

HARDIN MEDICAL CENTER
(a component unit of Hardin County)

**Consolidated Financial Statements and
Supplemental Schedules**

June 30, 2013 and 2012

(With Independent Auditors' Report Thereon)



LATTIMORE BLACK MORGAN & CAIN, PC
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

HARDIN MEDICAL CENTER
(a component unit of Hardin County)

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INDEPENDENT AUDITORS' REPORT

**The Board of Commissioners
Hardin Medical Center
Savannah, Tennessee:**

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Hardin Medical Center (the "Medical Center"), a component unit of Hardin County, Tennessee, as of and for the years ended June 30, 2013 and 2012, and the related notes to the consolidated financial statements, which are comprised of the Medical Center's basic consolidated financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated 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 entity'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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the respective financial position of the Medical Center as of June 30, 2013 and 2012, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis on pages 3 - 5 be presented to supplement the basic consolidated financial statements. Such information, although not part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operation, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplemental schedules are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental schedules are fairly presented in all material respects in relation to the basic consolidated financial statements taken as a whole.

Report on Other Legal and Regulatory Requirements

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2013 on our consideration of the Medical Center's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our 2013 audit.

Catherine Bleck Meyer & Cain, P.C.

Brentwood, Tennessee
December 3, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the financial performance of Hardin Medical Center (including HMC Health and Rehabilitation Center and HMC Physician Services, Inc.) provides an overview of the Medical Center's financial activities for the year ended June 30, 2013.

FINANCIAL HIGHLIGHTS

Condensed information follows:

	<u>2013</u>	<u>2012</u>	<u>\$</u>	<u>%</u>	<u>2011</u>
Current assets	\$ 18,947,551	\$ 18,523,190	\$ 424,361	2.29%	\$ 17,588,914
Property & equipment, net	16,557,525	16,312,737	244,788	1.50%	\$ 16,412,075
Other assets	376,513	447,041	(70,528)	-15.78%	\$ 963,361
Current liabilities	3,817,722	4,163,658	(345,936)	-8.31%	4,224,683
Long-term liabilities	8,155,986	8,655,402	(499,416)	-5.77%	9,271,443
Total net position, invested in capital assets, net of related debt	7,903,124	6,967,821	935,303	13.42%	6,521,219
Total net position, unrestricted	16,004,757	15,496,087	508,670	3.28%	14,947,005
Net patient service revenue	37,159,130	35,145,900	2,013,230	5.73%	33,411,839
Total revenues and nonoperating income	38,782,963	37,592,947	1,190,016	3.17%	36,199,860
Total expenses	37,338,990	36,597,263	741,727	2.03%	32,717,425
Change in net position	1,443,973	995,684	448,289	45.02%	3,482,435
Ending net position	23,907,881	22,463,908	1,443,973	6.43%	21,468,224

USING THE FINANCIAL REPORT

The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position include all assets and liabilities of the Hospital, Health and Rehabilitation Center and Physician Services using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid. These statements provide information about whether the entity is better off or worse off as a result of the year's activities.

Net position is the difference between assets and liabilities. Over time, increases or decreases in net position provide one indicator of the financial health of the facility.

CAPITAL ASSETS AND DEBT ADMINISTRATION

During the year, \$1,773,260 of fixed assets were acquired. Accumulated depreciation increased \$1,528,472.

ECONOMIC FACTORS AND NEXT YEAR'S ESTIMATES AND RATES

In FYE 2013 the Medical Center (including the Health and Rehabilitation Center and Physician Services) had a net profit of \$1,443,973 and generated \$111 million in gross operating revenue; i.e., before contractual and bad debt adjustments. The breakdown for operating revenue consists of 27% inpatient and 73% outpatient. The Medical Center experienced a 45% increase in change in net position from 2012 to 2013 and a 71% decrease in change in net position from 2011 to 2012. Factors relating to this include the Medical Center recognizing \$1,125,000 in donations for the construction of a cancer treatment center in 2011 and an initial year loss of approximately \$1,000,000 recognized by HMC Physician Services in 2012.

The Medical Center is dependent on governmental programs. Medicare and TennCare make up approximately 70% of the Hospital's payor mix, commercial insurance equals 23% and self pay accounts equal 7%.

The budgeting process is a participatory process in that departmental directors are involved in its development and monitoring. Department heads are provided a framework of economic conditions and general assumptions and they, in turn, request the resources they will need to accomplish their goals and objectives within that framework.

For fiscal year beginning July 1, 2013, the Medical Center projects an increase of 3.5% in net patient service revenue, an increase of 3% in salaries, and an increase of 7% in other expenses.

CONTACTING THE HARDIN MEDICAL CENTER MANAGEMENT

This financial report is designed to provide our citizens, customers, taxpayers and creditors with a general overview of the facilities' finances and to show accountability for the money they receive. If you have questions about this report or need additional financial information, contact the Finance Department of the Hardin Medical Center, 935 Wayne Road, Savannah, Tennessee 38372.

**HARDIN MEDICAL CENTER
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HARDIN MEDICAL CENTER
(a component unit of Hardin County)

Consolidated Statements of Net Position

June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<u>Assets</u>		
Current assets:		
Cash and cash equivalents	\$ 7,970,151	\$ 6,302,399
Investments	3,682,223	3,671,146
Patient accounts receivable, less allowance for uncollectible accounts of approximately \$2,299,848 and \$2,343,251 in 2013 and 2012, respectively	4,767,181	5,340,713
Other accounts receivable	1,185,496	1,707,844
Inventories	1,314,505	1,324,299
Prepaid expenses and other current assets	<u>27,995</u>	<u>176,789</u>
Total current assets	18,947,551	18,523,190
Property and equipment, net	16,557,525	16,312,737
Other assets	<u>376,513</u>	<u>447,041</u>
	<u>\$ 35,881,589</u>	<u>\$ 35,282,968</u>
<u>Liabilities and Net Position</u>		
Current liabilities:		
Current portion of long-term debt	\$ 358,224	\$ 350,224
Current portion of capital lease obligations	140,191	339,290
Accounts payable	1,068,208	1,273,604
Accrued expenses and other current liabilities	2,240,708	2,133,540
Estimated third-party payor settlements	<u>10,391</u>	<u>67,000</u>
Total current liabilities	3,817,722	4,163,658
Long-term debt, excluding current portion	6,284,384	6,643,608
Capital lease obligations, excluding current portion	<u>1,871,602</u>	<u>2,011,794</u>
Total liabilities	<u>11,973,708</u>	<u>12,819,060</u>
Net position:		
Unrestricted:		
Invested in capital assets, net of related debt	7,903,124	6,967,821
Unrestricted net position	<u>16,004,757</u>	<u>15,496,087</u>
Total unrestricted net position	<u>23,907,881</u>	<u>22,463,908</u>
	<u>\$ 35,881,589</u>	<u>\$ 35,282,968</u>

See accompanying notes to the financial statements.

