AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION
OF
LINCOLN COUNTY HEALTH SYSTEM
LINCOLN COUNTY, TENNESSEE
Years Ended June 30, 2013 and 2012

LINCOLN COUNTY HEALTH SYSTEM
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INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Lincoln County Health System as of and for the years ended June 30, 2013 and 2012, and the related notes to the 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 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 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 financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lincoln County Health System as of June 30, 2013 and 2012, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A, the financial statements present only the Lincoln County Health System and do not purport to, and do not, present fairly the financial position of Lincoln County, Tennessee, as of June 30, 2013 and 2012, the changes in its financial position, or, where applicable, its cash flows 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 the management's discussion and analysis on pages 5 through 9 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the 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 audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying financial information listed as other financial information in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements of the Lincoln County Health System.

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 14, 2013 on our consideration of Lincoln County Health System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 Lincoln County Health System's internal control over financial reporting and compliance.

Fayetteville, Tennessee
October 14, 2013

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Our discussion and analysis of Lincoln County Health System's (the "System's") financial performance provides an overview of the System's financial activities for the fiscal years ended June 30, 2013 and 2012. Please read it in conjunction with the System's financial statements, which begin on page 10.

Financial Highlights

- The System's net position decreased in the past year by $1,960,989 or 7.6 percent in 2013 and net position increased in 2012 by $1,099,007 or 4.5 percent.
- The System reported an operating loss in 2013 of ($1,662,609) and operating income in 2012 of $205,657 due primarily to a payment methodology error made by the fiscal intermediary for laboratory payments. The error was related to payments received in fiscal years 2011 and 2012. Operating income in 2013 decreased by $1,868,266 under the income reported in 2012. Operating income in 2012 decreased by $1,518,496 or 88.1 percent from 2011.
- Non-operating revenues decreased by $1,246,486 or 81.4 percent in 2013 compared to 2012 due primarily to a reduction in meaningful use incentive payments under the Affordable Care Act. Non-operating expenses decreased in 2013 by $24,856 or 3.7 percent compared to 2012.

Using This Annual Report

The System's financial statements consist of three statements – a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Net Position; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the System, including resources held by the System but restricted for specific purposes by contributors, grantors, or enabling legislation.

The Statement of Net Position and Statement of Revenues, Expenses, and Changes in Net Position

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

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

The Statement of Cash Flows

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

The System's Net Position

The System's net position is the difference between its assets and liabilities reported in the Statement of Net Position on page 10. The System's net position decreased in 2013 by $1,960,989 (7.6 percent) and increased $1,099,007 (4.5 percent) in 2012, as presented in Table 1.

Table 1: Assets, Liabilities, and Net Position

	2013	2012	2011
Assets:			
Current assets	$ 12,258,259	$ 13,628,625	$ 11,672,754
Capital assets, net	18,361,942	19,544,850	20,860,227
Other noncurrent assets	9,816,703	9,932,559	9,729,274
Total Assets	40,436,904	43,106,034	42,262,255
Liabilities:			
Long-term liabilities	12,277,816	13,073,950	13,645,224
Other	4,337,910	4,249,917	3,933,871
Total Liabilities	16,615,726	17,323,867	17,579,095
Net position:			
Net investment in capital assets	5,212,307	5,511,072	6,304,130
Restricted for debt service	1,083,871	1,083,785	1,083,776
Restricted for other purposes	67,533	78,436	71,839
Unrestricted	17,457,467	19,108,874	17,223,415
Total Net Position	$ 23,821,178	$ 25,782,167	$ 24,683,160

A significant component of the change in the System's assets is the change in cash and cash equivalents. Cash decreased $1,182,588 or 15.8 percent in 2013 primarily due to recoupment of payment by the fiscal intermediary for the error in laboratory payments in FY 2011 and 2012 and the reduction in meaningful use payments as discussed in financial highlights above. Cash increased $2,494,217 or 50.1% in 2012.

Operating Results and Changes in the System's Net Position

A summary of the System's operating results and changes in net position is presented below in Table 2.

Table 2: Operating Results and Changes in Net Position

	2013	2012	2011
Operating Revenues:			
Net patient service revenues	$ 38,172,872	$ 39,647,879	$ 39,469,648
Other operating revenues	1,074,537	845,180	845,398
Total operating revenues	39,247,409	40,493,059	40,315,046
Operating Expenses			
Salaries and benefits	24,167,351	24,228,774	22,661,885
Fees to individuals and organizations	5,509,710	4,513,919	4,600,645
Medical supplies and drugs	4,635,975	4,939,545	4,620,273
Depreciation	2,154,046	2,175,674	2,273,350
Other operating expenses	4,442,936	4,429,490	4,434,740
Total operating expenses	40,910,018	40,287,402	38,590,893
Operating income (loss)	(1,662,609)	205,657	1,724,153
Nonoperating Revenues and Expenses			
Investment income	92,358	97,327	116,578
Interest expense	(590,012)	(615,471)	(649,048)
Amortization	(47,126)	(48,229)	(48,229)
Noncapital grants, contributions and incentive payments	192,733	1,434,250	13,879
Other nonoperating revenues and expenses, net	(2,033)	(327)	(9,531)
Total nonoperating revenues (expenses)	(354,080)	867,550	(576,351)
Excess (deficiency) of revenues over expenses before capital grants and contributions	(2,016,689)	1,073,207	1,147,802
Grants and contributions			
Capital grants and contributions	55,700	25,800	50,000
Change in net position	(1,960,989)	1,099,007	1,197,802
Net position beginning of year	25,782,167	24,683,160	23,485,358
Net position end of year	$ 23,821,178	$ 25,782,167	$ 24,683,160

Operating Income

The overall change in the System's net position is its operating income – generally, the difference between net patient service revenues and the expenses incurred to perform those services. The System reported an operating loss of ($1,662,609) in 2013. Operating income in 2013 decreased by $1,868,266 from income reported in 2012. Operating income in 2012 decreased by $1,518,496 or 88.1 percent under 2011.

The primary components of these changes in operating incomes are:

- A decrease in total operating revenue of $1,245,650 or 3% in 2013 as compared to 2012.
- An increase in fees to individuals and organizations of $995,791 or 22% from 2012.

Total operating revenues decreased in 2013 compared to 2012 primarily from the recoupment of lab payments by the fiscal intermediary due to an error in processing lab payments that was related to prior years. Other contributors to the reduction were sequestration and bad debts during the 2013 year.

Fees to individuals and organizations have increased $995,791 or 22% from 2012 due to expansion of the hospitalist program.

Employee compensation and benefits decreased in 2013 by $61,423 compared to an increase for 2012 of $1,566,889.

Supplies expense decreased $303,570 in 2013 compared to $319,272 increase in 2012 due to lower operating room costs resulting from lower volumes.

