

**CLAIBORNE COUNTY HOSPITAL & NURSING
HOME AND SUBSIDIARY (A COMPONENT UNIT OF
CLAIBORNE, TENNESSEE)**

Tazewell, Tennessee

CONSOLIDATED FINANCIAL STATEMENTS

**Nine months ended March 31, 2014 and
year ended June 30, 2013**

JOHNSON, HICKEY & MURCHISON, P.C.
Certified Public Accountants
Chattanooga, Tennessee

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INDEPENDENT AUDITORS' REPORT

**To the Board of Trustees of
Claiborne County Hospital & Nursing Home and Subsidiary
(a component unit of Claiborne County, TN):**

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated statement of net position of Claiborne County Hospital & Nursing Home and Subsidiary (a component unit of Claiborne County, Tennessee) (the Hospital), as of March 31, 2014 and June 30, 2013, and the related consolidated statement of revenues, expenses, and changes in net position and consolidated statement of cash flows for the nine months ended March 31, 2014 and the year ended June 30, 2013, and the related notes to the consolidated financial statements, which collectively comprise the Hospital's consolidated financial statements.

Management's Responsibility for the Consolidated 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 misstatements, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatements.

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 auditors' 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 financial position of the Hospital, as of March 31, 2014 and June 30, 2013, and the changes in its financial position and its cash flows for the nine months ended March 31, 2014 and the year ended June 30, 2013 in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 17 to the consolidated financial statements, in 2014, the Hospital adopted new accounting guidance, GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although, not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 5, 2015, on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.

Johnson, Wickey & Meacham, P.C.

Chattanooga, Tennessee

March 5, 2015

CLAIBORNE COUNTY HOSPITAL & NURSING HOME AND SUBSIDIARY
(A COMPONENT UNIT OF CLAIBORNE COUNTY, TENNESSEE)
CONSOLIDATED STATEMENTS OF NET POSITION
MARCH 31, 2014 AND JUNE 30, 2013

ASSETS

	3/31/2014	6/30/2013
CURRENT ASSETS:		
Cash	\$ -	\$ 1,665,588
Patient accounts receivable, net of estimated uncollectibles of approximately \$4,070,000 in 2013	-	3,433,473
Inventories	-	544,398
Prepaid expenses	-	169,141
Other assets	-	419,404
Total current assets	-	6,232,004
ASSETS LIMITED AS TO USE:		
For construction of capital assets	-	64,780
Foundation	-	297,810
Under bond agreements - held by trustee	-	316,260
	-	678,850
CAPITAL ASSETS, net of accumulated depreciation	-	15,017,359
OTHER ASSETS	-	1,059,928
	\$ -	\$ 22,988,141

(The accompanying notes are an integral part of these statements.)

LIABILITIES AND NET POSITION

	<u>3/31/2014</u>	<u>6/30/2013</u>
CURRENT LIABILITIES:		
Current maturities of notes payable and capital leases	\$ -	\$ 319,226
Current maturities of bonds payable	-	455,000
Accounts payable and accrued expenses	-	2,209,742
Accrued payroll and withholdings	-	567,574
Accrued compensated absences	-	773,233
Accrued interest	-	50,435
Estimated third-party payor settlements	-	170,511
	<hr/>	<hr/>
Total current liabilities	-	4,545,721
	<hr/>	<hr/>
LONG-TERM DEBT, net of current maturities:		
Notes payable and capital leases	-	915,342
Bonds payable	-	4,831,128
	<hr/>	<hr/>
	-	5,746,470
	<hr/>	<hr/>
	-	10,292,191
	<hr/>	<hr/>
NET POSITION:		
Net investment in capital assets	-	8,877,703
Restricted - expendable for Foundation	-	297,810
Unrestricted	-	3,520,437
	<hr/>	<hr/>
	-	12,695,950
	<hr/>	<hr/>
	\$ -	\$ 22,988,141
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(The accompanying notes are an integral part of these statements.)

CLAIBORNE COUNTY HOSPITAL & NURSING HOME AND SUBSIDIARY
(A COMPONENT UNIT OF CLAIBORNE COUNTY, TENNESSEE)
CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION
NINE MONTHS ENDED MARCH 31, 2014 AND
YEAR ENDED JUNE 30, 2013

