

**AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION
OF
LINCOLN COUNTY HEALTH SYSTEM
LINCOLN COUNTY, TENNESSEE
Years Ended June 30, 2012 and 2011**

LINCOLN COUNTY HEALTH SYSTEM
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Years Ended June 30, 2012 and 2011

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the Lincoln County Health System (as described in Note A to the financial statements) as of and for the years ended June 30, 2012 and 2011. These financial statements are the responsibility of the Lincoln County Health System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note A, the financial statements present only the Lincoln County Health System and do not purport to, and do not, present fairly the financial position of Lincoln County, Tennessee, as of June 30, 2012 and 2011, and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lincoln County Health System as of June 30, 2012 and 2011, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 9, 2012 on our consideration of Lincoln County Health System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 9 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying financial information listed as other financial information in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements of the Lincoln County Health System. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

October 9, 2012

A handwritten signature in black ink, appearing to read "Putnam & Hancock". The signature is written in a cursive style with a large, sweeping flourish at the end.

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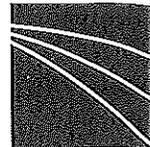
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LINCOLN COUNTY HEALTH SYSTEM



Our discussion and analysis of Lincoln County Health System's (the "System's") financial performance provides an overview of the System's financial activities for the fiscal years ended June 30, 2012 and 2011. Please read it in conjunction with the System's financial statements, which begin on page 10.

Financial Highlights

- The System's net assets increased in the past year with a \$1,099,007 or 4.5 percent increase in 2012 and \$1,197,802 or 5.1 percent increase in 2011.
- The System reported an operating income in 2012 of \$205,657 and an operating income in 2011 of \$1,724,153. Operating income in 2012 decreased by \$1,518,496 or 88.1 percent under the income reported in 2011. Operating income in 2011 decreased by \$763,878 or 30.7 percent.
- Non-operating revenues increased by \$1,443,901 or 250.5 percent in 2012 compared to 2011 due to receipt of \$1,421,395 Meaningful Use Incentive payments during 2012. Non-operating expenses decreased in 2011 by \$20,695 or 3.5 percent compared to 2010.

Using This Annual Report

The System's financial statements consist of three statements – a balance sheet; a statement of revenues, expenses, and changes in net assets; and a statement of cash flows. These financial statements and related notes provide information about the activities of the System, including resources held by the System but restricted for specific purposes by contributors, grantors, or enabling legislation.

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

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

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

The Statement of Cash Flows

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

The System's Net Assets

The System's net assets are the difference between its assets and liabilities reported in the Balance Sheet on page 10. The System's net assets increased in 2012 by \$1,099,007 (4.5 percent) and increased \$1,197,802 (5.1 percent) in 2011, as you can see from Table 1.

Table 1: Assets, Liabilities, and Net Assets

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Assets:			
Current assets	\$ 13,628,625	\$ 11,672,754	\$ 11,169,302
Capital assets, net	19,544,850	20,860,227	22,419,564
Other noncurrent assets	<u>10,115,669</u>	<u>9,926,549</u>	<u>9,782,285</u>
Total assets	<u>43,289,144</u>	<u>42,459,530</u>	<u>43,371,151</u>
Liabilities			
Long-term liabilities	13,257,060	13,842,499	15,163,429
Other	<u>4,249,917</u>	<u>3,933,871</u>	<u>4,722,364</u>
Total liabilities	<u>17,506,977</u>	<u>17,776,370</u>	<u>19,885,793</u>
Net assets:			
Invested in capital assets, net of related debt	5,511,072	6,304,130	6,703,194
Restricted for debt service	1,083,785	1,083,776	1,083,808
Restricted for other purposes	78,436	71,839	72,351
Unrestricted	<u>19,108,874</u>	<u>17,223,415</u>	<u>15,626,005</u>
Total Net Assets	<u>\$ 25,782,167</u>	<u>\$ 24,683,160</u>	<u>\$ 23,485,358</u>

A significant component of the change in the System's assets is the change in cash and cash equivalents. Cash increased \$2,494,217 or 50.1 percent in 2012 and increased \$17,803 or 0.4% in 2011.

Operating Results and Changes in The System's Net Assets

In 2012, the System's net assets increased by \$1,099,007 or 4.5 percent, as shown in Table 2. This increase is made up of very different components, and it represents a decrease compared with the increase in net assets for 2011 of \$1,197,802.

Table 2: Operating Results and Changes in Net Assets

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating Revenues:			
Net patient service revenues	\$ 39,647,879	\$ 39,469,648	\$ 39,742,062
Other operating revenues	<u>845,180</u>	<u>845,398</u>	<u>842,245</u>
Total operating revenues	40,493,059	40,315,046	40,584,307
Operating Expenses			
Salaries and benefits	24,228,774	22,661,885	22,356,618
Fees to individuals and organizations	4,513,919	4,600,645	4,640,797
Medical supplies and drugs	4,939,545	4,620,273	4,523,680
Depreciation and amortization	2,175,674	2,273,350	2,331,852
Other operating expenses	<u>4,429,490</u>	<u>4,434,740</u>	<u>4,243,329</u>
Total operating expenses	<u>40,287,402</u>	<u>38,590,893</u>	<u>38,096,276</u>
Operating income	<u>205,657</u>	<u>1,724,153</u>	<u>2,488,031</u>
Nonoperating Revenues and Expenses			
Investment income	97,327	116,578	132,919
Interest expense	(615,471)	(649,048)	(708,931)
Amortization	(48,229)	(48,229)	(48,562)
Noncapital grants, contributions and incentive payments	1,434,250	13,879	30,217
Other nonoperating revenues and expenses, net	<u>(327)</u>	<u>(9,531)</u>	<u>(2,689)</u>
Total nonoperating revenues (expenses)	<u>867,550</u>	<u>(576,351)</u>	<u>(597,046)</u>
Excess of revenues over expenses before capital grants and contributions	1,073,207	1,147,802	1,890,985
Grants and contributions			
Capital grants and contributions	<u>25,800</u>	<u>50,000</u>	<u>44,506</u>
Increase in net assets	1,099,007	1,197,802	1,935,491
Net assets beginning of year	<u>24,683,160</u>	<u>23,485,358</u>	<u>21,549,867</u>
Net assets end of year	<u>\$ 25,782,167</u>	<u>\$ 24,683,160</u>	<u>\$ 23,485,358</u>

Operating Income

The first component of the overall change in the System's net assets is its operating income - generally, the difference between net patient service revenues and the expenses incurred to perform those services. The System has reported an operating income for the last three years. Operating income in 2012 decreased by \$1,518,496 or 88.1 percent lower than the income reported in 2011. Operating income in 2011 decreased by \$763,878 or 30.7 percent under 2010.