Non-operating Revenues and Expenses

Non-operating revenues consist primarily of interest revenue, investment earnings and Medicare and Medicaid meaningful use unrestricted incentive payments. The System received $183,499 incentive payments in 2013 compared to $1,421,395 in 2012. The system anticipates receiving additional incentive payments totaling $1.5 million through 2015.

Grants, Contributions and Endowments

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

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

The System's Cash Flow

Changes in the System's cash flows are consistent with changes in operating incomes and nonoperating revenues and expenses, discussed earlier. The System generated cash flows from operating activities in 2013 of $857,075 or 71.8 percent less than in 2012. In 2012 the System generated $3,042,048 or 6.2 percent more in cash flows from operating activities than in 2011.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2013, the System had $18,361,942 invested in capital assets, net of accumulated depreciation, as detailed in Note G to the financial statements. In 2012, the System had $19,544,850 invested in capital assets, net of accumulated depreciation. Additions to capital in 2013 were $974,474 consisting of $219,496 in renovations to the Wellness Center, $166,400 for the electronic medical record, $149,125 for surgery and anesthesia equipment, $169,719 for the Care Centers' renovation, $91,840 for the Ambulance Service equipment, and $177,894 for other miscellaneous equipment for the Health System.

Debt

At the end of 2013, the System had $13,439,510 in revenue bonds, capital lease obligations and notes payable obligations outstanding as detailed in Note H to the financial statements. The System's formal debt issuances – revenue notes – cannot be issued without approval of the Lincoln County Board of commissioners. The amount of debt issued is subject to limitations that apply to the County and its component units as a whole. There have been no changes in the System's debt ratings in the past two years.

On June 5, 2013 the Industrial Development Board of the City of Fayetteville and Lincoln County, Tennessee issued a $6,735,000 Series 2013 Hospital Facility Lease Revenue and Tax Refunding Bonds to advance refund $6,795,000 of the Series 2004 bonds. See details in Note H to the financial statements.

Other Economic Factors

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

Hospitals are facing many payment reductions due to the Affordable Care Act (ACA), sequestration, high deductible insurance plans, and the rising number of uninsured. One part of the ACA will be efforts to increase the number of U.S. citizens and legal aliens with health insurance set to begin January 2014.

The System is continually evaluating the addition of services that we do not currently offer as well as recruiting physicians to the Lincoln County service area.

The System continues to strive to provide outstanding clinical care through improvement of quality and patient satisfaction scores. We value the trust and commitment of the community's support.

Contacting the System's Financial Management

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

LINCOLN COUNTY HEALTH SYSTEM
STATEMENTS OF NET POSITION

June 30, 2013 and 2012

	2013	2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 6,293,268	$ 7,475,856
Restricted cash	42,539	42,354
Accounts receivable, net of allowance for doubtful accounts of $2,710,835 (2013) $3,000,920 (2012)	4,346,291	4,553,362
Estimated third-party payor settlements receivable	565,808	632,315
Supplies, at cost	713,174	716,743
Prepaid expenses	207,917	154,582
Other assets	89,262	53,413
Total Current Assets	12,258,259	13,628,625
NONCURRENT ASSETS:		
Special Funds	9,244,404	9,196,120
Capital assets, net of accumulated depreciation	18,361,942	19,544,850
Other assets:		
Investment in insurance fund	160,915	145,125
Notes receivable, net	272,186	433,768
Deferred financing costs	139,198	157,546
Total Noncurrent Assets	28,178,645	29,477,409
TOTAL ASSETS	40,436,904	43,106,034
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES:		
Current maturities of long-term debt	871,819	776,718
Accounts payable	1,164,483	868,003
Accrued expenses:		
Salaries and payroll taxes	878,027	873,608
Compensated absences	980,983	966,040
Interest	54,660	93,836
Other	264,932	477,863
Estimated third-party payor settlements payable	80,467	151,495
Patient trust funds	42,539	42,354
Total Current Liabilities	4,337,910	4,249,917
NONCURRENT LIABILITIES:		
Long-term debt, net of current maturities	12,277,816	13,073,950
TOTAL LIABILITIES	16,615,726	17,323,867
NET POSITION		
Net investment in capital assets	5,212,307	5,511,072
Restricted:		
Bond indenture debt service	1,083,871	1,083,785
Other purposes	67,533	78,436
Unrestricted	17,457,467	19,108,874
TOTAL NET POSITION	$ 23,821,178	$ 25,782,167

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

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

Years Ended June 30, 2013 and 2012

	2013	2012
OPERATING REVENUES:		
Net patient service revenue, net of provision for bad debts of $6,470,303 (2013) and $5,422,842 (2012)	$ 38,172,872	$ 39,647,879
Other operating revenue	1,074,537	845,180
Total Operating Revenues	39,247,409	40,493,059
OPERATING EXPENSES:		
Employee compensation and benefits	24,167,351	24,228,774
Fees to individuals and organizations	5,509,710	4,513,919
Supplies	4,635,975	4,939,545
Other expenses	4,442,936	4,429,490
Depreciation	2,154,046	2,175,674
Total Operating Expenses	40,910,018	40,287,402
INCOME (LOSS) FROM OPERATIONS	(1,662,609)	205,657
NONOPERATING REVENUES AND (EXPENSES):		
Investment income	92,358	97,327
Interest expense	(590,012)	(615,471)
Amortization	(47,126)	(48,229)
Noncapital grants, contributions and incentive payments	192,733	1,434,250
(Loss) on disposal of capital assets	(2,033)	(327)
Nonoperating Revenues and (Expenses), net	(354,080)	867,550
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES	(2,016,689)	1,073,207
Capital Contributions	55,700	25,800
CHANGE IN NET POSITION	(1,960,989)	1,099,007
Total Net Position, at beginning of year	25,782,167	24,683,160
TOTAL NET POSITION, AT END OF YEAR	$ 23,821,178	$ 25,782,167

