AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION
OF
LINCOLN COUNTY HEALTH SYSTEM
LINCOLN COUNTY, TENNESSEE
Years Ended June 30, 2011 and 2010

LINCOLN COUNTY HEALTH SYSTEM
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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, 2011 and 2010. 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, 2011 and 2010, 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, 2011 and 2010, 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 19, 2011, 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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.

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. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

October 19, 2011

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LINCOLN MEDICAL CENTER

Our discussion and analysis of Lincoln County Health System's (System's) financial performance provides an overview of the System's financial activities for the fiscal years ended June 30, 2011 and 2010. Please read it in conjunction with the System's financial statements, which begin on page 10.

Financial Highlights

- The System's net assets increased in the past year with a $1,197,802 or 5.1 percent increase in 2011 and $1,935,491 or 9.0 percent increase in 2010.
- The System reported an operating income in 2011 of $1,724,153 and an operating income in 2010 of $2,488,031. Income in 2011 decreased by $763,878 or 30.7 percent over the income reported in 2010. Operating income in 2010 increased by $1,710,624 or 220.0 percent.
- Non-operating net revenues decreased by $20,695 or 3.5 percent in 2011 compared to 2010. Non-operating net revenues increased in 2010 by $201,979 or 51.1 percent compared to 2009.

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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

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Our analysis of the System's finances begins on this page. 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.

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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 10. The System's net assets increased in 2011 by $1,197,802 (5.1 percent) and increased $1,935,491 (9.0 percent) in 2010, as you can see from Table 1.

Table 1: Assets, Liabilities, and Net Assets

	2011	2010	2009
Assets:			
Current assets	$ 11,672,754	$ 11,169,302	$ 9,005,943
Capital assets, net	20,860,227	22,419,564	23,247,870
Other noncurrent assets	9,926,549	9,782,285	9,566,999
Total assets	42,459,530	43,371,151	41,820,812
Liabilities			
Long-term liabilities	13,842,499	15,163,429	16,084,900
Other	3,933,871	4,722,364	4,186,045
Total liabilities	17,776,370	19,885,793	20,270,945
Net assets:			
Invested in capital assets, net of related debt	6,670,163	6,703,194	6,540,859
Restricted for debt service	1,083,776	1,083,808	1,085,612
Restricted for other purposes	71,839	72,351	88,554
Unrestricted	16,857,382	15,626,005	13,834,842
Total Net Assets	$ 24,683,160	$ 23,485,358	$ 21,549,867

A significant component of the change in the System's assets is the change in cash and cash equivalents. Cash increased $17,803 or 0.4 percent in 2011 and increased $2,183,813 or 78.6% in 2010.

Operating Results and Changes in The System's Net Assets

In 2011, the System's net assets increased by $1,197,802 or 5.1 percent, as shown in Table 2. This increase is made up of very different components, and it represents an decrease compared with the increase in net assets for 2010 of $1,935,491.

Table 2: Operating Results and Changes in Net Assets

	2011	2010	2009
Operating Revenues:			
Net patient service revenues	$ 39,469,648	$ 39,742,062	$ 36,608,086
Other operating revenues	845,398	842,245	999,476
Total operating revenues	40,315,046	40,584,307	37,607,562
Operating Expenses			
Salaries and benefits	22,661,885	22,356,618	20,710,754
Fees to individuals and organizations	4,600,645	4,640,797	5,236,837
Medical supplies and drugs	4,620,273	4,523,680	4,253,436
Depreciation and amortization	2,273,350	2,331,852	2,242,004
Other operating expenses	4,434,740	4,243,329	4,387,124
Total operating expenses	38,590,893	38,096,276	36,830,155
Operating income	1,724,153	2,488,031	777,407
Nonoperating Revenues and Expenses			
Investment income	116,578	132,919	249,090
Interest expense	(649,048)	(708,931)	(749,203)
Amortization	(48,229)	(48,562)	(49,021)
Noncapital grants and contributions	13,879	30,217	152,137
Other nonoperating revenues and expenses, net	(9,531)	(2,689)	1,930
Total nonoperating revenues (expenses)	(576,351)	(597,046)	(395,067)
Excess of revenues over expenses before capital grants and contributions	1,147,802	1,890,985	382,340
Grants and Contributions			
Capital grants and contributions	50,000	44,506	104,040
Increase in net assets	1,197,802	1,935,491	486,380
Net assets beginning of year	23,485,358	21,549,867	21,063,487
Net assets end of year	$ 24,683,160	$ 23,485,358	$ 21,549,867

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 two years, the System has reported an operating income. Income in 2011 decreased by $763,878 or 30.7 percent lower than the income reported in 2010. Operating income in 2010 increased by $1,710,624 or 220.0 percent over 2009.

The primary components of these changes in operating incomes are:

- A decrease in total operating revenue of $269,261 in 2011 and an increase of $2,976,745 in 2010.
- An increase in employee compensation and benefits of $305,267, or 1.4 percent in 2011 compared to 2010 and an increase of $1,645,864 or 7.9% in 2010 compared to 2009.
- Supplies expense increased by $96,593, or 2.1 percent increase in 2011 compared to the increase of $270,244, or 6.4 percent increase in 2010.

