

**CHATTANOOGA-HAMILTON COUNTY  
HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System and  
Aggregate Discretely Presented  
Component Units)**

**Audited Combined Financial Statements  
(and Required Supplementary Information)**

**Years Ended June 30, 2012 and 2011**





**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Audited Combined Financial Statements (and Required Supplementary Information)***

***Years Ended June 30, 2012 and 2011***

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of  
Chattanooga-Hamilton County Hospital Authority  
(d/b/a Erlanger Health System):

We have audited the accompanying combined balance sheets of Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System (the Primary Health System) and aggregate discretely presented component units, as of June 30, 2012 and 2011 and the related combined statements of revenue, expenses and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of Chattanooga-Hamilton County Hospital Authority's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Chattanooga-Hamilton County Hospital Authority's internal control over financial reporting. Accordingly, we express no such opinion. 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 financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the aggregate discretely presented component units of Chattanooga-Hamilton County Hospital Authority as of June 30, 2012 and 2011, and the results of its operations 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 our report dated December 18, 2012 on our consideration of Chattanooga-Hamilton County Hospital Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and

compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis on pages 3 through 11 is not a required part of the basic financial statements but supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the combined financial statements that collectively comprise the Chattanooga-Hamilton County Hospital Authority's basic financial statements. The accompanying schedule of expenditures of federal awards and schedule of expenditures of state and other financial assistance are presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the State of Tennessee Comptroller of the Treasury, respectively, and are not a required part of the basic combined financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined 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 combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards and schedule of expenditures of state and other financial assistance are fairly stated, in all material respects, in relation to the basic combined financial statements taken as a whole.

*Reynolds Youngley: Associate PC*

Knoxville, Tennessee  
December 18, 2012

## **Management's Discussion and Analysis**

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Management's Discussion and Analysis***

***Years Ended June 30, 2012 and 2011***

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**

The discussion and analysis of Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System's financial performance provides an overview of the Primary Health System's financial activities for the fiscal year ended June 30, 2012 and 2011.

Erlanger Health System (the Primary Health System) is the largest healthcare provider in Southeast Tennessee. The Primary Health System maintains a number of very specialized clinical services such as Level I trauma, Level III neonatal, kidney transplantation, Regional Cancer Unit, a full service children's hospital, and open heart surgery, all of which are primarily serviced by four "Life Force" helicopters and supported by subspecialty physicians (residents, faculty and private attending physicians) located on its campuses.

**OVERVIEW OF THE COMBINED FINANCIAL STATEMENTS**

The combined financial statements consist of two parts: Management's Discussion and Analysis and the combined financial statements. The combined financial statements also include notes that explain in more detail some of the information in the combined financial statements.

The combined financial statements of the Primary Health System offer short-term and long-term financial information about its activities. The combined balance sheets include all of the Primary Health System's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to the Primary Health System's creditors (liabilities). The assets and liabilities are presented in a classified format, which distinguishes between current and long-term assets and liabilities. It also provides the basis for computing rate of return, evaluating the capital structure of the Primary Health System and assessing the liquidity and financial flexibility of the Primary Health System.

All of the fiscal year's revenues and expenses are accounted for in the combined statements of revenue, expenses, and changes in net assets. These statements measure the success of the Primary Health System's operations and can be used to determine whether the Primary Health System has successfully recovered all of its costs through the services provided, as well as its profitability and credit worthiness.

The final required financial statement is the combined statement of cash flows. The primary purpose of this statement is to provide information about the Primary Health System's cash receipts, cash payments and net changes in cash resulting from operating, investing, non-capital financing and financing activities. The statements also provide answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Management's Discussion and Analysis - Continued***

***Years Ended June 30, 2012 and 2011***

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**OVERVIEW OF THE COMBINED FINANCIAL STATEMENTS - Continued**

The analyses of the combined financial statements of the Primary Health System begin on the next page. One of the most important questions asked about the Primary Health System's finances is "Is the financial condition of the Primary Health System as a whole better or worse as a result of the fiscal year's activities?" The combined balance sheets and the combined statements of revenue, expenses and changes in net assets report information about the Primary Health System's activities in a way that will help answer this question. These two statements report the net assets of the Primary Health System and changes in them. One can think of the Primary Health System's net assets – the difference between assets and liabilities – as one way to measure financial health or financial position. Over time, increases or decreases in the Primary Health System's net assets are one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, regulations and new or changed government legislation.

**REPORTING ENTITY**

The Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System (the Primary Health System) was created by a private act passed by the General Assembly of the State of Tennessee on March 11, 1976, and adopted by a majority of the qualified voters of Hamilton County, Tennessee on August 5, 1976. The Primary Health System is considered the primary governmental unit for financial reporting purposes. As required by generally accepted accounting principles, these financial statements present the Primary Health System and its component units. The component units discussed below are included in the Primary Health System's reporting entity because of the significance of their operational or financial relationships with the Primary Health System.

ContinuCare HealthServices, Inc., Plaza Surgery, G.P., Cyberknife of Chattanooga, LLC (Cyberknife), UT-Erlanger Medical Group, Inc. (the Medical Group) and Erlanger Health Plan Trust are legally separate organizations for which the Primary Health System is either financially accountable or owns a majority interest. Accordingly, these organizations represent component units of the Primary Health System. The financial statements of Erlanger Health Plan Trust are blended with the financial statements of the Primary Health System, as the Board of Erlanger Health Plan Trust is substantially the same as that of the Primary Health System.

During 2012, the Primary Health System acquired 100% ownership in Plaza Surgery, G.P. As a result, Plaza Surgery, G.P. is shown as a blended component unit in 2012. The 2011 balance sheet and statement of revenue, expenses and changes in net assets have been reclassified to include Plaza Surgery, G.P. as a blended component unit of the Primary Health System as well.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Management's Discussion and Analysis - Continued***

***Years Ended June 30, 2012 and 2011***

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**REPORTING ENTITY - Continued**

During fiscal year 2011, Cyberknife was capitalized by contributions from the Primary Health System and certain other minority partners. Cyberknife provides radiation therapy services, specifically robotic stereotactic radiosurgical services through the use of a cyberknife stereotactic radiosurgery system on the Primary Health System campus. At June 30, 2011, the Primary Health System owned 51% of Cyberknife's outstanding membership units. The Medical Group was formed June 30, 2011 and provides professional healthcare services to the public and related services through its employed and contracted licensed physicians and other supporting healthcare providers. The Medical Group has no members; however, the Primary Health System may access the Medical Group's services. The Primary Health System is not entitled to any potential earnings of the Medical Group except for compensation for services rendered to the Medical Group on its behalf. The Medical Group is currently not active.

**KEY FINANCIAL INDICATORS**

The following key financial indicators are for Erlanger Health System as a whole. They are inclusive of the Primary Health System, ContinuCare HealthServices, Inc., and the 51% controlling share of Cyberknife of Chattanooga, LLC.

- Excess expenses over revenues from operations for Erlanger Health System for the fiscal year 2012 is \$9.5 million compared to excess revenues over expenses of \$5.4 million for the fiscal year 2011.
- Total cash and investment reserves at June 30, 2012 are \$45 million (excluding \$100 million of Board restricted and \$39 million of funds held by Trustees or restricted by donors or others, including cash held for Erlanger East expansion).
- Net days in accounts receivable for Erlanger Health System (utilizing a three month rolling average of net revenue) are 53 days at June 30, 2012 compared to 56 days at June 30, 2011.
- For fiscal year 2012, Erlanger Health System recognized \$11.4 million in essential access payments from the State of Tennessee compare to \$7.4 million in fiscal year 2011.
- For fiscal year 2012, Erlanger Health System recognized \$9.2 million in disproportionate share payments from the State of Tennessee compared to \$2.9 million in fiscal year 2011.
- For fiscal year 2012, Erlanger Health System recognized \$1.0 million in trauma fund payments from the State of Tennessee compared to \$1.1 million in fiscal year 2011.
- For fiscal year 2012, Erlanger Health System recognized \$3.3 million in a Medicare rural floor budget neutrality settlement payment.
- For fiscal year 2011, Erlanger Health System recognized \$2.9 million in a one time supplemental distribution from the Tennessee Hospital Assessment Fund.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

*Management's Discussion and Analysis - Continued*

*Years Ended June 30, 2012 and 2011*

**KEY FINANCIAL INDICATORS - Continued**

The required bond covenants ratios for fiscal year 2012 compared to bond requirements are as follows:

	<i>June 30, 2012</i>	<i>Master Trust Indenture</i>	<i>Bond Insurer Requirements</i>		
			<i>98 Series</i>	<i>00 Series</i>	<i>04 Series</i>
Debt service coverage ratio	1.16	1.10	1.10	1.35	1.35
Cushion ratio	7.94	N/A	1.50	N/A	N/A
Current ratio	2.35	N/A	1.50	1.50	1.50
Days cash on hand	81 days			65 days	65 days
Indebtedness ratio	48.93%				65%

Erlanger Health System satisfied the debt service coverage covenant required by the Master Trust Indenture but failed to satisfy the debt service coverage covenant required by one of the bond insurers. Erlanger Health System has contracted with a third party consultant, as required and approved by the Bond insurer, to provide a complete operational assessment and assist management in implementation of operational improvements.

**NET ASSETS**

Erlanger Health System's net assets for the combined Primary Health System and Aggregate Discretely Presented Component Units decreased by \$17 million in the fiscal year 2012. Our analysis focuses on the net assets (Table 1) and changes in net assets (Table 2) of the Primary Health System's operating activities. Discussion focuses on the Primary Health System and its blended component units.

**Table 1- Net Assets (in Millions)**

	<i>June 30, 2012</i>		<i>June 30, 2011</i>	
	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>
Current and other assets	\$ 314	\$ 11	\$ 335	\$ 14
Capital assets	158	10	163	7
<b>Total assets</b>	<b>\$ 472</b>	<b>\$ 21</b>	<b>\$ 498</b>	<b>\$ 21</b>

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

*Management's Discussion and Analysis - Continued*

*Years Ended June 30, 2012 and 2011*

NET ASSETS - Continued

	<i>June 30, 2012</i>		<i>June 30, 2011</i>	
	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>
Long-term debt outstanding	\$ 177	\$ 4	\$ 179	\$ 4
Other liabilities	108	3	115	3
<b>Total liabilities</b>	<b>\$ 285</b>	<b>\$ 7</b>	<b>\$ 294</b>	<b>\$ 7</b>
<b>Net assets</b>				
Capital assets, net of debt	\$ -	\$ 6	\$ 5	\$ 2
Restricted, expendable	2	-	3	-
Unrestricted	185	9	196	12
<b>Total net assets</b>	<b>\$ 187</b>	<b>\$ 14</b>	<b>\$ 204</b>	<b>\$ 14</b>

Net assets for the Primary Health System decreased from \$204 million as of June 30, 2011 to \$187 million as of June 30, 2012. The current ratio (current assets divided by current liabilities) increased from 2.13 in 2011 to 2.21 in 2012 for the Primary Health System.

Days in cash decreased from 105 days as of June 30, 2011 to 81 days as of June 30, 2012 for the Primary Health System due to decreased operating margins combined with a \$12.5 million receivable for funds drawn on a line of credit extended to Hutcheson Medical Center, Inc. in fiscal year 2012. Days in net accounts receivable decreased from 57 days as of June 30, 2011 to 55 days as of June 30, 2012. The Primary Health System received \$11.4 million in essential access payments from the State of Tennessee in fiscal year 2012 compared to \$7.4 million in fiscal year 2011. Additionally, the Primary Health System received \$9.2 million in disproportionate share payments from the State of Tennessee in fiscal year 2012 compared to \$2.9 million in fiscal year 2011. The Primary Health System recognized \$1.0 million in trauma funding in fiscal year 2012 compared to \$1.1 million in fiscal year 2011. The Primary Health System also received \$3.3 million in a Medicare rural floor budget neutrality settlement payment in fiscal year 2012. The Primary Health System received \$2.9 million in a one time supplemental distribution from the Tennessee Hospital Assessment Fund in fiscal year 2011.

Capital assets for the Primary Health System were \$158 million. Additions for the fiscal year 2012 amounted to \$31 million while \$59 million of assets were retired. The retirements included the sale and minority tenant leaseback of certain professional office buildings. A gain on the sale of approximately \$6.6 million was realized of which \$4.9 million was deferred. Depreciation expense was \$26 million for the Primary Health System. Retirement of assets reduced

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

***Management's Discussion and Analysis - Continued***

***Years Ended June 30, 2012 and 2011***

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NET ASSETS - Continued

accumulated depreciation by \$52 million in fiscal year 2012. Construction in progress was \$11 million as of June 30, 2011 and \$7 million as of June 30, 2012. Included in construction in progress at June 30, 2012 is the Erlanger East expansion of \$3.5 million.

	<b><i>Primary Health System</i></b>	
	<b><i>2012</i></b>	<b><i>2011</i></b>
Land and improvements	\$ 25	\$ 27
Buildings	224	243
Equipment	351	357
Total	600	627
Less accumulated depreciation	(449)	(475)
Construction in progress	7	11
Net property, plant and equipment	\$ 158	\$ 163

Long-term debt outstanding amounted to \$177 million as of June 30, 2012 compared to \$179 million as of June 30, 2011. The decrease in long-term debt reflects normal scheduled principal payments net of an increase in debt associated with the sale and minority tenant leaseback of the Erlanger East POB.

Other liabilities for the Primary Health System were \$108 million as of June 30, 2012 compared to \$115 million as of June 30, 2011.

**CHANGES IN NET ASSETS**

The focus for Erlanger Health System's management team during fiscal year 2012 was to increase the Primary Health System's volumes in a number of key product lines in a downturned economy, improve relationships with stakeholders, and improve operating efficiencies.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Management's Discussion and Analysis - Continued*

*Years Ended June 30, 2012 and 2011*

**CHANGES IN NET ASSETS - Continued**

**Table 2- Changes in Net Assets (in Millions)**

	<i>June 30, 2012</i>		<i>June 30, 2011</i>	
	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>
Net patient revenue	\$ 514	\$ 12	\$ 513	\$ 11
Other revenue	22	16	20	15
<b>Total revenue</b>	<b>536</b>	<b>28</b>	<b>533</b>	<b>26</b>
Expenses:				
Salaries	300	13	292	12
Supplies and expenses	111	10	112	13
Purchased services	104	3	94	1
Insurance and taxes	5	1	4	-
Depreciation and amortization	26	1	26	-
Impairment of goodwill			-	-
<b>Total expenses</b>	<b>546</b>	<b>28</b>	<b>528</b>	<b>26</b>
Operating income revenues in excess of (less than) expenses	(10)	-	5	-
Nonoperating gains	4	-	2	-
Interest expense and other	(11)	-	(8)	-
Operating/capital contributions	-		1	-
<b>Change in net assets</b>	<b>\$ (17)</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

Net patient service revenue for the Primary Health System increased from \$513 million in fiscal year 2011 to \$514 million in fiscal year 2012. Although total admissions were up 3.9% over fiscal year 2011, inpatient surgical patients decreased 4.9% over prior year which resulted in a higher medicine mix of patients. Neonatal intensive care unit patient days decreased by 8.7% compared to prior year.

Salaries for the Primary Health System increased from \$292 million in fiscal year 2011 to \$300 million in fiscal year 2012 due to continued growth in strategically critical new physician practices, increase in employee benefits, and approximately \$2.6 million in severance payments resulting from a reduction in workforce.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Management's Discussion and Analysis - Continued***

***Years Ended June 30, 2012 and 2011***

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**CHANGES IN NET ASSETS - Continued**

Supplies and expenses decreased from \$112 million in fiscal year 2011 to \$111 million in fiscal year 2012.

