

Annual Financial Report
Claiborne County Hospital
and Nursing Home and Subsidiary
*Years ended June 30, 2012 and 2011
with Report of Independent Auditors*

Claiborne County Hospital and Nursing Home and Subsidiary

Annual Financial Report

Years ended June 30, 2012 and 2011

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Report of Independent Auditors

Board of Directors
Claiborne County Hospital and Nursing Home and Subsidiary

We have audited the accompanying consolidated statements of net position of Claiborne County Hospital and Nursing Home and Subsidiary (the Hospital), a component unit of Claiborne County, Tennessee, as of June 30, 2012 and 2011, and the consolidated statements of revenues, expenses and changes in net position, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the net position of Claiborne County Hospital and Nursing Home and Subsidiary as of June 30, 2012 and 2011 and the changes in its net position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 28, 2012 on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions, laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

Board of Directors
Claiborne County Hospital and Nursing Home and Subsidiary

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

The List of Officials on page 24, which is of a nonaccounting nature, has not been subjected to the auditing procedures applied in the audit of the financial statements, and we express no opinion on it.

Coulter & Justus, P.C.

December 28, 2012

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

This section of Claiborne County Hospital and Nursing Home and Subsidiary's annual financial report presents management's discussion and analysis of the Hospital's financial performance during the fiscal years ended June 30, 2012, 2011 and 2010. The information contained herein should be considered in conjunction with the Hospital's accompanying financial statements.

Overview of the Financial Statements

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

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

Financial Highlights

Condensed financial information as of and for the years June 30, 2012, 2011 and 2010 is provided in the tables below (amounts in thousands):

	2012	2011	2010
Assets:			
Current assets	\$ 9,019	\$ 8,370	\$ 6,828
Capital assets, net	15,396	14,265	14,755
Assets limited as to use	748	1,895	2,480
Other	309	238	201
Total assets	\$ 25,472	\$ 24,768	\$ 24,264
Liabilities:			
Current liabilities	\$ 4,794	\$ 3,922	\$ 4,247
Long-term liabilities	6,455	6,539	7,083
Total liabilities	\$ 11,249	\$ 10,461	\$ 11,330
Net position:			
Net investments in capital assets	\$ 8,555	\$ 8,453	\$ 9,035
Unrestricted	5,418	5,459	3,491
Temporarily restricted	250	395	407
Total net position	\$ 14,223	\$ 14,307	\$ 12,933

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

Financial Highlights (continued)

	2012	2011	2010
Changes in net position:			
Operating revenues	\$30,105	\$30,672	\$31,565
Operating expenses	30,766	31,508	33,004
Operating loss	(661)	(836)	(1,439)
Nonoperating income (loss)	578	2,209	(148)
Excess of (expenses over revenues) revenues over expenses	\$ (83)	\$ 1,373	\$ (1,587)

Financial Position

Overall, the Hospital's net position increased in 2011 primarily as a result of the sale of the Home Health operation. Net position in 2012 declined slightly as the gain on the termination of the Baker Cancer Center (a radiation therapy center) agreement offset the operating losses incurred in 2012.

Property and equipment additions increased the amounts classified as net investment in capital assets in 2012. In 2011, depreciation offset by principal payments on long-term debt caused a decrease in net investment in capital assets.

Current assets increased from 2011 to 2012 primarily due to increases in patient accounts receivable and other receivables. Assets limited as to use decreased in 2012 due to the restriction on certain assets being released. Assets limited as to use consist of debt proceeds restricted for use in completing the Medical Office Building (MOB).