HARDIN MEDICAL CENTER
(a component unit of Hardin County)

Consolidated Statements of Revenue, Expenses and Changes in Net Position

Years ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Operating revenue:		
Patient service revenue, net of provision for bad debts of \$3,943,627 and \$3,633,407 in 2013 and 2012, respectively	\$ 37,159,130	\$ 35,145,900
Other revenue	<u>1,445,099</u>	<u>2,121,755</u>
Total operating revenue	<u>38,604,229</u>	<u>37,267,655</u>
Expenses:		
Salaries and wages	18,164,832	17,181,154
Employee benefits	3,712,760	4,078,496
Purchased services	3,333,525	2,922,995
Consultants	301,922	280,481
Insurance	396,232	323,515
Supplies	6,998,192	7,165,397
Utilities	346,771	373,226
Repairs and maintenance	1,396,170	1,373,519
Rent	270,645	406,554
Physician recruitment	166,896	167,445
Depreciation and amortization	1,528,472	1,657,124
Other expenses	<u>722,573</u>	<u>667,357</u>
Total expenses	<u>37,338,990</u>	<u>36,597,263</u>
Operating income	<u>1,265,239</u>	<u>670,392</u>
Nonoperating income (expense):		
Interest income	125,727	129,105
Interest expense	(107,676)	(120,559)
Loss on disposal of property and equipment	-	(16,025)
Contributions	45,581	144,000
Other revenue	<u>115,102</u>	<u>188,771</u>
Nonoperating income, net	<u>178,734</u>	<u>325,292</u>
Excess of revenue over expenses	1,443,973	995,684
Net position at beginning of year	<u>22,463,908</u>	<u>21,468,224</u>
Net position at end of year	<u><u>\$ 23,907,881</u></u>	<u><u>\$ 22,463,908</u></u>

See accompanying notes to the financial statements.

HARDIN MEDICAL CENTER
(a component unit of Hardin County)

Consolidated Statements of Cash Flows

Years ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 37,676,053	\$ 35,747,578
Payments to suppliers and employees	(35,163,097)	(35,352,943)
Other receipts and payments, net	<u>1,445,099</u>	<u>2,365,868</u>
Net cash provided by operating activities	<u>3,958,055</u>	<u>2,760,503</u>
Cash flows from noncapital financing activities:		
Contributions received	45,581	144,000
Other noncapital contributions	<u>100,000</u>	<u>154,312</u>
Net cash provided by noncapital financing activities	<u>145,581</u>	<u>298,312</u>
Cash flows from capital and related financing activities:		
Principal paid on long-term debt	(351,224)	(334,438)
Interest paid on long-term debt	(52,266)	(51,315)
Repayment of capital lease obligations	(339,291)	(277,104)
Interest paid on capital lease obligations	(55,410)	(69,244)
Proceeds from disposal of property and equipment	-	9,258
Purchases of property and equipment	<u>(1,773,260)</u>	<u>(1,517,467)</u>
Net cash used by capital and related financing activities	<u>(2,571,451)</u>	<u>(2,240,310)</u>
Cash flows from investing activities:		
Distributions from joint venture	20,917	41,205
Investment income	125,727	147,540
Purchases of investments, net	<u>(11,077)</u>	<u>(13,892)</u>
Net cash provided by investing activities	<u>135,567</u>	<u>174,853</u>
Increase in cash and cash equivalents	1,667,752	993,358
Cash and cash equivalents at beginning of year	<u>6,302,399</u>	<u>5,309,041</u>
Cash and cash equivalents at end of year	<u>\$ 7,970,151</u>	<u>\$ 6,302,399</u>

See accompanying notes to the financial statements.

HARDIN MEDICAL CENTER
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Consolidated Statements of Cash Flows, Continued

Years ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 1,265,239	\$ 670,392
Adjustments to reconcile changes in net position to cash provided by operating activities:		
Depreciation and amortization	1,528,472	1,657,124
Provision for bad debts	3,943,627	3,633,407
Loss on disposal of property and equipment	-	16,025
(Increase) decrease in operating assets:		
Patient accounts receivable	(3,370,095)	(2,916,935)
Other accounts receivable	522,348	(660,163)
Inventories	9,794	158,084
Prepaid expenses and other current assets	148,794	(141,419)
Other assets	64,713	475,114
Increase (decrease) in operating liabilities:		
Accounts payable	(205,396)	(8,855)
Accrued expenses and other current liabilities	107,168	(7,474)
Estimated third-party payor settlements	<u>(56,609)</u>	<u>(114,797)</u>
Net cash provided by operating activities	\$ <u>3,958,055</u>	\$ <u>2,760,503</u>
Supplemental schedule of noncash investing, capital and financing activities:		
Property and equipment acquired under capital lease obligations	\$ <u>-</u>	\$ <u>65,602</u>

See accompanying notes to the financial statements.

HARDIN MEDICAL CENTER
(a component unit of Hardin County)

Notes to the Consolidated Financial Statements

June 30, 2013 and 2012

(1) Nature of operations

Hardin Medical Center (the "Medical Center"), HMC Health and Rehabilitation Center ("HMCHRC") and HMC Physician Services, Inc. ("HMCPS") are located in Savannah, Tennessee. The Medical Center is a 58-bed community medical center providing general and specialized medical services to patients. HMCHRC is a 73-bed intermediate and skilled care facility. HMCPS, a wholly-owned subsidiary of the Medical Center, is a physician practice which provides medical and other health care services. Under accounting principles generally accepted in the United States of America, the Medical Center constitutes a component unit of Hardin County, Tennessee (the "County") for financial reporting purposes. The County Board of Commissioners is responsible for appointing each member of the Medical Center's Board of Commissioners which also oversees HMCHRC's activities. Hardin County also guarantees a loan held by the Medical Center (see Note 7). Information relative to Hardin County, Tennessee may be obtained by reading its separately issued financial statements.

