

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

**Audited Combined Financial Statements
(and Other Information)**

Years Ended June 30, 2013 and 2012



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

Audited Combined Financial Statements (and Other Information)

Years Ended June 30, 2013 and 2012

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Combined Financial Statements

We have audited the accompanying combined financial statements of the business type activities of Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System (the Primary Health System) and aggregate discretely presented component units, as of and for the years ended June 30, 2013 and 2012 and the related notes to the combined financial statements, which collectively comprise the Primary Health System's basic combined financial statements as listed in the table of contents.

Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Primary Health System's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Primary Health System's internal control. Accordingly, we express no such

opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities and the aggregate discretely presented component units of the Primary Health System as of June 30, 2013 and 2012, and the changes in financial position and, where applicable, cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A to the combined financial statements, during 2013 the Primary Health System adopted the provisions of Governmental Accounting Standards Board Statement No. 61, *The Financial Reporting Entity: Omnibus - an Amendment of GASB Statements No. 14 and No.34*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information: Accounting principles generally accepted in the United States of America require that Management' Discussion and Analysis on pages 4 to 12 be presented to supplement the basic combined financial statements. Such information, although not a part of the basic combined 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 combined 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' responses to our inquiries, the basic combined financial statements, and other knowledge we obtained during our audit of the basic combined 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.

Other Information: Our audits were conducted for the purpose of forming an opinion on the combined financial statements as a whole. The accompanying Schedules of Expenditures of Federal Awards and State and Other Financial Assistance is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the combined financial statements.

The Schedules of Expenditures of Federal Awards and State and Other Financial Assistance is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedules of Expenditures of Federal Awards and State and Other Financial Assistance is fairly stated in all material respects in relation to the combined financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 27, 2013 on our consideration of the Primary Health System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Primary Health System's internal control over financial reporting and compliance.

Perkins Yarbally: Annals PC

Knoxville, Tennessee
December 27, 2013

Management's Discussion and Analysis

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

Management's Discussion and Analysis

Years Ended June 30, 2013 and 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

The discussion and analysis of Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System's financial performance provides an overview of the Primary Health System's financial activities for the fiscal years ended June 30, 2013, 2012 and 2011.

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

OVERVIEW OF THE COMBINED FINANCIAL STATEMENTS

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

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

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

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

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

Management's Discussion and Analysis - Continued

Years Ended June 30, 2013 and 2012

OVERVIEW OF THE COMBINED FINANCIAL STATEMENTS - Continued

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

REPORTING ENTITY

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

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

During 2012, the Primary Health System acquired 100% ownership in Plaza Surgery, G.P. As a result, Plaza Surgery, G.P.'s operations are no longer distinct from the Primary Health System.

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

Management's Discussion and Analysis - Continued

Years Ended June 30, 2013 and 2012

REPORTING ENTITY - Continued

During fiscal year 2011, Cyberknife was capitalized by contributions from the Primary Health System and certain other minority partners. Cyberknife provides radiation therapy services, specifically robotic stereotactic radiosurgical services through the use of a Cyberknife stereotactic radiosurgery system on the Primary Health System campus. At June 30, 2013, 2012 and 2011, the Primary Health System owned 51% of Cyberknife's outstanding membership units. The Medical Group was formed on June 30, 2011 and will provide professional healthcare and related services to the public through its employed and contracted licensed physicians and other supporting healthcare providers. The Medical Group has no members; however, the Primary Health System may access the Medical Group's services. The Primary Health System is not entitled to any potential earnings of the Medical Group except for compensation for services rendered to the Medical Group on its behalf. The Medical Group is currently not active.

KEY FINANCIAL INDICATORS

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

- Excess expenses over revenues from operations for Erlanger Health System for the fiscal year 2013 is \$7.9 million compared to excess revenues over expenses of \$9.5 million for the fiscal year 2012 and excess revenues over expenses of \$5.4 million for the fiscal year 2011.
- Total cash and investment reserves at June 30, 2013 are \$38 million (excluding \$99 million of Board restricted and \$31 million of funds held by Trustees or restricted by donors or others).
- Net days in accounts receivable for Erlanger Health System (utilizing a three month rolling average of net revenue) is 50 days at June 30, 2013 compared to 53 days at June 30, 2012 and 57 days at June 30, 2011.
- For fiscal year 2013, Erlanger Health System recognized \$10.6 million in essential access payments from the State of Tennessee compare to \$11.4 million in fiscal year 2012 and \$7.4 million in fiscal year 2011.
- For fiscal year 2013, Erlanger Health System recognized \$8.5 million in disproportionate share payments from the State of Tennessee compared to \$9.2 million in fiscal year 2012 and \$2.9 million in fiscal year 2011.
- For fiscal year 2012, Erlanger Health System recognized \$1.1 million in trauma fund payments from the State of Tennessee compared to \$1.0 million in fiscal year 2012 and \$1.1 million in fiscal year 2011.
- For fiscal year 2012, Erlanger Health System recognized \$3.2 million in a Medicare rural floor budget neutrality settlement payment.

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

Management's Discussion and Analysis - Continued

Years Ended June 30, 2013 and 2012

KEY FINANCIAL INDICATORS - Continued

- For fiscal year 2011, Erlanger Health System recognized \$2.9 million in a one-time supplemental distribution from the Tennessee Hospital Assessment Fund.

The required bond covenants ratios for fiscal year 2013 compared to bond requirements are as follows:

	<i>June 30, 2013</i>	<i>Master Trust Indenture</i>	<i>Bond Insurer Requirements</i>		
			<i>98 Series</i>	<i>00 Series</i>	<i>04 Series</i>
Debt service coverage ratio	1.11	1.10	1.10	1.35	1.35
Cushion ratio	6.71	N/A	1.50	N/A	N/A
Current ratio	2.12	N/A	1.50	1.50	1.50
Days cash on hand	70 days			65 days	65 days
Indebtedness ratio	51.31%				65%

The trust indentures and related documents underlying the bonds contain certain covenants and restrictions. For fiscal years 2013 and 2012, the Primary Health System failed to satisfy the debt service coverage ratio required by one of the bond insurers. As a result of the non-compliance, the Primary Health System will be required to engage a management consultant or obtain a waiver from the bond insurer.

NET POSITION

Erlanger Health System's net position for the combined Primary Health System and Aggregate Discretely Presented Component Units decreased by approximately \$14 million in the fiscal year 2013. Our analysis focuses on the net position (Table 1) and changes in net position (Table 2) of the Primary Health System's operating activities. Discussion focuses on the Primary Health System and its blended component units.

Net position for the Primary Health System decreased from \$200 million as of June 30, 2012 to \$186 million as of June 30, 2013. The current ratio (current assets divided by current liabilities) decreased from 2.33 in 2012 to 2.12 in 2013 for the Primary Health System.

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

Management's Discussion and Analysis - Continued

Years Ended June 30, 2013 and 2012

NET POSITION - Continued

Table 1- Net Position (in Millions)

	<i>June 30, 2013</i>		<i>June 30, 2012</i>		<i>6/30/2011 (before GASB 61 adoption)</i>	
	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>
Current and other assets	\$ 313	\$ 12	\$ 328	\$ 12	\$ 335	\$ 14
Capital assets	161	10	158	10	163	7
Total assets	\$ 474	\$ 22	\$ 486	\$ 22	\$ 498	\$ 21
Long-term debt outstanding	\$ 169	\$ 4	\$ 177	\$ 4	\$ 179	\$ 4
Other liabilities	119	4	109	4	115	3
Total liabilities	\$ 288	\$ 8	\$ 286	\$ 8	\$ 294	\$ 7
Net position						
Capital assets, net of debt	\$ 10	\$ 6	\$ -	\$ 5	\$ 5	\$ 2
Restricted, expendable	2	-	2	-	3	-
Unrestricted	174	8	198	9	196	12
Total net position	\$ 186	\$ 14	\$ 200	\$ 14	\$ 204	\$ 14

Days in cash decreased from 81 days as of June 30, 2012 to 73 days as of June 30, 2013 for the Primary Health System resulting from decreased operating margins combined with an \$8 million increase in receivable for funds drawn on a line of credit extended to Hutcheson Medical Center, Inc. in fiscal year 2013. Days in cash decreased from 105 days as of June 30, 2011 to 81 days as of June 30, 2012 for the Primary Health System due to decreased operating margins combined with a \$12.5 million receivable for funds drawn on a line of credit extended to Hutcheson Medical Center, Inc. in fiscal year 2012.

Days in net accounts receivable decreased from 55 days as of June 30, 2012 to 51 days as of June 30, 2013. Days in net accounts receivable decreased from 57 days as of June 30, 2011 to 55 days as of June 30, 2012.

Capital assets for the Primary Health System were \$161 million. Additions for fiscal year 2013 totaled \$30 million while \$4 million of assets were retired. Depreciation expense was \$27 million for the Primary Health System. Retirement of assets reduced accumulated depreciation by \$4 million in fiscal year 2013. Construction in progress was \$9 million as of June 30, 2013.

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

Management's Discussion and Analysis - Continued

Years Ended June 30, 2013 and 2012

NET POSITION - Continued

Included in construction in progress at June 30, 2013 are surgical suite expansion projects totaling \$3.2 million. Additions for the fiscal year 2012 amounted to \$31 million while \$59 million of assets were retired. The retirements included the sale and minority tenant leaseback of certain professional office buildings. A gain on the sale of approximately \$6.6 million was realized of which \$4.9 million was deferred. Depreciation expense was \$26 million for the Primary Health System in fiscal year 2012. Retirement of assets reduced accumulated depreciation by \$52 million in fiscal year 2012. Construction in progress was \$11 million as of June 30, 2011 and \$7 million as of June 30, 2012. Included in construction in progress at June 30, 2012 is the Erlanger East expansion of \$3.5 million.

	<i>Primary Health System</i>		
	<i>2013</i>	<i>2012</i>	<i>2011</i>
Land and improvements	\$ 26	\$ 25	\$ 27
Buildings	231	224	243
Equipment	367	351	357
Total	624	600	627
Less accumulated depreciation	(472)	(449)	(475)
Construction in progress	9	7	11
Net property, plant and equipment	<u>\$ 161</u>	<u>\$ 158</u>	<u>\$ 163</u>

Long-term debt outstanding amounted to \$169 million as of June 30, 2013 compared to \$177 million as of June 30, 2012. The decrease in long-term debt reflects normal scheduled principal payments. Long-term debt outstanding amounted to \$177 million as of June 30, 2012 compared to \$179 million as of June 30, 2011. The decrease in long-term debt reflects normal scheduled principal payments net of an increase in debt associated with the sale and minority tenant leaseback of the Erlanger East POB.

Other liabilities for the Primary Health System were \$119 million as of June 30, 2013, \$108 million at June 30, 2012, compared to \$115 million as of June 30, 2011.

CHANGES IN NET POSITION

The focus for Erlanger Health System's management team during fiscal year 2013 and 2012 was to increase the Primary Health System's volumes in a number of key product lines in a downturned economy, improve relationships with stakeholders, and improve operating efficiencies.