Purchased services increased from \$94 million in fiscal year 2011 to \$104 million in fiscal year 2012 due to the implementation of Cyberknife services, service excellence initiatives, outsourced security services and billing service fees associated with increased employed physicians' revenue.

Insurance and taxes increased from \$4 million in fiscal year 2011 to \$5 million in fiscal year 2012 due to increased malpractice liability.

Depreciation and amortization expense was \$26 million in fiscal years 2011 and 2012.

Interest expense, including gain (or loss) on mark-to-market of interest rate swaps, increased from \$8 million in fiscal year 2011 to \$11 million in fiscal year 2012. The market value of the liability for the mark-to-market of interest rate swaps increased by \$1.1 million in fiscal year 2012 compared to a decrease of \$1.6 million in fiscal year 2011.

**OUTLOOK**

The State of Tennessee continues to review the TennCare program (the State's Medicaid program). For fiscal years 2011 and 2012, the State passed a Hospital Coverage Fee to offset shortfalls in the State's budget for TennCare. The fee is expected to remain intact for the third consecutive year and TennCare rates are expected to be stable in fiscal year 2013. Out-of-state Medicaid and TennCare changes would affect the Primary Health System's bottom line with TennCare and Medicaid patients representing approximately 25% of the payer mix. Self Pay patients represent approximately 10% of the charge utilization. Healthcare reform and future changes in Medicare regulations could also have an adverse effect on the Primary Health System's future operations since Medicare represents approximately 30% of the payer mix.

The Primary Health System recognized Essential Access and Disproportionate Share payments from the State of Tennessee fiscal year 2012 which increased by \$10 million over fiscal year 2011. Additionally, the Primary Health System recognized trauma funding of \$1 million fiscal year 2012. Payments from the State of Tennessee for the fiscal year 2013 are expected to be consistent with the fiscal year 2012. Due to the 1966 Hamilton County Sales Tax Agreement expiring in May 2011, the Hamilton County appropriations to the Primary Health System have been reduced from \$3 million to \$1.5 million for fiscal 2012. An increase for the fiscal year 2013 is unlikely.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Management's Discussion and Analysis - Continued***

***Years Ended June 30, 2012 and 2011***

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**OUTLOOK - Continued**

Several initiatives are under way to bring the Primary Health System to a profitable position for the upcoming fiscal year. Operating improvements are being implemented to reduce expenses and grow surgical volumes. Increased surgery volumes are essential to the financial health of the Primary Health System

A Management Action Plan was implemented in December 2011 to address the negative operating margin. Included in the Management Action Plan was a labor reduction plan that reduced staff during the three months ended March 31, 2012 by approximately 180 FTEs. The ultimate goal of the labor management plan is to reach 5.4 FTE's per adjusted occupied bed, the midpoint operating efficiency for teaching hospitals in the country. The Primary Health System contracted with an outside consultant in June 2012 to conduct a complete operational assessment and growth strategy. The outside consultant will also assist in the implementation of the recommended operational improvements and growth initiatives.

## **Audited Combined Financial Statements**

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

***Combined Balance Sheets***

	<b><i>June 30, 2012</i></b>	
	<b><i>Primary Health System</i></b>	<b><i>Aggregate Discretely Presented Component Units</i></b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 27,820,469	\$ 35,714
Temporary investments	14,510,657	3,210,896
Assets limited as to use available for current liabilities	33,250	-
Patient accounts receivable, net	76,641,438	2,325,057
Estimated amounts due from third party payors	-	-
Due from other governments, net	899,987	501,472
Inventories	11,566,908	1,155,064
Other current assets	24,389,397	808,889
<b>TOTAL CURRENT ASSETS</b>	<b>155,862,106</b>	<b>8,037,092</b>
<b>NET PROPERTY, PLANT AND EQUIPMENT</b>	<b>157,718,163</b>	<b>9,884,006</b>
<b>LONG-TERM INVESTMENTS, for working capital</b>	<b>262,396</b>	<b>2,608,721</b>
<b>ASSETS LIMITED AS TO USE</b>	<b>138,419,178</b>	<b>-</b>
<b>OTHER ASSETS:</b>		
Deferred financing costs	6,458,443	-
Receivable from Hutcheson Medical Center	12,500,000	-
Other assets	1,073,820	1,131,272
<b>TOTAL OTHER ASSETS</b>	<b>20,032,263</b>	<b>1,131,272</b>
<b>TOTAL ASSETS</b>	<b>\$ 472,294,106</b>	<b>\$ 21,661,091</b>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable and accrued expenses	\$ 36,758,702	\$ 630,903
Accrued salaries and related liabilities	19,266,509	937,705
Estimated amounts due to third party payors	380,898	93,625
Due to other governments	501,472	899,987
Current portion of long-term debt and capital lease obligations	7,929,701	500,000
Other current liabilities	2,088,573	406,471
<b>TOTAL CURRENT LIABILITIES</b>	<b>66,925,855</b>	<b>3,468,691</b>
<b>LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS</b>	<b>177,310,823</b>	<b>3,916,667</b>
<b>OTHER LONG-TERM LIABILITIES</b>	<b>41,397,245</b>	<b>-</b>
<b>NET ASSETS:</b>		
Unrestricted	184,692,314	8,733,085
Invested in capital assets, net of related debt	(233,917)	5,542,648
Restricted expendable	2,201,786	-
<b>TOTAL NET ASSETS</b>	<b>186,660,183</b>	<b>14,275,733</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 472,294,106</b>	<b>\$ 21,661,091</b>

	<i>June 30, 2011</i>	
	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 35,645,908	\$ 3,606,829
Temporary investments	15,413,787	2,784,481
Assets limited as to use available for current liabilities	28,775	-
Patient accounts receivable, net	80,444,632	2,014,281
Estimated amounts due from third party payors, net	8,086,255	-
Due from other governments, net	527,561	296,272
Inventories	11,821,744	1,089,525
Other current assets	15,090,565	483,631
<b>TOTAL CURRENT ASSETS</b>	<b>167,059,227</b>	<b>10,275,019</b>
<b>NET PROPERTY, PLANT AND EQUIPMENT</b>	<b>163,330,930</b>	<b>6,887,710</b>
<b>LONG-TERM INVESTMENTS, for working capital</b>	<b>19,608,648</b>	<b>2,997,956</b>
<b>ASSETS LIMITED AS TO USE</b>	<b>139,905,215</b>	<b>-</b>
<b>OTHER ASSETS:</b>		
Deferred financing costs	7,096,163	-
Receivable from Hutcheson Medical Center	-	-
Other assets	624,823	1,140,135
<b>TOTAL OTHER ASSETS</b>	<b>7,720,986</b>	<b>1,140,135</b>
<b>TOTAL ASSETS</b>	<b>\$ 497,625,006</b>	<b>\$ 21,300,820</b>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable and accrued expenses	\$ 40,027,477	\$ 327,018
Accrued salaries and related liabilities	28,252,508	1,021,723
Estimated amounts due to third party payors	-	93,625
Due to other governments	296,272	527,561
Current portion of long-term debt and capital lease obligations	7,366,079	500,000
Other current liabilities	2,365,674	341,072
<b>TOTAL CURRENT LIABILITIES</b>	<b>78,308,010</b>	<b>2,810,999</b>
<b>LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS</b>	<b>178,584,382</b>	<b>4,416,667</b>
<b>OTHER LONG-TERM LIABILITIES</b>	<b>36,721,449</b>	<b>-</b>
<b>NET ASSETS:</b>		
Unrestricted	196,366,376	12,020,639
Invested in capital assets, net of related debt	5,226,648	2,052,515
Restricted expendable	2,418,141	-
<b>TOTAL NET ASSETS</b>	<b>204,011,165</b>	<b>14,073,154</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$ 497,625,006</b>	<b>\$ 21,300,820</b>

*See notes to combined financial statements.*

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

***Combined Statements of Revenue, Expenses and Changes in Net Assets***

	<b>Year Ended June 30, 2012</b>	
	<b>Primary Health System</b>	<b>Aggregate Discretely Presented Component Units</b>
<b>OPERATING REVENUE:</b>		
Charges for services:		
Net patient service revenue	\$ 514,081,693	\$ 11,758,042
Other revenue	22,467,500	16,271,756
<b>TOTAL OPERATING REVENUE</b>	<b>536,549,193</b>	<b>28,029,798</b>
<b>OPERATING EXPENSES:</b>		
Salaries, wages and benefits	300,099,607	13,101,376
Supplies and other expenses	111,165,013	10,454,042
Purchased services	103,908,488	2,788,577
Insurance and taxes	4,921,912	366,516
Depreciation	26,241,609	848,875
<b>TOTAL OPERATING EXPENSES</b>	<b>546,336,629</b>	<b>27,559,386</b>
<b>OPERATING INCOME (LOSS)</b>	<b>(9,787,436)</b>	<b>470,412</b>
<b>NONOPERATING REVENUE (EXPENSES):</b>		
Gain (loss) on disposal of assets	1,815,605	(17,139)
Interest and investment income	2,363,937	127,910
Interest expense	(10,232,817)	(218,057)
Provision for income taxes	-	(160,547)
Change in mark-to-market of interest rate swaps	(1,080,176)	-
<b>NET NONOPERATING REVENUE (EXPENSES)</b>	<b>(7,133,451)</b>	<b>(267,833)</b>
Income (loss) before contributions	(16,920,887)	202,579
Operating contributions (distributions)	(198,111)	-
Capital contributions/other, net	(231,984)	-
<b>CHANGE IN NET ASSETS</b>	<b>(17,350,982)</b>	<b>202,579</b>
<b>NET ASSETS AT BEGINNING OF YEAR</b>	<b>204,011,165</b>	<b>14,073,154</b>
<b>NET ASSETS AT END OF YEAR</b>	<b>\$ 186,660,183</b>	<b>\$ 14,275,733</b>

	<i>Year Ended June 30, 2011</i>	
	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>
<b>OPERATING REVENUE:</b>		
Charges for services:		
Net patient service revenue	\$ 512,916,915	\$ 10,649,062
Other revenue	20,228,866	15,320,522
<b>TOTAL OPERATING REVENUE</b>	<b>533,145,781</b>	<b>25,969,584</b>
<b>OPERATING EXPENSES:</b>		
Salaries, wages and benefits	291,883,901	11,993,950
Supplies and other expenses	112,145,736	12,878,103
Purchased services	94,234,841	375,607
Insurance and taxes	4,358,779	19,947
Depreciation	25,569,614	396,391
<b>TOTAL OPERATING EXPENSES</b>	<b>528,192,871</b>	<b>25,663,998</b>
<b>OPERATING INCOME</b>	<b>4,952,910</b>	<b>305,586</b>
<b>NONOPERATING REVENUE (EXPENSES):</b>		
Gain (loss) on disposal of assets	7,676	8,489
Interest and investment income	2,312,468	500,508
Interest expense	(10,352,223)	(74,979)
Provision for income taxes	-	(332,251)
Change in mark-to-market of interest rate swaps	1,600,620	-
<b>NET NONOPERATING REVENUE (EXPENSES)</b>	<b>(6,431,459)</b>	<b>101,767</b>
Income (loss) before contributions	(1,478,549)	407,353
Operating distributions	74,410	-
Capital contributions/other, net	886,327	1,200,000
<b>CHANGE IN NET ASSETS</b>	<b>(517,812)</b>	<b>1,607,353</b>
<b>NET ASSETS AT BEGINNING OF YEAR</b>	<b>204,528,977</b>	<b>12,465,801</b>
<b>NET ASSETS AT END OF YEAR</b>	<b>\$ 204,011,165</b>	<b>\$ 14,073,154</b>

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Combined Statements of Cash Flows***

	<b><i>Primary Health System Year Ended June 30, 2012                      2011</i></b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Receipts from third-party payors and patients	<b>\$ 522,220,700</b>	\$ 492,855,235
Payments to vendors and others for supplies, purchased services, and other expenses	<b>(222,829,499)</b>	(207,866,302)
Payments to and on behalf of employees	<b>(308,557,666)</b>	(289,078,422)
Other receipts	<b>17,379,057</b>	18,684,496
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>8,212,592</b>	14,595,007
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>		
Contributions (distributions)	<b>(198,111)</b>	74,410
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Acquisition and construction of capital assets, net	<b>(20,962,299)</b>	(26,446,924)
Principal paid on bonds, capital lease obligations and other	<b>(7,396,156)</b>	(7,850,276)
Proceeds from sale of assets	<b>11,256,695</b>	437,380
Interest payments on long-term debt	<b>(9,652,060)</b>	(9,881,067)
Proceeds received from long-term debt, net	<b>-</b>	2,177,310
Capital contributions/other, net	<b>(231,984)</b>	886,327
<b>NET CASH USED IN CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<b>(26,985,804)</b>	(40,677,250)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Interest, dividends, and net realized gains on investments	<b>2,168,553</b>	1,700,558
Change in long-term investments for working capital	<b>20,444,766</b>	(4,132,702)
Advances under note agreements	<b>(12,948,997)</b>	-
Cash provided by assets limited as to use	<b>1,481,562</b>	3,405,299
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<b>11,145,884</b>	973,155
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(7,825,439)</b>	(25,034,678)
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b>35,645,908</b>	60,680,586
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>\$ 27,820,469</b>	<b>\$ 35,645,908</b>

	<i>Primary Health System</i>	
	<i>Year Ended June 30,</i>	
	<i>2012</i>	<i>2011</i>
<b>RECONCILIATION OF OPERATING INCOME TO</b>		
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES:</b>		
Operating income (loss)	<b>\$ (9,787,436)</b>	<b>\$ 4,952,910</b>
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		-
Depreciation	<b>26,241,609</b>	25,569,614
Provision for self-insurance	<b>1,203,978</b>	1,283,158
Non-cash operating revenue recognized on Plaza		
Surgery acquisition	<b>(2,175,057)</b>	-
Changes in assets and liabilities:		-
Patient accounts receivable, net	<b>3,803,194</b>	(5,257,277)
Estimated amounts due from (due to) third party payors, net	<b>8,467,153</b>	(14,287,980)
Inventories and other assets	<b>(7,061,422)</b>	(5,530,646)
Accounts payable and accrued expenses	<b>(3,268,775)</b>	7,844,284
Accrued salaries and related liabilities	<b>(8,985,999)</b>	1,433,114
Other current and long-term liabilities	<b>(224,653)</b>	(1,412,170)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ 8,212,592</b>	<b>\$ 14,595,007</b>

**SUPPLEMENTAL INFORMATION:**

During the year ended June 30, 2012, the Primary Health System entered into several capital leases with third parties for office space. The capital leases represented liabilities at the inception of the leases of approximately \$6,600,000. Additionally, in 2012, as a result of the acquisition of all outstanding units of Plaza Surgery, G.P. (Note A) deferred receipts were recognized as other operating revenue. Further, in connection with the gain on the sale of property discussed in Note E, proceeds due to Primary Health System of \$2,355,000 were withheld and are reflected as other current assets in the combined balance sheets.