(2) Summary of significant accounting policies

(a) Basis of presentation

The Medical Center utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis, which is an economic resources measurement focus approach to accounting. 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 FASB and AICPA Pronouncements*. GASB 62 makes the GASB Accounting Standards Codification the sole source of authoritative accounting technical literature for governmental entities in the United States of America. In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflow of Resources, and Net Position*. GASB No. 62 and No. 63 were effective for periods beginning after December 15, 2011.

(b) Cash, cash equivalents, and investments

For the purpose of the statement of cash flows, cash and cash equivalents are defined as cash on hand or in banks and investments with original maturities at date of purchase of less than three months.

Cash and cash equivalents include cash on hand and certificates of deposit, with original maturities of less than three months, with financial institutions. Investments consist of certificates of deposit with original maturities of greater than three months. Those investments with original maturities greater than three months but less than one year are classified as short-term investments, while the remaining amount is classified as long-term. All of the Medical Center's cash and cash equivalents and investments are insured or collateralized by securities held by the financial institutions' trust department in the Medical Center's name.

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Notes to the Consolidated Financial Statements

June 30, 2013 and 2012

At June 30, 2013 and 2012, the total carrying value of the Medical Center's cash, cash equivalents and investments, was \$11,652,374 and \$9,973,545, respectively, and the bank balance was \$11,657,742 and \$9,981,141, respectively. The entire financial institution balance was covered by federal depository insurance or by collateral held by the trustee in the Medical Center's name.

(c) Inventories

Inventories are stated at the lower of cost, determined on the first-in, first-out (FIFO) basis, or market (net realizable value).

(d) Patient accounts receivable

The Medical Center reports patient accounts receivable for services rendered at net realizable amounts from third-party payors, patients and others. The Medical Center provides an allowance for uncollectible accounts based on a review of outstanding receivables, historical collection information and existing economic conditions.

(e) Fair value measurements

Fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, fair value accounting standards establish a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity including quoted market prices in active markets for identical assets (Level 1), or significant other observable inputs (Level 2) and the reporting entity's own assumptions about market participant assumptions (Level 3). The Medical Center has \$3,682,223 and \$3,671,146 as of June 30, 2013 and 2012, respectively, in certificates of deposit that would be classified as Level 2 under the hierarchy above. The Medical Center does not have any fair value measurements using significant unobservable inputs (Level 3) as of June 30, 2013 and 2012.

(f) Property and equipment

Property and equipment acquisitions are recorded at cost. The Medical Center capitalizes purchases that cost a minimum of \$5,000 and have a useful life greater than one year. Assets are depreciated on a straight-line basis over their estimated useful lives as follows: land improvements 5-30 years; buildings and improvements 5-50 years; equipment 3-20 years; and furniture and fixtures 5-30 years. Assets under capital lease obligations are included in property and equipment and the related amortization and accumulated amortization are included in depreciation and amortization expense and accumulated depreciation and amortization, respectively.

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets.

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Notes to the Consolidated Financial Statements

June 30, 2013 and 2012

(g) Physician guarantees

The Medical Center has entered into agreements with local physicians whereby it will guaranty monthly income, subject to stated maximums. The loans are to be forgiven if the physicians maintain a practice in the area for specified terms. At June 30, 2013 and 2012, physician guarantees totaled \$194,835 and \$320,019, respectively and are included in other assets within the statement of net position.

(h) Patient service revenue

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Patient service revenue is net of contractual adjustments and policy discounts of approximately \$68,000,000 and \$61,000,000 for the years ended June 30, 2013 and 2012, respectively. Approximately 31% and 29% of net patient service revenue was from Medicare for the years ended June 30, 2013 and 2012, respectively. Approximately 16% and 14% of net patient service revenue was from Medicaid/TennCare for the years ended June 30, 2013 and 2012, respectively.

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The costs of providing charity care are estimated based on the ratio of total costs to gross charges and amounted to approximately \$1,000,000 for the years ended June 30, 2013 and 2012.

(i) Operating activities

The Medical Center defines operating activities as reported in the Consolidated Statements of Revenue, Expenses and Changes in Net Position as those that generally result from exchange transactions, such as payments for providing services and payments for goods and services received. Non-exchange transactions, including contributions and grants, as well as interest income and interest expense, are considered non-operating revenues and expenses.

(j) Employee benefit plans

Medical Center employees are covered under The Tennessee Consolidated Retirement System, a defined benefit plan, or a 403(b) defined contribution plan. The Medical Center's costs are charged to expense and funded annually.

HARDIN MEDICAL CENTER
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Notes to the Consolidated Financial Statements

June 30, 2013 and 2012

(k) Compensated absences

The Medical Center provides its full-time employees with paid days off for holiday, vacation, sick, and bereavement absences. The qualifying date for receiving annual vacation is the employees' full-time anniversary date and is based on the table which follows. Such days may be taken only after the employee has earned them. All earned days must be taken within 24 months from the anniversary date earned. Such liabilities have been accrued in the accompanying statement of net position.

<u>Years of service</u>	<u>Days earned per year</u>
1-7	10
8-15	15
16 or more	20

Employees accrue their sick days upon their three month anniversary date and accrue one sick day per month thereafter. No payment is made for accumulated sick leave when an employee terminates employment.

(l) Risk management

The Medical Center is exposed to various risks of loss from medical malpractice; torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; and natural disasters. Commercial insurance is purchased for claims arising from such matters. The Medical Center is self-insured for employee health and workers' compensation claims and judgments as discussed (see Note 9).

(m) Net position

The Medical Center's net position is classified in three components. The *net position invested in capital assets, net of related debt* consists of capital assets net of accumulated depreciation and reduced by the remaining balances of any outstanding borrowings used to finance the purchase or construction of those assets. The *restricted net position* is the noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center, including amounts related to County contributions and bond indebtedness restricted for specific purposes. The *unrestricted net position* is the remaining net position that does not meet the definition of *invested in capital assets, net of related debt or restricted*. The Medical Center first applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position are available. As of June 30, 2013, there was no permanently or temporarily restricted net position.

(n) Income taxes

The Medical Center is a not-for-profit corporation as described in Chapter 176 of the Private Acts and is exempt from federal income taxes pursuant to Section 115 of the Internal Revenue Code.