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

Management's Discussion and Analysis - Continued

Years Ended June 30, 2013 and 2012

CHANGES IN NET POSITION - Continued

Table 2- Changes in Net Position (in Millions)

	<i>June 30, 2013</i>		<i>June 30, 2012</i>		<i>June 30, 2011</i>	
	<i>Aggregate Discretely</i>		<i>Aggregate Discretely</i>		<i>Aggregate Discretely</i>	
	<i>Primary Health System</i>	<i>Presented Component Units</i>	<i>Primary Health System</i>	<i>Presented Component Units</i>	<i>Primary Health System</i>	<i>Presented Component Units</i>
Net patient revenue	\$ 526	\$ 12	\$ 514	\$ 12	\$ 513	\$ 11
Other revenue	19	16	22	16	20	15
Total revenue	545	28	536	28	533	26
Expenses:						
Salaries	298	13	300	13	292	12
Supplies and expenses	111	10	111	10	112	13
Purchased services	114	3	104	3	94	1
Insurance and taxes	2	1	5	1	4	-
Depreciation and amortization	27	1	26	1	26	-
Total expenses	552	28	546	28	528	26
Operating income revenues in excess of (less than) expenses	(7)	-	(10)	-	5	-
Nonoperating gains	-	-	4	-	2	-
Interest expense and other	(7)	-	(11)	-	(8)	-
Operating/capital contributions	-	-	-	-	1	-
Change in net position	\$ (14)	\$ -	\$ (17)	\$ -	\$ -	\$ -

Net patient service revenue for the Primary Health System increased from \$514 million in fiscal year 2012 to \$526 million in fiscal year 2013. Admissions for fiscal year 2013 were comparable to fiscal year 2012, however, case mix increased over the prior year by 1.6%. The Erlanger East emergency room opened in March 2013 generating 6,100 additional emergency room visits. Net patient service revenue for the Primary Health System increased from \$513 million in fiscal year 2011 to \$514 million in fiscal year 2012. Although total admissions were up 3.9% over fiscal year 2011, inpatient surgical patients decreased 4.9% over prior year which resulted in a higher medicine mix of patients. Neonatal intensive care unit patient days decreased by 8.7% compared to prior year.

Salaries for the Primary Health System decreased from \$300 million in fiscal year 2012 to \$298 million in fiscal year 2013. Paid FTE's per adjusted occupied bed decreased from 5.60 in fiscal year 2012 to 5.40 in fiscal year 2013. Salaries for the Primary Health System increased from \$292 million in fiscal year 2011 to \$300 million in fiscal year 2012 due to continued growth in strategically critical new physician practices, increase in employee benefits, and approximately \$2.6 million in severance payments resulting from a reduction in workforce.

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

Management's Discussion and Analysis - Continued

Years Ended June 30, 2013 and 2012

CHANGES IN NET POSITION - Continued

Supplies and other expenses were \$111 million for fiscal years 2013 and 2012. Supplies and drugs per adjusted admission for the Primary Health System decreased from \$1,675 in fiscal year 2012 to \$1,587 in fiscal year 2013. Supplies and expenses decreased from \$112 million in fiscal year 2011 to \$111 million in fiscal year 2012.

Purchased Services increased from \$104 million in fiscal year 2012 to \$114 million in fiscal year 2013 due to contracted service expenditures assumed with the purchase of Plaza Surgery's minority interest, fees associated with the CEO search, fees associated with the third party operational assessment and implementation, and an increase in rent expense resulting from the sale of the Erlanger East POB. Purchased services increased from \$94 million in fiscal year 2011 to \$104 million in fiscal year 2012 due to the implementation of Cyberknife services, service excellence initiatives, outsourced security services and billing service fees associated with increased employed physicians' revenue.

Insurance and taxes decreased by \$2.5 million from fiscal year 2012 to fiscal year 2013 due to insurance payment received for prior year liability, decreased malpractice liability, and decreased expenses associated with the purchase of Plaza Surgery, G.P. Insurance and taxes increased from \$4 million in fiscal year 2011 to \$5 million in fiscal year 2012 due to increased malpractice liability.

Depreciation and amortization expense increased from \$26 million in fiscal year 2012 to \$27 million in fiscal year 2013 due, in part, to the addition of the Erlanger East emergency room. Depreciation and amortization expense was \$26 million in fiscal years 2011 and 2012.

Interest expense, including gain (or loss) on mark-to-market of interest rate swaps, decreased from \$11 million in fiscal year 2012 to \$7 million in fiscal year 2013. The market value of the liability for the mark-to-market of interest rate swaps decreased by \$2.3 million in fiscal year 2013 compared to an increase of \$1.1 million in fiscal year 2012. Interest expense, including gain (or loss) on mark-to-market of interest rate swaps, increased from \$8 million in fiscal year 2011 to \$11 million in fiscal year 2012. The market value of the liability for the mark-to-market of interest rate swaps increased by \$1.1 million in fiscal year 2012 compared to a decrease of \$1.6 million in fiscal year 2011.

OUTLOOK

The State of Tennessee continues to review the TennCare program (the State's Medicaid program). For fiscal years 2011 and 2012, the State passed a Hospital Coverage Fee to offset shortfalls in the State's budget for TennCare. The fee is remained intact for the third consecutive year and TennCare rates were stable in fiscal year 2013. There could be possible TennCare rate

CHATTANOOGA-HAMILTON COUNTY HOSPITAL AUTHORITY
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Management's Discussion and Analysis - Continued

Years Ended June 30, 2013 and 2012

OUTLOOK - Continued

changes in fiscal year 2014 as a result of rate variation initiatives. Out-of-state Medicaid and TennCare changes would affect the Primary Health System's bottom line with TennCare and Medicaid patients representing approximately 24% of the payer mix. Self Pay patients represent approximately 10% of the charge utilization. Healthcare reform and future changes in Medicare regulations could also have an adverse effect on the Primary Health System's future operations since Medicare represents approximately 30% of the payer mix.

The Primary Health System is currently pursuing participation in the Public Hospital Supplemental Payment Pool which could result in additional funding.

The Primary Health System recognized Essential Access and Disproportionate Share payments totaling \$19.1 million from the State of Tennessee for fiscal year 2013, a decrease of \$1.5 million from fiscal year 2012. The Primary Health System recognized Essential Access and Disproportionate Share payments from the State of Tennessee fiscal year 2012 which increased by \$10 million over fiscal year 2011. Additionally, the Primary Health System recognized trauma funding of \$1.1 million in fiscal year 2013 compared to \$1 million in fiscal year 2012 and \$1.1 million in fiscal year 2011. Payments from the State of Tennessee for the fiscal year 2014 are expected to be consistent with the fiscal year 2013 except for disproportionate share. The funding of disproportionate share for fiscal year 2014 has not been approved by the Federal government. However, it is likely that the Federal government will approve this extension. Due to the 1966 Hamilton County Sales Tax Agreement expiring in May 2011, the Hamilton County appropriations to the Primary Health System have been reduced from \$3 million to \$1.5 million for fiscal years 2013 and 2012. An increase for the fiscal year 2014 is unlikely.

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

Audited Combined Financial Statements

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

Combined Statements of Net Position

	<i>June 30, 2013</i>	
	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 17,250,905	\$ 930,587
Temporary investments	13,797,542	2,938,131
Assets limited as to use available for current liabilities	28,275	-
Patient accounts receivable, net	73,561,669	2,408,177
Estimated amounts due from third party payors	3,116,389	-
Due from other governments	528,032	377,239
Inventories	11,861,728	1,161,097
Receivable from Hutcheson Medical Center	20,550,000	-
Other current assets	20,129,320	1,917,719
TOTAL CURRENT ASSETS	<u>160,823,860</u>	<u>9,732,950</u>
NET PROPERTY, PLANT AND EQUIPMENT	160,973,575	9,643,816
LONG-TERM INVESTMENTS, for working capital	1,790,946	1,599,946
ASSETS LIMITED AS TO USE	130,231,028	-
OTHER ASSETS:		
Deferred financing costs	5,833,775	-
Equity in discretely presented component units and other	13,639,860	-
Other assets	437,820	858,972
TOTAL OTHER ASSETS	<u>19,911,455</u>	<u>858,972</u>
TOTAL ASSETS	<u>\$ 473,730,864</u>	<u>\$ 21,835,684</u>
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	\$ 46,945,723	\$ 1,425,315
Accrued salaries and related liabilities	19,131,496	910,318
Estimated amounts due to third party payors	-	93,625
Due to other governments	377,239	528,032
Current portion of long-term debt and capital lease obligations	8,058,625	556,698
Other current liabilities	2,194,117	838,223
TOTAL CURRENT LIABILITIES	<u>76,707,200</u>	<u>4,352,211</u>
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS	169,370,173	3,445,959
OTHER LONG-TERM LIABILITIES	41,790,984	-
NET POSITION:		
Unrestricted	173,517,742	8,321,046
Net investment in capital assets	10,125,742	5,716,468
Restricted expendable	2,219,023	-
TOTAL NET POSITION	<u>185,862,507</u>	<u>14,037,514</u>
TOTAL LIABILITIES AND NET POSITION	<u>\$ 473,730,864</u>	<u>\$ 21,835,684</u>

	<i>June 30, 2012</i>	
	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 27,820,469	\$ 35,714
Temporary investments	14,510,657	3,210,896
Assets limited as to use available for current liabilities	33,250	-
Patient accounts receivable, net	76,641,438	2,325,057
Due from other governments	905,829	501,472
Inventories	11,566,908	1,155,064
Other current assets	24,383,555	1,528,889
TOTAL CURRENT ASSETS	155,862,106	8,757,092
NET PROPERTY, PLANT AND EQUIPMENT	157,718,163	9,884,006
LONG-TERM INVESTMENTS, for working capital	262,396	2,608,721
ASSETS LIMITED AS TO USE	138,419,178	-
OTHER ASSETS:		
Deferred financing costs	6,458,443	-
Receivable from Hutcheson Medical Center	12,500,000	-
Equity in discretely presented component units and other	13,901,747	175,000
Other assets	461,820	956,272
TOTAL OTHER ASSETS	33,322,010	1,131,272
TOTAL ASSETS	\$ 485,583,853	\$ 22,381,091
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	\$ 36,758,702	\$ 630,903
Accrued salaries and related liabilities	19,266,509	937,705
Estimated amounts due to third party payors	380,898	93,625
Due to other governments	501,472	905,829
Current portion of long-term debt and capital lease obligations	7,929,701	500,000
Other current liabilities	2,088,573	1,120,629
TOTAL CURRENT LIABILITIES	66,925,855	4,188,691
LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS	177,310,823	3,916,667
OTHER LONG-TERM LIABILITIES	41,397,245	-
NET POSITION:		
Unrestricted	197,982,061	8,733,085
Net investment in capital assets	(233,917)	5,542,648
Restricted expendable	2,201,786	-
TOTAL NET POSITION	199,949,930	14,275,733
TOTAL LIABILITIES AND NET POSITION	\$ 485,583,853	\$ 22,381,091

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

Combined Statements of Revenue, Expenses and Changes in Net Position

	<i>Year Ended June 30, 2013</i>	
	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>
OPERATING REVENUE:		
Charges for services:		
Net patient service revenue	\$ 526,139,300	\$ 11,345,856
Other revenue	18,969,187	16,241,907
TOTAL OPERATING REVENUE	545,108,487	27,587,763
OPERATING EXPENSES:		
Salaries, wages and benefits	297,831,739	13,607,440
Supplies and other expenses	110,970,317	10,199,559
Purchased services	114,011,044	2,981,048
Insurance and taxes	2,476,434	295,336
Depreciation	26,856,073	1,045,235
TOTAL OPERATING EXPENSES	552,145,607	28,128,618
OPERATING LOSS	(7,037,120)	(540,855)
NONOPERATING REVENUE (EXPENSES):		
Gain on disposal of assets	244,660	590,326
Interest and investment income	24,827	104,642
Net loss from discretely presented component units and other	(261,887)	(175,000)
Interest expense	(9,542,163)	(208,669)
Provision for income taxes	-	(8,663)
Change in mark-to-market of interest rate swaps	2,256,035	-
NET NONOPERATING REVENUE (EXPENSES)	(7,278,528)	302,636
Loss before contributions	(14,315,648)	(238,219)
Operating contributions (distributions)	7,248	-
Capital contributions/other, net	220,977	-
CHANGE IN NET POSITION	(14,087,423)	(238,219)
NET POSITION AT BEGINNING OF YEAR	199,949,930	14,275,733
NET POSITION AT END OF YEAR	\$ 185,862,507	\$ 14,037,514