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

LINCOLN COUNTY HEALTH SYSTEM
STATEMENT OF CASH FLOWS

Years Ended June 30, 2013 and 2012

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third-party payors	$ 38,642,424	$ 40,392,384
Other operating cash receipts	2,139,828	1,882,874
Cash paid to employees for wages and benefits	(24,106,118)	(23,911,853)
Cash paid to suppliers for goods and services	(15,819,059)	(15,321,357)
Net Cash Provided by Operating Activities	857,075	3,042,048
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Noncapital grants, contributions and incentive payments	192,733	1,434,250
Net Cash Provided by Noncapital Financing Activities	192,733	1,434,250
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Additions to capital assets, net	(974,474)	(665,210)
Proceeds from disposal of capital assets	1,303	1,000
Capital contributions	55,700	25,800
Principal payments on long-term debt	(776,717)	(741,583)
Interest paid on long-term debt, net	(582,281)	(620,934)
Net Cash Used by Capital and Related Financing Activities	(2,276,469)	(2,000,927)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest received	95,432	79,981
(Increase) in special funds	(51,359)	(61,135)
Net Cash Provided by Investing Activities	44,073	18,846
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(1,182,588)	2,494,217
CASH AND CASH EQUIVALENTS, beginning of year	7,475,856	4,981,639
CASH AND CASH EQUIVALENTS, end of year	$ 6,293,268	$ 7,475,856
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES:		
Income (loss) from operations	$ (1,662,609)	$ 205,657
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	2,154,046	2,175,674
Provision for bad debts	6,470,303	5,422,842
Provision for note receivable arrangements	190,097	97,367
Advances under note receivable arrangements, net	(28,515)	(248,400)
Investment in insurance funds, net	(15,790)	15,016
Changes in operating assets and liabilities:		
(Increase) in accounts receivable	(6,263,232)	(4,772,180)
Decrease in supplies	3,569	51,441
(Increase) decrease in prepaid expenses	(53,335)	72,802
(Increase) decrease in other assets	(35,849)	1,993
Increase in accounts payable	296,480	100,347
Increase (decrease) in accrued expenses	(193,569)	116,278
(Increase) in estimated third-party payor settlements, net	(4,521)	(196,789)
Net Cash Provided by Operating Activities	$ 857,075	$ 3,042,048
SCHEDULE OF NONCASH FINANCING AND INVESTING ACTIVITIES:		
Capital lease obligation issued to acquire equipment	$ -	$ 196,413
LMC Series 2004 bonds refunded	(6,795,000)	-
LMC Series 2013 bond proceeds used to refund 2004 bonds	6,735,000	-
Issue costs paid by LMC Series 2013 refunding bonds	(77,086)	-

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

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

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

Principles of Departmental Combination

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

The Medical Center provides general acute health care services for Lincoln County and surrounding areas. It is licensed for 49 acute care beds and 10 geropsych beds. The Ambulance Service provides emergency medical transportation services. The Home Health Care provides skilled nursing, therapy, personal care and hospice services. The Patrick Rehab-Wellness Center provides centralized rehabilitation, health education, therapy and other related programs and services to other departments of the Health System and to local businesses, industries and residents. The Lincoln Care Center and Donalson Care Center provide long-term health care services. The Care Centers are licensed for 115 intermediate-level care beds and 125 skilled-level care beds. The Donalson Care Center is licensed for 24 beds for assisted living services.

The Medical Center's financial statements include Lincoln Medical Center Auxiliary Gift Shop (the "Auxiliary"). The Auxiliary is not a separate legal entity and it is subject to financial accountability to the Committee. As of and for the year ended June 30, 2013, the Auxiliary's total assets, current assets, and net position totaled $67,533, and are reported as restricted for other purposes in the statement of net position. Their income from operations totaled $(10,903). During 2013, the Auxiliary made noncapital contributions of $21,992 to the Health System.

Basis of Accounting

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

The accompanying financial statements of the Health System conform with accounting principles generally accepted in the United States as applied to governments and general practices of governmental health care entities. The Governmental Accounting Standards Board (GASB) is the standard setting body for establishing governmental accounting and financial reporting standards. The GASB's *Codification of Governmental Accounting and Financial Reporting Standards* document these principles.

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of Estimates

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

Deposits

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

Investments

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

Supplies

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

Capital Assets

Capital assets are stated at cost, less accumulated depreciation that is computed on the straight-line method over the estimated useful life of the asset. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the established useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. There was no interest cost capitalized on borrowed funds for the years ended June 30, 2013 and 2012, respectively.

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

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

Grants and Contributions

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

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Absences

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

Deferred Financing Costs

Financing costs incurred for issuance of bonds are amortized over the term of the respective bond issue using the straight-line method. Amortization expense was $47,126 and $48,229 for the years ended June 30, 2013 and 2012, respectively.

Charity Care

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

Income Taxes

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

Risk Management

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

Net Position

Net position is the difference between assets plus deferred outflows of resources and liabilities plus deferred inflows of resources. Net investment in capital assets represent capital assets reduced by accumulated depreciation and by any outstanding debt related to the acquisition, construction or improvement of those assets as well as any deferred outflows or inflows of resources attributable to the acquisition, construction, or improvement of those assets. The restricted component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Restricted assets occur when constraints are placed on the asset by creditors (such as debt covenants), grantors, contributions, laws, regulations, etc. Unrestricted net position is the amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position. The debt service reserve is presented as a restricted component of net position. The reserve amount is in compliance with the required amount. The Health System does not have any deferred outflows of resources or deferred inflows of resources required to be reported for the year ended June 30, 2013.

Operating Revenues and Expenses

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

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating Revenues and Expenses (Continued)

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

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

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

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

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

Reclassifications

Certain reclassifications have been made in the 2012 financial statements to conform to the 2013 financial statements presentation. Such reclassifications had no effect on the results of operations as previously reported.

NOTE B: DESIGNATED NET POSITION

Unrestricted net position includes special funds designated by the Health System totaling $8,101,736 and $8,041,943 as of June 30, 2013 and 2012, respectively, for specific purposes such as future capital improvements, insurance and debt service as described in Note E. The internally designated special funds remain under the control of the Health System which may at its discretion later use the funds for other purposes.

NOTE C: CHARITY CARE

Charges foregone for services and supplies furnished under the Health System's charity care policy totaled $724,086 and $997,969 for the years ended June 30, 2013 and 2012, respectively.

NOTE D: NET PATIENT SERVICE REVENUE

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

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

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

NOTE D: NET PATIENT SERVICE REVENUE (CONTINUED)

Home Health payments for services to Medicare beneficiaries are based on the patient's resource group classification for patient clinical, functional, and service level factors.

Revenue from the Medicare program accounted for approximately 31 percent and 29 percent of the hospital-based departments' and Care Centers' net patient revenue, respectively, for the year ended June 30, 2013.

Each department is reimbursed at a tentative rate with final settlement determined after submission of an annual cost report by the department and audit thereof by the Medicare fiscal intermediary. The Health System's Medicare cost reports have been audited by the fiscal intermediary through June 30, 2010.

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

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

Revenue from the Medicaid program accounted for approximately 7 percent and 56 percent of the hospital-based departments' and Care Centers' net patient revenue, respectively, for the year ended June 30, 2013.

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

The Medical Center received $4,501 and $7,206, from an endowment fund for the years ended June 30, 2013 and 2012, respectively, for patient care that is included in net patient service revenue.