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

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

Results of Operations

Operating revenues and expenses are as follows for the years ended June 30, 2012, 2011 and 2010 (amounts in thousands):

	2012	Relative %	2011	Relative %	2010	Relative %
Operating revenue:						
Net patient service revenues	\$28,921	96%	\$29,549	96%	\$30,405	96%
Other revenue	1,184	4%	1,123	4%	1,160	4%
Total operating revenues	30,105	100%	30,672	100%	31,565	100%
Operating expenses:						
Salaries and wages	18,236	60%	19,068	62%	20,177	64%
Medical supplies and drugs	3,353	11%	3,237	11%	3,242	10%
Other supplies	888	3%	761	2%	790	2%
Insurance	719	2%	792	3%	752	2%
Depreciation and amortization	1,250	4%	1,376	5%	1,415	5%
Other expenses	6,320	21%	6,274	21%	6,628	21%
Total operating expenses	30,766	102%	31,508	103%	33,004	104%
Operating loss	(661)	(2)%	(836)	(3%)	(1,439)	(4%)
Nonoperating income (expenses):						
Investment income	114	-	93	-	131	-
Interest expense	(238)	-	(325)	(1%)	(339)	(1%)
Other income	-	-	-	-	60	-
Gain on sale	702	2%	2,441	8%		
Nonoperating income (loss)	578	2%	2,209	7%	(148)	(1%)
Excess (expenses over revenues) revenues over expenses	\$ (83)	-	\$ 1,373	4%	\$ (1,587)	(5%)

Net patient service revenues decreased 2% in 2012 and 3% in 2011 primarily due to lower demand from the economic downturn and resulting loss of medical insurance by residents of the area served by the Hospital. Operating expenses in 2012 decreased due to cost containment efforts by Hospital management and staff, including efforts to purchase supplies and drugs at lower costs and a workforce reduction. In total, operating expenses decreased 2% in 2012 and 5% in 2011. The decrease in 2012 operating revenue, offset by a decrease in operating expenses, resulted in an operating loss for 2012 of \$661,225. The 2012 operating loss was lower than the 2011 loss of \$836,201. The Hospital has operated on a continuation budget for the past two years and management has directed efforts toward effective cost control.

Other changes to the excess of (expenses over revenues) revenues over expenses included sale of the Home Health division in March 2011. The Home Health division operation represented approximately \$160,000 in operating loss for 9 months of 2011. The sale generated cash of approximately \$2,250,000 and a note receivable from the buyer of \$250,000. In addition, the Hospital terminated its interest in the Baker Cancer Center. The Cancer Center represented \$224,687 in operating income in 2011, respectively. The termination generated cash of approximately \$770,000.

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

Capital Acquisitions and Construction Activities

Note 6 to the consolidated financial statements summarizes property and equipment by class and changes for the years ended June 30, 2012 and 2011. Additional information regarding accounting policies for capital assets is provided in Note 1 to the financial statements.

Total additions to property and equipment were \$3,385,378 in 2012 and \$1,631,955 in 2011. Additions in 2012 include a new CT scanner and building renovations to accommodate the scanner and electronic medical records software. Additions in 2011 included completion of the MOB, upgrades to current facilities to house a new digital mammography unit and other routine upgrades and improvements. Construction in progress at June 30, 2011 consisted primarily of renovations necessary for the digital mammography unit which opened in August 2011.

Long-Term Debt Activity

Principal payments on the 2010 bond issues were \$395,000 for 2012. Balances outstanding at June 30, 2012 and 2011 were \$5,580,000 and \$5,975,000 respectively (before bond premiums, discounts, and deferred refunding loss).

The Hospital also entered into two new lease agreements totaling approximately \$985,000 related to the CT scanner and electronic medical records acquisition.

Interest costs in 2012 decreased due to the repayment of the 2009 bonds in 2011. Interest expense in 2011 reflected the increases in variable rates paid in connection with the bonds outstanding during this period.