The primary components of these changes in operating incomes are:

- An increase in total operating revenue of \$178,013 in 2012 and a decrease of \$269,261 in 2011.
- An increase in employee compensation and benefits of \$1,566,889, or 6.9 percent in 2012 compared to 2011 and an increase of \$305,267 or 1.4% in 2011 compared to 2010.
- Supplies expense increased by \$319,272, or 6.9 percent increase in 2012 compared to the increase of \$96,593, or 2.1 percent increase in 2011.

Total operating revenues have remained stable in response to a decrease in the System's hospital and nursing home patient days due to regulatory changes and bed reductions offset by increases in rates and utilization of outpatient services. Effective June 1, 2011, the System reduced its number of intermediate-level care beds at the nursing homes by 30 beds. A new 10-bed inpatient psychiatric unit was opened in July 2008, increasing the number of beds for the System's hospital from 49 to 59. A total of 2,369 psychiatric days were recorded for 2012, a 10.5 percent decrease from 2011. A total of 2,646 psychiatric days were recorded for 2011, a 13.5 percent decrease from 3,060 days in 2010. This unit is a geriatric unit, accepting patients age 55 and older.

Employee compensation and benefits increased in 2012 primarily due to increased pay rates, health insurance costs, and employed physicians compared to the 2011 increase primarily in health insurance costs.

Supplies expense increase in in both 2012 and 2011 due to increased emergency and operating room costs and general price increases.

Non-operating Revenues and Expenses

Non-operating revenues consist primarily of interest revenue, investment earnings and this year Medicare and Medicaid Electronic Health Record (EHR) unrestricted incentive payments totaling \$1,421,395. The Health System anticipates receiving additional incentive payments totaling \$1.6 million through 2015.

Grants and Contributions

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

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

The System's Cash Flow

Changes in the System's cash flows are consistent with changes in operating incomes and non-operating revenues and expenses, discussed earlier. The System generated cash flows from operating activities in 2012 of \$3,042,048 or 6.2 percent more than in 2011. In 2011 the System generated \$2,865,112 or 46.2 percent less in cash flows from operating activities than in 2010.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2012, the System had \$19,544,850 invested in capital assets, net of accumulated depreciation, as detailed in Note G to the financial statements. In 2011, the System had \$20,860,227 invested in capital assets, net of accumulated depreciation. In 2012, the System purchased new equipment costing \$665,210. In addition a chemistry blood analyzer costing \$196,413 was acquired through a capital lease obligation and reported as a noncash financing activity in the statement of cash flows.

Debt

At year-end, the System had \$14,276,227 in revenue bonds, capital lease obligations and notes payable obligations outstanding as detailed in Note H to the financial statements. Except for a capital lease of \$196,413 initiated in 2012, the System issued no new debt in 2012 or 2011. The System's formal debt issuances - revenue notes - cannot be issued without approval of the Lincoln County Board of commissioners. The amount of debt issued is subject to limitations that apply to the County and its component units as a whole. There have been no changes in the System's debt ratings in the past two years.

Other Economic Factors

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

Hospitals are facing many payment reductions and other payment issues dealing with the Patient Protection and Affordable Care Act (the "Act"). One part of the Act, though, will be to increase the number of U.S. citizens and legal aliens with health insurance through expansion of the Medicaid Program, incentives to employers and individuals to purchase health insurance and expansion of coverage via Medicaid and the private insurance market.

The System is continuing to actively recruit general physicians and specialists for the success of its operations. The search continues for a hospitalist program.

Another factor is the System is also continually evaluating the addition of services that we do not currently offer.

Contacting the System's Financial Management

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

**LINCOLN COUNTY HEALTH SYSTEM
BALANCE SHEETS**

June 30, 2012 and 2011

ASSETS

	<u>2012</u>	<u>2011</u>
CURRENT ASSETS:		
Cash and cash equivalents	\$ 7,475,856	\$ 4,981,639
Restricted cash	42,354	52,086
Accounts receivable, net of allowance for doubtful accounts of \$3,000,920 (2012) \$3,586,200 (2011)	4,553,362	5,204,024
Estimated third-party payor settlements receivable	632,315	384,031
Supplies, at cost	716,743	768,184
Prepaid expenses	154,582	227,384
Other assets	53,413	55,406
Total Current Assets	<u>13,628,625</u>	<u>11,672,754</u>
NONCURRENT ASSETS:		
Restricted investments	9,196,120	9,117,640
Capital assets, net of accumulated depreciation	19,544,850	20,860,227
Other assets:		
Investment in insurance fund	145,125	160,141
Notes receivable, net	433,768	282,735
Deferred financing costs	340,656	366,033
Total Noncurrent Assets	<u>29,660,519</u>	<u>30,786,776</u>
TOTAL ASSETS	<u>\$ 43,289,144</u>	<u>\$ 42,459,530</u>

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 776,718	\$ 713,598
Accounts payable	868,003	767,656
Accrued expenses:		
Salaries and payroll taxes	873,608	734,685
Compensated absences	966,040	883,668
Interest	93,836	99,299
Other	477,863	582,879
Estimated third-party payor settlements payable	151,495	100,000
Patient trust funds	42,354	52,086
Total Current Liabilities	<u>4,249,917</u>	<u>3,933,871</u>
NONCURRENT LIABILITIES:		
Long-term debt, net of current maturities	<u>13,257,060</u>	<u>13,842,499</u>
TOTAL LIABILITIES	<u>17,506,977</u>	<u>17,776,370</u>
NET ASSETS:		
Invested in capital assets, net of related debt	5,511,072	6,304,130
Restricted:		
Expendable:		
Bond indenture debt service	1,083,785	1,083,776
Other purposes	78,436	71,839
Unrestricted assets	<u>19,108,874</u>	<u>17,223,415</u>
TOTAL NET ASSETS	<u>25,782,167</u>	<u>24,683,160</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 43,289,144</u>	<u>\$ 42,459,530</u>

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

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

Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
OPERATING REVENUES:		
Net patient service revenue, net of provision for bad debts of \$5,422,842 in 2012 and \$4,560,415 in 2011	\$ 39,647,879	\$ 39,469,648
Other operating revenue	<u>845,180</u>	<u>845,398</u>
Total Operating Revenues	40,493,059	40,315,046
OPERATING EXPENSES:		
Employee compensation and benefits	24,228,774	22,661,885
Fees to individuals and organizations	4,513,919	4,600,645
Supplies	4,939,545	4,620,273
Other expenses	4,429,490	4,434,740
Depreciation	<u>2,175,674</u>	<u>2,273,350</u>
Total Operating Expenses	40,287,402	38,590,893
INCOME FROM OPERATIONS	<u>205,657</u>	<u>1,724,153</u>
NONOPERATING REVENUES AND (EXPENSES):		
Investment income	97,327	116,578
Interest expense	(615,471)	(649,048)
Amortization	(48,229)	(48,229)
Noncapital grants, contributions and incentive payments	1,434,250	13,879
(Loss) on disposal of capital assets	<u>(327)</u>	<u>(9,531)</u>
Nonoperating Revenues and (Expenses), net	867,550	(576,351)
EXCESS OF REVENUES OVER EXPENSES	1,073,207	1,147,802
Capital Contributions	<u>25,800</u>	<u>50,000</u>
INCREASE IN NET ASSETS	1,099,007	1,197,802
Net Assets Balance, beginning of year	<u>24,683,160</u>	<u>23,485,358</u>
Net Assets Balance, end of year	<u>\$ 25,782,167</u>	<u>\$ 24,683,160</u>