	3/31/2014	6/30/2013
OPERATING REVENUES:		
Patient service revenue	\$ 24,482,819	\$ 30,118,509
Provision for bad debts	(3,862,165)	(4,363,047)
Net patient service revenue	20,620,654	25,755,462
Other revenue	1,535,394	2,744,469
	22,156,048	28,499,931
 OPERATING EXPENSES:		
Salaries and benefits	13,247,776	18,272,363
Medical supplies and drugs	2,296,992	2,764,586
Other supplies	664,984	824,025
Insurance	516,861	792,168
Depreciation and amortization	805,894	1,044,659
Other expenses	6,843,009	6,146,585
	24,375,516	29,844,386
 OPERATING LOSS	(2,219,468)	(1,344,455)
 NONOPERATING REVENUES (EXPENSES):		
Investment income	126,567	121,490
Interest expense	(171,561)	(258,631)
Loss on note receivable	-	(34,023)
	(44,994)	(171,164)
 INCOME BEFORE OTHER REVENUES, EXPENSES, GAINS, LOSSES, AND TRANSFERS	(2,264,462)	(1,515,619)
 TRANSFER TO FOUNDATION	324,669	-
 TRANSFER TO COUNTY	10,106,819	-
 DECREASE IN NET POSITION	(12,695,950)	(1,515,619)
 NET POSITION, beginning of year	12,695,950	14,211,569
 NET POSITION, end of year	\$ -	\$ 12,695,950

(The accompanying notes are an integral part of these statements.)

CLAIBORNE COUNTY HOSPITAL & NURSING HOME AND SUBSIDIARY
(A COMPONENT UNIT OF CLAIBORNE COUNTY, TENNESSEE)
CONSOLIDATED STATEMENTS OF CASH FLOWS
NINE MONTHS ENDED MARCH 31, 2014 AND
YEAR ENDED JUNE 30, 2013

	3/31/2014	6/30/2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third-party payors	\$ 20,320,382	\$ 26,909,921
Cash payments to suppliers for goods and services	(11,169,999)	(13,903,463)
Cash payments to employees for services	(11,201,416)	(15,137,453)
Other revenue	1,535,394	2,744,469
Net cash (used) provided by operating activities	(515,639)	613,474
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Interest paid on debt	(121,124)	(255,874)
Purchase of capital assets	(376,406)	(548,209)
Payments on long-term debt	(245,671)	(824,435)
Net deposits to funds held by trustee	(1,195)	(1,202)
Net cash used by capital and related financing activities	(744,396)	(1,629,720)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Transfer of cash to new owner	(351,909)	-
Transfer of cash to County	(180,211)	-
Net cash used by noncapital financing activities	(532,120)	-
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment income received	126,567	121,490
Net cash provided by investing activities	126,567	121,490
NET DECREASE IN CASH	(1,665,588)	(894,756)
Beginning	1,665,588	2,560,344
Ending	\$ -	\$ 1,665,588

(The accompanying notes are an integral part of these statements.)

	<u>3/31/2014</u>	<u>6/30/2013</u>
RECONCILIATION OF OPERATING LOSS TO NET		
CASH (USED) PROVIDED BY OPERATING ACTIVITIES:		
Operating loss	\$ (2,219,468)	\$ (1,344,455)
Adjustments to reconcile operating loss to net cash (used) provided by operating activities -		
Depreciation and amortization	805,894	1,044,659
Provision for bad debts	3,862,165	4,363,047
Loss on physician receivables	1,247,376	
Net (increase) decrease in operating assets -		
Accounts receivable	(3,654,709)	(3,032,075)
Inventories	10,242	59,879
Prepaid expenses	94,369	(46,513)
Estimated third party payor settlements	(387,217)	-
Other assets	(472,362)	(296,226)
Net increase (decrease) in operating liabilities -		
Accounts payable and accrued expenses	235,276	103,764
Accrued payroll and withholdings	104,553	34,130
Accrued compensated absences	(21,247)	(96,223)
Estimated third party payor settlements	(120,511)	(176,513)
Net cash (used) provided by operating activities	<u>\$ (515,639)</u>	<u>\$ 613,474</u>

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Non-cash capital and related financing transactions -

Capital assets purchased with assets limited as to use	<u>\$ -</u>	<u>\$ 118,059</u>
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(The accompanying notes are an integral part of these statements.)

CLAIBORNE COUNTY HOSPITAL & NURSING HOME AND SUBSIDIARY
(A COMPONENT UNIT OF CLAIBORNE COUNTY, TENNESSEE)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 AND JUNE 30, 2013

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Organization –

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

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

Basis of presentation –

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

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

	<u>3/31/2014</u>	<u>6/30/2013</u>
Capital assets, net	\$ -	\$ 15,017,359
Assets limited as to use – construction of capital assets	-	64,780
Assets limited as to use – under bond agreements	-	316,260
Less –		
Current portion of long-term debt related to the acquisition of capital assets	-	(774,226)
Long-term debt, excluding current portion, relating to the acquisition of capital assets	-	(5,746,470)
Net investment in capital assets	\$ -	\$ 8,877,703

CLAIBORNE COUNTY HOSPITAL & NURSING HOME AND SUBSIDIARY
(A COMPONENT UNIT OF CLAIBORNE COUNTY, TENNESSEE)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 AND JUNE 30, 2013

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Basis of presentation (continued) –

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

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

When both restricted and unrestricted amounts of fund balance are available for expenditures, it is the Hospital's policy to use restricted amounts first and then unrestricted amounts as they are needed.