NOTE E: DEPOSITS AND SPECIAL FUNDS

The Health System's carrying amount of deposits was $6,293,268 and $7,475,856 and the bank balance was $6,577,810 and $7,628,565 as of June 30, 2013 and 2012, respectively. The Health System's carrying amount for special funds, excluding amounts held under an indenture agreement, was $8,203,072 and $8,154,689 and the bank balance was $8,175,824 and $8,069,306 as of June 30, 2013 and 2012, respectively. The bank balances totaling $14,753,634 are either insured by the Federal Deposit Insurance Corporation or Tennessee Bank Collateral Pool. The bank balances are not subject to custodial credit risk.

Interest Rate Risk

For an investment, this is the risk that a change in interest rates will affect the fair market value of investments held. The Health System has established a debt service reserve fund under an indenture agreement for repayment of the outstanding Series 2007 and 2013 bonds. The reserve fund consists of a money market fund that normally invests at least 80% of its assets in U. S. Treasury securities and repurchase agreements for those securities. Its value as of June 30, 2013 was $1,083,871. Generally, these investments maintain a dollar weighted average maturity at 60 days or less.

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

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

NOTE E: DEPOSITS AND SPECIAL FUNDS (CONTINUED)

Special funds are held as follows as of June 30:

	2013	2012
Internally designated for capital improvements, insurance and debt service:	$ 8,101,736	$ 8,041,943
Restricted by contributors	58,797	70,392
Held under an indenture agreement	1,083,871	1,083,785
Held under patient trust fund arrangements - cash	42,539	42,354
	9,286,943	9,238,474
Less amounts reclassified to meet current liabilities	42,539	42,354
	$ 9,244,404	$ 9,196,120

NOTE F: NOTES RECEIVABLE ARRANGEMENTS

The Medical Center has advanced money to physicians to assist in the establishment of their medical professional practices. Advances are to be repaid by cash payment or amortized by continuation of the physicians' medical practice for a certain period based upon the terms of each arrangement. Net advances to physicians totaled $28,515 and $248,400 for the years ended June 30, 2013 and 2012, respectively. Net repayments, primarily from amortization of advances to physicians, totaled $190,097 and $97,367 for the years ended June 30, 2013 and 2012, respectively. As of June 30, 2013 and 2012, net advances totaling $272,186 and $433,768, respectively, were due under these arrangements.

NOTE G: CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2013 was as follows:

	June 30, 2012	Additions	Retirements	June 30, 2013
Capital assets, not being depreciated:				
Land	$ 773,754	$ -	$ -	$ 773,754
Property under capitalized lease	300,000	-	-	300,000
Construction in progress	25,262	213,244	-	238,506
Other assets not in service	5,200	-	(5,200)	-
Total capital assets, not being depreciated	1,104,216	213,244	(5,200)	1,312,260
Capital assets, being depreciated:				
Ground improvements	2,308,042	-	-	2,308,042
Building & improvements	27,168,572	191,975	-	27,360,547
Equipment	15,508,086	574,455	(217,329)	15,865,212
Equipment under capitalized lease	355,753	-	-	355,753
Total capital assets being depreciated	45,340,453	766,430	(217,329)	45,889,554
Less accumulated depreciation for:				
Ground improvements	(865,427)	(80,534)	-	(945,961)
Buildings and improvements	(14,109,385)	(835,577)	-	(14,944,962)
Equipment	(11,779,313)	(1,178,735)	213,993	(12,744,055)
Equipment under capitalized lease	(145,694)	(59,200)	-	(204,894)
Total accumulated depreciation and amortization	(26,899,819)	(2,154,046)	213,993	(28,839,872)
Capital assets, net	$ 19,544,850	$ (1,174,372)	$ (8,536)	$ 18,361,942

NOTE G: CAPITAL ASSETS (CONTINUED)

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

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

The general depreciation rates based on the useful lives for depreciable capital assets is 5% for ground improvements, 2.5% to 5% for building and improvements, and 5% to 20% for equipment and equipment under capital lease. Depreciation and amortization of capital lease obligations expense for the years ended June 30, 2013 and 2012 totaled $2,154,046 and $2,175,674, respectively. Accumulated amortization for equipment under capital lease obligations was $204,894 and $145,694 at June 30, 2013 and 2012, respectively.

During the current year the Health System completed its construction project at Donalson Care Center and began the renovation of the entrance and the parking lot at the Wellness Center. This project is expected to be completed by July 2013. Additionally, planning cost has been incurred for the expansion of certain areas at the Medical Center.

NOTE H: LONG-TERM DEBT

The following is a schedule of long-term debt and capital lease obligations activity for the year ended June 30, 2013:

	June 30, 2012	Additions	Reductions	June 30, 2013	Due Within One Year
Series 1998, final installment of $495,000 due May 2013, at an interest rate of 5.125%	$ 495,000	$ -	$ (495,000)	$ -	$ -
Series 2004, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of $45,000 to $800,000 through May 2023, at an interest rate of 3.875%.	6,840,000	-	(6,840,000)	-	-
Series 2007, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of $10,000 to $1,040,000 through May 2028, at an interest rate of 4.2%.	4,895,000	-	(10,000)	4,885,000	10,000
Series 2007, General Obligation Refunding Bonds, due in installments of $160,000 to $220,000 through May 2021, at an interest rate of 3.93%.	1,705,000	-	(160,000)	1,545,000	170,000
Capital Lease Obligation, due in monthly installments of $3,561 through April 2017, at an interest rate of 7.5%.	172,799	-	(30,817)	141,982	33,210
Capital Lease Obligation, due in monthly installments of $3,917 through August 2016, at an interest rate of 5.45%	168,428	-	(35,900)	132,528	38,609
Series 2013, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of $620,000 to $730,000 through May 2023, at an interest rate of 2%.	-	6,735,000	-	6,735,000	620,000
Toal long-term debt	14,276,227	$ 6,735,000	$ (7,571,717)	13,439,510	$ 871,819
Less current maturities of long-term debt	(776,718)			(871,819)	
Less Series 2004 deferred refunding costs	(246,745)			-	
Less Series 2007 deferred refunding costs	(178,814)			(161,333)	
Less Series 2013 deferred refunding costs	-			(311,256)	
Add unamortized bond premium	-			182,714	
Total noncurrent liabilities	$ 13,073,950			$ 12,277,816	

NOTE H: LONG-TERM DEBT (CONTINUED)

