MOB) suites, as well as grants and general contributions to the Hospital.

Income Taxes

CCH is classified as a governmental organization exempt from income tax. The Foundation is a not-for-profit organization defined by Section 501(c)(3) of the Internal Revenue Code as other than a private foundation. Accordingly, no provision for income taxes has been included in the consolidated accompanying financial statements for these entities. Income taxes related to Claiborne Home Health Care and Multi-Specialty Medical, P.C., if any, are included in other operating expenses (*Note 11*).

Claiborne County Hospital and Nursing Home and Subsidiary
Notes to Consolidated Financial Statements (continued)

1. Description of Reporting Entity and Significant Accounting Policies (continued)

Charity Care

The Hospital accepts patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the Hospital. Charges at established rates related to charity care are not included in net patient service revenue.

Patient Service Revenue

Patient service revenue is reported in the period in which services are provided, at rates which reflect the amount expected to be collected. Net patient service revenue includes amounts estimated by management to be reimbursable by third party payors under provisions of reimbursement formulas in effect and is net of the provision for bad debts.

Risk Management

The Hospital is self-insured for employee (including dependent) group health expenses and claims (*Note 5*). Commercial insurance is purchased for significant exposure to various other risks typical to the Hospital's operating environment and industry such as loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; and natural disasters. There were no significant losses in excess of insurance coverage during the last three years.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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.

Reclassifications

Certain 2010 amounts have been reclassified to conform with 2011 presentation.

Subsequent Events

The Hospital has evaluated subsequent events through December 23, 2011, the date which the financial statements were available to be issued.

Claiborne County Hospital and Nursing Home and Subsidiary
Notes to Consolidated Financial Statements (continued)

1. Description of Reporting Entity and Significant Accounting Policies (continued)

New Accounting Pronouncements

In June 2011, GASB issued, and the Hospital adopted, Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which changes certain terminology including net assets to net position.

2. Cash and Cash Equivalents

The Hospital's cash and cash equivalent balances are fully insured or collateralized against custodial credit risk. Funds on deposit at financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) with uninsured amounts being fully collateralized primarily through the financial institutions' participation in the Bank Collateral Pool (the Collateral Pool), which is administered by the Collateral Pool Board and monitored by the Treasury Department of the State of Tennessee. Financial institutions not participating in the Collateral Pool have collateralized uninsured funds on deposit with state and local government securities held by the agent in the County's name for the benefit of the Hospital.

The Hospital has not adopted formal policies relating to deposit limitations, custodial credit risks, or interest rate risks but does require that all public funds (those not related to for profit entities) not insured by the FDIC to be part of the Collateral Pool or fully collateralized by specific investments as described above.

Cash totaling \$12,571 and \$1,012,532 at June 30, 2011 and 2010, respectively, and reported as assets limited for use is held at financial institutions in accounts owned by the County. These funds are authorized to be used directly for the benefit of the Hospital and as such, are reported as assets of the Hospital on the statement of net position.

3. Net Patient Service Revenue

A reconciliation of the amount of services provided to patients at established rates to net patient service revenue as presented in the statements of revenues, expenses and changes in net position is as follows:

	Year ended June 30	
	2011	2010
Gross patient service charges	\$81,487,066	\$81,651,187
Contractual adjustments and discounts	(47,828,248)	(46,411,935)
Charity care charges foregone	(351,766)	(689,039)
Provision for bad debts	(3,757,715)	(4,145,360)
Net patient service revenue	\$29,549,337	\$30,404,853

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

4. Third Party Payor Agreements

The Hospital renders services to patients under contractual arrangements with the Medicare and TennCare programs. Laws, regulations and contracts governing third party payor programs can be extremely complex and subject to interpretation. Amounts earned under these contractual arrangements are subject to regulatory review and final determination by the various program intermediaries and other appropriate governmental authorities or their agents. In the opinion of management, adequate provision has been made in the consolidated financial statements for any adjustments which may result from such reviews.

The Medicare program pays for inpatient services on a prospective basis primarily based upon diagnostic related group assignments as determined by the patient's clinical diagnosis and medical procedures utilized. The Hospital receives additional payments from Medicare based on the provision of services to a disproportionate share of low income patients (as defined by the Medicare program). Medicare also pays for outpatient services on a prospective basis based upon ambulatory payment classifications and fee schedules. TennCare reimbursement for both inpatient and outpatient services is based upon prospectively determined rates and per diem amounts.