	<i>Year Ended June 30, 2012</i>	
	<i>Primary Health System</i>	<i>Aggregate Discretely Presented Component Units</i>
OPERATING REVENUE:		
Charges for services:		
Net patient service revenue	\$ 514,081,693	\$ 11,758,042
Other revenue	22,467,500	16,271,756
TOTAL OPERATING REVENUE	536,549,193	28,029,798
OPERATING EXPENSES:		
Salaries, wages and benefits	300,099,607	13,101,376
Supplies and other expenses	111,165,013	10,454,042
Purchased services	103,908,488	2,788,577
Insurance and taxes	4,921,912	366,516
Depreciation	26,241,609	848,875
TOTAL OPERATING EXPENSES	546,336,629	27,559,386
OPERATING INCOME (LOSS)	(9,787,436)	470,412
NONOPERATING REVENUE (EXPENSES):		
Gain (loss) on disposal of assets	1,815,605	(17,139)
Interest and investment income	2,363,937	127,910
Net gain from discretely presented component units and other	186,011	-
Interest expense	(10,232,817)	(218,057)
Provision for income taxes	-	(160,547)
Change in mark-to-market of interest rate swaps	(1,080,176)	-
NET NONOPERATING EXPENSES	(6,947,440)	(267,833)
Income (loss) before contributions	(16,734,876)	202,579
Operating distributions	(198,111)	-
Capital contributions/other, net	(231,984)	-
CHANGE IN NET POSITION	(17,164,971)	202,579
NET POSITION AT BEGINNING OF YEAR (as previously reported)	204,011,165	14,073,154
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	13,103,736	-
NET POSITION AT BEGINNING OF YEAR	217,114,901	14,073,154
NET POSITION AT END OF YEAR	\$ 199,949,930	\$ 14,275,733

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

Combined Statements of Cash Flows

	<i>Primary Health System</i>	
	<i>Year Ended June 30,</i>	
	<i>2013</i>	<i>2012</i>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from third-party payors and patients	\$ 527,371,215	\$ 522,376,450
Payments to vendors and others for supplies, purchased services, and other expenses	(217,039,131)	(222,829,499)
Payments to and on behalf of employees	(297,118,972)	(308,557,666)
Other receipts	23,375,977	17,223,307
NET CASH PROVIDED BY OPERATING ACTIVITIES	36,589,089	8,212,592
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Contributions (distributions)	7,248	(198,111)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition and construction of capital assets, net	(30,339,955)	(20,962,299)
Principal paid on bonds, capital lease obligations and other	(7,900,842)	(7,396,156)
Proceeds from sale of assets	473,130	11,256,695
Interest payments on long-term debt	(8,971,728)	(9,652,060)
Capital contributions/other, net	220,977	(231,984)
NET CASH USED IN CAPITAL AND RELATED FINANCING ACTIVITIES	(46,518,418)	(26,985,804)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest, dividends, and net realized gains (losses) on investments	2,468,950	2,168,553
Change in long-term investments for working capital	(815,435)	20,444,766
Advances under note agreements	(8,050,000)	(12,948,997)
Cash provided by assets limited as to use	5,749,002	1,481,562
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(647,483)	11,145,884
DECREASE IN CASH AND CASH EQUIVALENTS	(10,569,564)	(7,825,439)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	27,820,469	35,645,908
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 17,250,905	\$ 27,820,469

	<i>Primary Health System</i>	
	<i>Year Ended June 30,</i>	
	<i>2013</i>	<i>2012</i>
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating loss	\$ (7,037,120)	\$ (9,787,436)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	26,856,073	26,241,609
Amortization of deferred liabilities	(620,506)	(155,750)
Provision for self-insurance	178,439	1,203,978
Non-cash operating revenue recognized on Plaza Surgery acquisition	-	(2,175,057)
Changes in assets and liabilities:		
Patient accounts receivable, net	3,079,769	3,803,194
Estimated amounts due from (due to) third party payors, net	(3,497,287)	8,467,153
Inventories and other assets	6,261,212	(7,061,422)
Accounts payable and accrued expenses	10,187,021	(3,268,775)
Accrued salaries and related liabilities	(135,013)	(8,985,999)
Other current and long-term liabilities	1,316,501	(68,903)
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ 36,589,089	\$ 8,212,592

SUPPLEMENTAL INFORMATION:

During the year ended June 30, 2012, the Primary Health System entered into several capital leases with third parties for office space. The capital leases represented liabilities at the inception of the leases of approximately \$6,600,000. Additionally, in 2012, as a result of the acquisition of all outstanding units of Plaza Surgery, G.P. (see Note A) deferred receipts were recognized as other operating revenue. Further, in connection with the gain on the sale of property discussed in Note E, proceeds due to Primary Health System of \$2,355,000 were withheld and are reflected as other current assets in the combined statements of net position at June 30, 2012. The Primary Health System received the remaining proceeds during the year ended June 30, 2013.

During the year ended June 30, 2013, The Primary Health System received a commitment from a third party to reimburse the Primary Health System for \$1,900,000 in renovations performed at Erlanger East. The Primary Health System also recorded a deferred liability in the amount of \$1,900,000 that will be amortized (and recognized as operating revenue) over the lease term of 20 years.

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

Notes to Combined Financial Statements

Years Ended June 30, 2013 and 2012

NOTE A--SIGNIFICANT ACCOUNTING POLICIES

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

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

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

Erlanger Health Plan Trust, Plaza Surgery, G.P., ContinuCare HealthServices, Inc., Cyberknife of Chattanooga, LLC, and UT-Erlanger Medical Group, Inc. are legally separate organizations which the Primary Health System has determined are component units of the Primary Health System.

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

Plaza Surgery, G.P. (Plaza) operated an ambulatory surgery center on the Primary Health System's campus. In 2012, the Primary Health System purchased the remaining outstanding units of Plaza and its operations are no longer distinct from the Primary Health System, although Plaza remains a separate legal entity. The accompanying 2013 and 2012 combined financial statements reflect Plaza's operations, assets and liabilities as a blended component unit.

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

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

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

ContinuCare owes the Primary Health System for various services, supplies, and rents provided, or expenses paid on its behalf. Actual expenses incurred related to these services were \$2,119,466 and \$1,728,869 in 2013 and 2012, respectively, including management fees of approximately \$33,000 each year. In addition, ContinuCare provides staffing, contract nurse visits, and administrative services to the Primary Health System. Revenues from such services were \$617,427 and \$508,888 for the years ended 2013 and 2012, respectively. Amounts due at June 30, 2013 and 2012 are included in amounts due to/from other governments in the accompanying combined financial statements.

2. Cyberknife of Chattanooga, LLC (Cyberknife) provides radiation therapy services, specifically robotic stereotactic radiosurgical services, through the use of a cyberknife stereotactic radiosurgery system on the Primary Health System's campus. At June 30, 2013 and 2012 the Primary Health System owns 51% of Cyberknife's outstanding membership units and Cyberknife is fiscally dependent on the Primary Health System.

During fiscal year 2011, Cyberknife was capitalized by the contribution of the Primary Health System of \$612,000 and the contribution of cash from certain minority partners of \$588,000. In addition to the capital contributions, each Member is required as a condition precedent to such Member's admission as a Member of Cyberknife, to deliver limited guaranties, guaranteeing prorata repayment of indebtedness of Cyberknife incurred to finance its equipment costs and its working capital needs. As of June 30, 2013 and 2012, total debt outstanding was \$3,916,667 and \$4,416,667 respectively. Income is allocated to Members based on ownership percentages and taxed at the Member level based upon the tax status of the partner. The portion of

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

Years Ended June 30, 2013 and 2012

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

income allocated to the Primary Health System is exempt from income taxes based on the Primary Health System's tax-exempt status.

As of June 30, 2013 and 2012, Cyberknife owes the Primary Health System for various services, supplies and rents provided, or expenses paid on its behalf. The Primary Health System owes Cyberknife for radiation services provided by Cyberknife to the Primary Health System's patients. Revenues related to those services provided to the Primary Health System were \$1,560,900 and \$1,595,300 in 2013 and 2012, respectively. Amounts due at June 30, 2013 and 2012 are included in amounts due to/from other governments in the accompanying combined statements of net position.

3. UT-Erlanger Medical Group, Inc. (the Medical Group) was formed on June 30, 2011 and will provide professional healthcare and related services to the public through employed and contracted licensed physicians and other supporting healthcare providers. The Medical Group is not yet active. The Medical Group has no members; however, the Primary Health System may access the Medical Group's services. The Primary Health System is not entitled to any potential earnings of the Medical Group except for compensation for services rendered to the Medical group on its behalf. However, based upon the significance of the Medical Group's operation to the Primary Health System, management believes its exclusion would be misleading and as such, includes the Medical Group as a component unit.

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

Contributions from the Foundation totaling approximately \$920,395 and \$494,000 for the years ended June 30, 2013 and 2012, respectively, were recognized as contribution revenue by the Primary Health System.

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

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

Years Ended June 30, 2013 and 2012

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

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

Recently Issued or Effective Accounting Pronouncements: In November 2010, the GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus* (GASB 61). The Statement is effective for financial statement periods beginning after June 15, 2012 and amends Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis - for State and Local Governments*. This Statement modifies certain requirements for inclusion of component units in the financial reporting entity and amends the criteria for reporting component units as if they were part of the primary government in certain circumstances. The Primary Health System adopted GASB 61 in fiscal year 2013. The impact of the adoption resulted in the Primary Health System recognizing its investment in Cyberknife and ContinuCare on the combined statement of net position and recognition of its share of gains or losses on these entities in the combined statements of revenue, expenses and changes in net position. The 2012 combined financial statements have been restated to comply with GASB 61 and the cumulative effect of a change in accounting principle is included in the combined statement of revenue, expenses and changes in net position to reflect the Primary Health System's cumulative investment in these entities as of July 1, 2011.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement amends the net asset reporting requirements of GASB Statement No. 34 and other pronouncements by incorporating deferred outflows and inflows of resources into the definitions of the required components of the residual measure and renaming that measure as net position, rather than net

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

Years Ended June 30, 2013 and 2012

NOTE A—SIGNIFICANT ACCOUNTING POLICIES - Continued

assets. The requirements of this Statement were adopted by the Primary Health System in fiscal year 2013 and the adoption did not have a material impact on the combined financial statements.

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

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. Statement No. 68 provides guidance for improved accounting and financial reporting by state and local government entities related to pensions. It also replaces the requirements of GASB Statement No. 27 and Statement No. 50, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria. This Statement is required for fiscal years beginning after June 15, 2014 with early adoption encouraged. This Statement will be effective for the Primary Health System in 2015 and management is currently evaluating its impact on the combined financial statements.