Requests for Information

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

Respectfully submitted,



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

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

	June 30	
	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,560,344	\$ 2,852,773
Patient accounts receivable, less allowances for uncollectible accounts of approximately \$2,300,000 in 2012 and \$2,500,000 in 2011	4,764,445	4,367,488
Other receivables	967,532	411,512
Inventories	604,277	588,160
Prepaid expenses	122,628	150,529
Total current assets	9,019,226	8,370,462
Assets limited as to use:		
For construction of capital assets	182,839	487,576
Foundation	250,107	395,142
Under bond agreements--held by trustee	315,058	1,012,571
	748,004	1,895,289
Property and equipment, net	15,395,750	14,264,988
Bond issuance costs, net	11,955	12,658
Other assets	297,300	224,358
Total assets	\$ 25,472,235	\$ 24,767,755

	June 30	
	2012	2011
Liabilities and net position		
Current liabilities:		
Accounts payable and accrued expenses	\$ 2,159,637	\$ 1,468,553
Accrued payroll and withholdings	533,444	792,432
Accrued compensated absences	869,456	815,211
Estimated amounts due to third-party payors	347,024	72,526
Current portion of notes payable and capital leases	429,817	377,857
Current portion of bonds payable	455,000	395,000
Total current liabilities	<u>4,794,378</u>	<u>3,921,579</u>
Long-term debt:		
Notes payable and capital leases, less current portion	1,174,186	795,894
Bonds payable, less current portion	5,280,147	5,743,440
Total long-term debt	<u>6,454,333</u>	<u>6,539,334</u>
Total liabilities	<u>11,248,711</u>	<u>10,460,913</u>
Net position:		
Net investment in capital assets	8,555,258	8,452,944
Unrestricted	5,418,159	5,458,756
Temporarily restricted	250,107	395,142
Total net position	<u>14,223,524</u>	<u>14,306,842</u>
Total liabilities and net position	<u>\$ 25,472,235</u>	<u>\$ 24,767,755</u>

See accompanying Notes to Consolidated Financial Statements.

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

	Year ended June 30	
	2012	2011
Operative revenues:		
Net patient service revenue	\$ 28,921,377	\$ 29,549,337
Other revenue	1,184,030	1,122,846
Total operating revenues	30,105,407	30,672,183
Operating expenses:		
Salaries, wages, and benefits	18,236,151	19,068,353
Medical supplies and drugs	3,352,895	3,236,919
Other supplies	887,720	760,917
Insurance	719,495	792,450
Depreciation and amortization	1,250,291	1,375,519
Other expenses	6,320,080	6,274,226
Total operating expenses	30,766,632	31,508,384
Operating loss	(661,225)	(836,201)
Nonoperating income (expenses):		
Investment income	113,831	93,579
Interest expense	(237,952)	(324,660)
Gain on termination of radiation therapy center agreement	702,028	-
Gain on sale of Claiborne Home Health Care	-	2,440,579
Net nonoperating income	577,907	2,209,498
Excess of (expenses over revenues) revenues over expenses	(83,318)	1,373,297
Net position at beginning of year	14,306,842	12,933,545
Net position at end of year	\$ 14,223,524	\$ 14,306,842

See accompanying Notes to Consolidated Financial Statements.

Claiborne County Hospital and Nursing Home and Subsidiary

Consolidated Statements of Cash Flows

	Year ended June 30	
	2012	2011
Cash flows from operating activities		
Cash received from patients and third-party payors	\$ 28,546,524	\$ 30,194,842
Other operating cash receipts	1,184,030	1,122,846
Cash payments to suppliers for good and services	(13,859,443)	(14,497,643)
Cash payments to employees for services	(15,597,734)	(15,952,006)
Net cash provided by operating activities	273,377	868,039
Cash flows from capital and related financing activities		
Acquisition and construction of capital assets	(1,445,600)	(809,532)
Proceeds from sale of home health	-	2,191,840
Proceeds from termination of radiation therapy center agreement	770,000	-
Principal paid on long-term debt	(908,186)	(1,225,750)
Proceeds from issuance of long-term debt	-	637,835
Interest paid on long-term debt	(240,629)	(335,900)
Net cash (used in) provided by capital and related financing activities	(1,824,415)	458,493
Cash flows from investing activities		
Interest received	113,831	93,579
Net (decrease) increase in restricted and unrestricted cash	(1,437,207)	1,420,111
Cash and cash equivalents at beginning of year	4,712,856	3,292,745
Cash and cash equivalents at end of year	\$ 3,275,649	\$ 4,712,856
Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents in current assets	\$ 2,560,344	\$ 2,852,773
Cash and cash equivalents included in assets limited as to use	715,305	1,860,083
Total cash and cash equivalents	\$ 3,275,649	\$ 4,712,856