Contractual adjustments for Medicare, TennCare and other third party discount arrangements are recognized when the related revenues are reported in the consolidated financial statements. The percentage of gross patient charges from the Medicare and TennCare programs was approximately 35% and 16%, respectively, for 2011 and 39% and 19%, respectively, in 2010.

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

5. Malpractice and Employee Group Health Claims

The Hospital is covered under the "Tennessee Governmental Tort Liability Act" (T.C.A. 29-20-101, et seq.). In addition to requiring claims be made in conformance with this Act, special provisions include, but are not limited to, special notice of requirements imposed upon the claimant, a one year statute of limitations, and a requirement that the governmental entity purchase insurance or be self-insured with certain limits. This Act also prohibits a judgment or award exceeding the minimum amounts of insurance coverage set out in the Act or the amount of insurance purchased by the governmental entity.

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

5. Malpractice and Employee Group Health Claims (continued)

The Hospital provides professional liability coverage through a claims-made medical malpractice insurance policy with an independent carrier. The policy covers all claims reported to the carrier during the coverage period. At June 30, 2011, the Hospital is involved in medical malpractice litigation in which management of the Hospital, after consultation with legal counsel, is of the opinion that liability, if any, related to these claims would not be material to the consolidated financial statements. No amounts are accrued for potential losses related to unreported incidents or reported incidents which have not yet resulted in asserted claims as the Hospital is not able to estimate such amounts.

The Hospital is self-insured for employee (and dependent) group health claims up to \$60,000 per covered person annually. Commercial insurance coverage is purchased for claims in excess of the annual maximum. A liability is recorded for those claims known but unpaid and estimated claims incurred but not reported. Changes in estimates are recorded in the year the estimates are revised. The liability for employee group health claims was \$118,289 and \$96,930 at June 30, 2011 and 2010, respectively. The total expense related to employee group health claims (net of employee paid premiums) was approximately \$1,432,000 and \$1,236,000 for 2011 and 2010, respectively.

6. Property and Equipment

A summary of changes in property and equipment as of June 30, 2011, is as follows:

	Balance July 1, 2010	Additions	Retirements and Transfers	Balance June 30, 2011
Cost:				
Land	\$ 308,092	\$ -	\$ -	\$ 308,092
Buildings and improvements	18,120,449	820,531	-	18,940,980
Equipment	14,669,804	242,633	(30,100)	14,882,337
Construction in progress	340,511	568,791	(820,531)	88,771
Total cost	<u>33,438,856</u>	<u>1,631,955</u>	<u>(850,631)</u>	<u>34,220,180</u>
Allowances for depreciation:				
Buildings and improvements	6,950,200	488,508	-	7,438,708
Equipment	11,733,478	811,214	(28,208)	12,516,484
Total allowances for depreciation	<u>18,683,678</u>	<u>1,299,722</u>	<u>(28,208)</u>	<u>19,955,192</u>
Net property and equipment	<u>\$14,755,178</u>	<u>\$ 332,233</u>	<u>\$ (822,423)</u>	<u>\$14,264,988</u>

Claiborne County Hospital and Nursing Home and Subsidiary
Notes to Consolidated Financial Statements (continued)

6. Property and Equipment (continued)

A summary of changes in property and equipment as of June 30, 2010, is as follows:

	Balance July 1, 2009	Additions	Retirements and Transfers	Balance June 30, 2010
Cost:				
Land	\$ 308,092	\$ –	\$ –	\$ 308,092
Buildings and improvements	18,112,319	8,130	–	18,120,449
Equipment	14,052,309	617,495	–	14,669,804
Construction in progress	156,022	201,526	(17,037)	340,511
Total cost	32,628,742	827,151	(17,037)	33,438,856
Allowances for depreciation:				
Buildings and improvements	6,388,511	561,689	–	6,950,200
Equipment	10,921,911	811,567	–	11,733,478
Total allowances for depreciation	17,310,422	1,373,256	–	18,683,678
Net property and equipment	<u>\$15,318,320</u>	<u>\$ (546,105)</u>	<u>\$ (17,037)</u>	<u>\$14,755,178</u>

Construction in progress at June 30, 2011 consists of costs related to the digital mammography project. Estimated costs to complete this project are approximately \$212,000.