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

	June 30, 2011	Additions	Reductions	June 30, 2012	Due Within One Year
Series 1998, final installment of $495,000 due May 2013, at an interest rate of 5.125%	$ 970,000	$ -	$ (475,000)	$ 495,000	$ 495,000
Series 2004, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of $45,000 to $800,000 through May 2023, at an interest rate of 3.875%.	6,885,000	-	(45,000)	6,840,000	45,000
Series 2007, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of $10,000 to $1,040,000 through May 2028, at an interest rate of 4.2%.	4,905,000	-	(10,000)	4,895,000	10,000
Series 2007, General Obligation Refunding Bonds, due in installments of $160,000 to $220,000 through May 2021, at an interest rate of 3.93%.	1,860,000	-	(155,000)	1,705,000	160,000
Capital Lease Obligation, due in monthly installments of $3,561 through April 2017, at an interest rate of 7.5%.	201,397	-	(28,598)	172,799	30,818
Capital Lease Obligation, due in monthly installments of $3,917 through August 2016, at an interest rate of 5.45%	-	196,413	(27,985)	168,428	35,900
Toal long-term debt	14,821,397	$ 196,413	$ (741,583)	14,276,227	$ 776,718
Less current maturities of long-term debt	(713,598)			(776,718)	
Less Series 1998 deferred refunding costs	(10,225)			-	
Less Series 2004 deferred refunding costs	(264,410)			(246,745)	
Less Series 2007 deferred refunding costs	(187,940)			(178,814)	
Total noncurrent liabilities	$ 13,645,224			$ 13,073,950	

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

The annual requirements to amortize all long-term debt outstanding as of June 30, 2013 are as follows:

Year Ending June 30,	Principal	Interest
2014	$ 871,819	$ 405,784
2015	887,310	393,514
2016	908,222	367,901
2017	892,159	342,479
2018	870,000	320,305
2019-2023	4,225,000	1,276,943
2024-2028	4,785,000	619,710
	$ 13,439,510	$ 3,726,636

NOTE H: LONG-TERM DEBT (CONTINUED)

Series 1998

The Series 1998 Hospital Facility Lease Revenue and Tax Bonds were issued in the total amount of $15,000,000 to construct and purchase equipment for the new Medical Center built in 2001. The bonds were paid in full in 2013.

Series 2004

The Health System defeased a portion of the Series 1998 bonds by issuance of $7,115,000 Series 2004 Hospital Facility Lease Revenue and Tax Refunding Bonds and placing the proceeds of the bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Health System's financial statements. At June 30, 2013, $6,625,000 of the bonds outstanding are considered defeased.

The Series 2004 bonds maturing on or after May 1, 2014 were redeemed by an advance refunding in June 2013 as discussed below.

Series 2007

The Health System defeased certain outstanding portions of its Series 1998 and Series 2001 bonds by issuance of $4,960,000 Series 2007 Hospital Facility Lease Revenue and Tax Refunding Bonds and $1,905,000 Series 2007 General Obligation Refunding Bonds and placing the proceeds of the bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Health System's financial statements. At June 30, 2013, $6,655,000 of the bonds outstanding are considered defeased.

Both Series 2007 bonds are the ultimate obligation of Lincoln County, Tennessee. Both Series 2007 bonds are subject to redemption prior to maturity, as a whole or in part, at any time, at the redemption price plus interest accrued to the redemption date for bonds maturing after May 1, 2017.

Series 2013

On June 5, 2013, the Industrial Development Board of the City of Fayetteville and Lincoln County, Tennessee issued $6,735,000 Series 2013 Hospital Facility Lease Revenue and Tax Refunding Bonds to advance refund $6,795,000 of the Series 2004 bonds described above.

The net proceeds of $6,918,992 (which includes a net premium of $183,992 less payments for issue costs totaling $77,086 and accrued interest $46,906) were used to purchase government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the Series 2004 refunded bonds. As a result, the Series 2004 bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements.

The advanced refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $311,256. This difference is being netted against the new debt and amortized through the new debt maturity. This advanced refunding was undertaken to reduce the Health System's total debt service payments over the next 10 years by $842,103 and to obtain an economic gain of $772,821.

The Series 2013 bonds are the ultimate obligation of Lincoln County, Tennessee. The Series 2013 bonds are subject to redemption prior to maturity, as a whole or in part, at any time, at the redemption price plus interest accrued to the redemption date for bonds maturing after May 1, 2023. The Series 2013 bonds are on a parity lien with the Series 2007 bonds.

NOTE H: LONG-TERM DEBT (CONTINUED)

Series 2013

For the year ended June 30, 2013, the Health System did not maintain the required debt service covenant ratio of 1.15:1 established for the outstanding Series 2007 and Series 2013 bonds. To cure this technical deficiency as required by the bonds' covenant, the Health System has retained a consultant to recommend procedures to maintain this ratio in the future.

Other Debt

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

NOTE I: PENSION PLAN

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

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

Plan Description

Employees of Lincoln County Courthouse Employees' Pension Plan are members of the Political Subdivision Pension Plan (PSPP), an agent multiple-employer defined benefit pension plan (the "Plan") administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement benefits as well as death and disability benefits. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with 5 years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members at the age of 55. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty.

Plan Description

Members joining the system after July 1, 1979, become vested after 5 years of service and members joining prior to July 1, 1979, were vested after 4 years of service. Benefit provisions are established in state statute found in Title 8, Chapter 34-37 of the Tennessee Code Annotated (TCA). State statutes are amended by the Tennessee General Assembly.

Political subdivisions such as Lincoln County Courthouse Employees participate in the TCRS as individual entities and are liable for all costs associated with the operation and administration of their plan. Benefit improvements are not applicable to a political subdivision unless approved by the chief governing body.

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

NOTE I: PENSION PLAN (CONTINUED)

Funding Policy

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

Plan members are required to contribute at an actuarially determined rate. The current rate is 6.12% of annual covered payroll. The contribution requirement of plan members is set by state statute. The contribution requirement for Lincoln County Courthouse Employees' Pension Plan is established and may be amended by the TCRS Board of Trustees. The Health System contributions for participating departments for the years ending June 30, 2013, 2012, and 2011 were $638,024, $679,037, and $589,946 respectively, equal to the required contributions for each year.

Care Centers

The Care Centers adopted a defined contribution pension plan, under Sections 401(a) and 457 of the Internal Revenue Code, covering all employees who are 21 years of age and have completed 1,000 hours of service. Participants become fully vested after six years (20% after 2 years plus 20% for each subsequent year). Participants become eligible to retire at the age of 60 or completion of 5 years of service, whichever is later. The plan provides for early retirement at the age of 55 and the completion of 30 years of service. Eligible participants may contribute a portion of their salary, up to the legal limit established by the Internal Revenue Code. The Care Centers will match up to 50% of the employee's contribution up to the first 3% of gross pay. Employer and employee contributions under this plan totaled $28,195 and $29,133 and $116,608 and $132,026 for the years ended June 30, 2013 and 2012, respectively.