Principles of consolidation –

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

Cash and cash equivalents –

The Hospital considers currency on hand and demand deposits with financial institutions to be cash. The Hospital considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. State statutes authorize the Hospital to invest in obligations of the U.S. Treasury, bank certificates of deposit, state approved repurchase agreements and pooled investment funds, and state or local bonds rated A or higher by a nationally recognized rating service. There were no cash equivalents at March 31, 2014 or June 30, 2013.

Patient accounts receivable –

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

Inventories –

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

Capital assets –

Assets with a useful life of greater than one year and a cost of greater than \$1,000 are recorded as capital assets and are stated at cost or fair value at date of donation. Although title to certain land and buildings rests with the County, these assets have been recorded by the Hospital as the County has authorized their use by the Hospital. Repairs and maintenance costs are expensed as incurred while significant asset purchases and improvements are capitalized. Depreciation of property and equipment is computed by the straight-line method over the estimated useful lives of the assets.

CLAIBORNE COUNTY HOSPITAL & NURSING HOME AND SUBSIDIARY
(A COMPONENT UNIT OF CLAIBORNE COUNTY, TENNESSEE)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 AND JUNE 30, 2013

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Capital assets (continued) –

The estimated useful lives are based on guidelines established for the healthcare industry, which are summarized as follows –

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

Accrued compensated absences –

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

Bond premiums and discounts –

Bond premiums and discounts are amortized over the period the bonds are outstanding using the effective interest method.

Operating revenues and expenses –

Revenue and expenses associated with the Hospital’s mission of providing healthcare services are considered to be operating activities. Nonoperating income consists primarily of investment income, including interest income and income from rental of Medical Office Building (MOB) suites, gains, and grants and general contributions to the Hospital. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Income taxes –

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

Charity care –

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

Patient service revenue –

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

CLAIBORNE COUNTY HOSPITAL & NURSING HOME AND SUBSIDIARY
(A COMPONENT UNIT OF CLAIBORNE COUNTY, TENNESSEE)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 AND JUNE 30, 2013

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Deferred outflows/inflows of resources –

During the current year, the Hospital adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Under this Statement, GASB has defined deferred outflows of resources and deferred inflows of resources as follows –

Deferred outflows of resources – a consumption of net assets by the government that is applicable to a future reporting period.

Deferred inflows of resources – an acquisition of net assets by the government that is applicable to a future reporting period.

The hospital had no deferred outflows or inflows of resources at March 31, 2014 and June 30, 2013.

Risk management –

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

Use of estimates –

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

(2) CASH AND CASH EQUIVALENTS:

Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. Funds on deposit at financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) with uninsured amounts being collateralized primarily through the financial institution's participation in the Bank Collateral Pool (the Collateral Pool), which is administered by the Collateral Pool Board and monitored by the Treasury Department of the State of Tennessee.

The Hospital requires that all public funds (those not related to for profit entities) not insured by the FDIC to be part of the Collateral Pool or fully collateralized by specific investments as described above. At June 30, 2013, approximately \$70,000 of deposits were uninsured and uncollateralized.

CLAIBORNE COUNTY HOSPITAL & NURSING HOME AND SUBSIDIARY
(A COMPONENT UNIT OF CLAIBORNE COUNTY, TENNESSEE)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 AND JUNE 30, 2013

(3) NET PATIENT SERVICE REVENUE:

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

	<u>3/31/2014</u>	<u>6/30/2013</u>
Gross patient service charges	\$ 63,608,828	\$ 81,421,079
Less: Contractual adjustments and discounts	(39,126,009)	(51,302,570)
Provision for bad debts	(3,862,165)	(4,363,047)
 Net patient service revenue	 <u>\$ 20,620,654</u>	 <u>\$ 25,755,462</u>

Net patient service revenues decreased by approximately \$5,100.00 in 2014 due to sale of operations effective March 25, 2014. and \$312,000 in 2013 due to prior year retroactive adjustments in excess of amounts previously estimated.

(4) THIRD-PARTY PAYOR AGREEMENTS:

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

Medicare –

The Medicare program pays inpatient services on a prospective basis primarily based upon diagnostic related group assignments as determined by the patient’s clinical diagnosis and medical procedures utilized. The Hospital receives additional payments from Medicare based on the provision of services to a disproportionate share of low income patients (as defined by the Medicare program). Medicare also pays for outpatient services on a prospective basis based upon ambulatory payment classifications and fee schedules. Revenue from the Medicare program accounted for approximately 27% and 28% for the nine months ended March 31, 2014 and the year ended June 30, 2013, respectively.