Claiborne County Hospital and Nursing Home and Subsidiary

Consolidated Statements of Cash Flows (continued)

	Year ended June 30	
	2012	2011
Reconciliation of operating loss to net cash provided by operating activities		
Operating loss	\$ (661,225)	\$ (836,201)
Adjustments to reconcile operating loss to net cash flows provided by operating activities:		
Depreciation and amortization expense	1,250,291	1,375,519
Provision for bad debts	4,172,429	3,757,715
Changes in operating assets and liabilities:		
Patient accounts receivable	(4,569,386)	(3,266,123)
Inventories, prepaid expenses and other current assets	(612,236)	212,000
Restricted assets	2,930	8,323
Other assets	(72,942)	(46,000)
Accounts payable and accrued expenses	693,761	(292,773)
Accrued payroll and withholdings	(258,988)	(102,041)
Accrued compensated absences	54,245	(11,037)
Other liabilities	274,498	68,657
Net cash provided by operating activities	\$ 273,377	\$ 868,039
Supplemental disclosure		
Noncash investment in equipment through capital lease	\$ 943,438	\$ -
Promissory note received from sale of Claiborne Home Health Care	-	250,000

See accompanying Notes to Consolidated Financial Statements.

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements

June 30, 2012

1. Description of Reporting Entity and Significant Accounting Policies

Reporting Entity

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

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

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

Basis of Presentation

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

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

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

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

Basis of Presentation (continued)

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

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

Principles of Consolidation

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

Cash and Cash Equivalents

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

Patient Accounts Receivable

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

Inventories

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

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

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

Property and Equipment

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

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

Bond Issuance Costs

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

Accrued Compensated Absences

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

Operating Revenues and Expenses

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

Income Taxes

CCH is classified as a governmental organization exempt from income tax. The Foundation is a not-for-profit organization defined by Section 501(c)(3) of the Internal Revenue Code as other than a private foundation. Accordingly, no provision for income taxes has been included in the consolidated accompanying financial statements for these entities. Income taxes related to Claiborne Home Health Care and Multi-Specialty Medical, P.C., if any, are included in other operating expenses (*Note 10*).

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

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

Charity Care

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

Patient Service Revenue

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

Risk Management

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

Use of Estimates

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

Subsequent Events

The Hospital has evaluated subsequent events through December 28, 2012, the date which the financial statements were available to be issued.

2. Cash and Cash Equivalents

The Hospital's cash and cash equivalent balances are fully insured or collateralized against custodial credit risk. Funds on deposit at financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) with uninsured amounts being fully collateralized primarily through the financial institutions' participation in the Bank Collateral Pool (the Collateral Pool), which is administered by the Collateral Pool Board and monitored by the Treasury Department of the State of Tennessee.

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

2. Cash and Cash Equivalents (continued)

The Hospital requires that all public funds (those not related to for profit entities) not insured by the FDIC to be part of the Collateral Pool or fully collateralized by specific investments as described above.

3. Net Patient Service Revenue

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

	Year ended June 30	
	2012	2011
Gross patient service charges	\$83,691,480	\$81,487,066
Contractual adjustments and discounts	(50,169,056)	(47,828,248)
Charity care charges foregone	(428,616)	(351,766)
Provision for bad debts	(4,172,429)	(3,757,715)
Net patient service revenue	<u>\$28,921,377</u>	<u>\$29,549,337</u>

4. Third Party Payor Agreements

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

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

Contractual adjustments for Medicare, TennCare and other third party discount arrangements are recognized when the related revenues are reported in the consolidated financial statements. The percentage of gross patient charges from the Medicare and TennCare programs was approximately 31% and 16%, respectively, for 2012 and 35% and 16%, respectively, in 2011.