Net Patient Service Revenue/Receivables: Net patient service revenue is reported on the accrual basis in the period in which services are provided at rates which reflect the amount expected to be collected. Net patient service revenue includes amounts estimated by management to be reimbursable by third-party payer programs under payment formulas in effect. Net patient revenue also includes an estimated provision for bad debts based upon management's evaluation of collectability based upon the age of the receivables and other criteria, such as payer classification and management's assumptions about conditions it expects to exist and courses of action it expects to take. The Primary Health System's policies do not require collateral or other security for accounts receivable, although the Primary Health System routinely accepts assignment or is otherwise entitled to receive patient benefits payable under health insurance programs, plans or policies. Supplemental payments from the State of Tennessee are recognized when determinable (see Note B).

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

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

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

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

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

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

Derivative Instruments: The Primary Health System records all derivatives as assets or liabilities on the combined statements of net position at estimated fair value and includes credit value adjustments. The Primary Health System's derivative holdings consist of interest rate swap agreements. Since these derivatives have not been determined to be effective the gain or loss resulting from changes in the fair value of the derivatives is recognized in the accompanying combined statements of revenue, expenses and changes in net position. The Primary Health System's objectives in using derivatives are to take advantage of the differences between taxable and tax-exempt debt, and manage exposure to interest rate risks associated with various debt instruments (see Note N).

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

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

The Primary Health System previously adopted the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. The Primary Health System did not experience any prominent events or changes in circumstances affecting capital assets which would require determination as to whether impairment of a capital asset has occurred during the years ended June 30, 2013 and 2012.

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

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

Income Taxes: The Primary Health System is exempt from income taxes under Section 501(a) as an organization described in Section 501(c)(3) of the Internal Revenue Code (IRC). In addition, it qualifies for exemption from federal income taxes pursuant to IRC Section 115 as an instrumentality of the State of Tennessee. Therefore, no provision for income taxes has been recognized in the accompanying combined financial statements for the Primary Health System. Tax returns for the years ended June 30, 2010 through 2013 are subject to examination by taxing authorities.

As a for-profit entity, ContinuCare is subject to state and federal income taxes. ContinuCare HealthServices, Inc. and its subsidiary file consolidated federal income tax returns separately

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

from the Primary Health System. At June 30, 2013 and 2012, ContinuCare had no significant uncertain tax positions. Tax returns for the years ended June 30, 2008 through 2013 are subject to examination by taxing authorities.

As a Limited Liability Corporation, Cyberknife, a discretely presented component unit, is subject to State of Tennessee income taxes. At June 30, 2013 and 2012, Cyberknife had no significant uncertain tax positions. Tax returns for the years ended June 30, 2010 through 2013 are subject to examination by taxing authorities.

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

Net Position: The net position of the Primary Health System is classified into three components. *Net investment in capital assets* consists of capital and other assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. The *restricted expendable* net position consists of assets that must be used for a particular purpose that are either externally imposed by creditors, grantors, contributors or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. The *unrestricted net position* is remaining assets that do not meet the definition of *net investment in capital assets* or *restricted expendable*. The Primary Health System generally applies restricted resources when expenses are incurred, if both restricted and unrestricted funds are available.

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

The carrying value of long-term debt and capital lease obligations (including the current portion) was \$177,428,798 as of June 30, 2013 and \$185,240,524 as of June 30, 2012. The estimated fair value of long-term debt and capital lease obligations (including current portion) was \$186,227,537 and \$194,322,333 as of June 30, 2013 and 2012, respectively. The fair value of long-term debt related to fixed interest long-term debt and capital lease obligations was estimated using discounted cash flows, based on the Primary Health System's incremental borrowing rates or from quotes obtained from investment advisors. The fair value of long-term debt related to variable rate debt approximates its carrying value.

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

Years Ended June 30, 2013 and 2012

NOTE A--SIGNIFICANT ACCOUNTING POLICIES - Continued

Subsequent Events: The Primary Health System evaluated all events or transactions that occurred after June 30, 2013 through September 17, 2013, the date the combined financial statements were available to be issued. Management did not note any material recognizable subsequent events that required recognition or disclosure in the June 30, 2013 combined financial statements other than an agreement reached with the University of Tennessee College of Medicine (UTCOCM) in September 2013 to reimburse the Primary Health System approximately \$2,300,000 related to a refund of employment taxes in fiscal year 2013 to UTCOCM by the Internal Revenue Service. The Primary Health System had previously reimbursed UTCOCM for these expenses. The amount was recognized as a receivable at June 30, 2013 in the combined statement of net position and as a reduction of salaries, wages and benefits expense in the combined statement of revenues, expenses and changes in net position.

Reclassifications: In addition to the adoption of GASB 61, discussed previously, certain reclassifications have been made to the 2012 combined financial statements to conform with the 2013 combined financial statement presentation.

NOTE B--NET PATIENT SERVICE REVENUE

A reconciliation of the amount of services provided to patients at established rates by the Primary Health System to net patient service revenue as presented in the combined statements of revenue, expenses and changes in net position for the years ended June 30, 2013 and 2012 is as follows:

	<i>Primary Health System</i>	
	<i>2013</i>	<i>2012</i>
Inpatient service charges	\$ 986,725,639	\$ 1,007,816,189
Outpatient service charges	706,628,068	657,002,015
Gross patient service charges	1,693,353,707	1,664,818,204
Less: Contractual adjustments and other discounts	991,945,605	974,199,369
Charity care	101,729,252	77,554,683
Estimated provision for bad debts	73,539,550	98,982,459
	<u>1,167,214,407</u>	<u>1,150,736,511</u>
Net patient service revenue	<u>\$ 526,139,300</u>	<u>\$ 514,081,693</u>

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

Years Ended June 30, 2013 and 2012

NOTE B--NET PATIENT SERVICE REVENUE - Continued

Charity Care and Community Benefit: The Private Act of the State of Tennessee establishing the Primary Health System obligates the Primary Health System to make its facilities and patient care programs available to the indigent residents of Hamilton County to the extent of funds appropriated by Hamilton County and adjusted operating profits, as defined. The annual appropriation from Hamilton County was not to be less than \$3,000,000 in each fiscal year without approval of the Primary Health System, so long as the 1966 Hamilton County Sales Tax Agreement remains in effect. The Sales Tax Agreement expired in May 2011 which resulted in a \$1,500,000 reduction for fiscal year 2013 and 2012. Total charity care charges for services provided to the certified indigent residents of Hamilton County (net of the appropriation) were approximately \$23,757,000 and \$23,387,000 for the years ended June 30, 2013 and 2012 for the Primary Health System.

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

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

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

Uncompensated Care Costs: The following table summarizes the estimated total uncompensated care costs provided by Erlanger Medical Center as defined by the State of Tennessee for the years ended June 30, 2013 and 2012:

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE B--NET PATIENT SERVICE REVENUE - Continued

	<u>2013</u>	<u>2012</u>
Uncompensated cost of TennCare/Medicaid	\$ 28,228,719	\$ 27,864,201
Traditional charity uncompensated costs	33,423,115	25,568,279
Bad debt cost	23,429,117	32,074,717
Total uncompensated care costs	<u>\$ 85,080,951</u>	<u>\$ 85,507,197</u>

The uncompensated cost of TennCare/Medicaid is estimated by taking the estimated cost of providing care to the TennCare/Medicaid patients less payments from the TennCare and Medicaid programs. The payments exclude revenues from essential access and other, one-time supplemental payments from TennCare of approximately \$10,615,000 and \$11,359,300 for the years ended June 30, 2013 and 2012, respectively, as such payments are not guaranteed for future periods. Traditional charity uncompensated costs exclude approximately \$1,500,000 of local government support annually in 2013 and 2012.

Revenue from Significant Payers: Gross patient service charges related to the Medicare program accounted for approximately 29.6% and 29.7% of the Primary Health System's patient service charges for the years ended June 30, 2013 and 2012, respectively. Gross patient service charges related to the TennCare/Medicaid programs accounted for approximately 24.1% and 24.8% of the Primary Health System's patient service charges for the years ending June 30, 2013 and 2012, respectively. TennCare typically reimburses providers at an amount less than their cost of providing services to TennCare patients. At June 30, 2013 and 2012, the Primary Health System has a credit concentration related to the Medicare and TennCare programs.

During 2013 and 2012, the Primary Health System recognized revenue from these programs related to disproportionate share payments and trauma fund payments of \$9,622,000 and \$10,176,000, respectively. During 2013 and 2012, the Primary Health System also recognized approximately \$2,667,000 and \$3,100,000, respectively, of revenue related to electronic health records expenditures reimbursed by the Medicare and Medicaid programs. Such amounts are subject to audit. Additionally, in 2012, the Primary Health System received approximately \$3,200,000 from Medicare related to a rural floor budget neutrality settlement that has been recognized as net patient revenue.

Laws and regulations governing the Medicare and TennCare/Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates, as they relate to revenue recognized from these programs, will change by a material amount in the near term. The estimated reimbursement amounts are adjusted in subsequent

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE B--NET PATIENT SERVICE REVENUE - Continued

periods as cost reports are prepared and filed and as final settlements are determined. Final determination of amounts earned under prospective payment and cost reimbursement activities is subject to review by appropriate governmental authorities or their agents. Management believes that adequate provisions have been made for adjustments that may result from final determination of amounts earned under Medicare and Medicaid programs. The effect of prior year cost report settlements, or changes in estimates, increased net patient service revenue by approximately \$2,163,000 in 2013 and by approximately \$1,770,000 in 2012.

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

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

NOTE C--CASH AND CASH EQUIVALENTS

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

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

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

Years Ended June 30, 2013 and 2012

NOTE C--CASH AND CASH EQUIVALENTS - Continued

	<i>Primary Health System</i>	
	<u>2013</u>	<u>2012</u>
General Fund:		
Demand deposits	\$ 15,087,535	\$ 25,703,339
Cash on hand	9,904	10,254
Cash equivalents	2,153,466	2,106,876
	<u>\$ 17,250,905</u>	<u>\$ 27,820,469</u>

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

Bank balances consist of the following at June 30:

	<i>Primary Health System</i>	
	<u>2013</u>	<u>2012</u>
Insured (FDIC)	\$ 622,493	\$ 3,770,196
Collateralized under the State of Tennessee Bank		
Collateral Pool	21,221,755	20,008,446
Other	272,275	-
	<u>\$ 22,116,523</u>	<u>\$ 23,778,642</u>

In addition to the above bank balances, the Primary Health System held investments which met the definition of a cash equivalent and are included in cash and cash equivalents. At June 30, 2013 and 2012, amounts totaling \$2,153,466 and \$2,106,876 respectively, were invested in U.S. Government agency obligations and commercial paper.

Through December 31, 2010, the Primary Health System maintained bank balances with certain financial institutions which participated in the Federal Deposit Insurance Corporation (FDIC) Transaction Account Guarantee (TAG) Program. The TAG program expired on December 31, 2010, with the Dodd-Frank Deposit Insurance Provision becoming effective through December 31, 2012. Under the Dodd-Frank Deposit Insurance Provision, all non-interest bearing transaction accounts held by FDIC-insured depository institutions are fully insured by the FDIC for the entire balance of the account. On December 31, 2012 the Dodd-Frank Insurance Provisions expired and as of June 30, 2013, FDIC insurance was \$250,000 per account holder, per bank.