HARDIN MEDICAL CENTER
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Notes to the Consolidated Financial Statements

June 30, 2013 and 2012

(o) Performance indicator

Excess of revenue over expenses (expenses over revenue) reflected in the accompanying statements of revenue, expenses and changes in net position is a performance indicator.

(p) Adoption of new accounting pronouncements

In November 2010, the GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*. This statement amends the reporting standards for reporting component units in a government's financial statements. The statement requires inclusion of a component unit if a financial benefit or burden is present or if the financial statements would be misleading if excluded. This accounting standard was effective for financial statements for fiscal years beginning after June 15, 2012. Therefore the Medical Center adopted this accounting standard at the beginning of fiscal year 2013. The adoption of this accounting standard did not have a material impact on the Medical Center's financial statements.

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This statement amends accounting standards relating to the application of FASB Statements that do not contradict GASB pronouncements and incorporates into the GASB authoritative literature certain accounting and financial reporting guidance to bring all authoritative literature together in one place. This accounting standard was effective for financial statements for fiscal years beginning after December 15, 2011. Therefore the Medical Center adopted this accounting standard at the beginning of fiscal year 2013. The adoption of this accounting standard did not have a material impact on the Medical Center's financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflow of Resources, and Net Position*. This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources and identifies net position as the residual of all other elements presented in a statement of financial position. This accounting standard was effective for financial statements for fiscal years beginning after December 15, 2011. Therefore the Medical Center adopted this accounting standard at the beginning of fiscal year 2013. The adoption of this accounting standard did not have a material impact on the Medical Center's financial statements.

(q) New accounting pronouncements

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities and is effective for financial statements for fiscal years beginning after December 15, 2012. Therefore the Medical Center expects to adopt this accounting standard at the beginning of fiscal year 2014.

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In March 2012, the GASB issued Statement No. 66, *Technical Corrections*. This statement establishes standards to clarify accounting for operating lease payments that vary from a straight-line basis and how to apply GASB Statement 13. These amendments are effective for financial statements for fiscal years beginning after December 15, 2012. Therefore the Medical Center expects to adopt these standards at the beginning of fiscal year 2014.

In January 2013, the GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. This statement relates to accounting and financial reporting for government combinations and disposals of government operations and is effective for financial statements for fiscal years beginning after December 15, 2013. Therefore the Medical Center expects to adopt these standards at the beginning of fiscal year 2015.

In March 2013, the GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This statement relates to accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees and is effective for financial statements for fiscal years beginning after June 15, 2013. Therefore the Medical Center expects to adopt these standards at the beginning of fiscal year 2014.

The Medical Center is currently assessing the impact of adopting these accounting standards.

(r) Use of estimates

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

(s) Reclassifications

Certain reclassifications have been made to the 2012 consolidated financial statements in order for them to conform to the 2013 presentation. These reclassifications have no effect on net position or changes in net position as previously reported.

(t) Events occurring after reporting date

The Medical Center has evaluated events and transactions that occurred between June 30, 2013 and December 3, 2013, which is the date the consolidated financial statements were available to be issued, for possible recognition or disclosure in the consolidated financial statements.

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(3) Third-party reimbursement programs

The Medical Center receives revenue under various third-party reimbursement programs which include Medicare, Medicaid, TennCare, and other third-party payors. Contractual adjustments under third-party reimbursement programs represent the difference between the Medical Center's billings at its established rates and the amounts reimbursed by third-party payors. They also include any differences between estimated third-party reimbursement settlements for prior years and subsequent tentative or final settlements. The adjustments resulting from tentative or final settlements to estimated reimbursement amounts resulted in an increase (decrease) to patient service revenue of approximately \$11,000 and \$20,000 for the years ended June 30, 2013 and 2012, respectively.

(a) Medicare

The Medical Center is paid for substantially all services rendered to inpatient Medicare program beneficiaries under prospectively determined rates-per-discharge. Those rates vary according to a classification system that is based on clinical, diagnostic, and other factors. The Medical Center is paid for outpatient and emergency medical services under a Medicare program known as the Ambulatory Payment Classification (APC) system. Under the APC system, outpatient services are classified into APC categories based on standard procedure codes for the service provided and payment for the APC categories are determined using prospectively determined Federal payment rates adjusted for geographical area wage differences. The Medical Center receives cash payments at an interim rate with final settlement determined after the Medical Center's submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Medical Center's classification of patients under the Medicare Prospective Payment System and the appropriateness of the patients' admissions are subject to validation reviews by the Medicare peer review organization.

(b) Medicaid

The Medicaid program reimburses HMCHRC for the cost of services rendered to Medicaid beneficiaries at a prospective rate which is based on the lower of the reimbursable cost of services rendered or a reimbursement cap set by Medicaid. The reimbursement cap is expressed as a per diem.

(c) TennCare

The State of Tennessee TennCare program is a managed care program which provides healthcare coverage to those previously eligible for Medicaid as well as the uninsured population. The Medical Center contracts with various managed care organizations (MCO's) which offer both Health Maintenance Organization (HMO) and Preferred Provider Organization (PPO) healthcare products. Reimbursement to the Medical Center is received through per diems, Diagnosis-Related Group (DRG) payments and discounted fee for service.

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(d) Commercial payors

The Medical Center has entered into payment agreements with certain commercial insurance carriers, HMO's, and PPO's. The basis for payment to the Medical Center under these agreements includes prospectively determined rates per discharge and discounts from established rates.

(e) Credit concentration

The Medical Center grants credit to patients and generally does not require collateral or other security in extending credit; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans or policies. At June 30, 2013 and 2012, the Medical Center had net receivables from the Federal Government (Medicare) of approximately \$1,692,000 and \$2,190,000, respectively, and from Medicaid/TennCare of approximately \$535,000 and \$440,000, respectively.