Deferred Compensation Plan

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

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

NOTE J: RISK MANAGEMENT

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

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

NOTE J: RISK MANAGEMENT (CONTINUED)

As of June 30, 2013 and 2012, the Health System accrued $141,481 and $305,464 respectively, for an estimated claims lag. Changes in the reported liability for 2013 and 2012 resulted from the following:

	2013	2012
Balance, beginning of year	$ 305,464	$ 417,546
Current year claims and settlements	2,580,431	2,645,854
Claim payments	(2,744,414)	(2,757,936)
Balance, end of year	$ 141,481	$ 305,464

The Committee has internally designated cash to use for payment of future insurance premiums. As of June 30, 2013, this internally designated cash, including interest earned, totaled $159,452.

NOTE K: CONCENTRATIONS OF CREDIT RISK

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

	2013	2012
Medicare	30%	30%
Medicaid	19%	19%
Other third-party payors	21%	26%
Patients	30%	25%
	100%	100%

NOTE L: MANAGEMENT AGREEMENT

Effective March 1, 2012, the Health System entered into an agreement with Quorum Health Resources, LLC, ("QHR"), to provide management services and certain special personnel, as defined in the agreement. The agreement is for a three year term that expires February 28, 2015 with a two year "opt-out provision" after its effective date. The annual management fee is $322,032 payable in monthly installments, subject to annual adjustment by an inflation factor of the lessor of 5% or percentage increase in the Medical Component of the Consumer Price Index ("CPI"), as defined in the agreement. The annual fee is in addition to payments for special personnel and reimbursements. Management fees paid for 2013 and 2012 were $813,259 and $703,627, respectively. Total payments to QHR for 2013 and 2012 were $817,521 and $714,825, respectively, which includes reimbursement for travel, dues, and special personnel who provide services to the Health System.

NOTE M: CONTINGENCIES AND COMMITMENTS

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

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

NOTE M: CONTINGENCIES AND COMMITMENTS (CONTINUED)

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

The following is a schedule by year of future minimum noncancelable lease payments as of June 30, 2013:

Year Ending June 30,	
2014	$ 15,000
2015	15,000
2016	15,000
2017	13,750
	$ 58,750

Rental expense under all operating leases for 2013 and 2012 totaled $263,347 and $221,059, respectively.

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

Year Ending June 30,	
2014	$ 96,077
2015	62,225
2016	10,593
	$ 168,895

Rental income received for 2013 and 2012 totaled $242,545 and $244,108 respectively. Rental income is included in other operating revenue in the accompanying financial statements. The cost and accumulated depreciation related to the medical office building is included in property and equipment (see Note G) as follows:

Cost	$ 3,569,499
Accumulated depreciation	(1,199,408)
Net Book Value	$ 2,370,091

NOTE N: LINCOLN COUNTY HEALTH SYSTEM FOUNDATION

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

NOTE N: LINCOLN COUNTY HEALTH SYSTEM FOUNDATION (CONTINUED)

For informational purposes only, a summary of the Foundation's assets, liabilities, net position, results of operations, and changes in net position follows as of June 30, 2013.

Assets, cash and cash equilvalents	$ 34,054
Liabilities	-
Unrestricted net position	$ 34,054
Support and revenue	$ 33,146
Expenses	(47,130)
Deficiency of support and revenue over expenses	(13,984)
Unrestricted net position, beginning of year	48,038
Unrestricted net position, end of year	$ 34,054

NOTE O - PLEDGED REVENUES

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

Operating Revenues	Current Year Principal and Interest Paid on Revenue Bonds	Percent of Current Revenue	Remaining Pledge based on future Principal and Interest Requirements	Commitment Period through Fiscal Year
$ 39,247,409	$ 1,046,009	2.7%	$ 15,022,388	2028

NOTE P -ELECTRONIC HEALTH RECORD INCENTIVE PAYMENTS

The Health System received $183,499 and $1,421,395 in Medicare and Medicaid Electronic Health Record (EHR) unrestricted incentive payments for the year ended June 30, 2013 and 2012, respectively, which is reported as nonoperating revenue. The Health Information Technology for Economic and Clinical Health Act (HITECH Act) established programs under Medicare and Medicaid to provide incentive payments for the meaningful use of certified EHR technology. The Health System anticipates receiving additional incentive payments totaling $1.5 million through 2015.

NOTE Q -NET SERVICE REVENUE

Accounts receivable is reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Health System management analyzes its past collection history utilizing a hindsight review methodology along with identification of collection trends and current status of the existing receivables for each of its major sources of revenue to estimate the allowance for doubtful accounts and provision of bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

The difference between the standard rates (or the discounted rates) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

NOTE Q -NET SERVICE REVENUE (CONTINUED)

The allowance for doubtful accounts ranged from 38.4% to 39.7% of accounts receivable as of June 30, 2013 and 2012, respectively. Total net writeoffs increased $1,019,887 to $6,241,440 for 2013 from $5,221,553 for 2012. The increase was as a result of negative trends experienced in the collection of amounts due from patients in 2013. The Health System has not changed its charity care or uninsured discount policies during the fiscal years 2013 or 2012.

The following schedule summarizes total revenues for the fiscal years ended June 30, 2013 and 2012:

	2013	2012
Patient service revenue (net of contractual allowances and discounts	$ 44,643,175	$ 45,070,721
Provision for bad debt	(6,470,303)	(5,422,842)
Net patient revenue less provision for bad debt	38,172,872	39,647,879
Other operating revenue	1,074,537	845,180
Total revenue	$ 39,247,409	$ 40,493,059