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

Years Ended June 30, 2013 and 2012

NOTE C--CASH AND CASH EQUIVALENTS - Continued

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

NOTE D--DISAGGREGATION OF RECEIVABLE AND PAYABLE BALANCES

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

	<i>Primary Health System</i>	
	2013	2012
Gross patient accounts receivable	\$ 270,824,481	\$ 296,701,066
Estimated allowances for contractual adjustments and uncollectible accounts	(197,262,812)	(220,059,628)
Net patient accounts receivable	<u>\$ 73,561,669</u>	<u>\$ 76,641,438</u>

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

	<i>Primary Health System</i>	
	2013	2012
Prepaid expenses	\$ 5,205,938	\$ 5,000,884
Other receivables	14,923,382	19,382,671
Total other current assets	<u>\$ 20,129,320</u>	<u>\$ 24,383,555</u>

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

	<i>Primary Health System</i>	
	2013	2012
Due to vendors	\$ 44,847,075	\$ 33,759,165
Other	2,098,648	2,999,537
Total accounts payable and accrued expenses	<u>\$ 46,945,723</u>	<u>\$ 36,758,702</u>

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

Years Ended June 30, 2013 and 2012

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

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

	<i>Primary Health System</i>	
	<i>2013</i>	<i>2012</i>
Pension obligation	\$ 10,439,507	\$ 10,547,623
Postretirement benefits other than pensions	5,921,563	4,851,114
Compensated absences	6,567,615	7,019,203
Medical malpractice and general liabilities	4,985,000	5,462,500
Interest rate swaps	4,856,429	7,112,464
Deferred gain on sale of property	4,400,481	4,865,237
Other	4,620,389	1,539,104
Total other long-term liabilities	\$ 41,790,984	\$ 41,397,245

NOTE E--NET PROPERTY, PLANT AND EQUIPMENT

Net property, plant and equipment activity for the Primary Health System for the years ended June 30, 2013 and 2012 consisted of the following:

	<i>Balance at June 30, 2011</i>	<i>Additions</i>	<i>Reductions/ Transfers</i>	<i>Balance at June 30, 2012</i>	<i>Additions</i>	<i>Reductions/ Transfers</i>	<i>Balance at June 30, 2013</i>
Capital assets:							
Land and improvements	\$ 26,883,511	\$ 385,757	\$ 1,913,362	\$ 25,355,906	\$ 298,962	\$ -	\$ 25,654,868
Buildings	243,445,965	9,082,187	28,652,217	223,875,935	6,845,858	-	230,721,793
Equipment	357,235,297	21,779,957	28,498,593	350,516,661	20,581,177	4,240,082	366,857,756
	627,564,773	31,247,901	59,064,172	599,748,502	27,725,997	4,240,082	623,234,417
Accumulated depreciation :							
Land and improvements	12,552,092	589,770	1,916,632	11,225,230	398,356	-	11,623,586
Buildings	176,624,223	7,720,427	22,551,870	161,792,780	7,808,629	319,543	169,281,866
Equipment	285,520,631	17,931,412	27,664,817	275,787,226	18,649,088	3,692,069	290,744,245
	474,696,946	26,241,609	52,133,319	448,805,236	26,856,073	4,011,612	471,649,697
Capital assets net of accumulated depreciation	152,867,827	5,006,292	6,930,853	150,943,266	869,924	228,470	151,584,720
Construction in progress (\$11,366,347 estimated cost to complete at June 30, 2013)	10,463,103	16,548,309	20,236,515	6,774,897	24,935,626	22,321,668	9,388,855
	\$ 163,330,930	\$ 21,554,601	\$ 27,167,368	\$ 157,718,163	\$ 25,805,550	\$ 22,550,138	\$ 160,973,575

Depreciation expense totaled \$26,856,073 and \$26,241,609 for the years ended June 30, 2013 and 2012, respectively. Construction in progress at June 30, 2013 consists of various projects for additions and renovations to the Primary Health System's facilities.

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

Years Ended June 30, 2013 and 2012

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

During 2012, the Primary Health System entered into an agreement to sell certain professional office buildings (POBs) and concurrently entered into agreements to lease space from the purchaser. The sales price of the POBs was approximately \$13,333,000, and a gain of approximately \$6,695,000 was realized, including proceeds of approximately \$2,355,000 held back until such time as certain of the leases are finalized. The amount held back is included as other current assets in the combined statement of net position at June 30, 2012 and was received during the year ended June 30, 2013.

Since the Primary Health System is leasing back certain space, accounting principles generally accepted in the United States required a portion of the gain be deferred and recognized over the terms of the leases. At June 30, 2013 and 2012, the deferred gain totaled approximately \$4,400,000 and \$4,865,000, respectively and is included as a part of other long-term liabilities in the accompanying combined statements of net position. Amortization of the deferred gain is included in non-operating revenue (expenses) for the years ended June 30, 2013 and 2012.

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

NOTE F--INVESTMENTS AND ASSETS LIMITED AS TO USE

The Primary Health System's investments (including assets limited as to use) are reported at estimated fair value based, generally, on quoted market prices in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The Primary Health System invests in United States government and agency bonds, municipal bonds, corporate debt, certificates of deposit and short-term money market investments that are in accordance with the Primary Health System's investment policy. Temporary investments at June 30, 2013 and 2012 consist primarily of United States government agency bonds, state and local government bonds and commercial paper.

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

	<i>Primary Health System</i>	
	<u>2013</u>	<u>2012</u>
U.S. Government and agency bonds, including municipal bonds, mutual funds, and other	\$ 111,569,814	\$ 119,596,675
Corporate bonds and commercial paper	4,348,798	940,586
Short-term investments and cash equivalents	16,131,637	18,177,563
Total investments and assets limited as to use	<u>\$ 132,050,249</u>	<u>\$ 138,714,824</u>

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

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

Assets limited as to use are classified as follows:

	<i>Primary Health System</i>	
	<i>2013</i>	<i>2012</i>
By board of trustees for capital improvements	\$ 99,572,404	\$ 108,023,256
Under bond indentures - held by trustees	20,901,235	20,900,048
Self-insurance trust	6,318,010	6,089,183
Restricted by donors and other	3,467,654	3,439,941
	<u>130,259,303</u>	<u>138,452,428</u>
Less current portion	(28,275)	(33,250)
Total assets whose use is limited	<u>\$ 130,231,028</u>	<u>\$ 138,419,178</u>

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

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

	<i>Primary Health System</i>	
	<i>2013</i>	<i>2012</i>
Debt service reserve funds	\$ 20,718,915	\$ 20,712,768
Principal and interest funds	28,275	33,250
Other funds	154,045	154,030
Total funds held by trustees under bond indenture	<u>\$ 20,901,235</u>	<u>\$ 20,900,048</u>

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

The Primary Health System has implemented the disclosure requirements of GASB Statement No. 40, *Deposit and Investment Risk Disclosures* (GASB No. 40) and, accordingly, the Primary Health System has assessed the custodial credit risk, the concentration of credit risk, credit risk,

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

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

and investment rate risk of its cash and investments. The Primary Health System's investment policy specifies the types of investments which can be included in board-designated assets limited as to use, as well as collateral or other security requirements. The investment policy also specifies the maximum maturity of the portfolio of board-designated assets. Assets limited as to use and held by trustees are invested as permitted by the bond indenture.

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

As of June 30, 2013 and 2012, the Primary Health System's investments, including assets limited as to use, were comprised of various short-term investments, U.S. government and government agency bonds, municipal obligations, corporate bonds, commercial paper, and other U.S. Treasury obligations. Substantially all of the Primary Health System's investments, including assets limited as to use, are uninsured or unregistered. Securities are held by the counterparty, or by its trust department or agent, in the Primary Health System's name.

Concentration of Credit Risk: This is the risk associated with the amount of investments the Primary Health System has with any one issuer that exceeds 5% or more of its total investments. Investments issued or explicitly guaranteed by the U.S. Government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. The Primary Health System's investment policy does not restrict the amount that may be held for any single issuer. At June 30, 2013, none of the Primary Health System's investments with any one issuer exceed 5% of its total investments except certain U.S. Government agencies.

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

The credit risk profile of the Primary Health System's investments, including assets limited as to use (excluding U.S. Government securities), as of June 30, 2013, is as follows:

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

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

<i>Investment Type</i>	<i>Balance as of June 30, 2013</i>	<i>Rating</i>					<i>N/A</i>
		<i>AAA</i>	<i>AA</i>	<i>A</i>	<i>BBB</i>	<i>BB</i>	
U.S Government agency bonds	\$ 41,071,080	\$ 39,483,550	\$ 1,587,530	\$ -	\$ -	\$ -	-
Bond mutual funds and other	5,618,901	5,618,901	-	-	-	-	-
Municipal bonds	6,747,750	1,540,570	4,200,440	1,006,740	-	-	-
Corporate bonds and commercial paper	4,348,798	3,004,200	-	1,344,598	-	-	-
Cash equivalents	16,153,954	-	-	-	-	-	16,153,954
Total investments	\$ 73,940,483	\$ 49,647,221	\$ 5,787,970	\$ 2,351,338	\$ -	\$ -	\$ 16,153,954

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

The distribution of the Primary Health System's investments, including assets limited as to use, and excluding the self-insurance trust, by maturity as of June 30, 2013, is as follows:

<i>Investment Type</i>	<i>Balance as of June 30, 2013</i>	<i>Remaining Maturity</i>				<i>N/A</i>
		<i>12 months or less</i>	<i>13-24 Months</i>	<i>25-60 Months</i>	<i>Over 60 Months</i>	
U.S. Government bonds and agency funds and other	\$ 103,283,374	\$ 26,781,628	\$ 19,349,742	\$ 31,925,740	\$ 25,226,264	\$ -
Municipal bonds	5,298,686	-	3,324,586	1,974,100	-	-
Corporate bonds and commercial paper	4,348,798	4,348,798	-	-	-	-
Cash equivalents	12,801,381	12,801,381	-	-	-	-
Total investments	\$ 125,732,239	\$ 43,931,807	\$ 22,674,328	\$ 33,899,840	\$ 25,226,264	\$ -

Additionally, the distribution of the Primary Health System's investments held under the self-insurance trust as of June 30, 2013, is as follows:

<i>Investment Type</i>	<i>Balance as of June 30, 2013</i>	<i>Remaining Maturity</i>				<i>N/A</i>
		<i>24 months or less</i>	<i>25-60 Months</i>	<i>61-120 Months</i>	<i>121-240 Months</i>	
Bond Mutual Funds	\$ 5,618,901	\$ -	\$ -	\$ -	\$ -	\$ 5,618,901
Cash equivalents	699,109	699,109	-	-	-	-
Total investments	\$ 6,318,010	\$ 699,109	\$ -	\$ -	\$ -	\$ 5,618,901

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE G--LONG-TERM DEBT

Long-term debt at June 30 consists of the following:

	<i>Primary Health System</i>	
	<i>2013</i>	<i>2012</i>
Revenue and Refunding Bonds, Series 2004, net of bond discount of \$532,793 in 2013 and \$684,990 in 2012 and including bond issue premium of \$1,443,483 in 2013 and \$1,584,311 in 2012	\$ 71,955,690	\$ 76,754,321
Hospital Revenue Refunding Bonds, Series 2000, including bond issue premium of \$281,255 in 2013 and \$304,215 in 2012	34,581,255	36,404,215
Hospital Revenue Bonds, Series 1998A, net of bond discount of \$280,615 in 2013 and \$295,384 in 2012	18,329,385	18,859,616
Hospital Revenue Bonds, Taxable Series 1997A	41,000,000	41,000,000
Total bonds payable	165,866,330	173,018,152
Less: unamortized premium paid on advance refunding	(809,251)	(895,189)
Total bonds payable, net	165,057,079	172,122,963
Other Loans and Notes Payable	5,630,515	6,282,894
Capital leases - Note M	6,741,204	6,834,667
	177,428,798	185,240,524
Less: current portion	(8,058,625)	(7,929,701)
	<u>\$ 169,370,173</u>	<u>\$ 177,310,823</u>

During fiscal year 2011, the Primary Health System entered into a term loan (the Loan) with a financial institution in the maximum amount of \$7,000,000 to finance the acquisition of the Lifestyle Center property. The rate of interest on the loan is a fixed rate equal to 5.45%. Monthly payments of principal and interest are payable on the first day of each month for a 10 year term beginning December 1, 2010, with a final payment equal to the unpaid principal plus accrued and unpaid interest due at maturity. The loan contains certain covenants and restrictions. Management believes the Primary Health System was in compliance with all such covenants at June 30, 2013.