Subsequent to June 30, 2011, the Board approved and the Hospital entered into two capital leases for equipment for a total lease amount of approximately \$1,000,000.

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

7. Bonds Payable

Changes in bonds payable are summarized as follows:

	Balance July 1, 2010	Additions	Principal Payments	Balance June 30, 2011
Series 2010A Bonds	\$4,130,000	\$ –	\$(115,000)	\$4,015,000
Series 2010A New Money Bonds	985,000	–	(5,000)	980,000
Series 2010B Bonds	1,075,000	–	(95,000)	980,000
Total outstanding	<u>6,190,000</u>	<u>\$ –</u>	<u>\$(215,000)</u>	<u>5,975,000</u>
Less unamortized discount	(34,363)			(2,165)
Plus unamortized premium	189,997			180,378
Less deferred refunding loss	(59,455)			(14,773)
Less current portion	<u>(215,000)</u>			<u>(395,000)</u>
Long-term portion	<u>\$6,071,179</u>			<u>\$5,743,440</u>
	Balance July 1, 2009	Additions	Principal Payments	Balance June 30, 2010
Series 1997 Bonds	\$ 725,000	\$ –	\$ (725,000)	\$ –
Series 1998 Bonds	571,337	–	(571,337)	–
Series V-J-1 Bonds	2,980,000	–	(2,980,000)	–
Series V-J-2 Bonds	1,030,000	–	(1,030,000)	–
Series 2010A Bonds	–	4,130,000	–	4,130,000
Series 2010A New Money Bonds	–	985,000	–	985,000
Series 2010B Bonds	–	1,075,000	–	1,075,000
Total outstanding	<u>5,306,337</u>	<u>\$6,190,000</u>	<u>\$(5,306,337)</u>	<u>6,190,000</u>
Less unamortized discount	(28,143)			(34,363)
Plus unamortized premium	–			189,997
Less deferred refunding loss	–			(59,455)
Less current portion	<u>(140,000)</u>			<u>(215,000)</u>
Long-term portion	<u>\$5,138,194</u>			<u>\$6,071,179</u>

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

7. Bonds Payable (continued)

On March 30, 2010, the County issued on behalf of CCH \$6,190,000 of Series 2010A tax exempt and 2010B taxable bonds. Interest on these bonds ranges from 2.5% to 4.125% for Series 2010A and 1% to 4.6% for Series 2010B. The Series 2010A tax exempt bond proceeds of \$2,326,353 were used to refund the Series 1997 and 1998 Bonds on April 30, 2010. On June 1, 2010, escrowed funds from the 2010A bond issue were used to repay the 2009 Series V-J-2 Taxable Bonds. Escrowed Series 2010A bond proceeds totaling \$3,039,600 were held with the bond trustee and used to refund the 2009 Series V-J-1 Tax Exempt Bonds on the maturity date of December 1, 2010 in the amount of \$2,980,000 plus accrued interest of \$59,600. As the proceeds were held by the bond trustee, the debt was considered to be extinguished at June 30, 2010.

The Series 2010A bonds are subject to redemption at the option of CCH, in whole or in part, at the redemption price of par plus accrued interest to the redemption date.

Maturities related to the balances outstanding as of June 30, 2011, are summarized as follows:

	Series 2010A	Series 2010B	Total
2012	\$ 300,000	\$ 95,000	\$ 395,000
2013	355,000	100,000	455,000
2014	355,000	100,000	455,000
2015	370,000	105,000	475,000
2016	260,000	105,000	365,000
2017 - 2021	1,145,000	475,000	1,620,000
2022 - 2026	1,130,000	–	1,130,000
2027 - 2030	1,080,000	–	1,080,000
	\$4,995,000	\$980,000	\$5,975,000

Claiborne County Hospital and Nursing Home and Subsidiary
Notes to Consolidated Financial Statements (continued)

7. Bonds Payable (continued)

Future interest payments related to the bonds are as follows:

	Series 2010A	Series 2010B	Total
2012	\$ 191,044	\$ 34,305	\$ 225,349
2013	182,044	32,595	214,639
2014	171,394	30,345	201,739
2015	160,744	27,645	188,389
2016	145,944	24,285	170,229
2017 – 2021	562,233	54,190	616,423
2022 – 2026	356,979	–	356,979
2027 – 2030	111,425	–	111,425
	\$1,881,807	\$203,365	\$2,085,172

The bonds are payable from the net revenues of the Hospital and collateralized by the ad valorem taxes to be levied on all taxable property within the corporate limits of the County.