In response to changing utilization patterns in Tennessee's long-term care facilities, the Care Centers received approval in the current year to reduce its number of intermediate-level care beds from 145 to 115. In July 2008, a new 10-bed inpatient psychiatric unit was opened, increasing the number of beds for the Medical Center from 49 to 59. A total of 2,646 psychiatric days were recorded for 2011, a 13.5 percent decrease from 2010. A total of 3,060 psychiatric days were recorded for 2010, a 46.1 percent increase from 2,095 days in 2009, the first year in operation. This unit is a geriatric unit, accepting patients age 55 and older.

Non-operating Revenues and Expenses

Non-operating revenues consist primarily of investment income, noncapital grants and contributions, and interest expenses.

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 2011 of $2,865,112 or 46.2 percent less than in 2010. In 2010 the System generated $5,324,821 or 124.4 percent more in cash flows from operating activities than in 2009.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2011, the System had $20,860,227 invested in capital assets, net of accumulated depreciation, as detailed in Note G to the financial statements. In 2010, the System had $22,419,564 invested in capital assets, net of accumulated depreciation.

Debt

At year-end, the System had $14,821,397 in revenue bonds, capital lease obligations and notes payable obligations outstanding as detailed in Note H to the financial statements. Debt decreased $1,574,535 or 9.6% in 2011 as a result of payments. 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.

Medicare recently announced an 11.4% decrease in reimbursement for Skilled Nursing Facility payments effective October 2011. This will be a challenge for the long-term care industry.

The System is continuing to actively recruit physicians of general and specialty for the success of its operations. The search for an orthopedic surgeon, an OB GYN and a part- time ENT were successful this past year with the employment of all three. The search continues for a second hospitalist. Two family practice physicians also joined the community at existing practices.

Another factor is the System is also continually evaluating the addition of services that we do not currently offer. An example would be calcium scoring that was added this past year.

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, 2011 and 2010

ASSETS

	2011	2010
CURRENT ASSETS:		
Cash and cash equivalents	$ 4,981,639	$ 4,963,836
Restricted cash	52,086	46,919
Accounts receivable, net of allowance for doubtful accounts of $3,586,200 (2011) $4,535,072 (2010)	5,204,024	4,857,993
Estimated third-party payor settlements receivable	384,031	240,923
Supplies, at cost	768,184	770,259
Prepaid expenses	227,384	261,879
Other assets	55,406	27,493
Total Current Assets	11,672,754	11,169,302
NONCURRENT ASSETS:		
Restricted investments	9,117,640	9,041,029
Capital assets, net of accumulated depreciation	20,860,227	22,419,564
Other assets:		
Investment in insurance fund	160,141	126,560
Notes receivable, net	282,735	223,286
Deferred financing costs	366,033	391,410
Total Noncurrent Assets	30,786,776	32,201,849
TOTAL ASSETS	$ 42,459,530	$ 43,371,151

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:		
Current maturities of long-term debt	$ 713,598	$ 944,351
Accounts payable	767,656	1,271,164
Accrued expenses:		
Salaries and payroll taxes	734,685	640,910
Compensated absences	883,668	852,685
Interest	99,299	103,326
Other	582,879	654,046
Estimated third-party payor settlements payable	100,000	208,963
Patient trust funds	52,086	46,919
Total Current Liabilities	3,933,871	4,722,364
NONCURRENT LIABILITIES:		
Long-term debt, net of current maturities	13,842,499	15,163,429
TOTAL LIABILITIES	17,776,370	19,885,793
NET ASSETS:		
Invested in capital assets, net of related debt	6,670,163	6,703,194
Restricted:		
Expendable:		
Bond indenture debt service	1,083,776	1,083,808
Other purposes	71,839	72,351
Unrestricted assets	16,857,382	15,626,005
TOTAL NET ASSETS	24,683,160	23,485,358
TOTAL LIABILITIES AND NET ASSETS	$ 42,459,530	$ 43,371,151

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, 2011 and 2010

	2011	2010
OPERATING REVENUES:		
Net patient service revenue, net of provision for bad debts of $4,560,415 in 2011 and $5,149,467 in 2010	$ 39,469,648	$ 39,742,062
Other operating revenue	845,398	842,245
Total Operating Revenues	40,315,046	40,584,307
OPERATING EXPENSES:		
Employee compensation and benefits	22,661,885	22,356,618
Fees to individuals and organizations	4,600,645	4,640,797
Supplies	4,620,273	4,523,680
Other expenses	4,434,740	4,243,329
Depreciation	2,273,350	2,331,852
Total Operating Expenses	38,590,893	38,096,276
INCOME FROM OPERATIONS	1,724,153	2,488,031
NONOPERATING REVENUES AND (EXPENSES):		
Investment income	116,578	132,919
Interest expense	(649,048)	(708,931)
Amortization	(48,229)	(48,562)
Noncapital grants and contributions	13,879	30,217
(Loss) on disposal of capital assets	(9,531)	(2,689)
Nonoperating Revenues and (Expenses), net	(576,351)	(597,046)
EXCESS OF REVENUES OVER EXPENSES	1,147,802	1,890,985
Capital Contributions	50,000	44,506
INCREASE IN NET ASSETS	1,197,802	1,935,491
Net Assets Balance, beginning of year	23,485,358	21,549,867
Net Assets Balance, end of year	$ 24,683,160	$ 23,485,358