(f) Meaningful use payments from Medicare and Medicaid

The American Recovery and Reinvestment Act of 2009 (ARRA) established incentive payments under the Medicare and Medicaid programs for hospitals that implemented "meaningfully use" certified electronic health record (EHR) technology. In order to receive incentive payments, a hospital which is able to meet the meaningful use criteria must attest that during the EHR reporting period, the hospital used certified EHR technology and specify the technology used satisfied the required meaningful use objectives and associated measures for the applicable stage, and must specify the EHR reporting period and provide the result of each applicable measure for all patients admitted to the inpatient or emergency department of the hospital during the EHR reporting period for which a selected measure is applicable. A hospital may receive an incentive payment for up to four years, provided it successfully demonstrates meaningful use of certified EHR technology for the EHR reporting period. Hospitals that adopt a certified EHR system and are meaningful users can begin receiving incentive payments in any federal fiscal year from 2011 (October 1, 2010 - September 30, 2011) to 2015; however, the incentive payments will decrease for hospitals that first start receiving payments in federal fiscal year 2014 or 2015.

The Medical Center met meaningful use criteria during 2013 and 2012. As a result, the Medical Center recognized income of \$175,595 and \$663,638 from Medicaid and Medicare, respectively, in 2013. The Medical Center recognized income of \$351,190 and \$1,179,801 from Medicaid and Medicare, respectively, in 2012. The Medical Center has receivables of \$839,233 in the aggregate from Medicare and Medicaid related to the meaningful use incentive as of June 30, 2013. The Medicare funds were received in November 2013 and the Medicaid funds are expected to be received in fiscal year 2014. The Medical Center had receivables of \$1,530,991 in the aggregate from Medicare and Medicaid as of June 30, 2012 for which the funds were received in August 2012. The income is reported as other revenue on the accompanying statements of revenue, expenses and changes in net position.

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(4) Inventories

A summary of inventories as of June 30, 2013 and 2012 is as follows:

	<u>2013</u>	<u>2012</u>
Pharmacy	\$ 411,256	\$ 409,967
Dietary	14,441	14,350
Departmental	<u>888,808</u>	<u>899,982</u>
	<u>\$ 1,314,505</u>	<u>\$ 1,324,299</u>

(5) Property and equipment

The major classifications and changes in property and equipment as of and for the years ended June 30, 2013 and 2012 are as follows:

	<u>Balance at</u> <u>June 30, 2012</u>	<u>Additions/</u> <u>Transfers</u>	<u>Placed in</u> <u>Service/</u> <u>Retirements</u>	<u>Balance at</u> <u>June 30, 2013</u>
Land	\$ 274,533	\$ -	\$ -	\$ 274,533
Land improvements	202,147	-	-	202,147
Buildings and improvements	18,386,209	1,011,639	-	19,397,848
Equipment	9,001,762	534,498	-	9,536,260
Furniture and fixtures	277,119	46,989	-	324,108
Assets under capital lease	<u>1,370,842</u>	<u>-</u>	<u>-</u>	<u>1,370,842</u>
	<u>29,512,612</u>	<u>1,593,126</u>	<u>-</u>	<u>31,105,738</u>
Less allowance for depreciation and amortization:				
Land improvements	(195,039)	(2,692)	-	(197,731)
Buildings and improvements	(5,380,343)	(708,139)	-	(6,088,482)
Equipment	(6,228,193)	(675,081)	-	(6,903,274)
Furniture and fixtures	(164,287)	(18,732)	-	(183,019)
Assets under capital lease	<u>(1,232,013)</u>	<u>(123,828)</u>	<u>-</u>	<u>(1,355,841)</u>
	<u>(13,199,875)</u>	<u>(1,528,472)</u>	<u>-</u>	<u>(14,728,347)</u>
	16,312,737	64,654	-	16,377,391
Construction in progress	<u>-</u>	<u>282,286</u>	<u>(102,152)</u>	<u>180,134</u>
	<u>\$ 16,312,737</u>	<u>\$ 346,940</u>	<u>\$ (102,152)</u>	<u>\$ 16,557,525</u>

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	<u>Balance at June 30, 2011</u>	<u>Additions/ Transfers</u>	<u>Placed in Service/ Retirements</u>	<u>Balance at June 30, 2012</u>
Land	\$ 274,533	\$ -	\$ -	\$ 274,533
Land improvements	317,090	-	(114,943)	202,147
Buildings and improvements	16,615,567	2,555,765	(785,123)	18,386,209
Equipment	13,863,539	933,217	(5,794,994)	9,001,762
Furniture and fixtures	309,770	27,513	(60,164)	277,119
Assets under capital lease	<u>2,853,852</u>	<u>-</u>	<u>(1,483,010)</u>	<u>1,370,842</u>
	<u>34,234,351</u>	<u>3,516,495</u>	<u>(8,238,234)</u>	<u>29,512,612</u>
Less allowance for depreciation and amortization:				
Land improvements	(297,761)	(11,316)	114,038	(195,039)
Buildings and improvements	(5,517,659)	(644,752)	782,068	(5,380,343)
Equipment	(11,265,078)	(748,786)	5,785,671	(6,228,193)
Furniture and fixtures	(206,153)	(18,086)	59,952	(164,287)
Assets under capital lease	<u>(2,480,839)</u>	<u>(234,184)</u>	<u>1,483,010</u>	<u>(1,232,013)</u>
	<u>(19,767,490)</u>	<u>(1,657,124)</u>	<u>8,224,739</u>	<u>(13,199,875)</u>
	14,466,861	1,859,371	(13,495)	16,312,737
Construction in progress	<u>1,945,214</u>	<u>462,113</u>	<u>(2,407,327)</u>	<u>-</u>
	<u>\$ 16,412,075</u>	<u>\$ 2,321,484</u>	<u>\$ (2,420,822)</u>	<u>\$ 16,312,737</u>

No interest costs were capitalized during the year ended June 30, 2013. Interest costs of approximately \$45,000 were capitalized during the year ended June 30, 2012.

(6) Ambulance service

The County paid the construction cost of a building to house ambulance facilities and has also purchased ambulances and related equipment but the Medical Center is responsible for operating the ambulance service. Expenditures by the County since the Medical Center began operating the ambulance service in 1997 amounts to \$1,438,963 at June 30, 2013. This amount is not reflected within property and equipment in the accompanying consolidated financial statements. In addition, the County provides an annual subsidy to defray costs incurred in operating the ambulance service. For the years ended June 30, 2013 and 2012, the annual subsidy was \$100,000, which is reflected within other nonoperating revenues on the accompanying consolidated statement of revenue, expenses and changes in net position. This annual allocation is in addition to the cumulative expenditures mentioned above.