8. Notes Payable and Capital Leases

In March and May 2008, the Hospital obtained two notes through Powell Valley Electric Cooperative (PVEC) as a subrecipient of the Rural Economic Development Loan and Grant Program through the Rural Business Cooperative Service of the United States Department of Agriculture. Proceeds from the respective notes, in the amounts of \$360,000 and \$740,000, were restricted for use in constructing and completing the MOB. As of June 30, 2011 and 2010, assets whose use is limited for construction of capital assets represents the proceeds remaining to be expended for this purpose. The notes are payable in monthly installments of \$3,000 and \$7,709, respectively, through 2018 and both notes are non-interest bearing.

The Hospital entered into an agreement with a financial institution on December 3, 2010 for a \$500,000 note payable bearing interest at 5.25% per annum and collateralized by the Hospital's accounts receivable. Loan was paid in full on its maturity date, June 30, 2011.

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

8. Notes Payable and Capital Leases (continued)

Notes payable and capital lease activity from July 1, 2010 to June 30, 2011, is summarized as follows:

	Balance July 1, 2010	Additions	Principal Payments	Balance June 30, 2011
PVEC	\$ 276,000	\$ –	\$ (36,000)	\$ 240,000
PVEC	724,582	–	(92,508)	632,074
Bank note payable	270,719	137,835	(242,744)	165,810
Short term note payable	–	500,000	(500,000)	–
Capital leases	275,365	–	(139,498)	135,867
Total outstanding	<u>1,546,666</u>	<u>\$637,835</u>	<u>\$(1,010,750)</u>	<u>1,173,751</u>
Less current portion	<u>(535,152)</u>			<u>(377,857)</u>
Long-term portion	<u><u>\$1,011,514</u></u>			<u><u>\$ 795,894</u></u>

Notes payable and capital leases from July 1, 2009 to June 30, 2010, is summarized as follows:

	Balance July 1, 2009	Additions	Principal Payments	Balance June 30, 2010
PVEC	\$ 312,000	\$ –	\$ (36,000)	\$ 276,000
PVEC	740,000	–	(15,418)	724,582
Bank note payable	597,682	–	(326,963)	270,719
Capital leases	200,971	149,692	(75,298)	275,365
Total outstanding	<u>1,850,653</u>	<u>\$149,692</u>	<u>\$(453,679)</u>	<u>1,546,666</u>
Less current portion	<u>(446,657)</u>			<u>(535,152)</u>
Long-term portion	<u><u>\$1,403,996</u></u>			<u><u>\$1,011,514</u></u>

With the exception of the PVEC notes, which are non-interest bearing, interest rates on the notes and capital leases range from 3.28% to 6.64%. Monthly installments on the notes range from \$3,000 to \$12,520. Monthly installments on the capital leases range from \$1,032 to \$4,424.

Assets held under capital lease have a total cost of \$507,558 and a net book value of \$341,238 as of June 30, 2011. Amortization of assets under capital lease is included with depreciation expense in the accompanying financial statements.

Claiborne County Hospital and Nursing Home and Subsidiary
Notes to Consolidated Financial Statements (continued)

8. Notes Payable and Capital Leases (continued)

Scheduled payments on notes payable and capital leases are as follows as of June 30, 2011:

	Notes Payable		Capital Leases	
	Principal	Interest	Principal	Interest
2012	\$ 294,318	\$4,675	\$ 83,539	\$3,856
2013	128,508	—	52,328	1,030
2014	128,508	—	—	—
2015	128,508	—	—	—
2016	128,508	—	—	—
2017 – 2018	229,534	—	—	—
	\$1,037,884	\$4,675	\$135,867	\$4,886

9. Operating Leases

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. The following is a schedule by year of future minimum lease payments under operating leases as of June 30, 2011, that have initial or remaining lease terms in excess of one year.

2012	\$ 94,044
2013	81,948
2014	8,296
Total minimum lease payments	<u><u>\$184,288</u></u>

Rent expense totaled \$312,983 and \$433,075 for 2011 and 2010 respectively.