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

LINCOLN COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS

Years Ended June 30, 2011 and 2010

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	$ 39,163,626	$ 39,933,145
Other operating cash receipts	1,886,161	1,987,112
Cash paid to employees for wages and benefits	(22,541,451)	(22,339,112)
Cash paid to suppliers for goods and services	(15,643,224)	(14,256,324)
Net Cash Provided by Operating Activities	2,865,112	5,324,821
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Noncapital grants and contributions	13,879	30,217
Net Cash Provided by Noncapital Financing Activities	13,879	30,217
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Additions to capital assets, net	(723,545)	(1,508,510)
Proceeds from disposal of capital assets	-	2,275
Capital contributions	50,000	44,506
Principal payments on long-term debt	(1,574,535)	(1,039,203)
Interest paid on long-term debt, net	(653,075)	(715,012)
Net Cash Used by Capital and Related Financing Activities	(2,901,155)	(3,215,944)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest received	172,202	109,097
(Increase) in restricted investments	(132,235)	(64,378)
Net Cash Provided by Investing Activities	39,967	44,719
NET INCREASE IN CASH AND CASH EQUIVALENTS	17,803	2,183,813
CASH AND CASH EQUIVALENTS, beginning of year	4,963,836	2,780,023
CASH AND CASH EQUIVALENTS, end of year	$ 4,981,639	$ 4,963,836
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES:		
Income from operations	$ 1,724,153	$ 2,488,031
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,273,350	2,331,852
Provision for bad debts	4,560,415	5,149,467
Provision for note receivable arrangements	82,553	22,701
Advances under note receivable arrangements, net	(142,002)	(171,582)
Investment in insurance funds, net	(33,581)	(3,915)
Changes in operating assets and liabilities:		
(Increase) in accounts receivable	(4,906,446)	(5,067,157)
Decrease in supplies	2,075	74,328
(Increase) Decrease in prepaid expenses	34,495	(58,386)
(Increase) Decrease in other assets	(27,913)	101,397
Increase (Decrease) in accounts payable	(503,508)	326,762
Increase in accrued expenses	53,592	303,438
(Decrease) in estimated third-party payor settlements, net	(252,071)	(172,115)
Net Cash Provided by Operating Activities	$ 2,865,112	$ 5,324,821
SCHEDULE OF NONCASH FINANCING AND INVESTING ACTIVITIES:	none	none

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

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 rotational 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"), Lincoln Medical 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 acute care beds and 10 geropsych beds. 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. Effective June 1, 2011, the Care Centers received approval to reduce its number of intermediate-level care beds from 145 to 115; along with retaining 125 skilled-level care beds. The Donalson Care Center is also licensed for 24 beds 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, 2011, the Auxiliary's total assets, current assets, and net assets totaled $71,839, and are reported as restricted for other purposes in the balance sheet. Their income from operations totaled $8,610. During 2011, the Auxiliary made noncapital and capital contributions totaling $9,123 to the Medical Center. As noted above, these interdepartmental transactions have been eliminated in the financial statements.

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

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. The carrying amount for deposits approximates fair value.

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. The carrying amount for investments approximates fair value.

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, 2011 and 2010, 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.

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 $48,229 and $48,562 for the years ended June 30, 2011 and 2010, 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.

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.

Investment income, 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.

Reclassifications

Certain reclassifications have been made in the 2010 financial statements to conform to the 2011 financial statements presentation. Such reclassifications had no effect on the results of operations as previously reported.

NOTE B: DESIGNATED NET ASSETS

Unrestricted net assets include designated net assets by the Health System totaling $7,972,310 and $7,895,126 as of June 30, 2011 and 2010, respectively, for specific purposes such as future capital improvements, insurance and debt service as described in Note E. 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 $445,243 and $511,033 for the years ended June 30, 2011 and 2010, 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 using a prospective payment system based on the patient's ambulatory patient classification group. Geropysch 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.

NOTE D: NET PATIENT SERVICE REVENUE (CONTINUED)

Revenue from the Medicare program accounted for approximately 35 percent and 29 percent of the hospital-based departments' and Care Centers' net patient revenue, respectively, for the year ended June 30, 2011. Hospital-based departments include the Medical Center, Ambulance Service, Home Health Care, and Wellness Center.

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, 2007.

Medicaid - The Medicaid program for acute care services was replaced by a waiver program, TennCare, as approved by the Health Care Financing Administration ("HCFA"). Services to program beneficiaries are provided under contract with various managed care organizations 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.

Revenue from the Medicaid program accounted for approximately 10 percent and 57 percent of the hospital-based departments' and Care Centers' net patient revenue, respectively, for the year ended June 30, 2011.

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 prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates.

The Medical Center received $5,891 and $28,203, from an endowment fund for the years ended June 30, 2011 and 2010, respectively, for patient care that is included in net patient service revenue.