During the year ended June 30, 2011, the Primary Health System entered into a term loan with a financial institution to finance the acquisition of the Lifestyle Center, formerly leased from Sports Barn Inc. (see Notes E and G). The capital lease liability at time of purchase was approximately \$4,954,000. Additionally, during the year ended June 30, 2011, the Primary Health System entered into a five year capital lease with Cardiovascular Care Center, PLLC for the lease of certain equipment and furniture. The capital lease liability at time of inception was approximately \$313,915.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements***

***Years Ended June 30, 2012 and 2011***

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**NOTE A--SIGNIFICANT ACCOUNTING POLICIES**

***Reporting Entity:*** The Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System (the Primary Health System) was created by a private act passed by the General Assembly of the State of Tennessee on March 11, 1976, and adopted by a majority of the qualified voters of Hamilton County, Tennessee on August 5, 1976. The Chattanooga-Hamilton County Hospital Authority consists of the Primary Health System and its aggregate discretely presented component units as disclosed below.

The Primary Health System provides comprehensive healthcare services throughout Hamilton and Bledsoe counties, as well as outlying areas in southeastern Tennessee and north Georgia. These services are provided primarily through the hospital and other facilities located on the Baroness campus of Erlanger Medical Center. The Primary Health System also operates other hospitals and clinics throughout the area. The Primary Health System is considered the primary governmental unit for financial reporting purposes. As required by accounting principles generally accepted in the United States of America, these combined financial statements present the Primary Health System and its component units. The component units discussed below are included in the Primary Health System's reporting entity because of the significance of their operational or financial relationships with the Primary Health System.

The primary mission of the Primary Health System and its component units is to provide healthcare services to the citizens of Chattanooga, Hamilton County and the surrounding area. Only those activities directly associated with this purpose are considered to be operating activities. Other activities that result in gains or losses unrelated to the Primary Health System's primary mission are considered to be nonoperating.

ContinuCare HealthServices, Inc., Plaza Surgery, G.P., Cyberknife of Chattanooga, LLC, UT-Erlanger Medical Group, Inc., and Erlanger Health Plan Trust are legally separate organizations for which the Primary Health System is financially accountable. Accordingly, these organizations represent component units of the Primary Health System.

***Blended Component Units:*** The financial statements of Erlanger Health Plan Trust are blended with the Primary Health System in the basic combined financial statements as the board of Erlanger Health Plan Trust is substantially the same as that of the Primary Health System.

Plaza Surgery, G.P. (Plaza) operated an ambulatory surgery center on the Primary Health System's campus. At June 30, 2011, the Primary Health System owned a controlling 51% interest in Plaza. As a general partnership, general partners are jointly and separately liable for the debts of Plaza. Accordingly, Plaza was fiscally dependent on the Primary Health System. In 2012, the Primary Health System purchased the remaining outstanding units of Plaza for \$850,150. The accompanying 2012 combined financial statements reflect Plaza's operations,

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued**

assets and liabilities as a blended component unit. The 2011 combined financial statements have been reclassified to present Plaza as a blended component unit, rather than a discretely presented component unit as previously reported.

Plaza was capitalized September 1, 2001 by the contribution by the Primary Health System of cash of \$566,000 and the going concern value (i.e., goodwill) of Plaza Ambulatory Surgery Center (valued at \$7,402,000 by an appraisal agreed to by all of the general partners) and the contribution of cash from certain minority partners of \$3,369,000. Concurrent with the capitalization of Plaza, and execution of an Asset Transfer Agreement, Plaza distributed cash of \$2,935,000 to the Primary Health System such that the partners' capital of the Primary Health System and the minority partners after the distribution were in accordance with the Amended and Restated Partnership Agreement. The distribution of cash from Plaza has been reflected in other long-term liabilities of the Primary Health System in the accompanying 2011 combined financial statements as a result of certain put and call rights that the minority partners had with respect to Plaza. Upon the expiration of the put and call rights at August 31, 2003, the Primary Health System began amortizing this amount to income over the remaining term of the lease agreement associated with the Asset Transfer Agreement. Such amortization totaled \$149,448 in 2011, and is reflected within other revenue in the accompanying combined statements of revenue, expenses and changes in net assets. In 2012, due to the acquisition of all remaining outstanding units, the remaining deferred receipts have been reflected as part of other revenue.

*Discretely Presented Component Units:* The aggregate discretely presented component units column in the basic combined financial statements includes the financial data of the Primary Health System's other component units. They are reported in a separate column to emphasize that they are legally separate from the Primary Health System. See combined, condensed financial information in Note Q.

1. ContinuCare HealthServices, Inc. and subsidiary (ContinuCare) provide health and supportive services to individuals in their homes in the Hamilton County and north Georgia areas. ContinuCare also provides retail pharmacy goods and services at four locations in Hamilton County. The Primary Health System owns 100% of the stock of ContinuCare. Separately audited financial statements for ContinuCare HealthServices, Inc. may be obtained by mailing a request to 1501 Riverside Drive, Suite 140, Chattanooga, Tennessee 37406.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued**

ContinuCare owes the Primary Health System for various services, supplies, and rents provided, or expenses paid on its behalf. Actual expenses incurred related to these services were \$1,728,869 and \$1,497,179 in 2012 and 2011, respectively, including management fees of approximately \$33,000 each year. In addition, ContinuCare provides staffing, contract nurse visits, and administrative services to the Primary Health System. Such revenues were \$508,888 and \$293,986 in 2012 and 2011, respectively. Amounts due at June 30, 2012 and 2011 are included in amounts due to/from other governments in the accompanying combined financial statements.

2. Cyberknife of Chattanooga, LLC (Cyberknife) provides radiation therapy services, specifically robotic stereotactic radiosurgical services, through the use of a cyberknife stereotactic radiosurgery system on the Primary Health System's campus. At June 30, 2012 and 2011 the Primary Health System owns 51% of Cyberknife's outstanding membership units.

During fiscal year 2011, Cyberknife was capitalized by the contribution of the Primary Health System of \$612,000 and the contribution of cash from certain minority partners of \$588,000. In addition to the capital contributions, each Member is required, as a condition precedent to such Member's admission as a Member of Cyberknife, to deliver limited guaranties, guaranteeing prorata repayment of indebtedness of Cyberknife incurred to finance its equipment costs and its working capital needs. As of June 30, 2012, total debt outstanding was \$4,416,667. Income is allocated to Members based on ownership percentages and taxed at the Member level based upon the tax status of the partner. The portion of income allocated to the Primary Health System is exempt from income taxes based on the Primary Health System's tax-exempt status.

As of June 30, 2012, CyberKnife owes the Primary Health System for various services, supplies and rents provided, or expenses paid on its behalf. The Primary Health System owes Cyberknife for radiation services provided by Cyberknife to the Primary Health System's patients. Revenues related to those services provided to the Primary Health System were \$1,595,300 and \$223,600 in 2012 and 2011, respectively. Amounts due at June 30, 2012 and 2011 are included in amounts due to/from other governments in the accompanying combined balance sheets.

3. UT-Erlanger Medical Group, Inc. (the Medical Group) was formed on June 30, 2011 and provides professional healthcare services to the public and related services through its employed and contracted licensed physicians and other supporting healthcare providers. The Medical Group has no members; however, the Primary Health System

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued**

may access the Medical Group's services. The Primary Health System is not entitled to any potential earnings of the Medical Group except for compensation for services rendered to the Medical group on its behalf. The Medical Group is not yet active.

*Erlanger Health System Foundations (the Foundation):* The Foundation assists the Primary Health System to promote and develop charitable and educational opportunities as it relates to those healthcare services provided by the Primary Health System. The Primary Health System is not financially accountable for the Foundation and as a result the Foundation has not been included in the combined financial statements.

Contributions from the Foundation totaling approximately \$494,000 and \$1,487,000 for the years ended June 30, 2012 and 2011, respectively, were recognized as contribution revenue by the Primary Health System.

*Use of Estimates:* The preparation of the combined 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 disclosure of contingent assets and liabilities as of the date of the combined financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

*Enterprise Fund Accounting:* The Primary Health System and its blended component units utilize the enterprise fund method of accounting whereby revenue and expenses are recognized on the accrual basis using the economic resources measurement focus. In December 2010, the Governmental Accounting Standards Board (GASB) issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) Pronouncements*. This Statement incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, and which does not conflict with or contradict GASB pronouncements: FASB Statements and Interpretations; Accounting Principles Board Opinions; and Accounting Research Bulletins of the AICPA Committee on Accounting Procedure. This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. The requirements of this Statement are effective for financial statements for periods beginning after

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued**

December 15, 2011, however, earlier application is permitted and the provisions of the Statement are required to be applied retroactively for all periods presented. The requirements of this Statement were adopted by the Primary Health System in 2011 and the adoption did not have a material impact on the combined financial statements.

*Recently Issued or Effective Accounting Pronouncements:* In June 2010, the GASB issued Statement No. 59, *Financial Instruments Omnibus*. The Statement is effective for years beginning after June 15, 2010 and updates current standards regarding the financial reporting of financial instruments and external investment pools. The requirements of this Statement will improve financial reporting by providing more complete information, by improving consistency of measurements, and by providing clarifications of existing standards. The requirements of this Statement were adopted by the Primary Health System in fiscal year 2011 and the adoption did not have a material impact on the combined financial statements.

In November 2010, the GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*. The Statement is effective for financial statement periods beginning after June 15, 2012 and amends Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis - for State and Local Governments*. This Statement modifies certain requirements for inclusion of component units in the financial reporting entity and amends the criteria for reporting component units as if they were part of the primary government in certain circumstances. Management of the Primary Health System is evaluating the impact of this Statement on the combined financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement amends the net asset reporting requirements of GASB Statement No. 34 and other pronouncements by incorporating deferred outflows and inflows of resources into the definitions of the required components of the residual measure and renaming that measure as net position, rather than net assets. This Statement will be effective in fiscal year 2013 for the Primary Health System and is not expected to materially impact the combined financial statements.

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Statement No. 65 establishes reporting standards that reclassifying items previously reported as assets or liabilities as deferred inflows or outflows. This Statement will be effective for the Primary Health System in 2014 and management is currently evaluating its impact on the combined financial statements.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

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NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

In January 2010, FASB issued Accounting Standard Update 2010-06, *Improving Disclosures about Fair Value Measurements*, as it relates to FASB ASC 820, *Fair Value Measurement*. This Update provides amendments to FASB ASC 820 that requires both new disclosures and further clarifies existing disclosures. This Update was effective for years beginning after December 15, 2009, except for disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements, which was effective for years beginning after December 15, 2010. The requirements of this Update, excluding those related disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, were adopted by the Primary Health System in fiscal year 2011 and the adoption did not have a material impact on the combined financial statements. As it pertains to Level 3 fair value measurements, this Update was adopted in 2012 but did not have a material impact upon adoption.

In August 2010, FASB issued Accounting Standard Update 2010-23, *Measuring Charity Care for Disclosure*, that amends Topic 954, *Health Care Entities*. This Update provides amendments that require cost to be used as the measurement basis for charity care disclosure purposes and that cost be identified as the direct and indirect costs of providing the charity care. The amendments in this Update also require disclosure of the method used to identify or determine such costs. This Update was effective for the 2012 fiscal year and was applied retrospectively to 2011. Adoption of this Update by the Primary Health System did not impact the combined financial statements.

Also, in August 2010, FASB issued Accounting Standard Update 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries*, which provides amendments that clarify that a healthcare entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. Prior to this Update, healthcare entities were permitted to net insurance recoveries against the accrual of malpractice claims or similar liabilities. This Update was adopted in 2012 by the Primary Health System and there was no significant impact upon adoption.

*Net Patient Service Revenue/Receivables:* Net patient service revenue is reported on the accrual basis 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 payor programs under payment formulas in effect. Net patient revenue also includes an estimated provision for bad debts based upon management's evaluation

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued**

of collectability based upon the age of the receivables and other criteria, such as payor classification and management's assumptions about conditions it expects to exist and courses of action it expects to take. The Primary Health System's policies do not require collateral or other security for accounts receivable, although the Primary Health System routinely accepts assignment or is otherwise entitled to receive patient benefits payable under health insurance programs, plans or policies. Supplemental payments from the State of Tennessee are recognized when determinable (Note B).

*Charity Care:* The Primary Health System accepts patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain policies established by the County Auditor with regard to the Hamilton County indigent program or by the Primary Health System for other patients. Essentially, these policies define charity services as those services for which minimal payment is anticipated. In assessing a patient's inability to pay, the County and the Primary Health System utilize the generally recognized poverty income levels, but also include certain cases where incurred charges are significant when compared to the income of the patient. These charges are not included in net patient service revenue.

*Inventories:* Inventories consist principally of medical and surgical supplies, general store supplies, and pharmacy items and are stated at lower of cost (first-in, first-out) or fair market value.

*Cash Equivalents:* The Primary Health System considers all highly liquid investments with maturities of three months or less when purchased, excluding amounts whose use is limited by board designation, held by trustees under indenture agreement, or otherwise restricted as to use, to be cash equivalents.

*Investments:* The Primary Health System's investments (including assets limited as to use) are reported at fair market value based on quoted market prices in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Assets limited as to use include funds designated by the Board, funds held by trustees under trust indentures, and funds restricted by donors or grantors for specific purposes. The Primary Health System considers those investments with maturities of more than three months when purchased, maturing in more than one year and whose use is not limited by board designation, held by trustees under indenture agreement, or otherwise restricted as to use, to be long-term investments. Investments, including assets limited as to use, consist of United States government, government agency and municipal bonds, corporate debt and other short-term investments.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued**

***Temporary Investments:*** The Primary Health System considers all highly liquid investments with maturities of more than three months when purchased and maturing in less than one year, excluding amounts whose use is limited by board designation, held by trustees under indenture agreement, or otherwise restricted as to use, to be temporary investments. Temporary investments consist primarily of United States government agency bonds and commercial paper.

***Derivative Instruments:*** The Primary Health System records all derivatives as assets or liabilities on the combined balance sheets at estimated fair value and includes credit value adjustments. The Primary Health System's derivative holdings consist of interest rate swap agreements. Since these derivatives are not designated as hedging instruments, mark-to-market accounting applies, and the gain or loss resulting from changes in the fair value of the derivatives is recognized in the accompanying combined statements of revenue, expenses and changes in net assets. The Primary Health System's objectives in using derivatives are to take advantage of the differences between taxable and tax-exempt debt, and manage exposure to interest rate risks associated with various debt instruments, however, none of these swap agreements have been designated as a hedge for accounting purposes (see Note N).

***Net Property, Plant and Equipment:*** Property, plant and equipment is recorded on the basis of cost. Donated assets are recorded at their fair market value at the date of donation. Leases that are substantially installment purchases of property are recorded as assets and amortized over their estimated useful lives ranging from three to thirty years; related amortization is included in depreciation expense. Depreciation expense is computed over estimated service lives of the respective classes of assets using the straight-line method. The Primary Health System has established a capitalization threshold for property, plant and equipment of \$2,500 except for computer equipment, which has a threshold of \$1,000. Interest expense and interest income on borrowed funds related to construction projects are capitalized during the construction period, if material. Costs of maintenance and repairs are charged to expense as incurred.

The Primary Health System previously adopted the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. The Primary Health System did not experience any prominent events or changes in circumstances affecting capital assets which would require determination as to whether impairment of a capital asset has occurred during the years ended June 30, 2012 and 2011.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued**

***Compensated Absences:*** The Primary Health System recognizes an expense and accrues a liability for employees' paid annual leave and extended illness benefits in the period in which the employees' right to such compensated absences are earned. Liabilities expected to be paid within one year are included as accrued salaries and related liabilities in the accompanying combined balance sheets.