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

4. Third Party Payor Agreements (continued)

The American Recovery and Reinvestment Act established incentive payments under the Medicare and TennCare programs for certain hospitals that “meaningfully use” certified electronic health records technology. During 2012, the Hospital acquired certified electronic health records technology with plans to implement during the fiscal year ended June 30, 2013. It is the Hospital’s policy to recognize the incentive payments as revenue only when there is reasonable assurance the conditions specified for compliance will be met. Accordingly, the Hospital deferred revenue of \$252,394 in the June 30, 2012 Statement of Net Position and expects to recognize the revenue next year.

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

5. Malpractice and Employee Group Health Claims

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

The Hospital provides professional liability coverage through a claims-made medical malpractice insurance policy with an independent carrier. The policy covers all claims reported to the carrier during the coverage period. At June 30, 2012, the Hospital is involved in medical malpractice litigation in which management of the Hospital, after consultation with legal counsel, is of the opinion that liability, if any, related to these claims would not be material to the consolidated financial statements. No amounts are accrued for potential losses related to unreported incidents or reported incidents which have not yet resulted in asserted claims as the Hospital is not able to estimate such amounts.

The Hospital is self-insured for employee (and dependent) group health claims up to \$60,000 per covered person annually. Commercial insurance coverage is purchased for claims in excess of the annual maximum. A liability is recorded for those claims known but unpaid and estimated claims incurred but not reported. Changes in estimates are recorded in the year the estimates are revised. The liability for employee group health claims was \$191,947 and \$118,289 at June 30, 2012 and 2011, respectively. The total expense related to employee group health claims (net of employee paid premiums) was approximately \$1,206,000 and \$1,432,000 for 2012 and 2011, respectively.

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

6. Property and Equipment

A summary of changes in property and equipment as of June 30, 2012, is as follows:

	Balance July 1, 2011	Additions	Retirements and Transfers	Balance June 30, 2012
Cost:				
Land	\$ 308,092	\$ –	\$ –	\$ 308,092
Buildings and improvements	18,940,980	1,061,992	–	20,002,972
Equipment	14,882,337	1,414,562	–	16,296,899
Construction in progress	88,771	908,824	(997,595)	–
Total cost	<u>34,220,180</u>	<u>3,385,378</u>	<u>(997,595)</u>	<u>36,607,963</u>
Allowances for depreciation:				
Buildings and improvements	7,438,708	517,558	(1,255)	7,955,011
Equipment	12,516,484	740,718	–	13,257,202
Total allowances for depreciation	<u>19,955,192</u>	<u>1,258,276</u>	<u>(1,255)</u>	<u>21,212,213</u>
Net property and equipment	<u>\$14,264,988</u>	<u>\$2,127,102</u>	<u>\$ (996,340)</u>	<u>\$ 15,395,750</u>

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

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

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

7. Bonds Payable

Changes in bonds payable are summarized as follows:

	Balance July 1, 2011	Additions	Principal Payments	Balance June 30, 2012
Series 2010A Bonds	\$4,015,000	\$ –	\$(295,000)	\$ 3,720,000
Series 2010A New Money Bonds	980,000	–	(5,000)	975,000
Series 2010B Bonds	980,000	–	(95,000)	885,000
Total outstanding	<u>5,975,000</u>	<u>\$ –</u>	<u>\$(395,000)</u>	<u>5,580,000</u>
Less unamortized discount	(2,165)			(1,609)
Plus unamortized premium	180,378			170,756
Less deferred refunding loss	(14,773)			(14,000)
Less current portion	<u>(395,000)</u>			<u>(455,000)</u>
Long-term portion	<u>\$5,743,440</u>			<u>\$ 5,280,147</u>

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

On March 30, 2010, the County issued on behalf of CCH \$6,190,000 of Series 2010A tax exempt and 2010B taxable bonds. Interest on these bonds ranges from 2.5% to 4.125% for Series 2010A and 1% to 4.6% for Series 2010B. The Series 2010A tax exempt bond proceeds were used to refund several previously issued bonds prior to July 1, 2010.