NOTE E: DEPOSITS AND INVESTMENTS

The Health System's carrying amount of deposits was $4,981,639 and $4,963,836 and the bank balance was $5,183,282 and $5,294,075 as of June 30, 2011 and 2010, respectively. The Health System's carrying amount for restricted cash and investments, excluding amounts held under an indenture agreement, was $8,085,950 and $8,004,140 and the bank balance was $8,073,089 and $7,936,502 as of June 30, 2011 and 2010, respectively. The bank balances totaling $13,256,371 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, 2011 was $1,083,776. Generally, these investments maintain a dollar weighted average maturity 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

NOTE E: DEPOSITS AND INVESTMENTS (CONTINUED)

Restricted investments are held as follows as of June 30:

	2011	2010
Internally designated for capital improvements, insurance and debt service:	$ 7,972,310	$ 7,895,126
Restricted by contributors	61,554	62,095
Held under an indenture agreement	1,083,776	1,083,808
Held under patient trust fund arrangements - cash	52,086	46,919
	9,169,726	9,087,948
Less amounts reclassified to meet current liabilities	52,086	46,919
	$ 9,117,640	$ 9,041,029

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 $142,002 and $171,582 for the years ended June 30, 2011 and 2010, respectively. Net repayments from physicians totaled $-0- for both the years ended June 30, 2011 and 2010. The Health System provided provisions for continuation of the medical practices under these arrangements totaling $82,553 and $22,701 for 2011 and 2010, respectively. As of June 30, 2011 and 2010, net advances totaling $282,735 and $223,286, respectively, were due under these arrangements.

NOTE G: CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2011 was as follows:

	June 30, 2010	Additions	Retirements	June 30, 2011
Capital assets, not being depreciated:				
Land	$ 773,754	$ -	$ -	$ 773,754
Property under capitalized lease	300,000	-	-	300,000
Construction in progress	188,430	-	(188,430)	-
Other assets not in service	-	141,104	-	141,104
Total capital assets, not being depreciated	1,262,184	141,104	(188,430)	1,214,858
Capital assets, being depreciated:				
Ground improvements	2,258,292	-	-	2,258,292
Building & improvements	27,069,198	17,382	(15,300)	27,071,280
Equipment	14,715,993	655,598	(338,677)	15,032,914
Equipment under capitalized lease	159,340	-	-	159,340
Total capital assets being depreciated	44,202,823	672,980	(353,977)	44,521,826
Less accumulated depreciation for:				
Ground improvements	(708,257)	(80,134)	-	(788,391)
Buildings and improvements	(12,149,899)	(959,729)	15,300	(13,094,328)
Equipment	(10,147,452)	(1,173,734)	427,036	(10,894,150)
Equipment under capitalized lease	(39,835)	(59,753)	-	(99,588)
Total accumulated depreciation	(23,045,443)	(2,273,350)	442,336	(24,876,457)
Capital assets, net	$ 22,419,564	$ (1,459,266)	$ (100,071)	$ 20,860,227

NOTE G: CAPITAL ASSETS (CONTINUED)

Capital asset activity for the year ended June 30, 2010 was as follows:

	June 30, 2009	Additions	Retirements	June 30, 2010
Capital assets, not being depreciated:				
Land	$ 773,754	$ -	$ -	$ 773,754
Property under capitalized lease	300,000	-	-	300,000
Construction in progress	1,870	188,430	(1,870)	188,430
Total capital assets, not being depreciated	1,075,624	188,430	(1,870)	1,262,184
Capital assets, being depreciated:				
Ground improvements	2,258,292	-	-	2,258,292
Building & improvements	26,932,266	136,932	-	27,069,198
Equipment	13,629,172	1,185,018	(98,197)	14,715,993
Equipment under capitalized lease	159,340	-	-	159,340
Total capital assets being depreciated	42,979,070	1,321,950	(98,197)	44,202,823
Less accumulated depreciation for:				
Ground improvements	(627,163)	(81,094)	-	(708,257)
Buildings and improvements	(11,188,685)	(961,214)	-	(12,149,899)
Equipment	(8,971,059)	(1,269,626)	93,233	(10,147,452)
Equipment under capitalized lease	(19,917)	(19,918)	-	(39,835)
Total accumulated depreciation	(20,806,824)	(2,331,852)	93,233	(23,045,443)
Capital assets, net	$ 23,247,870	$ (821,472)	$ (6,834)	$ 22,419,564

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 and equipment under capital lease. Depreciation expense for the years ended June 30, 2011 and 2010 totaled $2,273,350 and $2,331,852, respectively.

A contract was signed June 27, 2011 for the roofing of Donaldson Care Center. The estimated total cost is $76,209 and the project is expected to be completed by August 2011.