***Deferred Financing Costs:*** Deferred financing costs consist principally of costs associated with bond issues and are being amortized, generally, over the terms of the respective debt issues by the effective interest method.

***Income Taxes:*** The Primary Health System is exempt from income taxes under Section 501(a) as an organization described in Section 501(c)(3) of the Internal Revenue Code (IRC). In addition, it qualifies for exemption from federal income taxes pursuant to IRC Section 115 as an instrumentality of the State of Tennessee. Therefore, no provision for income taxes has been recognized in the accompanying combined financial statements for the Primary Health System.

As a for-profit entity, ContinuCare is subject to state and federal income taxes. ContinuCare HealthServices, Inc. and its subsidiary file consolidated federal income tax returns separately from the Primary Health System. At June 30, 2012 and 2011, ContinuCare had no significant uncertain tax positions.

As a Limited Liability Corporation, Cyberknife, a discretely presented component unit, is subject to State of Tennessee income taxes. As such, Cyberknife recognizes liabilities for uncertain tax positions when it is more likely than not that a tax position will not be sustained upon examination and settlement with various taxing authorities. At June 30, 2012 and 2011, Cyberknife had no significant uncertain tax positions.

***Contributed Resources:*** Resources restricted by donors for specific operating purposes are held as restricted funds and recognized as operating or capital contributions in the accompanying combined financial statements. When expended for the intended purpose, they are reported as operating distributions and recognized as other operating revenue. Contributed resources consist of amounts restricted by donors for specific purposes. Fundraising expenses are netted against contributions recognized.

***Net Assets:*** Net assets of the Primary Health System are classified in three components. *Net assets invested in capital assets, net of related debt* consist of capital and other 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

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
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***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued**

net assets that must be used for a particular purpose that are either externally imposed by creditors, grantors, contributors or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. *Unrestricted* net assets are remaining net assets that do not meet the definition of *invested in capital assets, net of related debt or restricted expendable*.

*Fair Value of Financial Instruments:* The carrying amounts reported in the combined balance sheets for cash, accounts receivable, investments, accounts payable and accrued expenses approximate fair value.

The carrying value of long-term debt and capital lease obligations (including the current portion) was \$185,240,524 as of June 30, 2012 and \$185,950,461 as of June 30, 2011. The estimated fair value of long-term debt and capital lease obligations (including current portion) was \$194,322,333 and \$190,984,131 as of June 30, 2012 and 2011, respectively. The fair value of long-term debt related to fixed interest long-term debt and capital lease obligations was estimated using discounted cash flows, based on the Primary Health System's incremental borrowing rates or from quotes obtained from investment advisors. The fair value of long-term debt related to variable rate debt approximates its carrying value.

*Subsequent Events:* The Primary Health System evaluated all events or transactions that occurred after June 30, 2012 through December 18, 2012, the date the combined financial statements were available to be issued. Management did not note any material recognizable subsequent events that required recognition or disclosure in the June 30, 2012 combined financial statements, other than as disclosed in Note P.

*Reclassifications:* Certain reclassifications have been made to the 2011 combined financial statements to conform with the 2012 combined financial statements presentation. The 2011 financial statements have been reclassified to reflect Plaza as a blended component unit due to the Primary Health System's acquisition of a 100% interest in 2012. The impact on the previously reported Primary Health System's results is as follows:

	<b><i>2011</i></b>	<b><i>2011</i></b>
	<b><i>Reclassified</i></b>	<b><i>As Originally Reported</i></b>
Income (loss) before contributions	<u>\$ (1,478,549)</u>	<u>\$ (1,432,170)</u>
Net assets	<u>\$ 204,011,165</u>	<u>\$ 203,610,917</u>

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
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*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE B--NET PATIENT SERVICE REVENUE**

A reconciliation of the amount of services provided to patients at established rates by the Primary Health System to net patient service revenue as presented in the combined statements of revenue, expenses and changes in net assets for the years ended June 30, 2012 and 2011 is as follows:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Inpatient service charges	\$ 1,007,816,189	\$ 994,671,357
Outpatient service charges	657,002,015	626,186,169
Gross patient service charges	1,664,818,204	1,620,857,526
Less: Contractual adjustments and other discounts	974,199,369	943,692,763
Charity care	77,554,683	78,764,922
Estimated provision for bad debts	98,982,459	85,482,926
	<u>1,150,736,511</u>	<u>1,107,940,611</u>
Net patient service revenue	<u>\$ 514,081,693</u>	<u>\$ 512,916,915</u>

*Charity Care and Community Benefit:* The Private Act of the State of Tennessee establishing the Primary Health System obligates the Primary Health System to make its facilities and patient care programs available to the indigent residents of Hamilton County to the extent of funds appropriated by Hamilton County and adjusted operating profits, as defined. The annual appropriation from Hamilton County is not to be less than \$3,000,000 in each fiscal year without approval of the Primary Health System, so long as the 1966 Hamilton County Sales Tax Agreement remains in effect. The Sales Tax Agreement expired in May 2011 which resulted in a \$1,500,000 reduction for fiscal year 2012. Total charity care charges for services provided to the certified indigent residents of Hamilton County (net of the appropriation) were approximately \$23,387,000 and \$23,241,000 for the years ended June 30, 2012 and 2011 for the Primary Health System.

In addition to charity care provided to specific patients within the hospital setting, the Primary Health System also provides unreimbursed services to the community which includes free and low cost health screenings. The Primary Health System also hosts health fairs and helps sponsor many other events that are free to the public and are spread throughout the year in various community locations.

The Primary Health System's Community Relations department, which conducts health, wellness and safety education classes and health screenings, includes Erlanger HealthLink Plus,

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
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*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

NOTE B--NET PATIENT SERVICE REVENUE - Continued

a free adult membership program with over 15,000 members in the Chattanooga Statistical Metropolitan Service Area. The program provides over 16 classes and/or screenings and fitness opportunities per month that are free or at a low cost to members and to the community. These classes and screenings are held in two primary locations with additional classes at satellite locations in the region. As part of Community Relations, Safe & Sound, an injury prevention service of Children's Hospital, offers free educational events regarding childhood injury prevention, including free car seat inspection and installation workshops. The Community Relations program utilizes the services of physicians, nurses, volunteers, educators, registered dietitians, social workers, secretaries and management personnel of the Primary Health System.

The Primary Health System's consumer call center, Erlanger HealthLink (423-778-LINK) is a free call center staffed by RN's to answer health questions, offer free physician referrals and to register participants in the programs offered by Community Relations, Women's & Infant Services and other departments and divisions of the Primary Health System.

*Uncompensated Care Costs:* The following table summarizes the estimated total uncompensated care costs provided by Erlanger Medical Center as defined by the State of Tennessee for the years ended June 30, 2012 and 2011:

	<i>2012</i>	<i>2011</i>
Uncompensated cost of TennCare/Medicaid	\$ 27,864,201	\$ 29,415,995
Traditional charity uncompensated costs	25,568,279	26,179,522
Bad debt cost	32,074,717	27,395,230
Total uncompensated care costs	<u>\$ 85,507,197</u>	<u>\$ 82,990,747</u>

The uncompensated cost of TennCare/Medicaid is estimated by taking the estimated cost of providing care to the TennCare/Medicaid patients less payments from the TennCare and Medicaid programs. The payments exclude revenues from essential access and other, one-time supplemental payments from TennCare of approximately \$11,359,000 and \$7,367,300 for the years ended June 30, 2012 and 2011, respectively, as such payments are not guaranteed for future periods. Traditional charity uncompensated costs exclude approximately \$1,500,000 of local government support in 2012 and approximately \$3,000,000 in 2011.

*Revenue from Significant Payors:* Gross patient service charges related to the Medicare program accounted for approximately 29.7% and 29.6% of the Primary Health System's patient service charges for the years ended June 30, 2012 and 2011, respectively. Gross patient service charges related to the TennCare/Medicaid programs accounted for approximately 24.8% and 25.4% of the Primary Health System's patient service charges for the years ending June 30, 2012

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
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***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE B--NET PATIENT SERVICE REVENUE - Continued**

and 2011, respectively. TennCare typically reimburses providers at an amount less than their cost of providing services to TennCare patients. At June 30, 2012 and 2011, the Primary Health System has a credit concentration related to the Medicare and TennCare programs.

During 2012 and 2011, the Primary Health System recognized revenue from these programs related to disproportionate share payments and trauma fund payments of \$10,176,000 and \$4,002,000, respectively. In fiscal year 2011, the Primary Health System received payments from the Tennessee Hospital Assessment Fund of \$2,916,010, which have been recognized in the accompanying combined statements of revenue, expenses and changes in net assets. No such amounts were recognized in 2012. During 2012, the Primary Health System recognized approximately \$3,100,000 of revenue related to electronic health records expenditures to be reimbursed by the Medicaid program. Such amounts are subject to audit and amounts ultimately received may differ from amounts currently recognized. Additionally, in 2012, the Primary Health System received approximately \$3,200,000 from Medicare related to a rural floor budget neutrality settlement that has been recognized as revenue.

Laws and regulations governing the Medicare and TennCare/Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates, as they relate to revenue recognized from these programs, will change by a material amount in the near term. The estimated reimbursement amounts are adjusted in subsequent periods as cost reports are prepared and filed and as final settlements are determined. Final determination of amounts earned under prospective payment and cost reimbursement activities is subject to review by appropriate governmental authorities or their agents. Management believes that adequate provisions have been made for adjustments that may result from final determination of amounts earned under Medicare and Medicaid programs. The effect of prior year cost report settlements, or changes in estimates, increased net patient service revenue by approximately \$1,770,000 in 2012 and by approximately \$2,400,000 in 2011.

The Primary Health System believes that it is substantially in compliance with all applicable laws and regulations and is not aware of any on-going or threatened investigations involving allegations of potential wrongdoing. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers, such as the Medicare Recovery Audit Contractor Program. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Management believes that any amounts payable related to audits through the Medicare Recovery Audit Contractor program, or similar initiatives, will not

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
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*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE B--NET PATIENT SERVICE REVENUE - Continued**

have a significant impact on the combined financial statements. However, due to the uncertainties involved, management's estimate could change in the future.

The Primary Health System has also entered into reimbursement agreements with certain 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.

**NOTE C--CASH AND CASH EQUIVALENTS**

Cash and cash equivalents reported on the combined balance sheets include cash on hand and deposits with financial institutions including demand deposits and certificates of deposit.

The carrying amount of cash and cash equivalents consists of the following at June 30:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
General Fund:		
Demand deposits	\$ 25,703,339	\$ 9,604,835
Cash on hand	10,254	10,454
Cash equivalents	2,106,876	26,030,619
	<u>\$ 27,820,469</u>	<u>\$ 35,645,908</u>

Cash equivalents include certificates of deposit, money market accounts, U.S. Government agency investments and commercial paper whose maturity, when purchased, was three months or less.

Bank balances consist of the following at June 30:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Insured (FDIC)	\$ 3,770,196	\$ 4,582,345
Collateralized under the State of Tennessee Bank Collateral Pool	20,008,446	19,435,388
	<u>\$ 23,778,642</u>	<u>\$ 24,017,733</u>

In addition to the above bank balances, the Primary Health System held investments which met the definition of a cash equivalent and are included in cash and cash equivalents. At June 30,

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
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*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE C--CASH AND CASH EQUIVALENTS - Continued**

2012 and 2011, amounts totaling \$2,106,876 and \$21,030,619 respectively, were invested in U.S. Government agency obligations and commercial paper.

Through December 31, 2010, the Primary Health System maintained bank balances with certain financial institutions which participated in the Federal Deposit Insurance Corporation (FDIC) Transaction Account Guarantee (TAG) Program. The TAG program expired on December 31, 2010, with the Dodd-Frank Deposit Insurance Provision becoming effective as of the same date through December 31, 2012. Under the Dodd-Frank Deposit Insurance Provision, all non-interest bearing transaction accounts held by FDIC-insured depository institutions are fully insured by the FDIC for the entire balance of the account.

The Primary Health System's deposits would be exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized or are collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor government's name. The risk is that, in the event of the failure of a depository financial institution, the Primary Health System will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

**NOTE D--DISAGGREGATION OF RECEIVABLE AND PAYABLE BALANCES**

*Patient Accounts Receivable, Net:* Patient accounts receivable and related allowances are as follows at June 30:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Gross patient accounts receivable	\$ 296,701,066	\$ 310,069,861
Estimated allowances for contractual adjustments and uncollectible accounts	(220,059,628)	(229,625,229)
Net patient accounts receivable	<u>\$ 76,641,438</u>	<u>\$ 80,444,632</u>

*Other Current Assets:* Other current assets consist of the following at June 30:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Prepaid expenses	\$ 5,000,884	\$ 5,673,042
Other receivables	19,388,513	9,417,523
Total other current assets	<u>\$ 24,389,397</u>	<u>\$ 15,090,565</u>

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE D--DISAGGREGATION OF RECEIVABLE AND PAYABLE BALANCES - Continued**

*Accounts Payable and Accrued Expenses:* Accounts payable and accrued expenses consist of the following at June 30:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Due to vendors	\$ 33,759,165	\$ 37,792,269
Other	2,999,537	2,235,208
Total accounts payable and accrued expenses	<u>\$ 36,758,702</u>	<u>\$ 40,027,477</u>

*Other Long-Term Liabilities:* Other long-term liabilities consist of the following at June 30:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Pension obligation	\$ 10,547,623	\$ 10,650,625
Postretirement benefits other than pensions	4,851,114	2,820,106
Compensated absences	7,019,203	7,679,623
Medical malpractice and general liabilities	5,462,500	5,085,000
Interest rate swaps and other	8,651,568	10,486,095
Deferred gain on sale of property	4,865,237	-
Total other long-term liabilities	<u>\$ 41,397,245</u>	<u>\$ 36,721,449</u>

**NOTE E--NET PROPERTY, PLANT AND EQUIPMENT**

Net property, plant and equipment activity for the Primary Health System for the years ended June 30, 2012 and 2011 consisted of the following:

	<i>Balance at June 30, 2010</i>	<i>Additions</i>	<i>Reductions/ Transfers</i>	<i>Balance at June 30, 2011</i>	<i>Additions</i>	<i>Reductions/ Transfers</i>	<i>Balance at June 30, 2012</i>
Capital assets:							
Land and improvements	\$ 26,962,649	\$ -	\$ 79,138	\$ 26,883,511	\$ 385,757	\$ 1,913,362	\$ 25,355,906
Buildings	239,419,920	4,026,045	-	243,445,965	9,082,187	28,652,217	223,875,935
Equipment	346,964,512	20,240,036	9,969,251	357,235,297	21,779,957	28,498,593	350,516,661
	<u>613,347,081</u>	<u>24,266,081</u>	<u>10,048,389</u>	<u>627,564,773</u>	<u>31,247,901</u>	<u>59,064,172</u>	<u>599,748,502</u>
Accumulated depreciation :							
Land and improvements	12,284,636	267,456	-	12,552,092	589,770	1,916,632	11,225,230
Buildings	168,324,908	8,311,286	11,971	176,624,223	7,720,427	22,551,870	161,792,780
Equipment	278,136,475	16,990,872	9,606,716	285,520,631	17,931,412	27,664,817	275,787,226
	<u>458,746,019</u>	<u>25,569,614</u>	<u>9,618,687</u>	<u>474,696,946</u>	<u>26,241,609</u>	<u>52,133,319</u>	<u>448,805,236</u>

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

**NOTE E--NET PROPERTY, PLANT AND EQUIPMENT - Continued**

	<i>Balance at June 30, 2010</i>	<i>Additions</i>	<i>Reductions/ Transfers</i>	<i>Balance at June 30, 2011</i>	<i>Additions</i>	<i>Reductions/ Transfers</i>	<i>Balance at June 30, 2012</i>
Capital assets net of accumulated depreciation	154,601,062	(1,303,533)	429,702	152,867,827	5,006,292	6,930,853	150,943,266
Construction in progress (\$20,530,000 estimated cost to complete at June 30, 2012)	7,968,348	16,228,654	13,733,899	10,463,103	16,548,309	20,236,515	6,774,897
	<u>\$ 162,569,410</u>	<u>\$ 14,925,121</u>	<u>\$ 14,163,601</u>	<u>\$ 163,330,930</u>	<u>\$ 21,554,601</u>	<u>\$ 27,167,368</u>	<u>\$ 157,718,163</u>

Depreciation expense totaled \$26,241,609 and \$25,569,614 for the years ended June 30, 2012 and 2011, respectively. Construction in progress at June 30, 2012 consists of various projects for additions and renovations to the Primary Health System's facilities.