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(7) Long-term debt and capital lease obligations

The major types and changes in the Medical Center's long-term debt and capital lease obligations as of and for the years ended June 30, 2013 and 2012 is as follows:

	<u>Balance at June 30, 2012</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance at June 30, 2013</u>	<u>Amounts Due Within One Year</u>
Tennessee Valley Electric Cooperative - Series 2007	\$ 137,500	\$ -	\$ (30,000)	\$ 107,500	\$ 30,000
Tennessee Valley Electric Cooperative - Series 2010	678,332	-	(82,224)	596,108	82,224
Public Building Authority of the County of Montgomery, TN - Series 2003	6,178,000	-	(239,000)	5,939,000	246,000
Capital lease obligations	<u>2,351,084</u>	<u>-</u>	<u>(339,291)</u>	<u>2,011,793</u>	<u>140,191</u>
	<u>\$ 9,344,916</u>	<u>\$ -</u>	<u>\$ (690,515)</u>	<u>\$ 8,654,401</u>	<u>\$ 498,415</u>

	<u>Balance at June 30, 2011</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance at June 30, 2012</u>	<u>Amounts Due Within One Year</u>
Tennessee Valley Electric Cooperative - Series 2007	\$ 167,500	\$ -	\$ (30,000)	\$ 137,500	\$ 30,000
Public Building Authority of the County of Montgomery, TN - Series 2002	740,000	-	(61,668)	678,332	82,224
Public Building Authority of the County of Montgomery, TN - Series 2003	6,410,000	-	(232,000)	6,178,000	238,000
Capital lease obligations	2,562,586	65,602	(277,104)	2,351,084	339,290
Other	<u>10,770</u>	<u>-</u>	<u>(10,770)</u>	<u>-</u>	<u>-</u>
	<u>\$ 9,890,856</u>	<u>\$ 65,602</u>	<u>\$ (611,542)</u>	<u>\$ 9,344,916</u>	<u>\$ 689,514</u>

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During January 2007, the Medical Center borrowed \$300,000 from the Tennessee Valley Electric Cooperative under the Rural Economic Loan and Grant Program. The proceeds were used to finance new computer software. The note bears no interest and principal is to be repaid in monthly installments of \$2,500 through January 2017. Security is a certificate of deposit and an irrevocable standby letter of credit.

During July 2010, the Medical Center borrowed an additional \$740,000 from the Tennessee Valley Electric Cooperative under the Rural Economic Loan and Grant Program. The proceeds were used to finance construction on the cancer treatment center. The note bears no interest and principal is to be repaid in monthly installments of \$6,852 through September 2020. Security is a certificate of deposit and an irrevocable standby letter of credit.

During July 2003, the Medical Center entered into a loan agreement with the Public Building Authority of the County of Montgomery, Tennessee (Building Authority) whereby, the Building Authority loaned the Medical Center \$8,000,000 for improvements to the Medical Center. The loan agreement bears interest at an adjustable rate (.35% as of June 30, 2013), and is due May 25, 2031. The adjustable interest rate is adjusted weekly as determined by the remarketing agent. The loan is guaranteed by Hardin County.

Pursuant to the agreements for the Building Authority loans, if the principal of all bonds issued under such loans are accelerated, and the bonds are paid by the remarketing agent, the repayment schedule applicable to such loans shall be recalculated over a term of 60 months from the date of such acceleration. The interest rate on the loan amounts after such acceleration shall adjust to the prime rate as defined in the agreements.

The Medical Center has entered into capital lease agreements to finance the acquisition of certain equipment.

The Medical Center's obligation under these capital lease agreements is as follows:

	<u>2013</u>	<u>2012</u>
Minimum lease payments payable	\$ 2,338,091	\$ 2,732,792
Less portion representing interest	<u>326,298</u>	<u>381,708</u>
Capital lease obligations	2,011,793	2,351,084
Less current portion	<u>140,191</u>	<u>339,290</u>
Long-term portion	\$ <u>1,871,602</u>	\$ <u>2,011,794</u>

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A summary of approximate future maturities and interest of long-term debt and capital lease obligations as of June 30, 2013 are as follows:

<u>Year</u>	<u>Principal</u>	<u>Estimated Interest</u>	<u>Total Payments</u>
2014	\$ 498,415	\$ 69,000	\$ 567,415
2015	511,000	65,000	576,000
2016	523,000	60,000	583,000
2017	523,000	55,000	578,000
2018	518,000	51,000	569,000
2019 - 2023	2,572,000	178,000	2,750,000
2024 - 2028	2,272,000	41,000	2,313,000
2029 - 2032	<u>1,236,986</u>	<u>9,000</u>	<u>1,245,986</u>
	<u>\$ 8,654,401</u>	<u>\$ 528,000</u>	<u>\$ 9,182,401</u>

Approximate future minimum annual lease payments payable under the capital lease agreements as of June 30, 2013 are as follows:

<u>Year</u>	
2014	\$ 188,000
2015	188,000
2016	188,000
2017	188,000
2018	188,000
2019 and later years	<u>1,398,091</u>
Total minimum lease payments	2,338,091
Less amount representing interest	<u>326,298</u>
Present value of minimum lease payments under capital leases	2,011,793
Less current portion	<u>140,191</u>
Capital lease obligations, excluding current portion	<u>\$ 1,871,602</u>

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(8) Employee benefit plans

Pension plan

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

Effective July 1, 2008, the Medical Center closed the plan to new participants. Those employees who were employed by the Medical Center prior to July 1, 2008 are still eligible to accrue salary and service credit in TCRS. The Medical Center is responsible to continue to fund the retirement cost of the plan.

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

Funding policy

For employees hired before July 1, 1986, the Medical Center has adopted a noncontributory retirement plan for its employees by assuming employee contributions up to 5.0% of annual covered payroll. Employees hired on July 1, 1986 and after are required to contribute 5.0% of compensation.

The Medical Center is required to contribute at an actuarially determined rate; the rates for the years ended June 30, 2013 and 2012 were 12.10% and 11.96%, respectively, of annual covered payroll. The contribution requirement of plan members is set by State statute. Contribution requirements for the Medical Center are established and may be amended by the TCRS Board of Trustees.