NOTE H: LONG-TERM DEBT

The following is a schedule of long-term debt activity for the year ended June 30, 2011:

	June 30, 2010	Additions	Reductions	June 30, 2011	Due Within One Year
Series 1998, due in installments of $475,000 to $495,000 through May 2013, interest rates ranging from 5.00% to 5.125%.	$ 1,420,000	$ -	$ (450,000)	$ 970,000	$ 475,000
Series 2001, final installment of $140,000 paid May 2011, at an interest rate of 4.45%.	140,000	-	(140,000)	-	-
Series 2004, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of $45,000 to $800,000 through May 2023, at an interest rate of 3.875%.	6,925,000	-	(40,000)	6,885,000	45,000
Note Payable, General Electric Capital Corporation, final installment paid October 2010, at an interest rate of 4.28%.	40,392	-	(40,392)	-	-
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%.	4,915,000	-	(10,000)	4,905,000	10,000
Series 2007, General Obligation Refunding Bonds, due in monthly installments of $155,000 to $220,000 through May 2021, at an interest rate of 3.93%.	1,870,000	-	(10,000)	1,860,000	155,000
Capital Lease Obligation, due in monthly installments of $3,561 through April 2017, at an interest rate of 7.5%.	227,934	-	(26,537)	201,397	28,598
General Obligation Capital Outlay Note, paid obligation in full October 2010, at an interest rate of 3.9%.	857,606	-	(857,606)	-	-
Toal long-term debt	16,395,932	$ -	$ (1,574,535)	14,821,397	$ 713,598
Less current maturities of long-term debt	(944,351)			(713,598)	
Less Series 2004 deferred refunding costs	(228,175)			(210,509)	
Less Series 2007 deferred refunding costs	(95,407)			(88,351)	
Add unamortized bond premium	35,430			33,560	
Total noncurrent liabilities	$ 15,163,429			$ 13,842,499	

NOTE H: LONG-TERM DEBT (CONTINUED)

The following is a schedule of long-term debt activity for the year ended June 30, 2010:

	June 30, 2009	Additions	Reductions	June 30, 2010	Due Within One Year
Series 1998, due in installments of $430,000 to $495,000 through May 2013, interest rates ranging from 5.00% to 5.125%.	$ 1,850,000	$ -	$ (430,000)	$ 1,420,000	$ 450,000
Series 2001, final installment of $140,000 due May 2011, at an interest rate of 4.45%.	275,000	-	(135,000)	140,000	140,000
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%.	6,965,000	-	(40,000)	6,925,000	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%.	197,712	-	(157,320)	40,392	40,392
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%.	4,925,000	-	(10,000)	4,915,000	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%.	1,880,000	-	(10,000)	1,870,000	10,000
Capital Lease Obligation, due in monthly installments of $3,561 through April 2017, at an interest rate of 7.5%.	252,560	-	(24,626)	227,934	26,537
Capital Lease Obligation, final installment of $13,547 paid July 2009, at an interest rate of 4.4%.	13,547	-	(13,547)	-	-
General Obligation Capital Outlay Note, due in monthly installments of $21,403 through January 2014, at an interest rate of 3.9%.	1,076,316	-	(218,710)	857,606	227,422
Toal long-term debt	17,435,135	$ -	$ (1,039,203)	16,395,932	$ 944,351
Less current maturities of long-term debt	(1,039,231)			(944,351)	
Less Series 2004 deferred refunding costs	(245,840)			(228,175)	
Less Series 2007 deferred refunding costs	(102,464)			(95,407)	
Add unamortized bond premium	37,300			35,430	
Total noncurrent liabilities	$ 16,084,900			$ 15,163,429	

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

NOTE H: LONG-TERM DEBT (CONTINUED)

The annual requirements to amortize all long-term debt outstanding as of June 30, 2011 are as follows:

Year Ending June 30,	Principal	Interest
2012	$ 713,598	$ 609,749
2013	740,818	574,930
2014	778,210	538,717
2015	810,788	507,145
2016	838,567	474,208
2017-2021	4,559,416	1,857,411
2022-2026	4,345,000	985,791
2027-2028	2,035,000	129,150
	$ 14,821,397	$ 5,677,101

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, 2011, the Health System complied with the restrictive covenants including the required debt service covenant ratio.

The bonds maturing May 1, 2010 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 matured May 1, 2011 without the option of prior redemption. Bonds maturing on or after May 1, 2012 were redeemed by advance refunding in June 2007 as further described in Series 2007 bonds referenced below. The Series 2001 bonds were paid in full in the current year.

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, 2011, $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, 2011, the Medical Center complied with the debt service coverage ratio.

NOTE H: LONG-TERM DEBT (CONTINUED)

Series 2007

In a prior year, the Health System defeased portions of the Series 1998 and 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, 2011, $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, 2011, the Medical Center complied with the debt service coverage ratio.

Other Debt

The note payable and capital lease obligations are secured by the related property and equipment, respectively. The gross amount of assets recorded under capital leases and the accumulated amortization/depreciation is recorded in the balance sheet and described in Note G. The future minimum lease payments and the net present value of these minimum lease payments are included above in the annual requirements to amortize outstanding long-term debt.

The capital outlay note is a general obligation of Lincoln, County, and Tennessee. The obligation was paid in full in the current year.

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' Pension 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.

NOTE I: PENSION PLAN (CONTINUED)

Funding Policy

Lincoln County Courthouse Employees' Pension 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 6.36% of annual covered payroll. The contribution requirement of plan members is set by state statute. The contribution requirement for Lincoln County Courthouse Employees' Pension Plan is established and may be amended by the TCRS Board of Trustees. The Health System contributions for participating departments for the years ending June 30, 2011, 2010, and 2009 were $589,946, $502,444, and $462,425, respectively, equal to the required contributions for each year.