During 1998, the Primary Health System entered into a twenty-year capital lease with Sports Barn Inc., for the operation of the Lifestyle Center, which was recorded in net property, plant and equipment at the inception of the lease. During fiscal year 2011, the Primary Health System purchased the land and building, recording the difference between the capital lease liability and purchase price as an addition to buildings.

During 2012, the Primary Health System entered into an agreement to sell certain professional office buildings (POBs) and concurrently entered into agreements to lease space from the purchaser. The sales price of the POBs was approximately \$13,333,000, and a gain of approximately \$6,695,000 was realized, including proceeds of approximately \$2,355,000 held back until such time as certain of the leases are finalized. The amount held back is included as other current assets in the combined balance sheet at June 30, 2012.

Since the Primary Health System is leasing back certain space, accounting principles generally accepted in the United States required a portion of the gain be deferred and recognized over the terms of the leases. At June 30, 2012, the deferred gain totals approximately \$4,865,000 and is included as a part of other long-term liabilities in the accompanying combined balance sheets. The remainder of the gain is included in non-operating revenue (expenses) in 2012.

The leases entered into (or committed to) under this sale/leaseback agreement include certain leases which meet the criteria for capitalization and are included in Note M.

**NOTE F--INVESTMENTS AND ASSETS LIMITED AS TO USE**

The Primary Health System's investments (including assets limited as to use) are reported at estimated fair value based, generally, on quoted market prices in accordance with GASB

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
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*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

NOTE F--INVESTMENTS AND ASSETS LIMITED AS TO USE - Continued

Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The Primary Health System invests in United States government and agency bonds, municipal bonds, corporate debt, certificates of deposit and short-term money market investments that are in accordance with the Primary Health System's investment policy. Temporary investments at June 30, 2012 and 2011 consist primarily of United States government agency bonds and commercial paper.

The carrying and estimated fair values for long-term investments, and assets limited as to use, by type, at June 30 are as follows:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
U.S. Government and agency bonds, including municipal bonds, mutual funds, and other	\$ 119,596,675	\$ 140,986,774
Corporate bonds and commercial paper	940,586	2,069,065
Short-term investments and cash equivalents	18,177,563	16,486,799
Total investments and assets limited as to use	<u>\$ 138,714,824</u>	<u>\$ 159,542,638</u>

Assets limited as to use are classified as follows:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
By board of trustees for capital improvements	\$ 108,023,256	\$ 108,430,377
Under bond indentures - held by trustees	20,900,048	21,412,578
Self-insurance trust	6,089,183	6,644,322
Restricted by donors and other	3,439,941	3,446,713
	138,452,428	139,933,990
Less current portion	(33,250)	(28,775)
	<u>\$ 138,419,178</u>	<u>\$ 139,905,215</u>

Assets limited as to use by the board of trustees for capital improvements are to be used for the replacement of property and equipment or for any other purposes so designated.

Funds held by trustees under bond indenture at June 30 are as follows:

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
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*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

NOTE F--INVESTMENTS AND ASSETS LIMITED AS TO USE - Continued

	<i>Primary Health System</i>	
	<u>2012</u>	<u>2011</u>
Construction fund	\$ 6	\$ 521,373
Debt service reserve funds	20,712,768	20,708,421
Principal and interest funds	33,250	28,774
Other funds	154,024	154,010
Total funds held by trustees under bond indenture	<u>\$ 20,900,048</u>	<u>\$ 21,412,578</u>

These funds held by trustees consist primarily of United States government agency obligations, corporate debt, and other short-term investments and cash equivalents. The debt service reserve fund is to be used only to make up any deficiencies in other funds related to the Hospital Revenue and Refunding Bonds Series 1997A, Series 1998A, Series 2000 and Series 2004. The principal and interest funds are to be used only to pay principal and interest, respectively, on the Series 1997A, Series 1998A, Series 2000 and Series 2004 bonds.

The Primary Health System has implemented the disclosure requirements of GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (GASB No. 40) and, accordingly, the Primary Health System has assessed the custodial credit risk, the concentration of credit risk, credit risk, and investment rate risk of its cash and investments. The Primary Health System's investment policy specifies the types of investments which can be included in board-designated assets limited as to use, as well as collateral or other security requirements. The investment policy also specifies the maximum maturity of the portfolio of board-designated assets. Assets limited as to use and held by trustees are invested as permitted by the bond indenture.

*Custodial Credit Risk:* The Primary Health System's investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Primary Health System, and are held by either the counterparty or the counterparty's trust department or agent but not in the Primary Health System's name. The investment risk is that, in the event of the failure of the counterparty to a transaction, the Primary Health System will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party.

As of June 30, 2012 and 2011, the Primary Health System's investments, including assets limited as to use, were comprised of various short-term investments, U.S. government and government agency bonds, municipal obligations, corporate bonds, commercial paper, and other U.S. Treasury obligations. Substantially all of the Primary Health System's investments, including assets limited as to use, are uninsured or unregistered. Securities are held by the counterparty, or by its trust department or agent, in the Primary Health System's name.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
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***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

**NOTE F--INVESTMENTS AND ASSETS LIMITED AS TO USE - Continued**

***Concentration of Credit Risk:*** This is the risk associated with the amount of investments the Primary Health System has with any one issuer that exceeds 5% or more of its total investments. Investments issued or explicitly guaranteed by the U.S. Government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. The Primary Health System's investment policy does not restrict the amount that may be held for any single issuer. At June 30, 2012, none of the Primary Health System's investments with any one issuer exceed 5% of its total investments except certain U.S. Government agencies.

***Credit Risk:*** This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. GASB No. 40 requires that disclosure be made as to the credit rating of all debt security investments except for obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government. The Primary Health System's investment policy provides guidelines for its fund managers and lists specific allowable investments.

The credit risk profile of the Primary Health System's investments, including assets limited as to use, as of June 30, 2012, is as follows:

<b><i>Investment Type</i></b>	<b><i>Balance as of June 30, 2012</i></b>	<b><i>Rating</i></b>					
		<b><i>AAA</i></b>	<b><i>AA</i></b>	<b><i>A</i></b>	<b><i>BBB</i></b>	<b><i>BB</i></b>	<b><i>N/A</i></b>
U.S Government agency bonds	\$ 50,063,655	\$ 47,966,278	\$ 1,597,377	\$ -	\$ -	\$ -	\$ 500,000
Bond mutual funds and other	6,078,302	6,078,302	-	-	-	-	-
Municipal bonds	5,691,156	2,051,180	2,637,336	1,002,640	-	-	-
Corporate bonds and commercial paper	940,586	-	-	940,586	-	-	-
Cash equivalents	18,177,563	-	-	-	-	-	18,177,563
<b>Total investments</b>	<b>\$ 80,951,262</b>	<b>\$ 56,095,760</b>	<b>\$ 4,234,713</b>	<b>\$ 1,943,226</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 18,677,563</b>

***Investment Rate Risk:*** This is the risk that changes in interest rates will adversely affect the fair value of an investment. The Primary Health System's investment policy authorizes a strategic asset allocation that is designed to provide an optimal return over the Primary Health System's investment horizon and within specified risk tolerance and cash requirements.

The distribution of the Primary Health System's investments, including assets limited as to use, and excluding the self-insurance trust, by maturity as of June 30, 2012, is as follows:

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE F--INVESTMENTS AND ASSETS LIMITED AS TO USE - Continued**

<i>Investment Type</i>	<i>Balance as of June 30, 2012</i>	<i>Remaining Maturity</i>				<i>N/A</i>
		<i>12 months or less</i>	<i>13-24 Months</i>	<i>25-60 Months</i>	<i>Over 60 Months</i>	
U.S. Government bonds and agency funds and other	\$ 107,827,217	\$ 17,991,643	\$ 10,308,185	\$ 41,900,477	\$ 37,626,912	\$ -
Municipal bonds	5,691,156	2,969,561	1,718,955	1,002,640	-	-
Corporate bonds and commercial paper	940,586	940,586	-	-	-	-
Cash equivalents	18,166,682	18,166,682	-	-	-	-
<b>Total investments</b>	<b>\$ 132,625,641</b>	<b>\$ 40,068,472</b>	<b>\$ 12,027,140</b>	<b>\$ 42,903,117</b>	<b>\$ 37,626,912</b>	<b>\$ -</b>

Additionally, the distribution of the Primary Health System's investments held under the self-insurance trust as of June 30, 2012, is as follows:

<i>Investment Type</i>	<i>Balance as of June 30, 2012</i>	<i>Remaining Maturity</i>					<i>N/A</i>
		<i>24 months or less</i>	<i>25-60 Months</i>	<i>61-120 Months</i>	<i>121-240 Months</i>	<i>Over 240 Months</i>	
U.S. Government bonds and agencies	\$ 6,078,302	\$ 1,282,522	\$ 2,279,363	\$ 1,647,220	\$ 243,132	\$ 626,065	\$ -
Cash equivalents	10,881	10,881	-	-	-	-	-
<b>Total investments</b>	<b>\$ 6,089,183</b>	<b>\$ 1,293,403</b>	<b>\$ 2,279,363</b>	<b>\$ 1,647,220</b>	<b>\$ 243,132</b>	<b>\$ 626,065</b>	<b>\$ -</b>

**NOTE G-- LONG-TERM DEBT**

Long-term debt at June 30 consists of:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Revenue and Refunding Bonds, Series 2004, net of bond discount of \$684,990 in 2012 and \$836,893 in 2011 and including bond issue premium of \$1,584,311 in 2012 and \$1,725,138 in 2011	\$ 76,754,321	\$ 81,373,245
Hospital Revenue Refunding Bonds, Series 2000, including bond issue premium of \$304,215 in 2012 and \$327,175 in 2011	36,404,215	38,327,175

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

NOTE G--LONG-TERM DEBT - Continued

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Hospital Revenue Bonds, Series 1998A, net of bond discount of \$295,384 in 2012 and \$310,153 in 2011	18,859,616	18,984,847
Hospital Revenue Bonds, Taxable Series 1997A	41,000,000	41,000,000
Total bonds payable	173,018,152	179,685,267
Less: unamortized premium paid on advance refunding	(895,189)	(981,127)
Total bonds payable, net	172,122,963	178,704,140
Other Loans and Notes Payable	6,282,894	6,902,514
Capital leases - Note M	6,834,667	343,807
	185,240,524	185,950,461
Less: current portion	(7,929,701)	(7,366,079)
	<u>\$ 177,310,823</u>	<u>\$ 178,584,382</u>

During fiscal year 2011, the Primary Health System entered into a term loan (the Loan) with a financial institution in the maximum amount of \$7,000,000 to finance the acquisition of the Lifestyle Center property. The rate of interest on the loan is a fixed rate equal to 5.45%. Monthly payments of principal and interest are payable on the first day of each month for a 10 year term beginning December 1, 2010, with a final payment equal to the unpaid principal plus accrued and unpaid interest due at maturity. The loan contains certain covenants and restrictions. Management believes the Primary Health System was in compliance with all such covenants at June 30, 2012.

The Primary Health System entered into a non-revolving line of credit loan (the Credit Agreement) with a financial institution in the maximum amount of \$41,000,000 to potentially refund the outstanding principal amount of the Primary Health System's 1997A Hospital Revenue Bonds if London InterBank Offered Rate (LIBOR) materially changes. The rate of interest on disbursed funds, if any, will be a variable rate equal to the London InterBank Offered Rate plus an applicable margin, as outlined in the Credit Agreement. Monthly installment payments of the outstanding principal amount, if any, shall be amortized over a period of seventeen years. As of June 30, 2012, the Primary Health System has not drawn on the Credit Agreement.

During fiscal year 2010, the Primary Health System remarketed the Series 2004 Hospital Revenue Refunding Bonds (Series 2004) and the Series 2000 Hospital Revenue Refunding

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE G--LONG-TERM DEBT - Continued**

Bonds (Series 2000), as described below, and converted such bonds from a variable auction rate to a fixed rate.

On January 1, 2004, the Primary Health System issued \$85,000,000 insured Series 2004 bonds for the purpose of refunding \$80,925,000 of the total outstanding Series 1993 bonds (described below). The Primary Health System also utilized the proceeds to pay certain issuance costs and contributed a portion of the bond proceeds in the amount of \$1,633,658 to establish a debt service fund.

The Series 2004 bonds were issued on parity, with respect to collateral, with other outstanding bonds, described below. The Series 2004 bonds are also secured by a mortgage on a portion of the Primary Health System's main campus. The Series 2004 bonds mature annually on October 1 beginning in 2010 through 2023 in varying amounts. The Series 2004 bonds maturing after October 1, 2019 (excluding those maturing on October 1, 2023) may be redeemed by the Primary Health System after October 1, 2019 at a redemption price equal to the principal amount plus accrued interest. The bonds maturing on October 1, 2023 may be redeemed prior to maturity pursuant to the extraordinary optional redemption and redemption upon damage or condemnation provisions as described in the Remarketing Memorandum by the Primary Health System after October 1, 2014 at a redemption price equal to 100% of the principal amount plus accrued interest. Interest rates for the outstanding Series 2004 bonds range from 3.0% to 5.0%.

In August 2000, the Primary Health System issued \$47,300,000 insured Series 2000 bonds for the purpose of refunding \$40,000,000 of then outstanding Series 1987 bonds and funding a debt service reserve fund in an original amount of \$4,407,377 and to pay issuance costs. The Series 2000 bonds were issued on parity with other outstanding bond issues. The Series 2000 bonds consist of term bonds maturing on October 1, 2023; and serial bonds maturing on October 1 annually beginning in 2010 through 2025. The bonds maturing on October 1, 2023 are subject to mandatory sinking fund redemption prior to maturity and without premium at the principal amount thereof on October 1. The Series 2000 bonds maturing after October 1, 2014 may be redeemed by the Primary Health System after October 1, 2014 at a redemption price equal to the principal amount plus accrued interest.

Interest rates for the Series 2000 outstanding bonds are as follows:

Series Bonds	- 3.75% to 5.0%
Term Bonds	- 5.0%

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE G--LONG-TERM DEBT - Continued**

The Primary Health System's 1997A and 1998A Hospital Revenue Bonds (Series 1997A and Series 1998A, respectively) were issued to fund capital improvements for Erlanger Medical Center and establish a debt service reserve fund (1998A only) in an original amount of \$2,174,125. The Series 1997A bonds are taxable and are secured on a parity under a Master Trust Indenture with other outstanding bond issues. The bonds mature beginning in fiscal year 2015 through fiscal year 2028. The 1997A bonds are subject to optional redemption at 100% plus accrued interest. Interest is payable at a variable auction rate for a 35-day period, which was 0.61% at June 30, 2012 and 0.48% at June 30, 2011.