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Annual cost

For the years ended June 30, 2013 and 2012, the Medical Center's annual pension cost of \$277,833 and \$378,574, respectively, to TCRS were equal to its annual required and actual contributions. The required contribution was determined as part of the July 1, 2009 actuarial valuation using the frozen initial liability actuarial cost method. Significant actuarial assumptions used in the valuation include (a) rate of return on investment of present and future assets of 7.5% a year compounded annually, (b) projected salary increases of 4.75% (graded) annual rate (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries), (c) projected 3.5% annual increase in the Social Security wage base, and (d) projected post retirement increases of 3.0% annually. The actuarial value of assets was determined using techniques that smooth the effect of short-term volatility in the market value of total investments over a five-year period. The Medical Center's unfunded actuarial accrued liability is being amortized as a level dollar amount on a closed basis. The remaining amortization period as of July 1, 2009 was 6 years.

As of July 1, 2009, the most recent actuarial valuation date, the plan was 88.19% funded. The actuarial accrued liability for benefits was \$25.87 million, and the actuarial value of assets was \$22.82 million, resulting in unfunded actuarial accrual liability (UAAL) of \$3.06 million. The covered payroll (annual payroll of active employees covered by the plan) was \$4.78 million, and the ratio of the UAAL to the covered payroll was 63.88%.

Defined contribution plan

During July 2008 the Medical Center began providing a 403(b) plan which covers full-time employees who choose not to participate, or are not allowed to participate, in the defined benefit pension plan described above. The Medical Center contributes 3% of compensation plus it will match half of each employee's contribution (up to an additional 3%). The total retirement plan expense associated with this plan for the years ended June 30, 2013 and 2012 was \$510,798 and \$507,095, respectively.

(9) Commitments and contingencies

Operating commitments

The Medical Center leases various equipment and space under operating lease agreements. Rent expense was \$270,645 and \$406,554 in 2013 and 2012, respectively. The Medical Center does not have any material future minimum payments as a majority of the leases are on month-to-month terms. It is expected that in the normal course of business, leases that expire will be renewed or replaced by other leases; thus, it is anticipated that future lease payments will not be less than the expense for 2013.

The Medical Center generates rental income primarily from operating leases of medical office buildings and houses. Rental income was \$201,721 and \$151,770 in 2013 and 2012, respectively, and is included in other operating revenue. Lease terms are yearly or month-to-month.

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Insurance

The Medical Center maintains commercial insurance on a claims-made basis for medical malpractice liabilities. Insurance coverages are \$1,000,000 individually and \$3,000,000 in the aggregate annually. Management intends to maintain such coverages in the future. The Medical Center is involved in litigation arising in the ordinary course of business; however, management is of the opinion that insurance coverages are adequate to cover any potential losses on asserted claims. Management is unaware of any incidents which would ultimately result in a loss in excess of the Medical Center's insurance coverages.

The Medical Center is self-insured for a portion of employee medical and other healthcare benefits and workers' compensation claims. The risk of loss retained by the Medical Center is limited to \$80,000 per year for each employee's medical claims. The Medical Center has purchased excess insurance to provide coverage for claims in excess of the self-insured plan. Claims expenditures and liabilities are reported under the self-insurance plan when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Reserves included within accrued expenses on the accompanying balance sheets, related to employee medical and other healthcare benefits, amounted to \$192,772 and \$282,772 in 2013 and 2012, respectively.

Healthcare industry

The delivery of personal health care services entails an inherent risk of liability. Participants in the health care services industry have become subject to an increasing number of lawsuits alleging negligence or related legal theories, many of which involve large claims and result in the incurrence of significant exposure and defense costs. The Medical Center is insured with respect to medical malpractice risk on a claims-made basis. The Medical Center also maintains insurance for general liability, director and officer liability and property. Certain policies are subject to deductibles. In addition to the insurance coverage provided, the Medical Center indemnifies certain officers and directors for actions taken on behalf of the Medical Center. Management is not aware of any claims against the Medical Center which would have a material financial impact.

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigation and/or allegations concerning possible violations of fraud and abuse statutes and/or regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as repayments for patient services previously billed. Management believes that the Medical Center is in compliance with fraud and abuse statutes, as well as other applicable government laws and regulations. During fiscal year 2013, management became aware of certain compliance matters related to the Medical Center. These matters were addressed and a reserve of \$190,000 is included within accrued expenses on the accompanying balance sheet at June 30, 2013.

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Management continues to implement policies, procedures, and a compliance overview organizational structure to enforce and monitor compliance with the Health Insurance Portability and Accountability Act of 1996 and other government statues and regulations. the Medical Center's compliance with such laws and regulations is subject to future government review and interpretations, as well as regulatory actions which are unknown or unasserted at this time.

The Centers for Medicare and Medicaid Services ("CMS") have implemented a Recovery Audit Contractors ("RAC") program. The purpose of the program is to reduce improper Medicare and Medicaid payments through the detection and recovery of overpayments. CMS has engaged subcontractors to perform these audits and they are being compensated on a contingency basis based on the amount of overpayments that are recovered. While management believes that all Medicare and Medicaid billings are proper and adequate support is maintained, certain aspects of Medicare and Medicaid billing, coding and support are subject to interpretation and may be viewed differently by the RAC auditors. At June 30, 2013, the Medical Center recorded a reserve for potential recoveries. The reserve of \$185,674 is included within accrued expenses on the accompanying balance sheet at June 30, 2013. The reserve is based on the percentage success rate and the total dollar of potential claims that are under audit. At June 30, 2012, no reserve was recorded.

Healthcare Reform

In March 2010, Congress adopted comprehensive health care insurance legislation, the Patient Care Protection and Affordable Care Act and the Health Care and Education Reconciliation Act (collectively, the "Health Care Reform Legislation"). The Health Care Reform Legislation, among other matters, is designed to expand access to health care coverage to substantially all citizens through a combination of public program expansion and private industry health insurance. Provisions of the Health Care Reform Legislation become effective at various dates over the next several years and a number of additional steps are required to implement these requirements. Due to the complexity of the Health Care Reform Legislation, reconciliation and implementation of the legislation continues to be under consideration by lawmakers, and it is not certain as to what changes may be made in the future regarding health care policies. Changes to existing Medicaid coverage and payments are also expected to occur as a result of this legislation. While the full impact of Health Care Reform Legislation is not yet fully known, changes to policies regarding reimbursement, universal health insurance and managed competition may materially impact the Medical Center's operations.