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE G--LONG-TERM DEBT - Continued

The Primary Health System entered into a non-revolving line of credit loan (the Credit Agreement) with a financial institution in the maximum amount of \$41,000,000 to potentially refund the outstanding principal amount of the Primary Health System's 1997A Hospital Revenue Bonds if London InterBank Offered Rate (LIBOR) materially changes. The rate of interest on disbursed funds, if any, will be a variable rate equal to the London InterBank Offered Rate plus an applicable margin, as outlined in the Credit Agreement. Monthly installment payments of the outstanding principal amount, if any, shall be amortized over a period of seventeen years. As of June 30, 2013, the Primary Health System has not drawn on the Credit Agreement.

During fiscal year 2010, the Primary Health System remarketed the Series 2004 Hospital Revenue Refunding Bonds (Series 2004) and the Series 2000 Hospital Revenue Refunding Bonds (Series 2000), as described below, and converted such bonds from a variable auction rate to a fixed rate.

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

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

In August 2000, the Primary Health System issued \$47,300,000 insured Series 2000 bonds for the purpose of refunding \$40,000,000 of then outstanding Series 1987 bonds and funding a debt service reserve fund in an original amount of \$4,407,377 and to pay issuance costs. The Series 2000 bonds were issued on parity with other outstanding bond issues. The Series 2000 bonds consist of term bonds maturing on October 1, 2023 and serial bonds maturing on October 1 annually beginning in 2010 through 2025. The bonds maturing on October 1, 2023 are subject to

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE G--LONG-TERM DEBT - Continued

mandatory sinking fund redemption prior to maturity and without premium at the principal amount thereof on October 1. The Series 2000 bonds maturing after October 1, 2014 may be redeemed by the Primary Health System after October 1, 2014 at a redemption price equal to the principal amount plus accrued interest.

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

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

The Primary Health System's 1997A and 1998A Hospital Revenue Bonds (Series 1997A and Series 1998A, respectively) were issued to fund capital improvements for Erlanger Medical Center and establish a debt service reserve fund (1998A only) in an original amount of \$2,174,125. The Series 1997A bonds are taxable and are secured on a parity under a Master Trust Indenture with other outstanding bond issues. The bonds mature beginning in fiscal year 2015 through fiscal year 2028. The 1997A bonds are subject to optional redemption at 100% plus accrued interest. Interest is payable at a variable auction rate for a 35-day period, which was 0.49% at June 30, 2013 and 0.61% at June 30, 2012.

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

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

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

During fiscal year 2002, the Primary Health System defeased \$5,320,000 of the 1998A bond issuance because IRS regulations do not permit tax-exempt debenture proceeds to be used to fund for-profit endeavors. These funds were used in the construction of an Ambulatory Surgery Center. The Primary Health System contributed to an escrow account funds generated from its operations sufficient to fund all principal and interest payments for approximately \$5,320,000 of debentures until maturity. The Primary Health System was released from being the primary

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE G--LONG-TERM DEBT - Continued

obligor and cannot be held liable for the defeased obligation, of which approximately \$4,670,000 remains outstanding at June 30, 2013.

The trust indentures and related documents underlying the bonds contain certain covenants and restrictions. For fiscal years 2013 and 2012, the Primary Health System failed to satisfy the debt service coverage ratio required by one of the bond insurers. As a result of the non-compliance, the Primary Health System will be required to engage a management consultant or obtain a waiver from the bond insurer.

The Primary Health System's scheduled principal and interest payments (estimated for variable rate debt based on rates at June 30, 2013) on bonds payable and other long-term debt (excluding capital leases) are as follows for the years ending June 30:

	<i>Principal</i>	<i>Interest</i>	<i>Total</i>
2014	\$ 7,889,626	\$ 6,271,219	\$ 14,160,845
2015	10,605,736	5,868,787	16,474,523
2016	11,637,069	5,391,616	17,028,685
2017	11,723,446	4,945,072	16,668,518
2018	12,674,484	4,515,962	17,190,446
2019-2023	68,110,154	14,846,066	82,956,220
2024-2028	45,825,000	2,919,414	48,744,414
2029-2033	2,120,000	53,000	2,173,000
TOTAL	\$ 170,585,515	\$ 44,811,136	\$ 215,396,651

Long-term debt activity for the Primary Health System for the years ended June 30, 2013 and 2012 consisted of the following:

	<i>Balance at June 30, 2011</i>	<i>Additions/ Amortizations</i>	<i>Reductions/ Accretions</i>	<i>Balance at June 30, 2012</i>	<i>Additions/ Amortizations</i>	<i>Reductions/ Accretions</i>	<i>Balance at June 30, 2013</i>
Bonds Payable							
Series 2004	\$ 81,373,245	\$ 151,904	\$ 4,770,828	\$ 76,754,321	\$ 152,197	\$ 4,950,828	\$ 71,955,690
Series 2000	38,327,175	-	1,922,960	36,404,215	-	1,822,960	34,581,255
Series 1998A	18,984,847	14,769	140,000	18,859,616	14,769	545,000	18,329,385
Series 1997A	41,000,000	-	-	41,000,000	-	-	41,000,000
Premium paid on advance refunding	(981,127)	85,938	-	(895,189)	85,938	-	(809,251)
Total bonds payable	178,704,140	252,611	6,833,788	172,122,963	252,904	7,318,788	165,057,079

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

Years Ended June 30, 2013 and 2012

NOTE G--LONG-TERM DEBT - Continued

	<i>Balance at June 30, 2011</i>	<i>Additions/ Amortizations</i>	<i>Reductions/ Accretions</i>	<i>Balance at June 30, 2012</i>	<i>Additions/ Amortizations</i>	<i>Reductions/ Accretions</i>	<i>Balance at June 30, 2013</i>
Term Loan	6,902,514	-	619,620	6,282,894	-	652,379	5,630,515
Capital leases	343,807	6,616,296	125,436	6,834,667	-	93,463	6,741,204
Total long-term debt	\$ 185,950,461	\$ 6,868,907	\$ 7,578,844	\$ 185,240,524	\$ 252,904	\$ 8,064,630	\$ 177,428,798

NOTE H--PENSION PLAN

The Primary Health System sponsors a single-employer, non-contributory defined benefit pension plan covering substantially all employees meeting certain age and service requirements. In addition to normal retirement benefits, the plan also provides for early retirement, delayed retirement, disability and death benefits. The Primary Health System funds the plan as contributions are approved by the Board of Trustees but not in amounts less than the minimum required contribution determined by the plan's consulting actuary. During the years ended June 30, 2013 and 2012, the Primary Health System made contributions of \$11,165,100 and \$10,367,970, respectively to the plan. The Primary Health System has the right to amend, in whole or in part, any or all of the provisions of the plan. The plan issues a publicly available financial report that includes a financial statement and required supplementary information for the plan. That report may be obtained by writing to Erlanger Health System, Attention: Human Resources Department, 975 East Third Street, Chattanooga, Tennessee 37403 or by calling 423-778-7000.

The annual pension cost and net pension obligation for the years ended June 30, 2013 and 2012 are as follows:

	<i>Primary Health System</i>	
	<i>2013</i>	<i>2012</i>
Annual required contribution	\$ 11,165,100	\$ 10,367,970
Interest on net pension obligation	791,073	798,800
Adjustment to annual required contribution	(899,189)	(901,802)
Annual pension cost	11,056,984	10,264,968
Contributions made	(11,165,100)	(10,367,970)
Change in net pension obligation	(108,116)	(103,002)
Net pension obligation at beginning of year	10,547,623	10,650,625
Net pension obligation at end of year	\$ 10,439,507	\$ 10,547,623

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

Years Ended June 30, 2013 and 2012

NOTE H--PENSION PLAN - Continued

The annual expected contribution for the years ended June 30, 2013 and 2012, was determined as part of the January 1, 2013 and 2012 actuarial valuations, respectively, using the projected unit credit cost method. The following actuarial assumptions were utilized:

	<i>Primary Health System</i>	
	<i>2013</i>	<i>2012</i>
Investment rate of return	7.5%	7.5%
Projected salary increases	4.0%	4.0%
Inflation	2.5%	2.5%
Increase in Social Security taxable wage base	3.5%	3.5%

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

<i>Fiscal Year Ending</i>	<i>Three-Year Trend Information</i>		<i>Net Pension Obligation</i>
	<i>Annual Pension Cost (APC)</i>	<i>Percentage of APC Contributed</i>	
June 30, 2011	\$ 8,831,554	100%	\$ 10,650,625
June 30, 2012	10,264,968	101%	10,547,623
June 30, 2013	11,056,984	101%	10,439,507

The schedule of funding progress shown below presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. The actuarial asset values are determined using prior year valuations with the addition of current year contributions and expected investment return on market value of assets based on an assumed rate of 7.5%, and deducting benefit payments and administrative expenses for the year. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments using an average of cost and market value. The plan will reset the amortization base each year equal to the unfunded actuarial accrued liability to be amortized over a closed 20 year period (30 years in 2012 and prior periods) and using a level dollar amount as the amortization factor.

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

Years Ended June 30, 2013 and 2012

NOTE H--PENSION PLAN - Continued

<i>Schedule of Funding Progress</i>						
<i>Actuarial Valuation Date</i>	<i>Actuarial Value of Assets</i>	<i>Actuarial Accrued Liability (AAL)</i>	<i>Total Unfunded AAL (UAAL)</i>	<i>Funded Ratio %</i>	<i>Annual Covered Payroll</i>	<i>UAAL as a Percentage of Covered Payroll</i>
1/1/11	\$125,335,932	\$ 150,926,741	\$25,590,809	83.0%	\$ 147,947,134	17.3%
1/1/12	124,520,999	160,704,688	36,183,689	77.5%	138,807,819	26.1%
1/1/13	121,700,323	170,980,311	49,279,988	71.2%	121,093,695	40.7%

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

NOTE I--OTHER RETIREMENT PLANS

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

The Primary Health System matches 50% of each participant's contribution up to 2% of the participant's earnings. Additionally, for eligible employees hired on after July 1, 2009 the Primary Health System will make profit sharing contributions equal to 3% of their earnings, regardless if the employee is making contributions. Employer contributions to the plan were \$1,826,075 and \$1,765,972 for the years ended June 30, 2013 and 2012, respectively. Employee contributions were \$8,883,953 and \$9,036,506 in 2013 and 2012, respectively.

NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

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

The Primary Health System reports other postemployment benefits in accordance with the GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment*

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued

Benefits Other Than Pensions. This Statement addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. This Statement also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time.