The Series 1998A insured bonds are tax-exempt and consisted of \$6,080,000 serial bonds maturing annually on October 1 of each year through 2013 in varying amounts; and term bonds maturing on October 1, 2018 and 2028 (\$5,825,000 and \$17,095,000, respectively). Such bonds are secured on parity with other outstanding bonds. The bonds maturing after October 1, 2008 may be redeemed by the Primary Health System after April 1, 2008 at amounts ranging from 100% to 101% of par value plus accrued interest.

Interest rates for the outstanding Series 1998A bonds are as follows:

\$ 6,080,000 Series Bonds	- 4.75% to 5.00%
\$ 5,825,000 Term Bonds	- 5.0%
\$17,095,000 Term Bonds	- 5.0%

During fiscal year 2002, the Primary Health System defeased \$5,320,000 of the 1998A bond issuance because IRS regulations do not permit tax-exempt debenture proceeds to be used to fund for-profit endeavors. These funds were used in the construction of the Plaza Ambulatory Surgery Center that was contributed to Plaza on September 1, 2001, as discussed in Note A. The Primary Health System contributed to an escrow account funds generated from its operations sufficient to fund all principal and interest payments for approximately \$5,320,000 of debentures until maturity. The Primary Health System was released from being the primary obligor and cannot be held liable for the defeased obligation, of which approximately \$4,700,000 remains outstanding at June 30, 2012.

The trust indentures and related documents underlying the bonds contain certain covenants and restrictions. As of June 30, 2012, the Primary Health System was not in compliance with one such covenant. Failure to meet the covenant required the Primary Health System to engage a management consultant to prepare a report containing recommendations. Prior to June 30, 2012, management had engaged such consultants and, as such, believe they have cured the covenant violation.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE G--LONG-TERM DEBT - Continued**

The Primary Health System's scheduled principal and interest payments (estimated for variable rate debt based on rates at June 30, 2012) on bonds payable and other long-term debt (excluding capital leases) are as follows for the years ending June 30:

	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2013	\$ 7,803,006	\$ 6,700,700	\$ 14,503,706
2014	7,889,626	6,296,060	14,185,686
2015	10,605,736	5,895,685	16,501,421
2016	11,641,442	5,414,599	17,056,041
2017	11,723,446	4,968,036	16,691,482
2018-2022	65,224,638	17,588,468	82,813,106
2023-2027	55,120,000	4,668,930	59,788,930
2028-2032	8,385,000	216,550	8,601,550
<b>TOTAL</b>	<b>\$ 178,392,894</b>	<b>\$ 51,749,028</b>	<b>\$ 230,141,922</b>

Long-term debt activity for the Primary Health System for the years ended June 30, 2012 and 2011 consisted of the following:

	<i>Balance at June 30, 2010</i>	<i>Additions/ Amortizations</i>	<i>Reductions</i>	<i>Balance at June 30, 2011</i>	<i>Additions/ Amortizations</i>	<i>Reductions/ Accretions</i>	<i>Balance at June 30, 2012</i>
<b>Bonds Payable</b>							
Series 2004	\$ 85,877,464	\$ 151,609	\$ 4,655,828	\$ 81,373,245	\$ 151,904	\$ 4,770,828	\$ 76,754,321
Series 2000	40,150,134	-	1,822,959	38,327,175	-	1,922,960	36,404,215
Series 1998A	19,500,077	14,770	530,000	18,984,847	14,769	140,000	18,859,616
Series 1997A	41,000,000	-	-	41,000,000	-	-	41,000,000
Premium paid on advance refunding	(1,067,065)	85,938	-	(981,127)	85,938	-	(895,189)
<b>Total bonds payable</b>	<b>185,460,610</b>	<b>252,317</b>	<b>7,008,787</b>	<b>178,704,140</b>	<b>252,611</b>	<b>6,833,788</b>	<b>172,122,963</b>
<b>Term Loan</b>	<b>74,231</b>	<b>7,180,000</b>	<b>351,717</b>	<b>6,902,514</b>	<b>-</b>	<b>619,620</b>	<b>6,282,894</b>
<b>Capital leases</b>	<b>5,651,417</b>	<b>313,915</b>	<b>5,621,525</b>	<b>343,807</b>	<b>6,616,296</b>	<b>125,436</b>	<b>6,834,667</b>
<b>Total long-term debt</b>	<b>\$ 191,186,258</b>	<b>\$ 7,746,232</b>	<b>\$ 12,982,029</b>	<b>\$ 185,950,461</b>	<b>\$ 6,868,907</b>	<b>\$ 7,578,844</b>	<b>\$ 185,240,524</b>

**NOTE H--PENSION PLAN**

The Primary Health System sponsors a single-employer, non-contributory defined benefit pension plan covering substantially all employees meeting certain age and service requirements. In addition to normal retirement benefits, the plan also provides for early retirement, delayed retirement, disability and death benefits. The Primary Health System funds the plan as contributions are approved by the Board of Trustees but not in amounts less than the minimum

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

NOTE H--PENSION PLAN - Continued

required contribution determined by the plan's consulting actuary. During the years June 30, 2012 and 2011, the Primary Health System made contributions of \$10,367,970 and \$8,833,973, respectively to the plan. The Primary Health System has the right to amend, in whole or in part, any or all of the provisions of the plan. The plan issues a publicly available financial report that includes a financial statement and required supplementary information for the plan. That report may be obtained by writing to Erlanger Health System, Attention: Human Resources Department, 975 East Third Street, Chattanooga, Tennessee 37403 or by calling 423-778-7000.

The annual pension cost and net pension obligation for the years ended June 30, 2012 and 2011 are as follows:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Annual required contribution	\$ 10,367,970	\$ 8,833,977
Interest on net pension obligation	798,797	798,978
Adjustment to annual required contribution	(901,802)	(801,401)
Annual pension cost	10,264,965	8,831,554
Contributions made	(10,367,970)	(8,833,973)
Change in net pension obligation	(103,005)	(2,419)
Net pension obligation at beginning of year	10,650,625	10,653,044
Net pension obligation at end of year	<u>\$ 10,547,620</u>	<u>\$ 10,650,625</u>

The annual expected contribution for the years ended June 30, 2012 and 2011, was determined as part of the January 1, 2012 and 2011 actuarial valuations, respectively, using the projected unit credit cost method. The following actuarial assumptions were utilized:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Investment rate of return	7.5%	7.5%
Projected salary increases	4.0%	4-4.5%
Inflation	2.5%	2.5%
Increase in Social Security taxable wage base	3.5%	3.5%

Annual pension costs, contribution information and the net pension obligation for the last three fiscal years follows:

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

NOTE H--PENSION PLAN - Continued

<i>Fiscal Year Ending</i>	<i>Three-Year Trend Information</i>		
	<i>Annual Pension Cost (APC)</i>	<i>Percentage of APC Contributed</i>	<i>Net Pension Obligation</i>
June 30, 2010	\$ 7,554,226	99%	\$ 10,653,044
June 30, 2011	8,831,554	100%	10,650,625
June 30, 2012	10,264,965	101%	10,547,620

The schedule of funding progress shown below presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. The actuarial asset values are determined using prior year valuations with the addition of current year contributions and expected investment return on market value of assets based on an assumed rate of 7.5%, and deducting benefit payments and administrative expenses for the year. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments using an average of cost and market value. The plan will reset the amortization base each year equal to the unfunded actuarial accrued liability to be amortized over a closed 30 year period and using a level dollar amount as the amortization factor.

<i>Schedule of Funding Progress</i>						
<i>Actuarial Valuation Date</i>	<i>Actuarial Value of Assets</i>	<i>Actuarial Accrued Liability (AAL)</i>	<i>Total Unfunded AAL (UAAL)</i>	<i>Funded Ratio %</i>	<i>Annual Covered Payroll</i>	<i>UAAL as a Percentage of Covered Payroll</i>
1/1/10	\$120,326,010	\$ 136,794,907	\$16,468,897	88.0%	\$ 144,176,724	11.4%
1/1/11	125,335,932	150,926,741	25,590,809	83.0%	147,947,134	17.3%
1/1/12	124,520,999	160,704,688	36,183,689	77.5%	138,807,819	26.1%

Effective July 1, 2009, the Chattanooga-Hamilton County Hospital Authority Pension Plan was amended to be closed to new employees or rehires, and to further clarify the maximum years of service to be 30. The benefits of current employees will be protected and they will continue to participate in, and accrue services under, the Plan.

NOTE I--OTHER RETIREMENT PLANS

The Primary Health System maintains defined contribution plans under Section 403(b) and 401(a) of the IRC which provides for voluntary contributions by employees. The Plans are for the benefit of all employees 25 years of age or older with at least 12 months of employment.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE I--OTHER RETIREMENT PLANS - Continued**

Effective January 27, 2011, both the 401(a) Profit Sharing Plan and the 403(b) Plan were revised and amended to meet the latest federal tax law requirements. There were no changes in benefits or retroactive changes.

The Primary Health System matches 50% of each participant's contribution up to 2% of the employee's earnings. Additionally, for eligible employees hired on after July 1, 2009 the Primary Health System will make profit sharing contributions equal to 3% of their earnings, regardless if the employee is making contributions. Employer contributions to the plan were \$1,765,972 and \$1,728,924 for the years ended June 30, 2012 and 2011, respectively.

**NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS**

The Primary Health System sponsors three defined benefit postretirement plans, other than pensions, for full-time employees who have reached retirement age, as defined. The respective plans provide medical, dental and life insurance benefits, along with a lump-sum cash payment for one-half of the hours in the participant's extended illness benefit bank at retirement. The postretirement health and dental plan is contributory and contains other cost-sharing features, such as deductibles and coinsurance. The life insurance plan and the extended illness bank are noncontributory.

The Primary Health System reports other postemployment benefits in accordance with the GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. This Statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time.

Beginning in 2018, under the Patient Protection and Affordable Care Act (the Act), a 40% excise tax will be imposed on the excess benefit provided to an employee or retiree in any month under any employer-sponsored health plan. In the case of a self-insured plan, the plan administrator must pay the tax. Because of the significant uncertainties regarding the excise tax on high cost plans, management of the Primary Health System is evaluating the impact of this Act but does not anticipate a material impact on the accrued liability at this time; however, actual results could differ from these estimates.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued**

The following table shows the plan's funded status as of the actuarial valuation date as of June 30:

	<u>2012</u>	<u>2011</u>
Actuarial accrued liability	\$ 28,788,147	\$ 24,966,769
Market value of assets	-	-
Unfunded actuarial accrued liability	<u>\$ 28,788,147</u>	<u>\$ 24,966,769</u>

The following is a summary of the components of the annual OPEB cost recognized by the Primary Health System for the years ended June 30:

	<u>2012</u>	<u>2011</u>
Annual required contribution	\$ 2,659,068	\$ 2,506,202
Interest on the net obligation	163,912	96,386
Amortization of net obligation	(156,587)	(93,920)
OPEB cost recognized	<u>\$ 2,666,393</u>	<u>\$ 2,508,668</u>

Reconciliation of the net OPEB obligation for the fiscal years ended June 30:

	<u>2012</u>	<u>2011</u>
Net OPEB obligation beginning of the year	\$ 4,097,800	\$ 2,409,655
OPEB cost recognized	2,666,393	2,508,668
Actual contributions	(1,057,000)	(820,523)
Net OPEB obligation end of the year	<u>\$ 5,707,193</u>	<u>\$ 4,097,800</u>

***Trend Information***

<i>Fiscal Year Ending</i>	<i>Annual OPEB Cost</i>	<i>Percentage of Annual OPEB Cost Contributed</i>	<i>Net OPEB Obligation at the End of Year</i>
June 30, 2010	\$ 2,202,195	59.6%	\$ 2,409,655
June 30, 2011	2,508,668	32.7%	4,097,800
June 30, 2012	2,666,393	39.6%	5,707,193

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued**

*Schedule of Funding Progress*

<i>Actuarial Valuation Date</i>	<i>Actuarial Value of Assets</i>	<i>Actuarial Accrued Liability</i>	<i>Unfunded Actuarial Accrued Liability</i>	<i>Annual Covered Payroll</i>	<i>Unfunded Actuarial Accrued Liability as a Percent of Covered Payroll</i>	<i>Funded Ratio</i>
June 30, 2010	\$ -	\$ 20,854,837	\$ 20,854,837	\$144,176,724	14.5%	0%
June 30, 2011	-	24,966,769	24,966,769	147,947,134	16.9%	0%
June 30, 2012	-	28,788,147	28,788,147	138,807,819	20.7%	0%

The actuarial calculations reflect a long term perspective. Accordingly, the actuarial valuation involves estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The schedule of funding progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability. The calculations are based on the benefits currently provided under the terms of the plan as of the date of each valuation and on the sharing of cost between employer and plan members at that point.

The actuarial cost method utilized is the projected unit credit cost method. The 2012 postretirement benefit cost assumed an average weighted annual rate increase in per capita cost of covered health benefits of 9.6%, decreasing gradually to 4.6% in 2028 and subsequent years. The 2011 postretirement benefit cost assumed an average weighted annual rate increase in per capita cost of pre-Medicare covered health benefits of 8.0%, decreasing gradually to 4.5% in 2028 and subsequent years and a weighted average annual rate increase in per capita cost of post-Medicare covered healthcare benefits of 8.4%, decreasing gradually to 4.5% in 2028 and subsequent years.

The amortization method used is the level percent of payroll method over a thirty year amortization. Other assumptions include a 4% discount rate and assumed salary increases of 4.0% annually until age 65. The plan is currently open.

The Primary Health System also has a job injury program to provide benefits to workers injured in employment-related accidents. This program provides medical and indemnity benefits to employees injured in the course of employment for a period up to 24 months from the date of injury. The Primary Health System has recorded a projected liability of approximately \$916,000 and \$1,500,000 at June 30, 2012 and 2011, respectively. Such amounts are included as a part of

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued**

other long-term liabilities in the combined balance sheets. The projected liability was discounted using a 4% rate of return at June 30, 2012 and 2011.

**NOTE K--MEDICAL MALPRACTICE AND GENERAL LIABILITY CLAIMS**

As of January 1, 1976, the Primary Health System adopted a self-insurance plan to provide for malpractice and general liability claims and expenses arising from services rendered subsequent to that date. In 1980, the Primary Health System's Self-Insurance Trust Agreement (the Agreement) was amended to include all coverages that a general public liability insurance policy would cover. In 1988, the Agreement was amended and restated to comply with amendments to the Tennessee Governmental Tort Liability Act and to formally include any claims and expenses related to acts of employees of the Primary Health System. The Primary Health System is funding actuarial estimated liabilities through a revocable trust fund with a bank included as a part of Assets Limited as to Use in the accompanying combined balance sheets. Such amounts in the trust can be withdrawn by the Primary Health System only to the extent there is an actuarially determined excess. The annual deposit to the self-insurance trust fund is determined by management based on known and threatened claims, consultation with legal counsel, and a report of an independent actuary. Losses against the Primary Health System are generally limited by the Tennessee Governmental Tort Liability Act to \$300,000 for injury or death to any one person in any one occurrence or \$700,000 in the aggregate. However, claims against healthcare practitioners are not subject to the foregoing limits applicable to the Primary Health System. Any such individuals employed by the Primary Health System, excluding employed physicians for which the Primary Health System has purchased insurance coverage, are covered by the Trust to the limits set forth therein.