HARDIN MEDICAL CENTER

Consolidating Schedule of Net Position Information

June 30, 2013

<u>Assets</u>				
	<u>Hospital and Physician Services</u>	<u>Health and Rehabilitation Center</u>	<u>Eliminations</u>	<u>Total</u>
Current assets:				
Cash and cash equivalents	\$ 7,685,655	\$ 284,496	\$ -	\$ 7,970,151
Investments	3,682,223	-	-	3,682,223
Patient accounts receivable, net	4,126,552	640,629	-	4,767,181
Other accounts receivable	1,185,496	-	-	1,185,496
Inventories	1,310,701	3,804	-	1,314,505
Prepaid expenses and other current assets	<u>27,995</u>	<u>-</u>	<u>-</u>	<u>27,995</u>
Total current assets	18,018,622	928,929	-	18,947,551
Property and equipment, net	16,031,379	526,146	-	16,557,525
Other assets	371,145	5,368	-	376,513
Due from Health and Rehabilitation Center	<u>4,223,820</u>	<u>-</u>	<u>(4,223,820)</u>	<u>-</u>
	<u>\$ 38,644,966</u>	<u>\$ 1,460,443</u>	<u>\$ (4,223,820)</u>	<u>\$ 35,881,589</u>
<u>Liabilities and Net Position</u>				
Current liabilities:				
Current portion of long-term debt	\$ 358,224	\$ -	\$ -	\$ 358,224
Current portion of capital lease obligations	140,191	-	-	140,191
Accounts payable	1,029,562	38,646	-	1,068,208
Accrued expenses and other current liabilities	2,080,119	160,589	-	2,240,708
Estimated third-party payor settlements	<u>10,391</u>	<u>-</u>	<u>-</u>	<u>10,391</u>
Total current liabilities	3,618,487	199,235	-	3,817,722
Long-term debt, excluding current portion	6,284,384	-	-	6,284,384
Capital lease obligations, excluding current portion	1,871,602	-	-	1,871,602
Due to Hospital	<u>-</u>	<u>4,223,820</u>	<u>(4,223,820)</u>	<u>-</u>
Total liabilities	<u>11,774,473</u>	<u>4,423,055</u>	<u>(4,223,820)</u>	<u>11,973,708</u>
Net position:				
Unrestricted:				
Invested in capital assets, net of related debt	7,376,978	526,146	-	7,903,124
Unrestricted net position	<u>19,493,515</u>	<u>(3,488,758)</u>	<u>-</u>	<u>16,004,757</u>
Total net position	<u>26,870,493</u>	<u>(2,962,612)</u>	<u>-</u>	<u>23,907,881</u>
	<u>\$ 38,644,966</u>	<u>\$ 1,460,443</u>	<u>\$ (4,223,820)</u>	<u>\$ 35,881,589</u>

See accompanying independent auditors' report.

HARDIN MEDICAL CENTER

Consolidating Schedule of Revenue, Expenses, and Changes in Net Position Information

Year ended June 30, 2013

	<u>Hospital</u>	<u>Health and Rehabilitation Center</u>	<u>Physician Services</u>	<u>Eliminations</u>	<u>Total</u>
Operating revenue:					
Patient service revenue, net	\$ 28,904,786	\$ 5,456,437	\$ 2,797,907	\$ -	\$ 37,159,130
Other revenue	<u>1,445,099</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,445,099</u>
Total operating revenue	<u>30,349,885</u>	<u>5,456,437</u>	<u>2,797,907</u>	<u>-</u>	<u>38,604,229</u>
Expenses:					
Salaries and wages	12,543,216	2,744,691	2,876,925	-	18,164,832
Employee benefits	2,961,776	560,994	189,990	-	3,712,760
Purchased services	2,478,045	487,035	368,445	-	3,333,525
Consultants	-	301,922	-	-	301,922
Insurance	232,505	130,197	33,530	-	396,232
Supplies	5,696,278	1,138,542	163,372	-	6,998,192
Utilities	217,042	93,289	36,440	-	346,771
Repairs and maintenance	1,281,519	104,246	10,405	-	1,396,170
Rent	154,310	-	116,335	-	270,645
Physician recruitment	166,896	-	-	-	166,896
Depreciation and amortization	1,453,470	75,002	-	-	1,528,472
Other expenses	<u>439,881</u>	<u>204,938</u>	<u>77,754</u>	<u>-</u>	<u>722,573</u>
Total expenses	<u>27,624,938</u>	<u>5,840,856</u>	<u>3,873,196</u>	<u>-</u>	<u>37,338,990</u>
Operating income (loss)	<u>2,724,947</u>	<u>(384,419)</u>	<u>(1,075,289)</u>	<u>-</u>	<u>1,265,239</u>
Nonoperating income:					
Interest income	125,244	483	-	-	125,727
Interest expense	(107,676)	-	-	-	(107,676)
Contributions	42,581	3,000	-	-	45,581
Other revenue	<u>115,102</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>115,102</u>
Nonoperating income	<u>175,251</u>	<u>3,483</u>	<u>-</u>	<u>-</u>	<u>178,734</u>
Excess of revenue over expenses (expenses over revenue)	2,900,198	(380,936)	(1,075,289)	-	1,443,973
Net position at beginning of year	<u>25,983,718</u>	<u>(2,581,676)</u>	<u>(938,134)</u>	<u>-</u>	<u>22,463,908</u>
Net position at end of year	<u>\$ 28,883,916</u>	<u>\$ (2,962,612)</u>	<u>\$ (2,013,423)</u>	<u>\$ -</u>	<u>\$ 23,907,881</u>

See accompanying independent auditors' report.

**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**

The Board of Commissioners
Hardin Medical Center
Savannah, Tennessee:

We have audited, in accordance with the 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 consolidated financial statements of Hardin Medical Center (the "Medical Center"), a component unit of Hardin County, Tennessee, as of and for the year ended June 30, 2013, and the related notes to the consolidated financial statements, which collectively comprise the Medical Center's basic financial statements, and have issued our report thereon dated December 3, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Medical Center'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 consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control. Accordingly, we do not express an opinion on the effectiveness of the Medical Center'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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's consolidated 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 by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain matters in internal control that we reported to management of the Medical Center, described in a separate letter dated December 3, 2013.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Medical Center's consolidated 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 consolidated 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. Management of the Medical Center made us aware of certain instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* which are described in the accompanying notes to the consolidated financial statements.

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 Medical Center'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 Medical Center's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Catherine Black Moya & Cain, P.C.

Brentwood, Tennessee
December 3, 2013