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

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

Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	\$ 40,392,384	\$ 39,163,626
Other operating cash receipts	1,882,874	1,886,161
Cash paid to employees for wages and benefits	(23,911,853)	(22,541,451)
Cash paid to suppliers for goods and services	<u>(15,321,357)</u>	<u>(15,643,224)</u>
Net Cash Provided by Operating Activities	<u>3,042,048</u>	<u>2,865,112</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Noncapital grants, contributions and incentive payments	<u>1,434,250</u>	<u>13,879</u>
Net Cash Provided by Noncapital Financing Activities	<u>1,434,250</u>	<u>13,879</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Additions to capital assets, net	(665,210)	(723,545)
Proceeds from disposal of capital assets	1,000	-
Capital contributions	25,800	50,000
Principal payments on long-term debt	(741,583)	(1,574,535)
Interest paid on long-term debt, net	<u>(620,934)</u>	<u>(653,075)</u>
Net Cash Used by Capital and Related Financing Activities	<u>(2,000,927)</u>	<u>(2,901,155)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest received	79,981	172,202
(Increase) in restricted investments	<u>(61,135)</u>	<u>(132,235)</u>
Net Cash Provided by Investing Activities	<u>18,846</u>	<u>39,967</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,494,217	17,803
CASH AND CASH EQUIVALENTS, beginning of year	<u>4,981,639</u>	<u>4,963,836</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 7,475,856</u>	<u>\$ 4,981,639</u>
RECONCILIATION OF OPERATING INCOME TO NET		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Income from operations	\$ 205,657	\$ 1,724,153
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,175,674	2,273,350
Provision for bad debts	5,422,842	4,560,415
Provision for note receivable arrangements	97,367	82,553
Advances under note receivable arrangements, net	(248,400)	(142,002)
Investment in insurance funds, net	15,016	(33,581)
Changes in operating assets and liabilities:		
(Increase) in accounts receivable	(4,772,180)	(4,906,446)
Decrease in supplies	51,441	2,075
Decrease in prepaid expenses	72,802	34,495
(Increase) Decrease in other assets	1,993	(27,913)
Increase (Decrease) in accounts payable	100,347	(503,508)
Increase in accrued expenses	116,278	53,592
(Increase) in estimated third-party payor settlements, net	<u>(196,789)</u>	<u>(252,071)</u>
Net Cash Provided by Operating Activities	<u>\$ 3,042,048</u>	<u>\$ 2,865,112</u>
SCHEDULE OF NONCASH FINANCING AND INVESTING ACTIVITIES:		
Capital lease obligation issued to acquire equipment	<u>\$ 196,413</u>	<u>none</u>

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

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

Principles of Departmental Combination

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

The Medical Center provides general acute health care services for Lincoln County and surrounding areas. It is licensed for 49 acute care beds and 10 geropsych beds. The Ambulance Service provides emergency medical transportation services. The Home Health Care provides skilled nursing, therapy and personal care services. The Patrick Rehab-Wellness Center provides centralized rehabilitation, health education, therapy and other related programs and services to other departments of the Health System and to local businesses, industries and residents. The Lincoln Care Center and Donalson Care Center provide long-term health care services. Effective June 1, 2011, the Care Centers received approval to reduce its number of intermediate-level care beds from 145 to 115; along with retaining 125 skilled-level care beds. The Donalson Care Center is also licensed for 24 beds for assisted living services.

The Medical Center's financial statements include Lincoln Medical Center Auxiliary Gift Shop (the "Auxiliary"). The Auxiliary is not a separate legal entity and it is subject to financial accountability to the Committee. As of and for the year ended June 30, 2012, the Auxiliary's total assets, current assets, and net assets totaled \$78,436, and are reported as restricted for other purposes in the balance sheet. Their income from operations totaled \$6,597. During 2012, the Auxiliary did not make noncapital and capital contributions to the Medical Center.

Basis of Accounting

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

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of Estimates

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

Deposits

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

Investments

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

Supplies

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

Capital Assets

Capital assets are stated at cost, less accumulated depreciation that is computed on the straight-line method over the estimated useful life of the asset. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the established useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. There was no interest cost capitalized on borrowed funds for the years ended June 30, 2012 and 2011, respectively.

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

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

Grants and Contributions

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Absences

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

Deferred Financing Costs

Financing costs incurred for issuance of bonds are amortized over the term of the respective bond issue using the straight-line method. Amortization expense was \$48,229 for the years ended June 30, 2012 and 2011, respectively.

Charity Care

The Health System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Health System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Income Taxes

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

Risk Management

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

Net Assets

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

Operating Revenues and Expenses

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating Revenues and Expenses (Continued)

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

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

Investment income, nonexchange revenues, grants, contributions and incentive payments received for purposes other than capital asset acquisition, are reported as nonoperating revenues. During the current year the Health System received unrestricted payments to provide meaningful use electronic health records as further described in Note P.

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

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

Reclassifications

Certain reclassifications have been made in the 2011 financial statements to conform to the 2012 financial statements presentation. Such reclassifications had no effect on the results of operations as previously reported.

NOTE B: DESIGNATED NET ASSETS

Unrestricted net assets include designated net assets by the Health System totaling \$8,041,943 and \$7,972,310 as of June 30, 2012 and 2011, respectively, for specific purposes such as future capital improvements, insurance and debt service as described in Note E. The designated funds remain under the control of the Health System which may at its discretion later use the funds for other purposes.

NOTE C: CHARITY CARE

Charges foregone for services and supplies furnished under the Health System's charity care policy totaled \$997,969 and \$445,243 for the years ended June 30, 2012 and 2011, respectively.

NOTE D: NET PATIENT SERVICE REVENUE

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

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

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE D: NET PATIENT SERVICE REVENUE (CONTINUED)

Revenue from the Medicare program accounted for approximately 31 percent and 28 percent of the hospital-based departments' and Care Centers' net patient revenue, respectively, for the year ended June 30, 2012.

Each department is reimbursed at a tentative rate with final settlement determined after submission of an annual cost report by the department and audit thereof by the Medicare fiscal intermediary. The Health System's Medicare cost reports have been audited by the fiscal intermediary through June 30, 2007.

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

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

Revenue from the Medicaid program accounted for approximately 7 percent and 58 percent of the hospital-based departments' and Care Centers' net patient revenue, respectively, for the year ended June 30, 2012.