In the opinion of management, the revocable trust fund assets are adequate at June 30, 2012, to cover potential liability and malpractice claims and expenses that may have been incurred to that date.

The Primary Health System provides for claims and expenses in the period in which the incidence related to such claims occur based on historical experience and consultation with legal counsel. It is the opinion of management that the reserve for estimated losses and loss adjustment expense (LAE) at June 30, 2012 and 2011, respectively, is adequate to cover potential liability and malpractice claims which may have been incurred but not reported (IBNR) to the Primary Health System. Such reserve for IBNR claims reflect a discount rate of 5.5% based on the Primary Health System's expected investment return during the payout period.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE K--MEDICAL MALPRACTICE AND GENERAL LIABILITY CLAIMS - Continued**

The following is a reconciliation of changes in the estimated losses and LAE that have been recognized in the combined financial statements for the years ended June 30, 2012 and 2011:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Reserve for losses and LAE at beginning of year	\$ 5,085,000	\$ 4,750,000
Provision for claims	1,203,977	1,618,158
Payments on claims	(826,477)	(1,283,158)
Reserve for losses and LAE at end of year	<u>\$ 5,462,500</u>	<u>\$ 5,085,000</u>

**NOTE L--COMMITMENTS AND CONTINGENCIES**

*Litigation:* The Primary Health System is subject to claims and suits which arise in the ordinary course of business. In the opinion of management, the ultimate resolution of such pending legal proceedings has been adequately provided for in its combined financial statements, and will not have a material effect on the Primary Health System's results of operations or financial position.

*Management Agreement:* During 2012, the Primary Health System entered into a Management Agreement with a third party related to Plaza. The Agreement is for an initial term of five years (subject to one three-year renewal). The Agreement requires annual payments of \$180,000 and reimbursement of defined expenses.

*Government Investigation:* The Primary Health System resolved an investigation, without any admission of wrongdoing by the Primary Health System, in October 2005 by entering into a civil settlement agreement with the U.S. Department of Justice and the Office of Inspector General of HHS. At that time the Primary Health System also entered into a five year Corporate Integrity Agreement. During fiscal 2011, the Primary Health System was released from the Corporate Integrity Agreement. The Primary Health System was not suspended, sanctioned or otherwise restricted from participating in any federal, state or private health insurance program.

*Health Care Reform:* In March 2010, Congress adopted comprehensive healthcare insurance legislation, Patient Care Protection and Affordable Care Act and Health Care and Education Reconciliation Act. The legislation, among other matters, is designated to expand access to coverage to substantively all citizens by 2019 through a combination of public program expansion and private industry health insurance. Changes to existing TennCare and Medicaid coverage and payments are also expected to occur as a result of this legislation. Implementing regulations are generally required for these legislative acts, which are to be adopted over a period of years and, accordingly, the specific impact of any future regulations is not determinable.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE M--LEASES**

*Capital:* As discussed in Note E, during 2012, the Primary Health System entered into a sale/leaseback arrangement, under which certain leases of office space meet the criteria as capital leases. Interest on these leases has been estimated at 7% per annum.

During 2011, the Primary Health System acquired a parcel of land from the Industrial Development Board of the City of Chattanooga, Tennessee for a nominal amount. The Primary Health System also entered into a project development agreement with a developer to facilitate final design, financing and construction of a medical office building for the benefit of Volkswagen Group of America Chattanooga Operations, LLC (Volkswagen) on this land. The Primary Health System has entered into a forty year ground lease, with the option of two ten year renewal terms, of the parcel to the developer. Additionally, in 2012, the Primary Health System has entered into a twenty year lease with the developer for certain space in the medical office building for a wellness center and other operations under a capital lease agreement.

Also, in fiscal year 2011, the Primary Health System entered into a five year capital lease with Cardiovascular Care Center, PLLC for the lease of certain equipment and furniture. At the completion of the lease term the Primary Health System will become owner of any of the leased assets whose fair market value is equal to or less than 10% of the fair market value at the inception of the lease. Title for such assets will be transferred to the Primary Health System.

The following is an analysis of the property under capital leases by major classes at June 30:

	<i>Primary Health System</i>	
	<i>2012</i>	<i>2011</i>
Buildings	\$ 6,597,396	\$ 1,025,649
Equipment	323,765	313,915
	6,921,161	1,339,564
Less: accumulated amortization	(159,961)	(1,014,793)
	<u>\$ 6,761,200</u>	<u>\$ 324,771</u>

The following is a schedule of future minimum lease payments under capital leases at June 30, 2012:

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

NOTE M--LEASES - Continued

<u>Year Ending June 30,</u>	
2013	\$ 889,250
2014	688,960
2015	702,264
2016	715,938
2017	729,998
2018-2022	3,875,094
2023-2027	3,622,896
2028-2032	<u>3,527,970</u>
Total minimum lease payments	14,752,370
Less: amount representing interest	<u>(7,917,703)</u>
Present value of minimum lease payments (including current portion of \$126,695)	<u>\$ 6,834,667</u>

*Operating:* The Primary Health System rents office space and office equipment under non-cancelable operating leases through 2020, containing various lease terms. The leases have other various provisions, including sharing of certain executory costs. Rent expense under operating leases was approximately \$6,130,000 and \$5,370,000 in 2012 and 2011, respectively. Future minimum lease commitments at June 30, 2012 for all non-cancelable leases with terms in excess of one year are as follows:

<u>Year Ending June 30,</u>	
2013	\$ 4,203,775
2014	3,418,887
2015	2,305,759
2016	1,342,752
2017	977,443
Thereafter	<u>660,712</u>
	<u>\$ 12,909,328</u>

*Rental Revenues:* The Primary Health System leases office space to physicians and others under various lease agreements with terms in excess of one year. Rental revenue recognized for the years ended June 30, 2012 and 2011 totaled approximately \$6,043,000 and \$6,443,000, respectively. The following is a schedule of future minimum lease payments to be received for the years ending June 30:

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE M--LEASES - Continued**

<u>Year Ending June 30,</u>	
2013	\$ 1,691,235
2014	1,163,209
2015	949,702
2016	596,234
2017	29,068
Thereafter	-
	<u>\$ 4,429,448</u>

**NOTE N--DERIVATIVE FINANCIAL INSTRUMENTS**

Simultaneous with the issuance of the \$85,000,000 Series 2004 bonds discussed in Note G, the Primary Health System entered into interest rate swap agreements. In an effort to take advantage of the differences between taxable and tax-exempt debt, and manage exposure to interest rate risks associated with various debt instruments, the Primary Health System was a party to three distinct interest rate swap agreements with Lehman Brothers Special Financing, Inc. (Lehman).

In 2012, the Primary Health System entered into a novation agreement whereby Lehman transferred its rights and obligations under the interest rate swaps to another party. The terms of the interest rate swap agreements did not substantially change and no gain or loss was recognized on this transfer.

With respect to the Series 2004 bonds, the Primary Health System executed a swap where the Primary Health System receives a variable rate equal to 67% of the one-month LIBOR-BBA rate and pays a fixed rate of 3% on a notional amount of \$18,500,000 at June 30, 2012. Unless terminated at an earlier date (at the Primary Health System's option), this agreement terminates on October 1, 2013.

With respect to the 1997A Series bonds, the Primary Health System executed a swap agreement whereby the Primary Health System receives a variable rate equal to the one-month LIBOR-BBA rate and pays a fixed rate equal to 5.087% on a notional amount of \$41,000,000. Unless terminated at an earlier date (at the Primary Health System's option), this agreement terminates on October 1, 2027.

With respect to the 1998A Series bonds, the Primary Health System executed a swap agreement whereby the Primary Health System receives a fixed rate of 3.932% and pays a variable rate equal to the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

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**NOTE N--DERIVATIVE FINANCIAL INSTRUMENTS - Continued**

Index on a notional amount of \$16,305,000. Unless terminated at an earlier date (at the Primary Health System's option), this agreement terminates on October 1, 2027.

Although these swap instruments are intended to manage exposure to interest rate risks associated with the various debt instruments referred to above, none of these swap agreements have been designated as a hedge for accounting purposes. Accordingly, the interest rate swaps are reflected in the accompanying combined balance sheets at their aggregate fair value (a net liability of \$7,112,464 and \$6,032,288 at June 30, 2012 and 2011, respectively) and the changes in the value of the swaps are reflected as a component of nonoperating revenues in the combined statements of revenue, expenses and changes in net assets.

Management has considered the effects of any credit value adjustment and while management believes the estimated fair value of the interest rate swap agreements is reasonable, the estimate is subject to change in the near term.

**NOTE O--FAIR VALUE MEASUREMENT**

FASB ASC 820, *Fair Value Measurements and Disclosures*, establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 - Quoted market prices in active markets for identical assets or liabilities.
- Level 2 - Observable market-based inputs or unobservable inputs that are corroborated by market data.
- Level 3 - Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes values determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Primary Health System's own assumptions.

In instances where the determination of the fair value hierarchy measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Primary Health System's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE O--FAIR VALUE MEASUREMENT - Continued**

The following tables present assets and liabilities reported at fair value as of June 30, 2012 and 2011 and their respective classification under the FASB ASC 820 valuation hierarchy:

	<i>Carrying Value</i>	<i>Level 1</i>	<i>Level 2</i>	<i>Level 3</i>
<b>As of June 30, 2012</b>				
<b>Assets Measured at Fair Value on a Recurring Basis</b>				
Investment in government and agency bonds, including municipal bonds, mutual funds and others	\$ 119,596,675	\$ 119,596,675	\$ -	\$ -
Investments in corporate bonds and commercial paper	940,586	940,586	-	-
Short-term investments and cash equivalents	32,688,220	32,688,220	-	-
<b>Liabilities Measured at Fair Value on a Recurring Basis</b>				
Interest rate swap agreements	(7,112,464)	-	-	(7,112,464)
<b>As of June 30, 2011</b>				
<b>Assets Measured at Fair Value on a Recurring Basis</b>				
Investment in government and agency bonds, including municipal bonds, mutual funds and others	\$ 140,986,774	\$ 140,986,774	\$ -	\$ -
Investments in corporate bonds and commercial paper	2,069,065	2,069,065	-	-
Short-term investments and cash equivalents	31,900,586	31,900,586	-	-
<b>Liabilities Measured at Fair Value on a Recurring Basis</b>				
Interest rate swap agreements	(6,032,288)	-	-	(6,032,288)

A certain portion of the inputs used to value the Primary Health System interest rate swap agreements are unobservable inputs available to a market participant. As a result, the Primary Health System has determined that the interest rate swap valuations are classified in Level 3 of the fair value hierarchy.

The following table provides a summary of changes in the fair value of the Primary Health System's interest rate swap agreements liabilities during the fiscal year ended June 30:

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Combined Financial Statements - Continued***

***Years Ended June 30, 2012 and 2011***

**NOTE O--FAIR VALUE MEASUREMENT - Continued**

	<u>2012</u>	<u>2011</u>
Beginning of year	\$ (6,032,288)	\$ (7,632,908)
Change in mark-to-market of interest rate swaps	(1,080,176)	1,600,620
End of Year	<u>\$ (7,112,464)</u>	<u>\$ (6,032,288)</u>

**NOTE P--MANAGEMENT AGREEMENT**

On April 13, 2011, the Primary Health System's Board of Trustees approved a resolution authorizing a management agreement (the Agreement) between the Primary Health System, Hutcheson Medical Center, Inc. and affiliates (collectively, Hutcheson) and the Hospital Authority of Walker, Dade and Catoosa Counties in Georgia (the Hospital Authority).

Additionally, the Board authorized the Primary Health System to accept assignment of a contract between Hutcheson and a third party consulting firm, described below.

Under the terms of the Agreement, the Primary Health System will propose general operating policies and directives for Hutcheson; be responsible for the day-to-day management of Hutcheson and provide oversight of ancillary aspects of Hutcheson, such as physician practices, education, research, and clinical services. The Agreement's initial term is through March 31, 2021 and the Primary Health System has the option to extend the agreement for two additional five year terms. The Primary Health System may terminate the Agreement, without cause, upon written notice at any point subsequent to May 25, 2013. Upon such termination, Hutcheson is obligated to make a Termination Payment to the Primary Health System consisting of all expenses then owed by Hutcheson and any outstanding advances under a Line of Credit Agreement, discussed below. Hutcheson may also terminate the agreement without cause at any point subsequent to May 25, 2013 by paying the Termination Payment, as well as the lesser of a) \$1,000,000 per year for each year the Agreement has been in place, or b) \$1,000,000 less any management fees paid in each Agreement year.

In addition to the Agreement, the Primary Health System agreed to extend a Line of Credit (the Line) to the Hospital Authority. The maximum amount available under the Line is \$20,000,000 and there were no draws on this Line as of June 30, 2011. At June 30, 2012, the draws on the Line totaled \$12,500,000. Subsequent to June 30, 2012, an additional \$5,200,000 was drawn on this Line.

The Line calls for interest only payments each month on the outstanding balance, based on the London InterBank Offered Rate plus 4% or a rate of 5%, whichever is greater. However, any

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

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**NOTE P--MANAGEMENT AGREEMENT - Continued**

unpaid interest through March 31, 2013 is deferred and paid over a twelve-month period commencing on that date. All outstanding draws are due at the maturity date, which is consistent with the Agreement termination dates, discussed above.

The Line is secured by a Security Agreement on the primary Hutcheson medical campus. Further, the Counties of Walker and Catoosa, Georgia (collectively, the Counties) have provided additional security in the form of guarantees under an Intergovernmental Agreement. Under the Intergovernmental Agreement, the Counties have each agreed to a maximum liability of \$10,000,000 to secure the line. The form of such guarantee is at the option of the Counties and would become enforceable upon a notice of default delivered by the Primary Health System. The form of the guarantee selected by the Counties can include a) a payment of 50% by each County of the amounts owing under the Line, b) payments as they become due up to the respective \$10,000,000 limits or c) after non-Judicial foreclosure under the Security Agreement, each County could elect to pay 50% of any deficiency between the amount outstanding under the Line and the then fair market value. Both Counties have agreed to levy annual property taxes, if current to honor these guarantees.

The Primary Health System accepted assignment of a contract between Hutcheson and a third party consultant. Such contract called for the third party consultant to provide management expertise and to develop, in conjunction with the Primary Health System and the Hutcheson Board of Trustees, a turnaround plan for Hutcheson. This contract required monthly payments of \$40,000 and was terminated in 2012.