Care Centers

The Care Centers adopted a defined contribution pension plan, 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 and employee contributions under this plan totaled $28,592 and $28,743 and $120,064 and $96,013 for the years ended June 30, 2011 and 2010, respectively.

Deferred Compensation Plan

The Health System offers an optional deferred compensation plan to its employees created in accordance with Section 457 of the Internal Revenue Code. This plan is available to all employees on a voluntary basis and allows participants to defer a portion of their current income until future years to shelter such funds and earnings from federal taxation until withdrawal. The deferred compensation is not available to participants until termination, retirement, death or unforeseeable emergency.

The plan is administered through a third-party administrator, The Hartford Group. The Health System does not perform the investing function and has no fiduciary accountability for the plan. Thus, plan assets and any related liabilities to plan participants have been excluded from the Health System's financial statements.

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).

NOTE J: RISK MANAGEMENT (CONTINUED)

As of June 30, 2011 and 2010, the Health System accrued $417,546 and $531,752 respectively, for an estimated claims lag. Changes in the reported liability for 2011 and 2010 resulted from the following:

	2011	2010
Balance, beginning of year	$ 531,752	$ 158,277
Current year claims and settlements	2,237,879	2,306,346
Claim payments	(2,352,086)	(1,932,871)
Balance, end of year	$ 417,546	$ 531,752

The Committee has internally designated cash to use for payment of future insurance premiums. As of June 30, 2011, this internally designated cash, including interest earned, totaled $158,658.

NOTE K: CONCENTRATIONS OF CREDIT RISK

The Health System grants credit without collateral to its patients, most of whom 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:

	2011	2010
Medicare	33%	31%
Medicaid	16%	17%
Other third-party payors	19%	19%
Patients	32%	33%
	100%	100%

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 ended June 30, 2010. This agreement was renewed for a fifteen month period, ending September 30, 2011, and later extended until December 31, 2011. Management fees are subject to annual adjustment by an inflation factor as defined in the agreement. Management fees paid for 2011 and 2010 were $693,638 and $664,146, respectively. Total payments to QHR for 2011 and 2010 were $701,352 and $702,301, 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 those matters not covered by insurance will be resolved without material adverse effect on the Health System's financial position or results of operations.

Also, in the ordinary course of business the Health System has maintenance and service contract commitments under agreements with various vendors to maintain equipment and provide medical services for terms not to exceed generally a five year period.

NOTE M: CONTINGENCIES AND COMMITMENTS (CONTINUED)

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, 2011:

Year Ending June 30,	Leases
2012	$ 15,000
2013	15,000
2014	15,000
2015	15,000
2016	15,000
Later Years	13,750
	$ 88,750

Rental expense under all operating leases for 2011 and 2010 totaled $161,667 and $205,710, 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 2016:

Year Ending June 30,	Leases to Physicians (MOB) & Dialysis Company (LCC)
2012	$ 157,142
2013	86,284
2014	62,225
2015	63,365
2016	10,593
	$ 379,609

Rental income received for 2011 and 2010 totaled $237,528 and $198,072, 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 (see Note G) as follows:

Cost	$ 3,569,499
Accumulated depreciation	(972,301)
Net Book Value	$ 2,597,198

NOTE N: LINCOLN COUNTY HEALTH SYSTEM FOUNDATION

The Lincoln County Health System Foundation ("Foundation") is a legally separate, tax-exempt supporting organization closely related to the Health System. The Health System does not control the timing or amount of receipts from the Foundation or have the ability to access the resources 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, 2011.

Assets, cash and cash equilvalents	$ 35,416
Liabilities	-
Unrestricted net assets	$ 35,416
Support and revenue	$ 23,430
Expenses	(45,712)
Deficiency of support and revenue over expenses	(22,282)
Unrestricted net assets, beginning of year	57,698
Unrestricted net assets, end of year	$ 35,416

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
$ 40,315,046	$ 1,046,986	2.6%	$ 17,963,017	2028