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

The Medical Center received \$7,206 and \$5,891, from an endowment fund for the years ended June 30, 2012 and 2011, respectively, for patient care that is included in net patient service revenue.

NOTE E: DEPOSITS AND INVESTMENTS

The Health System's carrying amount of deposits was \$7,475,856 and \$4,981,639 and the bank balance was \$7,628,565 and \$5,183,282 as of June 30, 2012 and 2011, respectively. The Health System's carrying amount for restricted cash and investments, excluding amounts held under an indenture agreement, was \$8,154,689 and \$8,085,950 and the bank balance was \$8,069,306 and \$8,073,089 as of June 30, 2012 and 2011, respectively. The bank balances totaling \$15,697,871 are either insured by the Federal Deposit Insurance Corporation or Tennessee Bank Collateral Pool. The bank balances are not subject to custodial credit risk.

Interest Rate Risk

For an investment, this is the risk that a change in interest rates will affect the fair market value of investments held. The Health System has established a debt service reserve fund under an indenture agreement for repayment of the Series 1998 bonds. The reserve fund consists of a money market fund that normally invests at least 80% of its assets in U. S. Treasury securities and repurchase agreements for those securities. Its value as of June 30, 2012 was \$1,083,785. Generally, these investments maintain a dollar weighted average maturity at 60 days or less.

These investments are exposed to declines in fair values due to interest rate changes. The Health System's exposure is mitigated through the limited maturities of the investments.

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE E: DEPOSITS AND INVESTMENTS (CONTINUED)

Restricted investments are held as follows as of June 30:

	<u>2012</u>	<u>2011</u>
Internally designated for capital improvements, insurance and debt service:	\$ 8,041,943	\$ 7,972,310
Restricted by contributors	70,392	61,554
Held under an indenture agreement	1,083,785	1,083,776
Held under patient trust fund arrangements - cash	<u>42,354</u>	<u>52,086</u>
	9,238,474	9,169,726
Less amounts reclassified to meet current liabilities	<u>42,354</u>	<u>52,086</u>
	<u>\$ 9,196,120</u>	<u>\$ 9,117,640</u>

NOTE F: NOTES RECEIVABLE ARRANGEMENTS

The Medical Center has advanced money to physicians to assist in the establishment of their medical professional practices. Advances are to be repaid by cash payment or amortized by continuation of the physicians' medical practice for a certain period based upon the terms of each arrangement. Net advances to physicians totaled \$248,400 and \$142,002 for the years ended June 30, 2012 and 2011, respectively. Net repayments, primarily from amortization of advances to physicians, totaled \$97,367 and \$82,553 for the years ended June 30, 2012 and 2011, respectively. As of June 30, 2012 and 2011, net advances totaling \$433,768 and \$282,735, respectively, were due under these arrangements.

NOTE G: CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2012 was as follows:

	June 30, <u>2011</u>	<u>Additions</u>	<u>Retirements</u>	June 30, <u>2012</u>
Capital assets, not being depreciated:				
Land	\$ 773,754	\$ -	\$ -	\$ 773,754
Property under capitalized lease	300,000	-	-	300,000
Construction in progress	-	25,262	-	25,262
Other assets not in service	<u>141,104</u>	-	<u>(135,904)</u>	<u>5,200</u>
Total capital assets, not being depreciated	1,214,858	25,262	(135,904)	1,104,216
Capital assets, being depreciated:				
Ground improvements	2,258,292	49,750	-	2,308,042
Building & improvements	27,071,280	97,292	-	27,168,572
Equipment	15,032,914	628,812	(153,640)	15,508,086
Equipment under capitalized lease	<u>159,340</u>	<u>196,413</u>	<u>-</u>	<u>355,753</u>
Total capital assets being depreciated	44,521,826	972,267	(153,640)	45,340,453
Less accumulated depreciation for:				
Ground improvements	(788,391)	(77,036)	-	(865,427)
Buildings and improvements	(13,094,328)	(1,015,057)	-	(14,109,385)
Equipment	(10,894,150)	(1,037,475)	152,312	(11,779,313)
Equipment under capitalized lease	<u>(99,588)</u>	<u>(46,106)</u>	<u>-</u>	<u>(145,694)</u>
Total accumulated depreciation and amortization	<u>(24,876,457)</u>	<u>(2,175,674)</u>	<u>152,312</u>	<u>(26,899,819)</u>
Capital assets, net	<u>\$ 20,860,227</u>	<u>\$ (1,178,145)</u>	<u>\$ (137,232)</u>	<u>\$ 19,544,850</u>

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

JUNE 30, 2012 and 2011

NOTE G: CAPITAL ASSETS (CONTINUED)

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

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

The general depreciation rates based on the useful lives for depreciable capital assets is 5% for ground improvements, 2.5% to 5% for building and improvements, and 5% to 20% for equipment and equipment under capital lease. Depreciation and amortization expense for the years ended June 30, 2012 and 2011 totaled \$2,175,674 and \$2,273,350, respectively. Accumulated amortization for equipment under capital lease obligations was \$145,694 and \$99,588 at June 30, 2012 and 2011, respectively.

During the current year the Health System completed a roofing project at Donalson Care Center and incurred planning costs for (1) the feasibility of expansion of the Emergency and Operating rooms at the Medical Center and; (2) parking lot and entrance renovation at the Wellness Center.

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

JUNE 30, 2012 and 2011

NOTE H: LONG-TERM DEBT

The following is a schedule of long-term debt and capital lease obligations activity for the year ended June 30, 2012:

	June 30, <u>2011</u>	<u>Additions</u>	<u>Reductions</u>	June 30, <u>2012</u>	Due Within <u>One Year</u>
Series 1998, final installment of \$495,000 due May 2013, at an interest rate of 5.125%	\$ 970,000	\$ -	\$ (475,000)	\$ 495,000	\$ 495,000
Series 2004, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of \$45,000 to \$800,000 through May 2023, at an interest rate of 3.875%.	6,885,000	-	(45,000)	6,840,000	45,000
Series 2007, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of \$10,000 to \$1,040,000 through May 2028, at an interest rate of 4.2%.	4,905,000	-	(10,000)	4,895,000	10,000
Series 2007, General Obligation Refunding Bonds, due in installments of \$160,000 to \$220,000 through May 2021, at an interest rate of 3.93%.	1,860,000	-	(155,000)	1,705,000	160,000
Capital Lease Obligation, due in monthly installments of \$3,561 through April 2017, at an interest rate of 7.5%.	201,397	-	(28,598)	172,799	30,818
Capital Lease Obligation, due in monthly installments of \$3,917 through August 2016, at an interest rate of 5.45%	-	196,413	(27,985)	168,428	35,900
Toal long-term debt	14,821,397	\$ 196,413	\$ (741,583)	14,276,227	\$ 776,718
Less current maturities of long-term debt	(713,598)			(776,718)	
Less Series 2004 deferred refunding costs	(210,509)			(192,845)	
Less Series 2007 deferred refunding costs	(88,351)			(81,294)	
Add unamortized bond premium	33,560			31,690	
Total noncurrent liabilities	\$ 13,842,499			\$ 13,257,060	