10. Management Agreement and Investment in Radiation Therapy Center

The Hospital entered into a five year agreement with a hospital management company for administrative services during 2010. The cost of services under the agreement is approximately \$230,000 annually.

For several years, the Hospital has had a sublease and management agreement with another health system (the Health System) for a radiation therapy center (the Center). The agreement and subsequent amendments give the Hospital a 49% undivided interest in the leasehold pursuant to a master facility lease. Additionally, the Hospital is entitled to receive 49% of net income up to 50%, reserving the remaining 50% for future capital needs. The agreement also holds the Hospital responsible for 49% of the Center's expense shortfalls, if any. During 2011, the Hospital received distributions totaling \$224,687 from the Center's operations.

Claiborne County Hospital and Nursing Home and Subsidiary
Notes to Consolidated Financial Statements (continued)

10. Management Agreement and Investment in Radiation Therapy Center (continued)

In December 2011 the Hospital reached an agreement to terminate its interest in the Center in exchange for approximately \$770,000.

11. Income Taxes

The Multi-Specialty Medical, P.C. has a calendar year reporting basis for tax purposes. At December 31, 2010, this entity had net operating loss carryforwards of approximately \$770,000 for federal and state income tax purposes. The loss carryforwards relate to operating losses and expire in years 2016 thru 2024. The loss carryforwards may be offset against future taxable income as permitted by the Internal Revenue Code and the Tennessee Code Annotated. A valuation reserve, equal to the deferred tax assets arising from the net operating losses, has been established based on an estimate that the potential tax benefits of the loss carryforwards will not be realized.

12. Pension Plan

The County and related entities, including the Hospital, participate in the Tennessee Consolidated Retirement System Pension Plan. The multiple-employer plan provides for both employee and employer contributions. Eligible employees are required to contribute 5% of their salaries to the Plan. The Hospital is required to contribute at an actuarially determined rate, which was 5.7% of covered payroll for both 2011 and 2010. The rate for employer contributions will be reevaluated for fiscal year 2013. Contributions by the Hospital totaled \$702,331 and \$635,457 for 2011 and 2010, respectively. During 2011 and 2010, eligible employees contributed \$615,001 and \$683,283, respectively. Funding status, contribution requirements, and trends appear in the financial statements of the County and are not separately identified for the Hospital.

13. Foundation

At June 30, 2011 and 2010 the Foundation's assets total \$395,142 and \$407,394 respectively, and consist of primarily of cash and inventory (there are no liabilities recorded). A portion of the cash at June 30, 2011 and 2010 totaling \$125,000 and \$102,450, respectively, is restricted for the purchase of a digital mammography unit for the Hospital. The 2011 statement of revenues, expenses and changes in net position includes Foundation contribution revenue of \$173,041, net investment income of \$3,702 and distributions and other expenses of \$188,995. The 2010 statement of revenues, expenses and changes in net position includes Foundation contribution revenue of \$181,174, net investment income of \$7,521 and distributions and other expenses of \$112,455. Separate financial statements of the Foundation are maintained by Hospital management. Except for certain expenses paid directly by the Foundation, the Hospital provides administrative services and pays for operating expenses to support the Foundation's activities.

Claiborne County Hospital and Nursing Home and Subsidiary

List of Officials (Unaudited)

June 30, 2011

Board of Directors

Chairman, Mayor Jack Daniels
County Attorney, James Estep III, Esq.
Vice Chairman, Robert Asbury, Esq.
Secretary, Lindsey Cadle, Esq.
Betsy Shoffner, RN
Bill DeBusk
John Russell
Russell Essary, Pharm.D.
Chester Gibson

Medical Chief of Staff

Dr. Christopher Yonts, D.O.

Executive Administration

CEO/Administrator, Timothy S. Brown



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

Board of Directors
Claiborne County Hospital and Nursing Home and Subsidiary

We have audited the consolidated financial statements of Claiborne County Hospital and Nursing Home and Subsidiary (the Hospital) as of and for the year ended June 30, 2011 and have issued our report thereon dated December 23, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital'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 Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over financial reporting.

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

Board of Directors
Claiborne County Hospital and Nursing Home and Subsidiary

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's consolidated 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 Board of Directors, management, others within the Hospital, the State of Tennessee Comptroller of the Treasury, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Coulter & Justus, P. C.

December 23, 2011