OTHER FINANCIAL INFORMATION

LINCOLN COUNTY HEALTH SYSTEM
DEPARTMENTAL BALANCE SHEET

June 30, 2011

	Lincoln Medical Center	Lincoln Medical Center EMS	Home Health Care	Patrick Rehab-Wellness Center	Lincoln & Donalson Care Centers	Total
ASSETS						
CURRENT ASSETS:						
Cash and cash equivalents	$ 1,651,382	$ -	$ 17,559	$ 6,033	$ 3,306,665	$ 4,981,639
Restricted cash	-	-	-	-	52,086	52,086
Accounts receivable - net	3,361,898	-	357,301	-	1,484,825	5,204,024
Estimated third-party payor settlements receivable	326,252	-	-	-	57,779	384,031
Supplies, at cost	701,207	-	-	-	66,977	768,184
Prepaid expenses	163,531	-	255	35	63,563	227,384
Due from (to) departments	(2,875,242)	-	-	-	2,875,242	-
Other assets	3,780	-	-	-	51,626	55,406
Total Current Assets	3,332,808	-	375,115	6,068	7,958,763	11,672,754
NONCURRENT ASSETS:						
Restricted investments	1,245,789	-	-	-	7,871,851	9,117,640
Capital assets, net of accumulated depreciation	15,238,396	520,340	103,381	1,046,301	3,951,809	20,860,227
Other assets:						
Investment in insurance fund	110,325	-	-	-	49,816	160,141
Notes receivable, net	282,735	-	-	-	-	282,735
Deferred financing costs	366,033	-	-	-	-	366,033
Total Noncurrent Assets	17,243,278	520,340	103,381	1,046,301	11,873,476	30,786,776
TOTAL ASSETS	$ 20,576,086	$ 520,340	$ 478,496	$ 1,052,369	$ 19,832,239	$ 42,459,530
LIABILITIES AND NET ASSETS						
CURRENT LIABILITIES:						
Current maturities of long-term debt	$ 685,000	$ -	$ -	$ 28,598	$ -	$ 713,598
Accounts payable	436,704	8,080	2,289	17,467	303,116	767,656
Accrued expenses:						
Salaries and payroll taxes	432,715	28,111	19,900	39,639	214,320	734,685
Compensated absences	495,052	36,019	23,005	37,812	291,780	883,668
Interest	99,299	-	-	-	-	99,299
Other	281,871	-	-	123	300,885	582,879
Estimated third-party payor settlements payable	100,000	-	-	-	-	100,000
Patient trust funds	-	-	-	-	52,086	52,086
Total Current Liabilities	2,530,641	72,210	45,194	123,639	1,162,187	3,933,871
NONCURRENT LIABILITIES:						
Long-term debt, net of current maturities	13,669,700	-	-	172,799	-	13,842,499
TOTAL LIABILITIES	16,200,341	72,210	45,194	296,438	1,162,187	17,776,370
NET ASSETS:						
Invested in capital assets, net of related debt	1,249,729	520,340	103,381	844,904	3,951,809	6,670,163
Restricted:						
Expendable:						
Bond indenture debt service	1,083,776	-	-	-	-	1,083,776
Other purposes	71,839	-	-	-	-	71,839
Unrestricted assets (deficit)	1,970,401	(72,210)	329,921	(88,973)	14,718,243	16,857,382
TOTAL NET ASSETS	4,375,745	448,130	433,302	755,931	18,670,052	24,683,160
TOTAL LIABILITIES AND NET ASSETS	$ 20,576,086	$ 520,340	$ 478,496	$ 1,052,369	$ 19,832,239	$ 42,459,530

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

Year Ended June 30, 2011

	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	$ 22,232,493	$ 1,588,677	$ 765,927	$ 1,638,954	$ 13,535,677	$ 292,080	$ 39,469,648
Other operating revenue	1,352,337	-	1,755	425,930	106,139	1,040,763	845,398
Total Operating Revenues	23,584,830	1,588,677	767,682	2,064,884	13,641,816	1,332,843	40,315,046
OPERATING EXPENSES:							
Employee compensation and benefits	12,242,045	1,012,486	684,945	1,225,239	7,467,914	29,256	22,661,885
Fees to individuals and organizations	3,158,912	107,185	230,113	173,181	1,791,902	(860,648)	4,600,645
Supplies	3,229,710	45,399	61,589	50,727	1,590,929	(358,081)	4,620,273
Other expenses	2,494,174	155,714	88,744	212,362	1,627,116	(143,370)	4,434,740
Depreciation	1,785,528	101,774	17,794	68,346	299,908	-	2,273,350
Total Operating Expenses	22,910,369	1,422,558	1,083,185	1,729,855	12,777,769	(1,332,843)	38,590,893
INCOME (LOSS) FROM OPERATIONS	674,461	166,119	(315,503)	335,029	864,047	-	1,724,153
NONOPERATING REVENUES AND (EXPENSES):							
Investment income	10,829	-	15,115	51	90,583	-	116,578
Interest expense	(632,853)	-	-	(16,195)	-	-	(649,048)
Amortization	(48,229)	-	-	-	-	-	(48,229)
Noncapital grants and contributions	8,745	-	4,357	-	777	-	13,879
(Loss) on disposal of capital assets	(8,714)	-	(817)	-	-	-	(9,531)
Nonoperating Revenues and (Expenses), net	(670,222)	-	18,655	(16,144)	91,360	-	(576,351)
Excess (Deficiency) Revenues over Expenses	4,239	166,119	(296,848)	318,885	955,407	-	1,147,802
Capital Contributions	20,000	30,000	-	-	-	-	50,000
Operating transfers from (to) departments, net	406,522	(34,627)	(35,416)	(336,479)	-	-	-
INCREASE (DECREASE) IN NET ASSETS	430,761	161,492	(332,264)	(17,594)	955,407	-	1,197,802
Net Assets, beginning of year	3,944,984	286,638	765,566	773,525	17,714,645	-	23,485,358
Net Assets, end of year	$ 4,375,745	$ 448,130	$ 433,302	$ 755,931	$ 18,670,052	$ -	$ 24,683,160