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE H: LONG-TERM DEBT (CONTINUED)

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

	June 30, <u>2010</u>	<u>Additions</u>	<u>Reductions</u>	June 30, <u>2011</u>	Due Within <u>One Year</u>
Series 1998, due in installments of \$475,000 to \$495,000 through May 2013, interest rates ranging from 5.00% to 5.125%.	\$ 1,420,000	\$ -	\$ (450,000)	\$ 970,000	\$ 475,000
Series 2001, final installment of \$140,000 paid May 2011, at an interest rate of 4.45%.	140,000	-	(140,000)	-	-
Series 2004, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of \$45,000 to \$800,000 through May 2023, at an interest rate of 3.875%.	6,925,000	-	(40,000)	6,885,000	45,000
Note Payable, General Electric Capital Corporation, final installment paid October 2010, at an interest rate of 4.28%.	40,392	-	(40,392)	-	-
Series 2007, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of \$10,000 to \$1,040,000 through May 2028, at an interest rate of 4.2%.	4,915,000	-	(10,000)	4,905,000	10,000
Series 2007, General Obligation Refunding Bonds, due in installments of \$155,000 to \$220,000 through May 2021, at an interest rate of 3.93%.	1,870,000	-	(10,000)	1,860,000	155,000
Capital Lease Obligation, due in monthly installments of \$3,561 through April 2017, at an interest rate of 7.5%.	227,934	-	(26,537)	201,397	28,598
General Obligation Capital Outlay Note, paid obligation in full October 2010, at an interest rate of 3.9%.	857,606	-	(857,606)	-	-
Toal long-term debt	16,395,932	\$ -	\$ (1,574,535)	14,821,397	\$ 713,598
Less current maturities of long-term debt	(944,351)			(713,598)	
Less Series 2004 deferred refunding costs	(228,175)			(210,509)	
Less Series 2007 deferred refunding costs	(95,407)			(88,351)	
Add unamortized bond premium	35,430			33,560	
Total noncurrent liabilities	<u>\$ 15,163,429</u>			<u>\$ 13,842,499</u>	

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE H: LONG-TERM DEBT (CONTINUED)

The annual requirements to amortize all long-term debt outstanding as of June 30, 2012 are as follows:

Year Ending <u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2013	\$ 776,718	\$ 586,034
2014	816,819	547,112
2015	852,310	512,627
2016	883,222	476,557
2017	877,158	440,198
2018-2022	4,475,000	1,680,146
2023-2027	4,555,000	808,420
2028	1,040,000	43,680
	<u>\$ 14,276,227</u>	<u>\$ 5,094,774</u>

Series 1998

The Series 1998 Hospital Facility Lease Revenue and Tax Bonds were issued in the total amount of \$15,000,000 to construct and purchase equipment for the new Medical Center built in 2001. The bonds are the ultimate obligation of Lincoln County, Tennessee. The Series 1998 bond agreement contains various covenants, including the establishment of a Debt Service Reserve Fund for repayment of the bonds, and maintenance of a certain debt service coverage ratio. For the year ended June 30, 2012, the Health System complied with the restrictive covenants including the required debt service covenant ratio.

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

Series 2001

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

Series 2004

In a prior year, the Health System defeased a portion of the Series 1998 bonds by issuance of \$7,115,000 Series 2004 Hospital Facility Lease Revenue and Tax Refunding Bonds and placing the proceeds of the bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Health System's financial statements. At June 30, 2012, \$6,625,000 of the bonds outstanding are considered defeased.

The Series 2004 bonds are the ultimate obligation of Lincoln County, Tennessee. The bonds maturing through May 1, 2013 are not subject to redemption prior to maturity. The bonds maturing May 1, 2014 and thereafter are subject to redemption on or after May 1, 2013 as a whole or in part, at any time, at the redemption price plus interest accrued to the redemption date. The Series 2004 bond agreement contains various covenants, including the maintenance of a certain debt service coverage ratio. For the year ended June 30, 2012, the Medical Center complied with the debt service coverage ratio.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE H: LONG-TERM DEBT (CONTINUED)

Series 2007

The Health System defeased portions of the Series 1998 and Series 2001 bonds by issuance of \$4,960,000 Series 2007 Hospital Facility Lease Revenue and Tax Refunding Bonds and \$1,905,000 Series 2007 General Obligation Refunding Bonds and placing the proceeds of the bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Health System's financial statements. At June 30, 2012, \$6,655,000 of the bonds outstanding are considered defeased.

Both Series 2007 bonds are the ultimate obligation of Lincoln County, Tennessee. Both Series 2007 bonds are subject to redemption prior to maturity, as a whole or in part, at any time, at the redemption price plus interest accrued to the redemption date for bonds maturing after May 1, 2017. The Series 2007 bonds contain various covenants, including the maintenance of a certain debt service coverage ratio. The unrefunded Series 1998 and Series 2004 bonds are on a parity lien with the Series 2007 bonds. For the year ended June 30, 2012, the Medical Center complied with the debt service coverage ratio.

Other Debt

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

The capital outlay note was a general obligation of Lincoln County, Tennessee. The obligation was paid in full in the 2011 year.

NOTE I: PENSION PLAN

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

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

Plan Description

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

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE I: PENSION PLAN (CONTINUED)

Funding Policy

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

Plan members are required to contribute at an actuarially determined rate. The current rate is 6.36% of annual covered payroll. The contribution requirement of plan members is set by state statute. The contribution requirement for Lincoln County Courthouse Employees' Pension Plan is established and may be amended by the TCRS Board of Trustees. The Health System contributions for participating departments for the years ending June 30, 2012, 2011, and 2010 were \$679,037, \$589,946, and \$502,444 respectively, equal to the required contributions for each year.

Care Centers

The Care Centers adopted a defined contribution pension plan, under Sections 401(a) and 457 of the Internal Revenue Code, covering all employees who are 21 years of age and have completed 1,000 hours of service. Participants become fully vested after six years (20% after 2 years plus 20% for each subsequent year). Participants become eligible to retire at the age of 60 or completion of 5 years of service, whichever is later. The plan provides for early retirement at the age of 55 and the completion of 30 years of service. Eligible participants may contribute a portion of their salary, up to the legal limit established by the Internal Revenue Code. The Care Centers will match up to 50% of the employee's contribution up to the first 3% of gross pay. Employer and employee contributions under this plan totaled \$29,133 and \$28,592 and \$132,026 and \$120,064 for the years ended June 30, 2012 and 2011, respectively.