OTHER FINANCIAL INFORMATION

LINCOLN COUNTY HEALTH SYSTEM
DEPARTMENTAL SCHEDULE OF NET POSITION

June 30, 2013

	Lincoln Medical Center	Lincoln Medical Center EMS	Home Health Care	Patrick Rehab-Wellness Center	Lincoln & Donalson Care Centers	Total
ASSETS						
CURRENT ASSETS:						
Cash and cash equivalents	$ 970,045	$ -	$ 58,177	$ 10,767	$ 5,254,279	$ 6,293,268
Restricted cash	-	-	-	-	42,539	42,539
Accounts receivable - net	3,109,968	-	94,411	-	1,141,912	4,346,291
Estimated third-party payor settlements receivable	538,945	-	-	-	26,863	565,808
Supplies, at cost	651,991	-	-	-	61,183	713,174
Prepaid expenses	159,402	-	-	35	48,480	207,917
Due from (to) departments	(2,642,153)	-	-	-	2,642,153	-
Other assets	54,021	-	-	-	35,241	89,262
Total Current Assets	2,842,219	-	152,588	10,802	9,252,650	12,258,259
NONCURRENT ASSETS:						
Special Funds	1,243,630	-	-	-	8,000,774	9,244,404
Capital assets, net of accumulated depreciation	12,916,567	410,068	72,204	1,149,746	3,813,357	18,361,942
Other assets:						
Investment in insurance fund	125,055	-	-	-	35,860	160,915
Notes receivable, net	272,186	-	-	-	-	272,186
Deferred financing costs	139,198	-	-	-	-	139,198
Total Noncurrent Assets	14,696,636	410,068	72,204	1,149,746	11,849,991	28,178,645
TOTAL ASSETS	17,538,855	410,068	224,792	1,160,548	21,102,641	40,436,904
LIABILITIES AND NET POSITION						
CURRENT LIABILITIES:						
Current maturities of long-term debt	838,609	-	-	33,210	-	871,819
Accounts payable	766,573	17,551	13,630	87,652	279,077	1,164,483
Accrued expenses:						
Salaries and payroll taxes	516,293	35,148	24,599	49,737	252,250	878,027
Compensated absences	529,485	49,649	25,689	34,493	341,667	980,983
Interest	54,660	-	-	-	-	54,660
Other	83,052	-	-	33	181,847	264,932
Estimated third-party payor settlements payable	80,467	-	-	-	-	80,467
Patient trust funds	-	-	-	-	42,539	42,539
Total Current Liabilities	2,869,139	102,348	63,918	205,125	1,097,380	4,337,910
NONCURRENT LIABILITIES:						
Long-term debt, net of current maturities	12,169,044	-	-	108,772	-	12,277,816
TOTAL LIABILITIES	15,038,183	102,348	63,918	313,897	1,097,380	16,615,726
NET POSITION:						
Net investment in capital assets	(91,086)	410,068	72,204	1,007,764	3,813,357	5,212,307
Restricted:						
Bond indenture debt service	1,083,871	-	-	-	-	1,083,871
Other purposes	67,533	-	-	-	-	67,533
Unrestricted (deficit)	1,440,354	(102,348)	88,670	(161,113)	16,191,904	17,457,467
TOTAL NET POSITION	$ 2,500,672	$ 307,720	$ 160,874	$ 846,651	$ 20,005,261	$ 23,821,178

LINCOLN COUNTY HEALTH SYSTEM
DEPARTMENTAL SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

Year Ended June 30, 2013

	Lincoln Medical Center	Lincoln Medical Center EMS	Home Health Care	Patrick Rehab-Wellness Center	Lincoln & Donalson Care Centers	Eliminations DR/(CR)	Total
OPERATING REVENUES:							
Net patient service revenue	$ 20,905,241	$ 1,848,999	$ 1,094,361	$ 1,646,162	$ 12,945,111	$ 267,002	$ 38,172,872
Other operating revenue	1,452,345	-	80	400,919	286,484	1,065,291	1,074,537
Total Operating Revenues	22,357,586	1,848,999	1,094,441	2,047,081	13,231,595	1,332,293	39,247,409
OPERATING EXPENSES:							
Employee compensation and benefits	13,691,648	1,108,024	659,844	1,359,721	7,290,453	57,661	24,167,351
Fees to individuals and organizations	4,288,525	125,736	282,938	34,685	1,695,706	(917,880)	5,509,710
Supplies	3,290,322	64,044	37,345	99,518	1,454,625	(309,879)	4,635,975
Other expenses	2,550,845	146,540	87,285	224,597	1,595,864	(162,195)	4,442,936
Depreciation	1,676,910	95,268	15,589	64,311	301,968	-	2,154,046
Total Operating Expenses	25,498,250	1,539,612	1,083,001	1,782,832	12,338,616	(1,332,293)	40,910,018
INCOME (LOSS) FROM OPERATIONS	(3,140,664)	309,387	11,440	264,249	892,979	-	(1,662,609)
NONOPERATING REVENUES AND (EXPENSES):							
Investment income	11,825	-	107	28	80,398	-	92,358
Interest expense	(578,097)	-	-	(11,915)	-	-	(590,012)
Amortization	(47,126)	-	-	-	-	-	(47,126)
Noncapital grants, contributions and incentive payments	189,838	-	2,895	-	-	-	192,733
Gain (loss) on disposal of capital assets	(1,114)	1,000	-	-	(1,919)	-	(2,033)
Nonoperating Revenues and (Expenses), net	(424,674)	1,000	3,002	(11,887)	78,479	-	(354,080)
Excess (Deficiency) Revenues over Expenses	(3,565,338)	310,387	14,442	252,362	971,458	-	(2,016,689)
Capital Contributions	20,700	-	-	35,000	-	-	55,700
Operating transfers from (to) departments, net	472,663	(321,620)	(6,010)	(145,033)	-	-	-
CHANGE IN NET POSITION	(3,071,975)	(11,233)	8,432	142,329	971,458	-	(1,960,989)
Total Net Position, at beginning of year	5,572,647	318,953	152,442	704,322	19,033,803	-	25,782,167
TOTAL NET POSITION, AT END OF YEAR	$ 2,500,672	$ 307,720	$ 160,874	$ 846,651	$ 20,005,261	$ -	$ 23,821,178