LINCOLN COUNTY HEALTH SYSTEM
DEPARTMENTAL STATEMENT OF CASH FLOWS

Year Ended June 30, 2011

	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	$ 21,544,999	$ 1,588,677	$ 1,053,070	$ 1,638,954	$ 13,337,926	$ 39,163,626
Other operating cash receipts	1,352,337	-	1,755	425,930	106,139	1,886,161
Cash paid to employees for wages and benefits	(12,207,978)	(1,008,485)	(665,221)	(1,216,396)	(7,443,371)	(22,541,451)
Cash paid to suppliers for goods and services	(9,338,671)	(311,842)	(380,769)	(451,821)	(5,160,121)	(15,643,224)
Net Cash Provided by Operating Activities	1,350,687	268,350	8,835	396,667	840,573	2,865,112
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:						
Noncapital grants and contributions	8,745	-	4,357	-	777	13,879
Operating transfers in (out), net	406,522	(34,627)	(35,416)	(336,479)	-	-
Advances from (to) departments, net	681,793	-	-	-	(681,793)	-
Net Cash Provided (Used) by Noncapital Financing Activities	1,097,060	(34,627)	(31,059)	(336,479)	(681,016)	13,879
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:						
Additions to capital assets, net	(398,573)	(263,723)	-	(21,000)	(40,249)	(723,545)
Capital contributions	20,000	30,000	-	-	-	50,000
Principal payments on long-term debt	(1,547,997)	-	-	(26,538)	-	(1,574,535)
Interest paid on long-term debt, net	(636,880)	-	-	(16,195)	-	(653,075)
Net Cash Used by Capital and Related Financing Activities	(2,563,450)	(233,723)	-	(63,733)	(40,249)	(2,901,155)
CASH FLOWS FROM INVESTING ACTIVITIES:						
Interest received	10,829	-	15,115	51	146,207	172,202
(Increase) Decrease in restricted investments	322	-	-	-	(132,557)	(132,235)
Net Cash Provided by Investing Activities	11,151	-	15,115	51	13,650	39,967
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(104,552)	-	(7,109)	(3,494)	132,958	17,803
CASH AND CASH EQUIVALENTS, beginning of year	1,755,934	-	24,668	9,527	3,173,707	4,963,836
CASH AND CASH EQUIVALENTS, end of year	$ 1,651,382	$ -	$ 17,559	$ 6,033	$ 3,306,665	$ 4,981,639
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES:						
Income from operations	$ 674,461	$ 166,119	$ (315,503)	$ 335,029	$ 864,047	$ 1,724,153
Adjustments to reconcile operating income to net cash provided by operating activities -						
Depreciation	1,785,528	101,774	17,794	68,346	299,908	2,273,350
Provision for bad debts	3,958,929	440,038	25,655	53,561	82,232	4,560,415
Provision for note receivable arrangements	82,553	-	-	-	-	82,553
Advances under note receivable arrangements, net	(142,002)					(142,002)
Investment in insurance funds, net	(26,262)	-	-	-	(7,319)	(33,581)
Changes in operating assets and liabilities -						
Accounts receivable	(4,361,156)	(440,038)	261,488	(53,561)	(313,179)	(4,906,446)
Supplies	18,275	-	-	-	(16,200)	2,075
Prepaid expenses	54,876	-	1,570	-	(21,951)	34,495
Other assets	2,388	-	-	-	(30,301)	(27,913)
Accounts payable	(477,246)	(3,544)	(1,893)	(15,620)	(5,205)	(503,508)
Accrued expenses	65,610	4,001	19,724	8,912	(44,655)	53,592
Estimated third-party payor settlements, net	(285,267)	-	-	-	33,196	(252,071)
Net Cash Provided by Operating Activities	$ 1,350,687	$ 268,350	$ 8,835	$ 396,667	$ 840,573	$ 2,865,112

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

June 30, 2011

Year Ending June 30,	Lincoln Medical Center Series 1998		Lincoln Medical Center Series 2004		Lincoln Medical Center Series 2007 Gen Oblig. Refg.		Lincoln Medical Center Series 2007 Refg. Rev.		Lincoln Medical Center Capital Lease Obligation		
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Total
2012	$ 475,000	$ 49,712	$ 45,000	$ 266,794	$ 155,000	$ 73,098	$ 10,000	$ 206,010	$ 28,598	$ 14,135	$ 1,323,347
2013	495,000	25,369	45,000	265,050	160,000	67,006	10,000	205,590	30,818	11,915	1,315,748
2014	-	-	565,000	263,306	170,000	60,718	10,000	205,170	33,210	9,523	1,316,927
2015	-	-	595,000	241,413	170,000	54,037	10,000	204,750	35,788	6,945	1,317,933
2016	-	-	610,000	218,356	180,000	47,356	10,000	204,330	38,567	4,166	1,312,775
2017	-	-	635,000	194,719	190,000	40,282	10,000	203,910	34,416	1,195	1,309,522
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	8,646	10,000	202,230	-	-	1,275,776
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
	$ 970,000	$ 75,081	$ 6,885,000	$ 2,063,826	$ 1,860,000	$ 426,205	$ 4,905,000	$ 3,064,110	$ 201,397	$ 47,879	$ 20,498,498

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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, 2011, and have issued our report thereon, dated October 19, 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 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 *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Health System'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.

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.

Putman & Hancock

October 19, 2011