Deferred Compensation Plan

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

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

NOTE J: RISK MANAGEMENT

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

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE J: RISK MANAGEMENT (CONTINUED)

As of June 30, 2012 and 2011, the Health System accrued \$305,464 and \$417,546 respectively, for an estimated claims lag. Changes in the reported liability for 2012 and 2011 resulted from the following:

	<u>2012</u>	<u>2011</u>
Balance, beginning of year	\$ 417,546	\$ 531,752
Current year claims and settlements	2,645,854	2,237,879
Claim payments	<u>(2,757,936)</u>	<u>(2,352,085)</u>
Balance, end of year	<u>\$ 305,464</u>	<u>\$ 417,546</u>

The Committee has internally designated cash to use for payment of future insurance premiums. As of June 30, 2012, this internally designated cash, including interest earned, totaled \$159,055.

NOTE K: CONCENTRATIONS OF CREDIT RISK

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

	<u>2012</u>	<u>2011</u>
Medicare	30%	33%
Medicaid	19%	16%
Other third-party payors	26%	19%
Patients	<u>25%</u>	<u>32%</u>
	<u>100%</u>	<u>100%</u>

NOTE L: MANAGEMENT AGREEMENT

Effective March 1, 2012, the Health System entered into an agreement with Quorum Health Resources, LLC, ("QHR"), to provide management services and certain special personnel, as defined in the agreement. The agreement is for a three year term that expires February 28, 2015 with a two year "opt-out provision" after its effective date. The annual management fee is \$310,752 payable in monthly installments, subject to annual adjustment by an inflation factor of the lessor of 5% or percentage increase in the Medical Component of the Consumer Price Index ("CPI"), as defined in the agreement. The annual fee is in addition to payments for special personnel and reimbursements. Prior to this date, the Health System operated under an interim agreement with QHR. Management fees paid for 2012 and 2011 were \$703,627 and \$693,638, respectively. Total payments to QHR for 2012 and 2011 were \$714,825 and \$701,352, respectively, which includes reimbursement for travel, dues, and special personnel who provide services to the Health System.

NOTE M: CONTINGENCIES AND COMMITMENTS

The Health System is involved in litigation arising in the ordinary course of business. The ultimate outcome of the litigation is unknown at the present time. Accordingly, no provision for any liability that might result has been made in the accompanying financial statements. After consultation with legal counsel, management estimates that those matters not covered by insurance will be resolved without material adverse effect on the Health System's financial position or results of operations.

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE M: CONTINGENCIES AND COMMITMENTS (CONTINUED)

Leases that do not meet the criteria for capitalization are classified as operating leases with related rentals charged to operations as incurred. The Health System leases various equipment and property under operating leases that can be canceled under terms less than one year.

The following is a schedule by year of future minimum noncancelable lease payments as of June 30, 2012:

Year Ending <u>June 30,</u>	
2013	\$ 15,000
2014	15,000
2015	15,000
2016	15,000
2017	<u>13,750</u>
	<u>\$ 73,750</u>

Rental expense under all operating leases for 2012 and 2011 totaled \$221,059 and \$161,667, respectively.

The Health System leases office space in its medical office building to physicians primarily under three-year lease terms and also leases office space at Lincoln Care Center. The following is a schedule by year of future minimum rentals under noncancelable leases that expire under existing terms through 2016:

Year Ending <u>June 30,</u>	
2013	\$ 86,284
2014	62,225
2015	63,365
2016	<u>10,593</u>
	<u>\$ 222,467</u>

Rental income received for 2012 and 2011 totaled \$244,108 and \$237,528, respectively. Rental income is included in other operating revenue in the accompanying financial statements. The cost and accumulated depreciation related to the medical office building is included in property and equipment (see Note G) as follows:

Cost	\$ 3,569,499
Accumulated depreciation	<u>(1,087,371)</u>
Net Book Value	<u>\$ 2,482,128</u>

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012 and 2011

NOTE N: LINCOLN COUNTY HEALTH SYSTEM FOUNDATION

The Lincoln County Health System Foundation (“Foundation”) is a legally separate, tax-exempt supporting organization closely related to the Health System. The Health System does not control the timing or amount of receipts from the Foundation or have the ability to access the resources from the Foundation. Accordingly, the net assets of the Foundation are not reported by the Health System.

However, for informational purposes only, a summary of the Foundation’s assets, liabilities, net assets, results of operations, and changes in net assets follows as of June 30, 2012.

Assets, cash and cash equivalents	\$	<u>48,038</u>
Liabilities		<u>-</u>
Unrestricted net assets	\$	<u>48,038</u>
Support and revenue	\$	29,626
Expenses		<u>(17,004)</u>
Excess of support and revenue over expenses		12,622
Unrestricted net assets, beginning of year		<u>35,416</u>
Unrestricted net assets, end of year	\$	<u>48,038</u>

NOTE O - PLEDGED REVENUES

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

Operating Revenues	Current Year Principal and Interest Paid on Revenue Bonds	Percent of Current Revenue	Remaining Pledge based on future Principal and Interest Requirements	Commitment Period through Fiscal Year
<u>\$ 40,493,059</u>	<u>\$ 1,052,516</u>	<u>2.6%</u>	<u>\$ 16,910,501</u>	2028

NOTE P -ELECTRONIC HEALTH RECORD INCENTIVE PAYMENTS

The Health System received \$1,421,395 in Medicare and Medicaid Electronic Health Record (EHR) unrestricted incentive payments for the year ended June 30, 2012 which is reported as nonoperating revenue. The Health Information Technology for Economic and Clinical Health Act (HITECH Act) established programs under Medicare and Medicaid to provide incentive payments for the meaningful use of certified EHR technology. The Health System anticipates receiving additional incentive payments totaling \$1.6 million through 2015.