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

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

7. Bonds Payable (continued)

Maturities related to the balances outstanding as of June 30, 2012, are summarized as follows:

	Series 2010A	Series 2010B	Total
2013	\$ 355,000	\$100,000	\$ 455,000
2014	355,000	100,000	455,000
2015	370,000	105,000	475,000
2016	260,000	105,000	365,000
2017	275,000	110,000	385,000
2018 – 2022	1,080,000	365,000	1,445,000
2023 – 2027	1,175,000	–	1,175,000
2028 – 2030	825,000	–	825,000
	\$4,695,000	\$885,000	\$5,580,000

Future interest payments related to the bonds are as follows:

	Series 2010A	Series 2010B	Total
2013	\$ 182,044	\$ 32,595	\$ 214,639
2014	171,394	30,345	201,739
2015	160,744	27,645	188,389
2016	145,944	24,285	170,229
2017	135,544	20,505	156,049
2018 – 2022	515,445	33,685	549,130
2023 – 2027	311,779	–	311,799
2028 – 2030	67,869	–	67,869
	\$1,690,763	\$169,060	\$1,859,823

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

8. Notes Payable and Capital Leases

In 2008, the Hospital obtained two notes through Powell Valley Electric Cooperative (PVEC) as a subrecipient of the Rural Economic Development Loan and Grant Program through the Rural Business Cooperative Service of the United States Department of Agriculture. Proceeds from the notes, in the amounts of \$740,000 and \$360,000, were restricted for use in constructing and completing a medical office building. As of June 30, 2012 and 2011, assets whose use is limited for construction of capital assets represents the proceeds remaining to be expended for this purpose. The notes are payable in monthly installments of \$3,000 and \$7,709, respectively, through 2018 and both notes are non-interest bearing.

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

8. Notes Payable and Capital Leases (continued)

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

Notes payable and capital lease activity from July 1, 2011 to June 30, 2012, is summarized as follows:

	Balance July 1, 2011	Additions	Principal Payments	Balance June 30, 2012
PVEC	\$ 240,000	\$ –	\$ (36,000)	\$ 204,000
PVEC	632,074	–	(92,508)	539,566
Bank note payable	165,810	–	(165,810)	–
Capital leases	135,867	943,438	(218,868)	860,437
Total outstanding	<u>1,173,751</u>	<u>\$943,438</u>	<u>\$ (513,186)</u>	<u>1,604,003</u>
Less current portion	<u>(377,857)</u>			<u>(429,817)</u>
Long-term portion	<u>\$ 795,894</u>			<u>\$1,174,186</u>

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

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

The Hospital entered into two new capital leases during the year ended June 30, 2012 to fund the acquisition and installation of medical equipment and software. Interest rates on all capital leases range from 3.2% to 5.8%. Monthly installments on the capital leases range from \$4,424 to \$12,467.

Assets held under capital lease have a total cost of approximately \$1,287,000 and a net book value of approximately \$1,100,000 as of June 30, 2012. Amortization of assets under capital lease is included with depreciation expense in the accompanying financial statements.

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

8. Notes Payable and Capital Leases (continued)

Scheduled payments on notes payable and capital leases are as follows as of June 30, 2012:

	Notes Payable		Capital Leases	
	Principal	Interest	Principal	Interest
2013	\$128,508	\$ —	\$301,309	\$29,825
2014	128,508	—	183,017	22,171
2015	128,508	—	165,003	15,248
2016	128,508	—	172,235	8,016
2017	128,508	—	43,899	1,208
2018	101,026	—	—	—
	\$743,566	\$ —	\$865,463	\$76,468