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

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

	<u>2013</u>	<u>2012</u>
Actuarial accrued liability	\$ 30,500,450	\$ 28,788,147
Market value of assets	-	-
Unfunded actuarial accrued liability	<u>\$ 30,500,450</u>	<u>\$ 28,788,147</u>

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

	<u>2013</u>	<u>2012</u>
Annual required contribution	\$ 2,945,355	\$ 2,659,068
Interest on the net obligation	228,288	163,912
Amortization of net obligation	(226,809)	(156,587)
OPEB cost recognized	<u>\$ 2,946,834</u>	<u>\$ 2,666,393</u>

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

Years Ended June 30, 2013 and 2012

NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued

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

	2013	2012
Net OPEB obligation beginning of the year	\$ 5,707,193	\$ 4,097,800
OPEB cost recognized	2,946,834	2,666,393
Actual contributions	(1,687,482)	(1,057,000)
Net OPEB obligation end of the year	<u>\$ 6,966,545</u>	<u>\$ 5,707,193</u>

Trend Information

<i>Fiscal Year Ending</i>	<i>Annual OPEB Cost</i>	<i>Percentage of Annual OPEB Cost Contributed</i>	<i>Net OPEB Obligation at the End of Year</i>
June 30, 2011	\$ 2,508,668	32.7%	\$ 4,097,800
June 30, 2012	2,666,393	39.6%	5,707,193
June 30, 2013	2,946,834	57.3%	6,966,545

Schedule of Funding Progress

<i>Actuarial Valuation Date</i>	<i>Actuarial Value of Assets</i>	<i>Actuarial Accrued Liability</i>	<i>Unfunded Actuarial Accrued Liability</i>	<i>Annual Covered Payroll</i>	<i>Unfunded Actuarial Accrued Liability as a Percent of Covered Payroll</i>	<i>Funded Ratio</i>
June 30, 2011	\$ -	\$ 24,966,769	\$ 24,966,769	\$147,947,134	16.9%	0%
June 30, 2012	-	28,788,147	28,788,147	138,807,819	20.7%	0%
June 30, 2013	-	30,500,450	30,500,450	155,727,806	19.6%	0%

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

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

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE J--POSTRETIREMENT BENEFITS OTHER THAN PENSIONS - Continued

The actuarial cost method utilized is the unit credit actuarial cost method. The 2013 postretirement benefit cost assumed an average weighted annual rate increase in per capita cost of covered health benefits of 7.4%, decreasing gradually to an ultimate rate of 4.8%. The 2012 postretirement benefit cost assumed an average weighted annual rate increase in per capita cost of covered health benefits of 9.6%, decreasing gradually to an ultimate rate of 4.6%.

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

The Primary Health System also has a job injury program to provide benefits to workers injured in employment-related accidents. This program provides medical and indemnity benefits to employees injured in the course of employment for a period up to 24 months from the date of injury. The Primary Health System has recorded a projected liability of approximately \$1,253,000 and \$916,000 at June 30, 2013 and 2012, respectively. Such amounts are included as a part of other long-term liabilities in the combined statements of net position. The projected liability was discounted using a 4% rate of return at June 30, 2013 and 2012.

NOTE K--MEDICAL MALPRACTICE AND GENERAL LIABILITY CLAIMS

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

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

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

In the opinion of management, the revocable trust fund assets are adequate at June 30, 2013, to cover potential liability and malpractice claims and expenses that may have been incurred to that date.

The Primary Health System provides for claims and expenses in the period in which the incidence related to such claims occur based on historical experience and consultation with legal counsel. It is the opinion of management that the reserve for estimated losses and loss adjustment expense (LAE) at June 30, 2013 and 2012, respectively, is adequate to cover potential liability and malpractice claims which may have been incurred but not reported (IBNR) to the Primary Health System. Such reserve for IBNR claims reflect a discount rate of 5.5% based on the Primary Health System's expected investment return during the payout period.

The following is a reconciliation of changes in the estimated losses and LAE that have been recognized in the combined financial statements for the years ended June 30, 2013 and 2012:

	<i>Primary Health System</i>	
	<i>2013</i>	<i>2012</i>
Reserve for losses and LAE at beginning of year	\$ 5,462,500	\$ 5,085,000
Provision for claims	178,439	1,203,977
Payments on claims	(655,939)	(826,477)
Reserve for losses and LAE at end of year	<u>\$ 4,985,000</u>	<u>\$ 5,462,500</u>

NOTE L--COMMITMENTS AND CONTINGENCIES

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

The prior Chief Executive Officer (CEO) resigned from Erlanger on December 31, 2011, after an interim CEO (the Executive Vice President) was established December 1, 2011. The interim CEO was replaced by the current CEO, hired on April 1, 2013. The Executive Vice President's employment at Erlanger ended when her leave expired in June, 2013. She has filed a wrongful termination lawsuit against Erlanger for \$25 million, which Erlanger, in conjunction with its Directors & Officers insurance carrier, is currently defending. The ultimate outcome of this lawsuit is uncertain.

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE L--COMMITMENTS AND CONTINGENCIES - Continued

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

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

NOTE M--LEASES

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

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

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

	<i>Primary Health System</i>	
	<u>2013</u>	<u>2012</u>
Buildings	\$ 6,601,812	\$ 6,597,396
Equipment	494,905	323,765
	<u>7,096,717</u>	<u>6,921,161</u>
Less: accumulated amortization	(593,019)	(159,961)
	<u>\$ 6,503,698</u>	<u>\$ 6,761,200</u>

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Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE M--LEASES - Continued

The following is a schedule of future minimum lease payments under capital leases at June 30, 2013:

<u>Year Ending June 30,</u>	
2014	\$ 845,820
2015	702,264
2016	715,938
2017	729,998
2018	744,472
2019-2023	3,827,865
2024-2028	3,693,101
2029-2033	<u>2,760,506</u>
Total minimum lease payments	14,019,964
Less: amount representing interest	<u>(7,278,760)</u>
Present value of minimum lease payments (including current portion of \$140,579)	<u>\$ 6,741,204</u>

Operating: The Primary Health System rents office space and office equipment under non-cancelable operating leases through 2033, containing various lease terms. The leases have other various provisions, including sharing of certain executory costs. Rent expense under operating leases was approximately \$7,450,000 and \$6,130,000 in 2013 and 2012, respectively. Future minimum lease commitments at June 30, 2013 for all non-cancelable leases with terms in excess of one year are as follows:

<u>Year Ending June 30,</u>	
2014	\$ 6,393,113
2015	4,151,854
2016	2,644,970
2017	2,603,297
2018	2,305,727
Thereafter	<u>19,292,193</u>
	<u>\$ 37,391,154</u>

Rental Revenues: The Primary Health System leases office space to physicians and others under various lease agreements with terms in excess of one year. Rental revenue recognized for the

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

Years Ended June 30, 2013 and 2012

NOTE M--LEASES - Continued

years ended June 30, 2013 and 2012 totaled approximately \$4,261,000 and \$6,043,000, respectively. The following is a schedule of future minimum lease payments to be received for the years ending June 30:

<u>Year Ending June 30,</u>	
2014	\$ 1,214,205
2015	874,495
2016	198,910
2017	122,057
2018	7,116
Thereafter	-
	<u>\$ 2,416,783</u>

NOTE N--DERIVATIVE FINANCIAL INSTRUMENTS

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

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

With respect to the Series 2004 bonds, the Primary Health System executed a swap where the Primary Health System receives a variable rate equal to 67% of the one-month LIBOR-BBA rate and pays a fixed rate of 3% on a notional amount of \$7,150,000 at June 30, 2013. Unless terminated at an earlier date (at the Primary Health System's option), this agreement terminates on October 1, 2013.

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

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE N--DERIVATIVE FINANCIAL INSTRUMENTS - Continued

With respect to the 1998A Series bonds, the Primary Health System executed a swap agreement whereby the Primary Health System receives a fixed rate of 3.932% and pays a variable rate equal to the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index on a notional amount of \$16,305,000. Unless terminated at an earlier date (at the Primary Health System's option), this agreement terminates on October 1, 2027.

Although these swap instruments are intended to manage exposure to interest rate risks associated with the various debt instruments referred to above, none of these swap agreements have been determined to be effective hedges. Accordingly, the interest rate swaps are reflected in the accompanying combined statements of net position at their aggregate fair value (a net liability of \$4,856,429 and \$7,112,464 at June 30, 2013 and 2012, respectively) and the changes in the value of the swaps are reflected as a component of non-operating revenues in the combined statements of revenue, expenses and changes in net position.

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

NOTE O--FAIR VALUE MEASUREMENT

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

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

In instances where the determination of the fair value hierarchy measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Primary Health System's assessment of the

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE O--FAIR VALUE MEASUREMENT - Continued

significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following tables present assets and liabilities reported at fair value as of June 30, 2013 and 2012 and their respective classification under the FASB ASC 820 valuation hierarchy:

	<i>Carrying Value</i>	<i>Level 1</i>	<i>Level 2</i>	<i>Level 3</i>
As of June 30, 2013				
Assets Measured at Fair Value on a Recurring Basis				
Investment in government and agency bonds, including municipal bonds, mutual funds and others	\$ 111,569,814	\$ 111,569,814	\$ -	-
Investments in corporate bonds and commercial paper	4,348,798	4,348,798	-	-
Short-term investments and cash equivalents	29,929,179	29,929,179	-	-
Liabilities Measured at Fair Value on a Recurring Basis				
Interest rate swap agreements	(4,856,429)	-	-	(4,856,429)
As of June 30, 2012				
Assets Measured at Fair Value on a Recurring Basis				
Investment in government and agency bonds, including municipal bonds, mutual funds and others	\$ 119,596,675	\$ 119,596,675	\$ -	-
Investments in corporate bonds and commercial paper	940,586	940,586	-	-
Short-term investments and cash equivalents	32,688,220	32,688,220	-	-
Liabilities Measured at Fair Value on a Recurring Basis				
Interest rate swap agreements	(7,112,464)	-	-	(7,112,464)

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

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

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE O--FAIR VALUE MEASUREMENT - Continued

	<u>2013</u>	<u>2012</u>
Beginning of year	\$ (7,112,464)	\$ (6,032,288)
Change in mark-to-market of interest rate swaps	2,256,035	(1,080,176)
End of Year	<u>\$ (4,856,429)</u>	<u>\$ (7,112,464)</u>

NOTE P--MANAGEMENT AGREEMENT

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

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

In addition to the Agreement, the Primary Health System agreed to extend a Line of Credit (the Line) to the Hospital Authority. The maximum amount available under the Line is \$20,000,000 at June 30, 2012. During the year ended June 30, 2013 The Agreement was amended to increase the maximum amount to \$20,550,000. At June 30, 2013 and 2012, the draws on the Line totaled \$20,550,000 and \$12,500,000, respectively.

The Line calls for interest only payments each month on the outstanding balance, based on the London InterBank Offered Rate plus 4% or a rate of 5%, whichever is greater. However, any unpaid interest through March 31, 2013 is deferred and paid over a twelve-month period commencing on that date. All outstanding draws are due at the maturity date, which is consistent with the Agreement termination dates, discussed above.

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE P--MANAGEMENT AGREEMENT - Continued

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

In June 2013, the Agreement was modified to allow Hutcheson to issue requests for proposals for the lease or sale of Hutcheson properties without creating a breach of the Agreement. As part of the Agreement, Hutcheson has committed to obtain alternative financing and repay the line of credit upon the earlier of the replacement financing being obtained by Hutcheson, or June 1, 2014. As such the line of credit is classified as a current asset as of June 30, 2013.