LINCOLN COUNTY HEALTH SYSTEM
DEPARTMENTAL SCHEDULE OF CASH FLOWS

Year Ended June 30, 2013

	Lincoln Medical Center	Lincoln Medical Center EMS	Home Health Care	Patrick Rehab-Wellness Center	Lincoln & Donalson Care Centers	Total
CASH FLOWS FROM OPERATING ACTIVITIES:						
Cash received from patients and third party payors	$ 21,140,192	$ 1,848,999	$ 1,117,486	$ 1,646,162	$ 12,889,585	$ 38,642,424
Other operating cash receipts	1,452,345	-	80	400,919	286,484	2,139,828
Cash paid to employees for wages and benefits	(13,714,682)	(1,104,472)	(649,194)	(1,364,824)	(7,272,946)	(24,106,118)
Cash paid to suppliers for goods and services	(10,040,357)	(332,067)	(407,992)	(290,205)	(4,748,438)	(15,819,059)
Net Cash Provided (Used) by Operating Activities	(1,162,502)	412,460	60,380	392,052	1,154,685	857,075
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:						
Noncapital grants, contributions and incentive payments	189,838	-	2,895	-	-	192,733
Operating transfers in (out), net	472,663	(321,620)	(6,010)	(145,033)	-	-
Advances from (to) departments, net	(115,818)	-	-	-	115,818	-
Net Cash Provided (Used) by Noncapital Financing Activities	546,683	(321,620)	(3,115)	(145,033)	115,818	192,733
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:						
Additions to capital assets, net	(402,387)	(91,840)	-	(230,669)	(249,578)	(974,474)
Proceeds from disposal of capital assets	303	1,000	-	-	-	1,303
Capital contributions	20,700	-	-	35,000	-	55,700
Principal payments on long-term debt	(745,900)	-	-	(30,817)	-	(776,717)
Interest paid on long-term debt, net	(570,366)	-	-	(11,915)	-	(582,281)
Net Cash Used by Capital and Related Financing Activities	(1,697,650)	(90,840)	-	(238,401)	(249,578)	(2,276,469)
CASH FLOWS FROM INVESTING ACTIVITIES:						
Interest received	12,365	-	107	28	82,932	95,432
(Increase) decrease in special funds	10,717	-	-	-	(62,076)	(51,359)
Net Cash Provided by Investing Activities	23,082	-	107	28	20,856	44,073
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(2,290,387)	-	57,372	8,646	1,041,781	(1,182,588)
CASH AND CASH EQUIVALENTS, beginning of year	3,260,432	-	805	2,121	4,212,498	7,475,856
CASH AND CASH EQUIVALENTS, end of year	$ 970,045	$ -	$ 58,177	$ 10,767	$ 5,254,279	$ 6,293,268
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES:						
Income (loss) from operations	$ (3,140,664)	$ 309,387	$ 11,440	$ 264,249	$ 892,979	$ (1,662,609)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities -						
Depreciation	1,676,910	95,268	15,589	64,311	301,968	2,154,046
Provision for bad debts	5,969,316	310,892	21,787	72,423	95,885	6,470,303
Provision for note receivable arrangements	190,097	-	-	-	-	190,097
Advances under note receivable arrangements, net	(28,515)					(28,515)
Investment in insurance funds, net	(6,503)	-	-	-	(9,287)	(15,790)
Changes in operating assets and liabilities -						
Accounts receivable	(5,741,934)	(310,892)	1,338	(72,423)	(139,321)	(6,263,232)
Supplies	5,565	-	-	-	(1,996)	3,569
Prepaid expenses	(61,021)	-	-	-	7,686	(53,335)
Other assets	(53,041)	-	-	-	17,192	(35,849)
Accounts payable	173,304	4,253	(424)	68,606	50,741	296,480
Accrued expenses	(153,585)	3,552	10,650	(5,114)	(49,072)	(193,569)
Estimated third-party payor settlements, net	7,569	-	-	-	(12,090)	(4,521)
Net Cash Provided (Used) by Operating Activities	$ (1,162,502)	$ 412,460	$ 60,380	$ 392,052	$ 1,154,685	$ 857,075

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

June 30, 2013

Year Ending June 30,	Lincoln Medical Center Series 2007 Gen Oblig. Refg. Principal	Lincoln Medical Center Series 2007 Gen Oblig. Refg. Interest	Lincoln Medical Center Series 2007 Refg. Rev. Principal	Lincoln Medical Center Series 2007 Refg. Rev. Interest	Lincoln Medical Center Series 2013 Refg. Rev. Principal	Lincoln Medical Center Series 2013 Refg. Rev. Interest	Lincoln Medical Center Capital Lease Obligation Principal	Lincoln Medical Center Capital Lease Obligation Interest	Lincoln Medical Center Capital Lease Obligation Principal	Lincoln Medical Center Capital Lease Obligation Interest	Total
2014	$ 170,000	$ 60,718	$ 10,000	$ 205,170	$ 620,000	$ 121,978	$ 33,210	$ 9,523	$ 38,609	$ 8,395	$ 1,277,603
2015	170,000	54,037	10,000	204,750	630,000	122,300	35,788	6,945	41,522	5,482	1,280,824
2016	180,000	47,356	10,000	204,330	635,000	109,700	38,567	4,166	44,655	2,349	1,276,123
2017	190,000	40,282	10,000	203,910	650,000	97,000	34,417	1,195	7,742	92	1,234,638
2018	195,000	32,815	10,000	203,490	665,000	84,000	-	-	-	-	1,190,305
2019	205,000	25,152	10,000	203,070	675,000	70,700	-	-	-	-	1,188,922
2020	215,000	17,095	10,000	202,650	695,000	57,200	-	-	-	-	1,196,945
2021	220,000	8,646	10,000	202,230	710,000	43,300	-	-	-	-	1,194,176
2022	-	-	10,000	201,810	725,000	29,100	-	-	-	-	965,910
2023	-	-	10,000	201,390	730,000	14,600	-	-	-	-	955,990
2024	-	-	880,000	200,970	-	-	-	-	-	-	1,080,970
2025	-	-	915,000	164,010	-	-	-	-	-	-	1,079,010
2026	-	-	955,000	125,580	-	-	-	-	-	-	1,080,580
2027	-	-	995,000	85,470	-	-	-	-	-	-	1,080,470
2028	-	-	1,040,000	43,680	-	-	-	-	-	-	1,083,680
	$ 1,545,000	$ 286,101	$ 4,885,000	$ 2,652,510	$ 6,735,000	$ 749,878	$ 141,982	$ 21,829	$ 132,528	$ 16,318	$ 17,166,146

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

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

We have audited, 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 financial statements of the Lincoln County Health System (the "Health System") as of and for the year ended June 30, 2013, and the related notes to the financial statements, and have issued our report thereon, dated October 14, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the 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 financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Health System's internal control. Accordingly, we do not express an opinion on the effectiveness of the 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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Health System's financial statements will not be prevented, or detected and corrected on a timely basis. 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.

Compliance and Other Matters

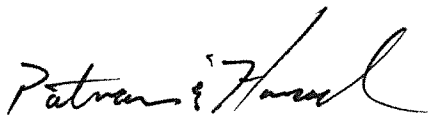
As part of obtaining reasonable assurance about whether the Health System's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which described in the accompanying schedule of findings and responses as 2013-1.

Lincoln County Health System's Response to Findings

Lincoln County Health System's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Health System's response and, accordingly, we express no opinion on it.

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 entity'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 Health System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Fayetteville, Tennessee
October 14, 2013

LINCOLN COUNTY HEALTH SYSTEM
SCHEDULE OF FINDINGS AND RESPONSES

YEARS ENDED JUNE 30, 2013 and 2012

FINDING NUMBER 2013-01

Condition and Criteria:
Lincoln County, Tennessee agreed in a sublease on the Series 1998 and certain subsequent parity bond issues (e.g. Series 2007 and Series 2013) to fix rates, fees and charges for services furnished by the Health System in an amount sufficient to produce income available for debt service adequate to maintain the funds created under this indenture and to pay the bonds at maturity and accrued interest thereon.

Effect:
For the year ended June 30, 2013, the Health System did not maintain the required debt service covenant ratio of 1.15:1 established for the outstanding Series 2007 and Series 2013 bonds.

Auditors' Recommendations:
As required by the bond rate covenant, the Health System shall employ a consultant to prepare a report containing recommendations as to changes in the operating policies of the Health System designed to maintain such amount in which the Health System determines to be in the best interests of the Health System.

Management Response:
To cure this technical deficiency as required by the bonds' rate covenant, the Health System has retained a consultant to recommend procedures to maintain this ratio in the future.

No prior year findings