OTHER FINANCIAL INFORMATION

**LINCOLN COUNTY HEALTH SYSTEM
DEPARTMENTAL BALANCE SHEET**

June 30, 2012

	Lincoln Medical Center	Lincoln Medical Center EMS	Home Health Care	Patrick Rehab- Wellness Center	Lincoln & Donalson Care Centers	Total
ASSETS						
CURRENT ASSETS:						
Cash and cash equivalents	\$ 3,260,432	\$ -	\$ 805	\$ 2,121	\$ 4,212,498	\$ 7,475,856
Restricted cash	-	-	-	-	42,354	42,354
Accounts receivable - net	3,337,350	-	117,536	-	1,098,476	4,553,362
Estimated third-party payor settlements receivable	617,542	-	-	-	14,773	632,315
Supplies, at cost	657,556	-	-	-	59,187	716,743
Prepaid expenses	98,381	-	-	35	56,166	154,582
Due from (to) departments	(2,757,971)	-	-	-	2,757,971	-
Other assets	980	-	-	-	52,433	53,413
Total Current Assets	<u>5,214,270</u>	<u>-</u>	<u>118,341</u>	<u>2,156</u>	<u>8,293,858</u>	<u>13,628,625</u>
NONCURRENT ASSETS:						
Restricted investments	1,254,888	-	-	-	7,941,232	9,196,120
Capital assets, net of accumulated depreciation	14,192,507	413,496	87,793	983,388	3,867,666	19,544,850
Other assets:						
Investment in insurance fund	118,552	-	-	-	26,573	145,125
Notes receivable, net	433,768	-	-	-	-	433,768
Deferred financing costs	340,656	-	-	-	-	340,656
Total Noncurrent Assets	<u>16,340,371</u>	<u>413,496</u>	<u>87,793</u>	<u>983,388</u>	<u>11,835,471</u>	<u>29,660,519</u>
TOTAL ASSETS	<u>\$ 21,554,641</u>	<u>\$ 413,496</u>	<u>\$ 206,134</u>	<u>\$ 985,544</u>	<u>\$ 20,129,329</u>	<u>\$ 43,289,144</u>
LIABILITIES AND NET ASSETS						
CURRENT LIABILITIES:						
Current maturities of long-term debt	\$ 745,900	\$ -	\$ -	\$ 30,818	\$ -	\$ 776,718
Accounts payable	593,269	13,298	14,054	19,046	228,336	868,003
Accrued expenses:						
Salaries and payroll taxes	522,535	36,965	20,262	46,766	247,080	873,608
Compensated absences	539,774	44,280	19,376	42,567	320,043	966,040
Interest	93,836	-	-	-	-	93,836
Other	220,106	-	-	44	257,713	477,863
Estimated third-party payor settlements payable	151,495	-	-	-	-	151,495
Patient trust funds	-	-	-	-	42,354	42,354
Total Current Liabilities	<u>2,866,915</u>	<u>94,543</u>	<u>53,692</u>	<u>139,241</u>	<u>1,095,526</u>	<u>4,249,917</u>
NONCURRENT LIABILITIES:						
Long-term debt, net of current maturities	13,115,079	-	-	141,981	-	13,257,060
TOTAL LIABILITIES	<u>15,981,994</u>	<u>94,543</u>	<u>53,692</u>	<u>281,222</u>	<u>1,095,526</u>	<u>17,506,977</u>
NET ASSETS:						
Invested in capital assets, net of related debt	331,528	413,496	87,793	810,589	3,867,666	5,511,072
Restricted:						
Expendable:						
Bond indenture debt service	1,083,785	-	-	-	-	1,083,785
Other purposes	78,436	-	-	-	-	78,436
Unrestricted assets (deficit)	4,078,898	(94,543)	64,649	(106,267)	15,166,137	19,108,874
TOTAL NET ASSETS	<u>5,572,647</u>	<u>318,953</u>	<u>152,442</u>	<u>704,322</u>	<u>19,033,803</u>	<u>25,782,167</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 21,554,641</u>	<u>\$ 413,496</u>	<u>\$ 206,134</u>	<u>\$ 985,544</u>	<u>\$ 20,129,329</u>	<u>\$ 43,289,144</u>

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

Year Ended June 30, 2012

	Lincoln Medical Center	Lincoln Medical Center EMS	Home Health Care	Patrick Rehab- Wellness Center	Lincoln & Donalson Care Centers	Eliminations DR/(CR)	Total
OPERATING REVENUES:							
Net patient service revenue	\$ 22,583,039	\$ 1,730,736	\$ 1,009,913	\$ 1,749,689	\$ 12,865,134	\$ 290,632	\$ 39,647,879
Other operating revenue	1,370,497	-	148	397,419	114,810	1,037,694	845,180
Total Operating Revenues	<u>23,953,536</u>	<u>1,730,736</u>	<u>1,010,061</u>	<u>2,147,108</u>	<u>12,979,944</u>	<u>1,328,326</u>	<u>40,493,059</u>
OPERATING EXPENSES:							
Employee compensation and benefits	13,464,914	1,119,572	644,512	1,397,833	7,521,332	80,611	24,228,774
Fees to individuals and organizations	3,238,115	119,768	272,958	70,090	1,727,607	(914,619)	4,513,919
Supplies	3,539,698	55,853	34,761	69,245	1,584,069	(344,081)	4,939,545
Other expenses	2,512,263	178,483	89,031	224,344	1,575,606	(150,237)	4,429,490
Depreciation	1,669,581	129,932	15,589	64,413	296,159	-	2,175,674
Total Operating Expenses	<u>24,424,571</u>	<u>1,603,608</u>	<u>1,056,851</u>	<u>1,825,925</u>	<u>12,704,773</u>	<u>(1,328,326)</u>	<u>40,287,402</u>
INCOME (LOSS) FROM OPERATIONS	<u>(471,035)</u>	<u>127,128</u>	<u>(46,790)</u>	<u>321,183</u>	<u>275,171</u>	<u>-</u>	<u>205,657</u>
NONOPERATING REVENUES AND (EXPENSES):							
Investment income	9,352	-	159	38	87,778	-	97,327
Interest expense	(601,336)	-	-	(14,135)	-	-	(615,471)
Amortization	(48,229)	-	-	-	-	-	(48,229)
Noncapital grants, contributions and incentive payments	1,430,695	-	2,505	-	1,050	-	1,434,250
(Loss) on disposal of capital assets	-	(79)	-	-	(248)	-	(327)
Nonoperating Revenues and (Expenses), net	<u>790,482</u>	<u>(79)</u>	<u>2,664</u>	<u>(14,097)</u>	<u>88,580</u>	<u>-</u>	<u>867,550</u>
Excess (Deficiency) Revenues over Expenses	319,447	127,049	(44,126)	307,086	363,751	-	1,073,207
Capital Contributions	20,800	5,000	-	-	-	-	25,800
Operating transfers from (to) departments, net	856,655	(261,226)	(236,734)	(358,695)	-	-	-
INCREASE (DECREASE) IN NET ASSETS	<u>1,196,902</u>	<u>(129,177)</u>	<u>(280,860)</u>	<u>(51,609)</u>	<u>363,751</u>	<u>-</u>	<u>1,099,007</u>
Net Assets, beginning of year	4,375,745	448,130	433,302	755,931	18,670,052	-	24,683,160
Net Assets, end of year	<u>\$ 5,572,647</u>	<u>\$ 318,953</u>	<u>\$ 152,442</u>	<u>\$ 704,322</u>	<u>\$ 19,033,803</u>	<u>\$ -</u>	<u>\$ 25,782,167</u>