NOTE Q--COMBINED, CONDENSED FINANCIAL INFORMATION

The following is combined, condensed, financial information related to those aggregate discretely presented component units as of and for the years ended June 30, 2013 and 2012:

	<i>ContinuCare HealthServices, Inc.</i>	<i>Cyberknife of Chattanooga, LLC</i>
As of June 30, 2013		
Due from other governments	\$ 248,239	\$ 129,000
Other current assets	8,865,703	490,008
Total Current Assets	9,113,942	619,008
Net property, plant and equipment	5,174,936	4,468,880
Other assets	2,383,609	75,309
Total Assets	\$ 16,672,487	\$ 5,163,197

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE Q--COMBINED, CONDENSED FINANCIAL INFORMATION - Continued

	<i>ContinuCare HealthServices, Inc.</i>	<i>Cyberknife of Chattanooga, LLC</i>
Due to other governments	\$ 408,032	\$ 120,000
Other current liabilities	3,035,595	788,584
Total Current Liabilities	3,443,627	908,584
Long-term debt and capital lease obligations	29,292	3,416,667
Total Liabilities	3,472,919	4,325,251
Net position		
Unrestricted	8,110,622	210,424
Invested in capital assets, net of related debt	5,088,946	627,522
Restricted expendable	-	-
Total Net Position	13,199,568	837,946
Total Liabilities and Net Position	\$ 16,672,487	\$ 5,163,197
Year Ended June 30, 2013		
Net patient and operating revenue	\$ 26,026,863	\$ 1,560,900
Operating expenses:		
Salaries, wages and benefits	13,395,486	211,954
Supplies and other expenses	9,715,354	484,205
Purchased services	2,914,446	66,602
Insurance and taxes	267,877	27,459
Depreciation	517,483	527,752
Total Operating Expenses	26,810,646	1,317,972
Operating Income	(783,783)	242,928
Nonoperating revenue (expenses)	497,259	(194,623)
Change in Net Position	(286,524)	48,305
Net Position at Beginning of Period	13,486,092	789,641
Net Position at End of Period	\$ 13,199,568	\$ 837,946

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE Q--COMBINED, CONDENSED FINANCIAL INFORMATION - Continued

	<i>ContinuCare HealthServices, Inc.</i>	<i>Cyberknife of Chattanooga, LLC</i>
As of June 30, 2012		
Due from other governments	\$ 234,872	\$ 266,600
Other current assets	7,984,697	270,923
Total Current Assets	8,219,569	537,523
Net property, plant and equipment	4,916,085	4,967,921
Other assets	3,664,684	75,309
Total Assets	\$ 16,800,338	\$ 5,580,753
Due to other governments	\$ 779,987	\$ 125,842
Other current liabilities	2,534,259	748,603
Total Current Liabilities	3,314,246	874,445
Long-term debt and capital lease obligations	-	3,916,667
Total Liabilities	3,314,246	4,791,112
Net position		
Unrestricted	8,570,007	163,078
Invested in capital assets, net of related debt	4,916,085	626,563
Total Net Position	13,486,092	789,641
Total Liabilities and Net Position	\$ 16,800,338	\$ 5,580,753
Year Ended June 30, 2012		
Net patient and operating revenue	\$ 26,434,498	\$ 1,595,300
Operating expenses:		
Salaries, wages and benefits	12,898,683	202,693
Supplies and other expenses	10,146,545	307,497
Purchased services	2,609,813	178,764
Insurance and taxes	259,226	107,290
Depreciation	327,769	521,106
Total Operating Expenses	26,242,036	1,317,350
Operating Income	192,462	277,950

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

Notes to Combined Financial Statements - Continued

Years Ended June 30, 2013 and 2012

NOTE Q—COMBINED, CONDENSED FINANCIAL INFORMATION - Continued

	<i>ContinuCare HealthServices, Inc.</i>	<i>Cyberknife of Chattanooga, LLC</i>
Nonoperating revenue (expenses)	(50,099)	(217,734)
Change in Net Position	142,363	60,216
Net Position at Beginning of Period	13,343,729	729,425
Net Position at End of Period	<u>\$ 13,486,092</u>	<u>\$ 789,641</u>

Other Information

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

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2013

<i>Grantor</i>	<i>Pass-Through Grantor Agency</i>	<i>Program Name</i>	<i>CFDA Number</i>	<i>Grant Number (Grant Period)</i>	<i>Federal Expenditures</i>
U.S. Department of Agriculture	Chattanooga-Hamilton County Health Department	Special Supplemental Nutrition Program for Women, Infants, and Children	10.557	GG-12-37227-00	\$ 18,134
				(10/1/11 - 9/30/12)	
				GG-13-34148-00	47,309
				(10/1/12 - 9/30/13)	
Total U.S. Department of Agriculture					65,443
U.S. Department of Health and Human Services	n/a	Community Health Centers	93.224*	H80CS00091-11-01	836,824
				(12/1/11 - 11/30/12)	
				H80CS00091-12-10	1,153,527
				(12/1/12 - 11/30/13)	
					1,990,351
U.S. Department of Health and Human Services	MeHarry Medical College	Cancer Centers Support CNP Program	93.397	091214MKH358-03	38,556
				(9/1/12-8/31/13)	
U.S. Department of Health and Human Services	MeHarry Medical College	Improving Diabetes Management in African Americans	93.779	110526KP114	31,396
				(9/30/11-9/29/12)	
				110526KP114	49,776
				(9/30/12-9/29/13)	
					119,728
U.S. Department of Health and Human Services	State of Tennessee Department of Finance and Administration Bureau of TennCare	High Risk Perinatal Program	93.778*	GG-11-31792-02	381,406
				(7/1/12-6/30/13)	
U.S. Department of Health and Human Services	State of Tennessee Department of Health	Bioterrorism Hospital Preparedness	93.889	GR-13-39206-00	187,400
				(7/1/12-6/30/13)	
				GR-13-39208-00	73,000
				(7/1/12-6/30/13)	
				GR-13-35567-00	20,000
				(7/1/12-6/30/13)	
				GR-13-35646-00	20,000
				(7/1/12-6/30/13)	
					300,400
U.S. Department of Health and Human Services	State of Tennessee Department of Health	Maternal and Child Health Services Block Grant to the States	93.994	GG-13-39394-00	219,219
				(7/1/12-6/30/13)	
				GG-13-33477-00	17,885
				(7/1/12-6/30/13)	
					237,104
Total U.S. Department of Health and Human Services					3,028,989
Total Expenditures of Federal Awards					\$ 3,094,432

* Denotes major program

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

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

Schedule of Expenditures of State and Other Financial Assistance

Year Ended June 30, 2013

<i>Grantor</i>	<i>Program Name</i>	<i>Contract Number (Contract Period)</i>	<i>Beginning Balance</i>	<i>Cash Received</i>	<i>Grant Expenditures (Adjustments)</i>	<i>Ending Balance</i>
State of Tennessee Department of Health, Bureau of TennCare	High Risk Perinatal Program	GG-11-31792-01 (7/1/11 - 6/30/12)	\$ 95,528	\$ 95,528	\$ -	\$ -
		GG-11-31792-02 (7/1/12-6/30/13)	-	283,165	381,406	98,241
State of Tennessee Department of Health	Maternal and Child Health Services Block Grant to the States	GG-10-28785-00 (7/1/09 - 6/30/14)	31,060	31,060	30,775	30,775
		GG-12-36728-00 (7/1/11 - 6/30/12)	27,907	27,907	-	-
		GG-13-39394-00 (7/1/12-6/30/13)	-	47,008	81,081	34,073
		GG-12-36617-00 (7/1/11 - 6/30/12)	1,293	1,293	-	-
		GG-13-33477-00 (7/1/12-6/30/13)	-	10,907	13,492	2,585
State of Georgia Department of Community Health	Life Force Air Ambulance Grant	12002G (7/1/012 - 6/30/13)	-	600,000	600,000	-
State of Tennessee Department of Finance and Administration	Medical Assistance Program	GG-10-28378-00 (7/1/09 - 6/30/12)	227,642	265,399	37,757	-
TOTAL STATE AND OTHER FINANCIAL ASSISTANCE			\$ 383,430	\$ 1,362,267	\$ 1,144,511	\$ 165,674

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

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

Year Ended June 30, 2013

NOTE A--BASIS OF PRESENTATION

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

NOTE B--CONTINGENCIES

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

NOTE C--BIOTERRORISM HOSPITAL PREPAREDNESS AWARDS

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

<i>Grant</i>	<i>Receivable/ (Unexpended) Balance at June 30, 2012</i>	<i>Receipts</i>	<i>Awards Earned by Expenditures (Adjustments)</i>	<i>Receivable/ (Unexpended) Balance at June 30, 2013</i>
GR-13-39206-00	\$ -	\$ 187,400	\$ 187,400	\$ -
GR-13-39208-00	-	73,000	73,000	-
GR-13-35567-00	-	20,000	20,000	-
GR-13-35646-00	-	20,000	20,000	-
Total	\$ -	\$ 300,400	\$ 300,400	\$ -

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

Schedule of Prior Audit Findings

Year Ended June 30, 2013

There were no prior audit findings.



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

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

We have audited, 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 the combined financial statements of the business-type activities and the aggregate discretely presented component units of Chattanooga-Hamilton County Hospital Authority d/b/a Erlanger Health System (the Primary Health System) as of and for the years ended June 30, 2013 and 2012, and the related notes to the combined financial statements, which collectively comprise the Primary Health System's basic combined financial statements, and have issued our report thereon dated December 27, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the combined financial statements, we considered the Primary Health System's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the combined financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Primary Health System's internal control. Accordingly, we do not express an opinion on the effectiveness of the Primary Health System's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention to those charged with governance.

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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Primary Health System's combined 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 the Primary Health System's combined 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Primary Health System's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Primary Health System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Patricia Yeremy: Annuals PC

Knoxville, Tennessee
December 27, 2013



**REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM
AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

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

Report on Compliance for Each Major Federal Program

We have audited Chattanooga-Hamilton County Hospital Authority's d/b/a Erlanger Health System (the Primary Health System) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013. The Primary Health System's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the Primary Health System's major programs. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the compliance audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Primary Health System's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major Federal programs. However, our audit does not provide a legal determination of the Primary Health System's compliance.

Opinion on the Major Federal Programs

In our opinion, the Primary Health System complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013.

Report on Internal Control Over Compliance

The management of the Primary Health System is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Primary Health System's internal control over compliance with the requirements that could have a direct and material effect on major federal programs in order to determine our auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Primary Health System's internal control over compliance.

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

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Permitting Yourself: Annuals 1c

Knoxville, Tennessee
December 27, 2013

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

Schedule of Findings and Questioned Costs

Year Ended June 30, 2013

Section I - Summary of Auditor's Results

FINANCIAL STATEMENTS

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

Internal control over financial reporting:

Material weakness(es) identified?	Yes [] No [X]
Significant deficiency identified not considered to be material weaknesses?	None Reported
Noncompliance material to combined financial statements noted?	Yes [] No [X]

FEDERAL AWARDS

The auditor's report on compliance for the major federal award program for Chattanooga-Hamilton County Hospital Authority expresses an unmodified opinion on its major federal program.

Internal control over major programs:

Material weakness(es) identified?	Yes [] No [X]
Significant deficiency identified not considered to be material weaknesses?	None Reported

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

Identification of Major Programs:

<i>CFDA Number(s)</i>	<i>Name of Federal Program or Cluster</i>
93.224	U.S. Department of Health and Human Services - Community Health Centers
93.778	U.S. Department of Health and Human Services - High Risk Perinatal Program

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

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

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

Schedule of Findings and Questioned Costs - Continued

Year Ended June 30, 2013

Section II - Financial Statement Findings

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

Not applicable, no financial statement findings.

Section III - Federal Award Findings and Questioned Costs

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

Not applicable, no financial statement findings or questioned costs.