9. Management Agreement and Investment in Radiation Therapy Center

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

For several years, the Hospital had a sublease and management agreement with another health system (the Health System) for a radiation therapy center (the Center). The agreement and subsequent amendments gave the Hospital a 49% undivided interest in the leasehold pursuant to a master facility lease. The Hospital was also entitled to receive 49% of net income up to 50%, reserving the remaining 50% for future capital needs. The agreement held the Hospital responsible for 49% of the Center's expense shortfalls, if any. During 2012, the Hospital terminated this sublease and management agreement and received approximately \$770,000 in cash, which fully repaid the outstanding receivable balance of approximately \$68,000 and resulted in a gain of approximately \$702,000.

10. Income Taxes

The Multi-Specialty Medical, P.C. has a calendar year reporting basis for tax purposes. At December 31, 2011, this entity had net operating loss carryforwards of approximately \$1,330,000 for federal and state income tax purposes. The loss carryforwards relate to operating losses and expire in years 2016 through 2026. The loss carryforwards may be offset against future taxable income as permitted by the Internal Revenue Code and the Tennessee Code Annotated. A valuation reserve, equal to the deferred tax assets arising from the net operating losses, has been established based on an estimate that the potential tax benefits of the loss carryforwards will not be realized.

Claiborne County Hospital and Nursing Home and Subsidiary

Notes to Consolidated Financial Statements (continued)

11. Pension Plan

The County and related entities, including the Hospital, participate in the Tennessee Consolidated Retirement System Pension Plan. The multiple-employer plan provides for both employee and employer contributions. Participating employees are required to contribute 5% of their salaries to the Plan. The Hospital is required to contribute at an actuarially determined rate, which was 5.7% of covered payroll for both 2012 and 2011. The rate for employer contributions will be reevaluated for fiscal year 2013. Contributions by the Hospital totaled \$699,246 and \$702,331 for 2012 and 2011, respectively. During 2012 and 2011, participating employees contributed \$612,300 and \$615,001, respectively. Funding status, contribution requirements, and trends appear in the financial statements of the County and are not separately identified for the Hospital.

12. Foundation

At June 30, 2012 and 2011 the Foundation's assets total \$250,107 and \$395,142 respectively, and consist primarily of cash and inventory (there are no significant liabilities recorded). A portion of the cash at June 30, 2011 totaling \$125,000, was restricted for the purchase of a digital mammography unit for the Hospital. The 2012 statement of revenues, expenses and changes in net position includes Foundation contribution revenue of \$142,325, net investment income of \$1,201 and distributions and other expenses of \$283,165. The 2011 statement of revenues, expenses and changes in net position includes Foundation contribution revenue of \$173,041, net investment income of \$3,702 and distributions and other expenses of \$188,995. Separate financial statements of the Foundation are maintained by Hospital management. Except for certain expenses paid directly by the Foundation, the Hospital provides administrative services and pays for operating expenses to support the Foundation's activities.

Claiborne County Hospital and Nursing Home and Subsidiary

List of Officials (Unaudited)

June 30, 2012

Board of Directors

Chairman, Mayor Jack Daniels
County Attorney, James Estep III, Esq.
Vice Chairman, Robert Asbury, Esq.
Secretary/Treasurer, Lindsey Cadle, Esq.
Mike Robertson
Chester Gibson
William Dunavant, Jr.
Russell Essary, Pharm.D.
Tom Zachary

Medical Chief of Staff

Dr. Richard Clark

Executive Administration

CEO/Administrator, Timothy S. Brown



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

Board of Directors
Claiborne County Hospital and Nursing Home and Subsidiary

We have audited the consolidated financial statements of Claiborne County Hospital and Nursing Home and Subsidiary (the Hospital) as of and for the year ended June 30, 2012 and have issued our report thereon dated December 28, 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 the Hospital is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Hospital's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over financial reporting.

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

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

Board of Directors
Claiborne County Hospital and Nursing Home and Subsidiary

Compliance and Other Matters

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

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

Coulter & Justus, P. C.

December 28, 2012