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

Year Ended June 30, 2012

	Lincoln Medical Center	Lincoln Medical Center EMS	Home Health Care	Patrick Rehab- Wellness Center	Lincoln & Donalson Care Centers	Total
CASH FLOWS FROM OPERATING ACTIVITIES:						
Cash received from patients and third party payors	\$ 22,367,792	\$ 1,730,736	\$ 1,249,678	\$ 1,749,689	\$ 13,294,489	\$ 40,392,384
Other operating cash receipts	1,370,497	-	148	397,419	114,810	1,882,874
Cash paid to employees for wages and benefits	(13,338,599)	(1,102,457)	(647,780)	(1,385,951)	(7,437,066)	(23,911,853)
Cash paid to suppliers for goods and services	(9,234,708)	(348,886)	(384,730)	(362,179)	(4,990,854)	(15,321,357)
Net Cash Provided by Operating Activities	<u>1,164,982</u>	<u>279,393</u>	<u>217,316</u>	<u>398,978</u>	<u>981,379</u>	<u>3,042,048</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:						
Noncapital grants, contributions and incentive payments	1,430,695	-	2,505	-	1,050	1,434,250
Operating transfers in (out), net	856,655	(261,226)	(236,734)	(358,695)	-	-
Advances from (to) departments, net	(117,271)	-	-	-	117,271	-
Net Cash Provided (Used) by Noncapital Financing Activities	<u>2,170,079</u>	<u>(261,226)</u>	<u>(234,229)</u>	<u>(358,695)</u>	<u>118,321</u>	<u>1,434,250</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:						
Additions to capital assets, net	(427,279)	(24,167)	-	(1,500)	(212,264)	(665,210)
Proceeds from disposal of capital assets	-	1,000	-	-	-	1,000
Capital contributions	20,800	5,000	-	-	-	25,800
Principal payments on long-term debt	(712,985)	-	-	(28,598)	-	(741,583)
Interest paid on long-term debt, net	(606,799)	-	-	(14,135)	-	(620,934)
Net Cash Used by Capital and Related Financing Activities	<u>(1,726,263)</u>	<u>(18,167)</u>	<u>-</u>	<u>(44,233)</u>	<u>(212,264)</u>	<u>(2,000,927)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:						
Interest received	8,811	-	159	38	70,973	79,981
(Increase) in restricted investments	(8,559)	-	-	-	(52,576)	(61,135)
Net Cash Provided by Investing Activities	<u>252</u>	<u>-</u>	<u>159</u>	<u>38</u>	<u>18,397</u>	<u>18,846</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS						
CASH AND CASH EQUIVALENTS, beginning of year	1,609,050	-	(16,754)	(3,912)	905,833	2,494,217
CASH AND CASH EQUIVALENTS, end of year	<u>1,651,382</u>	<u>-</u>	<u>17,559</u>	<u>6,033</u>	<u>3,306,665</u>	<u>4,981,639</u>
	<u>\$ 3,260,432</u>	<u>\$ -</u>	<u>\$ 805</u>	<u>\$ 2,121</u>	<u>\$ 4,212,498</u>	<u>\$ 7,475,856</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES:						
Income from operations	\$ (471,035)	\$ 127,128	\$ (46,790)	\$ 321,183	\$ 275,171	\$ 205,657
Adjustments to reconcile operating income to net cash provided by operating activities -						
Depreciation	1,669,581	129,932	15,589	64,413	296,159	2,175,674
Provision for bad debts	4,746,348	365,480	104,881	63,200	142,933	5,422,842
Provision for note receivable arrangements	97,367	-	-	-	-	97,367
Advances under note receivable arrangements, net	(248,400)	-	-	-	-	(248,400)
Investment in insurance funds, net	(8,227)	-	-	-	23,243	15,016
Changes in operating assets and liabilities -						
Accounts receivable	(4,721,800)	(365,480)	134,884	(63,200)	243,416	(4,772,180)
Supplies	43,651	-	-	-	7,790	51,441
Prepaid expenses	65,150	-	255	-	7,397	72,802
Other assets	2,800	-	-	-	(807)	1,993
Accounts payable	156,565	5,218	11,765	1,579	(74,780)	100,347
Accrued expenses	72,777	17,115	(3,268)	11,803	17,851	116,278
Estimated third-party payor settlements, net	(239,795)	-	-	-	43,006	(196,789)
Net Cash Provided by Operating Activities	<u>\$ 1,164,982</u>	<u>\$ 279,393</u>	<u>\$ 217,316</u>	<u>\$ 398,978</u>	<u>\$ 981,379</u>	<u>\$ 3,042,048</u>

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

June 30, 2012

Year Ending June 30,	Lincoln Medical Center Series 1998		Lincoln Medical Center Series 2004		Lincoln Medical Center Series 2007 Refg. Rev.		Lincoln Medical Center Series 2007 Gen Oblig. Refg.		Lincoln Medical Center Capital Lease Obligation		Lincoln Medical Center Capital Lease Obligation		Total
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	
2013	\$ 495,000	\$ 25,369	\$ 45,000	\$ 265,050	\$ 10,000	\$ 205,590	\$ 160,000	\$ 67,006	\$ 30,818	\$ 11,915	\$ 35,900	\$ 11,104	\$ 1,362,752
2014	-	-	565,000	263,306	10,000	205,170	170,000	60,718	33,210	9,523	38,609	8,395	1,363,931
2015	-	-	595,000	241,413	10,000	204,750	170,000	54,037	35,788	6,945	41,522	5,482	1,364,937
2016	-	-	610,000	218,356	10,000	204,330	180,000	47,356	38,567	4,166	44,655	2,349	1,359,779
2017	-	-	635,000	194,719	10,000	203,910	190,000	40,282	34,416	1,195	7,742	92	1,317,356
2018	-	-	665,000	170,113	10,000	203,490	195,000	32,815	-	-	-	-	1,276,418
2019	-	-	685,000	144,344	10,000	203,070	205,000	25,152	-	-	-	-	1,272,566
2020	-	-	720,000	117,800	10,000	202,650	215,000	17,095	-	-	-	-	1,282,545
2021	-	-	745,000	89,900	10,000	202,230	220,000	8,646	-	-	-	-	1,275,776
2022	-	-	775,000	61,031	10,000	201,810	-	-	-	-	-	-	1,047,841
2023	-	-	800,000	31,000	10,000	201,390	-	-	-	-	-	-	1,042,390
2024	-	-	-	-	880,000	200,970	-	-	-	-	-	-	1,080,970
2025	-	-	-	-	915,000	164,010	-	-	-	-	-	-	1,079,010
2026	-	-	-	-	955,000	125,580	-	-	-	-	-	-	1,080,580
2027	-	-	-	-	995,000	85,470	-	-	-	-	-	-	1,080,470
2028	-	-	-	-	1,040,000	43,680	-	-	-	-	-	-	1,083,680
	\$ 495,000	\$ 25,369	\$ 6,840,000	\$ 1,737,032	\$ 4,895,000	\$ 2,858,100	\$ 1,705,000	\$ 353,107	\$ 172,799	\$ 33,744	\$ 168,428	\$ 27,422	\$ 19,371,001

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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

We have audited the financial statements of the Lincoln County Health System (as described in Note A to the financial statements) as of and for the year ended June 30, 2012, and have issued our report thereon, dated October 9, 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 Lincoln County Health System is responsible for establishing and maintaining effective internal control over financial planning. In planning and performing our audit, we considered the Health System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Health System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Health System's internal control over financial reporting.

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

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

Compliance and Other Matters

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

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

October 9, 2012