**NOTE Q--COMBINED, CONDENSED FINANCIAL INFORMATION**

The following is combined, condensed, financial information related to those aggregate discretely presented component units as of and for the years ended June 30, 2012 and 2011:

	<i>ContinuCare HealthServices, Inc.</i>	<i>Cyberknife of Chattanooga, LLC</i>
<b>As of June 30, 2012</b>		
Due from other governments	\$ 234,872	\$ 266,600
Other current assets	7,264,697	270,923
<b>Total Current Assets</b>	<b>7,499,569</b>	<b>537,523</b>

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE Q--COMBINED, CONDENSED FINANCIAL INFORMATION - Continued**

	<i>ContinuCare HealthServices, Inc.</i>	<i>Cyberknife of Chattanooga, LLC</i>
Net property, plant and equipment	4,916,085	4,967,921
Other assets	3,664,684	75,309
Total Assets	<b>\$ 16,080,338</b>	<b>\$ 5,580,753</b>
Due to other governments	\$ 779,987	\$ 120,000
Other current liabilities	1,814,259	754,445
Total Current Liabilities	2,594,246	874,445
Long-term debt and capital lease obligations	-	3,916,667
Total Liabilities	2,594,246	4,791,112
Net assets		
Unrestricted	8,570,007	163,078
Invested in capital assets, net of related debt	4,916,085	626,563
Restricted expendable	-	-
Total Net Assets	13,486,092	789,641
Total Liabilities and Net Assets	<b>\$ 16,080,338</b>	<b>\$ 5,580,753</b>
<b>Period Ended June 30, 2012</b>		
Net patient and operating revenue	\$ 26,434,498	\$ 1,595,300
Operating expenses:		
Salaries, wages and benefits	12,898,683	202,693
Supplies and other expenses	10,146,545	307,497
Purchased services	2,609,813	178,764
Insurance and taxes	259,226	107,290
Depreciation	327,769	521,106
Total Operating Expenses	26,242,036	1,317,350
Operating Income	192,462	277,950
Nonoperating revenue (expenses)	(50,099)	(217,734)
Capital contributions/other, net	-	-
Change in Net Assets	142,363	60,216
Net Assets at Beginning of Period	13,343,729	729,425
Net Assets at End of Period	<b>\$ 13,486,092</b>	<b>\$ 789,641</b>

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

**NOTE Q--COMBINED, CONDENSED FINANCIAL INFORMATION - Continued**

	<i>ContinuCare HealthServices, Inc.</i>	<i>Cyberknife of Chattanooga, LLC</i>
<b>As of June 30, 2011</b>		
Due from other governments	\$ 214,572	\$ 81,700
Other current assets	8,999,195	979,552
Total Current Assets	9,213,767	1,061,252
Net property, plant and equipment	1,690,695	5,197,015
Other assets	4,056,619	81,472
Total Assets	\$ 14,961,081	\$ 6,339,739
Due to other governments	\$ 177,284	\$ 350,277
Other current liabilities	1,440,068	843,370
Total Current Liabilities	1,617,352	1,193,647
Long-term debt and capital lease obligations	-	4,416,667
Total Liabilities	1,617,352	5,610,314
Net assets		
Unrestricted	11,653,034	367,605
Invested in capital assets, net of related debt	1,690,695	361,820
Total Net Assets	13,343,729	729,425
Total Liabilities and Net Assets	\$ 14,961,081	\$ 6,339,739
<b>Period Ended June 30, 2011</b>		
Net patient and operating revenue	\$ 25,745,984	\$ 223,600
Operating expenses:		
Salaries, wages and benefits	11,946,869	47,081
Supplies and other expenses	12,821,095	57,008
Purchased services	-	375,607
Insurance and taxes	-	19,947
Depreciation	273,257	123,134
Total Operating Expenses	25,041,221	622,777
Operating Income (Loss)	704,763	(399,177)

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY**  
**(d/b/a Erlanger Health System)**

*Notes to Combined Financial Statements - Continued*

*Years Ended June 30, 2012 and 2011*

NOTE Q--COMBINED, CONDENSED FINANCIAL INFORMATION - Continued

	<i>ContinuCare HealthServices, Inc.</i>	<i>Cyberknife of Chattanooga, LLC</i>
Nonoperating revenue (expenses)	173,165	(71,398)
Capital contributions/other, net	-	1,200,000
Change in Net Assets	877,928	729,425
Net Assets at Beginning of Period	12,465,801	-
Net Assets at End of Period	<b>\$ 13,343,729</b>	<b>\$ 729,425</b>

## **Required Supplementary Information**

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Schedule of Expenditures of Federal Awards***

***Year Ended June 30, 2012***

<b><i>Grantor</i></b>	<b><i>Pass-Through Grantor Agency</i></b>	<b><i>Program Name</i></b>	<b><i>CFDA Number</i></b>	<b><i>Grant Number (Grant Period)</i></b>	<b><i>Federal Expenditures</i></b>				
U.S. Department of Agriculture	Chattanooga-Hamilton County Health Department	Special Supplemental Nutrition Program for Women, Infants, and Children	10.557	GG-11-33870-00 (10/1/10 - 9/30/11)	\$ 19,477				
				GG-12-37227-00 (10/1/11 - 9/30/12)	46,001				
Total U.S. Department of Agriculture					65,478				
Appalachian Regional Commission	East Tennessee State University	Cancer Control for Appalachian Communities	23.011	270121-18-2 (8/1/10-6/20/11)	2,666				
Total Appalachian Regional Commission					2,666				
U.S. Department of Health and Human Services	n/a	Community Health Centers	93.224*	H80CS00091-10-03 (12/1/10 - 11/30/11)	871,823				
				H80CS00091-11-00 (12/1/11 - 11/30/12)	1,255,553				
Total U.S. Department of Health and Human Services					2,127,376				
U.S. Department of Health and Human Services	MeHarry Medical College	Cancer Centers Support CNP Program	93.397	091214MKH358-03 (9/1/10-8/31/11)	44,458				
U.S. Department of Health and Human Services	n/a	ARRA-Grants to Health Center Programs	93.703*	C81CS13762 (6/29/09 - 10/31/11)	142,474				
U.S. Department of Health and Human Services	State of Tennessee Department of Finance and Administration Bureau of TennCare	Medical Assistance Program	93.778*	GG-11-31792-00 (7/1/10-6/30/12)	379,926				
U.S. Department of Health and Human Services	State of Tennessee Department of Health	Bioterrorism Hospital Preparedness	93.889	GR-11-32473-00 (7/1/10 - 6/30/11)	17,776				
				GR-11-32474-00 (7/1/10 - 6/30/11)	52,643				
				GR-11-32475-01 (7/1/10 - 6/30/11)	175,273				
				GR-11-32453-00 (7/1/10 - 6/30/11)	20,000				
				GR-12-36220-00 (7/1/11-6/30/12)	175,800				
				GR-12-36293-00 (7/1/11-6/30/12)	73,000				
				GR-12-36297-00 (7/1/11-6/30/12)	20,000				
				GR-12-36218-00 (7/1/11-6/30/12)	20,000				
				Total U.S. Department of Health and Human Services					554,492

*See notes to schedules of expenditures of federal awards and state and other financial assistance.*

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Schedule of Expenditures of Federal Awards - Continued***

***Year Ended June 30, 2012***

<b><i>Grantor</i></b>	<b><i>Pass-Through Grantor Agency</i></b>	<b><i>Program Name</i></b>	<b><i>CFDA Number</i></b>	<b><i>Grant Number (Grant Period)</i></b>	<b><i>Federal Expenditures</i></b>
U.S. Department of Health and Human Services	State of Tennessee Department of Health	Maternal and Child Health Services Block Grant to the States	93.994	GG-12-36728-00	220,900
				(7/1/11-6/30/12)	
				GG-12-36617-00	17,709
				(7/1/11-6/30/12)	<u>238,609</u>
Total U.S. Department of Health and Human Services					<u>3,487,335</u>
Total Expenditures of Federal Awards					<u>\$ 3,555,479</u>

\* Denotes major program

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Schedule of Expenditures of State and Other Financial Assistance***

***Year Ended June 30, 2012***

<b>Grantor</b>	<b>Program Name</b>	<b>Contract Number (Contract Period)</b>	<b>Beginning Balance</b>	<b>Cash Received</b>	<b>Grant Expenditures (Adjustments)</b>	<b>Ending Balance</b>
State of Tennessee Department of Health, Bureau of TennCare	Medical Assistance Program	GG-11-31792-00	\$ 101,482	\$ 97,997	\$ (3,485)	\$ -
		(7/1/10 - 6/30/11)				
		GG-11-31792-01	-	284,397	379,925	95,528
	(7/1/11-6/30/12)					
State of Tennessee Department of Health	Maternal and Child Health Services Block Grant to the States	GG-10-28785-00	26,410	26,410	-	-
		(7/1/09 - 6/30/14)				
		GG-10-28785-00	-	-	31,060	31,060
		(7/1/09 - 6/30/14)				
		GG-11-34341-00	59,652	59,652	-	-
		(7/1/10 - 6/30/11)				
		GG-12-36728-00	-	53,822	81,729	27,907
		(7/1/11-6/30/12)				
		GG-11-34381-00	7,254	7,254	-	-
		(7/1/10 - 6/30/11)				
State of Georgia Department of Community Health	Life Force Ambulance Grant	12002G	-	600,000	600,000	-
		(10/19/11-6/30/12)				
State of Tennessee Department of Finance and Administration	Medical Assistance Program	GG-10-28378-00	45,890	45,890	227,642	227,642
		(7/1/09 - 6/30/12)				
<b>TOTAL STATE AND OTHER FINANCIAL ASSISTANCE</b>			<b>\$ 240,688</b>	<b>\$ 1,187,488</b>	<b>\$ 1,330,230</b>	<b>\$ 383,430</b>

*See notes to schedules of federal awards and state and other financial assistance.*

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Notes to Schedules of Expenditures of Federal Awards and State and Other Financial Assistance***

***Year Ended June 30, 2012***

**NOTE A--BASIS OF PRESENTATION**

The accompanying schedule of expenditures of federal awards and the schedule of expenditures of state and other financial assistance includes the grant activity of Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System (the Primary Health System) and is presented on the accrual basis of accounting. The information in these schedules is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the Tennessee Comptroller of the Treasury, respectively. Therefore, some amounts presented in these schedules may differ from amounts presented in, or used in the preparation of, the basic financial statements.

**NOTE B--CONTINGENCIES**

The Primary Health System's federal programs are subject to financial and compliance audits by grantor agencies which, if instances of material noncompliance are found, may result in disallowed expenditures and affect the Primary Health System's continued participation in specific programs. The amount, if any, of expenditures which may be disallowed by the grantor agencies cannot be determined at this time, although the Primary Health System expects such amounts, if any, to be immaterial.

**NOTE C--BIOTERRORISM HOSPITAL PREPAREDNESS AWARDS**

The following is a reconciliation of the Bioterrorism Hospital Preparedness Awards of the Primary Health System:

<b>Grant</b>	<b><i>Receivable/ (Unexpended) Balance at June 30, 2011</i></b>	<b><i>Receipts</i></b>	<b><i>Awards Earned by Expenditures (Adjustments)</i></b>	<b><i>Receivable/ (Unexpended) Balance at June 30, 2012</i></b>
GR-10-30003-00	\$ 2,246	\$ -	\$ (2,246)	\$ -
GR-11-32453-00	(20,000)	-	20,000	-
GR-11-32473-00	(17,776)	-	17,776	-
GR-11-32474-00	(52,643)	-	52,643	-
GR-11-32475-01	(175,273)	-	175,273	-
GR-12-36220-00	-	175,800	175,800	-
GR-12-36293-00	-	73,000	73,000	-
GR-12-36297-00	-	20,000	20,000	-
GR-12-36218-00	-	20,000	20,000	-
<b>Total</b>	<b>\$ (263,446)</b>	<b>\$ 288,800</b>	<b>\$ 552,246</b>	<b>\$ -</b>

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Schedule of Prior Audit Findings***

***Year Ended June 30, 2012***

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There were no prior audit findings.



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 Board of Trustees of  
Chattanooga-Hamilton County Hospital Authority  
(d/b/a Erlanger Health System):

We have audited the financial statements of the business-type activities and the aggregate discretely presented component units of Chattanooga-Hamilton County Hospital Authority (d/b/a Erlanger Health System) as of and for the year ended June 30, 2012, which collectively comprise the Chattanooga-Hamilton County Hospital Authority's basic combined financial statements and have issued our report thereon dated December 18, 2012. 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

Management of Chattanooga-Hamilton County Hospital Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Chattanooga-Hamilton County Hospital Authority'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 Chattanooga-Hamilton County Hospital Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Chattanooga-Hamilton County Hospital Authority'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 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 Chattanooga-Hamilton County Hospital Authority'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 Board of Trustees, management, federal awarding agencies, pass-through entities, state awarding agencies and the State of Tennessee Comptroller of the Treasury and is not intended to be and should not be used by anyone other than these specified parties.

*Rebecca Young : Assistant PC*

Knoxville, Tennessee  
December 18, 2012



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH  
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT  
ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER  
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Board of Trustees of  
Chattanooga-Hamilton County Hospital Authority  
(d/b/a Erlanger Health System):

**Compliance**

We have audited Chattanooga-Hamilton County Hospital Authority's (d/b/a Erlanger Health System) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. Chattanooga-Hamilton County Hospital Authority's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Chattanooga-Hamilton County Hospital Authority's management. Our responsibility is to express an opinion on Chattanooga-Hamilton County Hospital Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Chattanooga-Hamilton County Hospital Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Chattanooga-Hamilton County Hospital Authority's compliance with those requirements.

In our opinion, Chattanooga-Hamilton County Hospital Authority complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

### Internal Control Over Compliance

The management of Chattanooga-Hamilton County Hospital Authority is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Chattanooga-Hamilton County Hospital Authority's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Chattanooga-Hamilton County Hospital Authority's internal control over compliance.

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

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

This report is intended solely for the information and use of the Board of Trustees, management, federal awarding agencies, pass-through entities, state awarding agencies and the State of Tennessee Comptroller of the Treasury and is not intended to be and should not be used by anyone other than these specified parties.

*Peoshing Yordley: Accountant, P.C.*

Knoxville, Tennessee  
December 18, 2012

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Schedule of Findings and Questioned Costs***

***Year Ended June 30, 2012***

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**Section I - Summary of Auditor's Results**

**FINANCIAL STATEMENTS**

The auditor's report expressed an unqualified opinion on the financial statements of Chattanooga-Hamilton County Hospital Authority.

**Internal control over financial reporting:**

Material weakness(es) identified? Yes [ ] No [X]  
Significant deficiency identified not considered to be material weaknesses? Yes [ ] No [X]  
Noncompliance material to financial statements noted? Yes [ ] No [X]

**FEDERAL AWARDS**

**Internal control over major programs:**

Material weakness(es) identified? Yes [ ] No [X]  
Significant deficiency identified not considered to be material weaknesses? Yes [ ] No [X]

The auditor's report expressed an unqualified opinion on compliance for major programs.

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133? Yes [ ] No [X]

**Identification of Major Programs:**

<b><i>CFDA Number(s)</i></b>	<b><i>Name of Federal Program or Cluster</i></b>
93.224	U.S. Department of Health and Human Services - Community Health Centers
93.703	U.S. Department of Health and Human Services - ARRA - Grants to Health Center Programs
93.778	U.S. Department of Health and Human Services - Medical Assistance Program

Dollar threshold used to distinguish between Type A and Type B programs: \$ 300,000

Auditee qualified as low-risk auditee? Yes [X] No [ ]

**CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY  
(d/b/a Erlanger Health System)**

***Schedule of Findings and Questioned Costs - Continued***

***Year Ended June 30, 2012***

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**Section II - Financial Statement Findings**

This section identifies the significant deficiencies, material weaknesses, fraud, illegal acts, violations of provisions of contracts and grant agreements, and abuse related to the financial statements for which *Government Auditing Standards* require reporting in a Circular A-133 audit.

Not applicable, no financial statement findings.

**Section III - Federal Award Findings and Questioned Costs**

This section identifies the audit findings required to be reported by Section 510(a) of Circular A-133 (for example, significant deficiencies, material weaknesses, and material instances of noncompliance, including questioned costs), as well as any abuse findings involving federal awards that are material to a major program.

Not applicable, no financial statement findings or questioned costs.