TennCare –

TennCare reimbursement for both inpatient and outpatient services is based upon prospectively determined rates and per diem amounts. Revenue from the TennCare program accounted for approximately 15% and 17% for the nine months ended March 31, 2014 and the year ended June 30, 2013, respectively.

Contractual adjustments for Medicare, TennCare and other third party discount arrangements are recognized when the related revenues are reported in the consolidated financial statements.

CLAIBORNE COUNTY HOSPITAL & NURSING HOME AND SUBSIDIARY
(A COMPONENT UNIT OF CLAIBORNE COUNTY, TENNESSEE)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 AND JUNE 30, 2013

(4) THIRD-PARTY PAYOR AGREEMENTS (Continued):

Electronic Health Record (EHR) Incentive Program –

The American Recovery and Reinvestment Act established incentive payments under the Medicare and TennCare programs for certain hospitals that “meaningfully use” certified electronic health records (EHR) technology. The Hospital recognizes EHR incentive payments when there is reasonable assurance that the Hospital will comply with the conditions of the meaningful use objectives and any other specific requirements. During the nine months ended March 31, 2014 and the year ended June 30, 2013, the Hospital recognized \$1,011,617 and \$1,884,199, respectively, in EHR incentive payments as other revenue in the consolidated statements of revenues, expenses and changes in net position. EHR incentive income is subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were initially calculated. Receipt of these funds is also subject to the fulfillment of certain obligations by the Hospital as prescribed by the program, subject to future audits and may be subject to repayment upon a determination of noncompliance.

Other payors –

The Hospital has also entered into reimbursement agreements with commercial insurance companies, health maintenance organizations and preferred provider organizations. The basis for reimbursement under these agreements includes prospectively determined rates, per diems and discounts from established charges. Receipt of these funds is subject to the fulfillment of certain obligations by the Hospital as prescribed by the program, subject to future audits and may be subject to repayment upon a determination of noncompliance.

(5) RISK MANAGEMENT AND EMPLOYEE GROUP HEALTH CLAIMS:

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

The Hospital is insured for professional liability under a claims-made policy with an independent insurance carrier. The policy covers all claims reported to the carrier during the coverage period. The primary level of coverage is \$1,000,000 per claim and \$3,000,000 in the aggregate. Coverage for workers’ compensation insurance is provided on a claims-made basis. The primary level of coverage is \$500,000 per claim, \$500,000 per employee, and \$500,000 in the aggregate. Premiums are determined by a variety of factors related to the Hospital.

The Hospital is self-insured for employee (and dependent) group health claims up to \$70,000 per covered person annually. Commercial stop-loss coverage is purchased for claims in excess of the annual maximum up to \$1,000,000 in the aggregate. A liability is recorded for those claims known but unpaid and estimated claims incurred but not reported. The liability for employee group health

CLAIBORNE COUNTY HOSPITAL & NURSING HOME AND SUBSIDIARY
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2014 AND JUNE 30, 2013

(5) RISK MANAGEMENT AND EMPLOYEE GROUP HEALTH CLAIMS (Continued):

claims was \$235,969 at June 30, 2013. The total expense related to employee group health claims (net of employee paid premiums) was approximately \$689,000 and \$1,460,000, respectively, for the nine months ended March 31, 2014 and the year ended June 30, 2013.

(6) CAPITAL ASSETS:

On March 25, 2014, the Hospital sold all equipment to the new hospital owners and transferred the remaining land and buildings to the County. A summary of changes in capital assets follows –

	<u>6/30/2013</u>	<u>Additions</u>	<u>Retirements</u>	<u>Reclass/ Transfers</u>	<u>3/31/2014</u>
Capital assets not being depreciated:					
Land	\$ 308,092	\$ -	\$ -	\$ 308,092	\$ -
Capital assets being depreciated:					
Buildings and improvements	20,372,671	3,381	-	20,376,052	-
Equipment	<u>16,593,468</u>	<u>373,400</u>	<u>16,966,868</u>	-	-
Total capital assets being depreciated	<u>36,966,139</u>	<u>376,781</u>	<u>16,966,868</u>	<u>20,376,052</u>	-
Less accumulated depreciation for:					
Buildings and improvements	8,491,930	407,007	-	8,898,937	-
Equipment	<u>13,764,942</u>	<u>398,887</u>	<u>14,237,582</u>	<u>(73,753)</u>	-
Total accumulated depreciation	<u>22,256,872</u>	<u>805,894</u>	<u>14,237,582</u>	<u>8,825,184</u>	-
Total capital assets being depreciated, net	<u>14,709,267</u>	<u>(429,113)</u>	<u>2,729,286</u>	<u>11,550,868</u>	-
Capital assets, net	<u>\$ 15,017,359</u>	<u>\$ (429,113)</u>	<u>\$ 2,729,286</u>	<u>11,858,960</u>	<u>\$ -</u>

	<u>6/30/2012</u>	<u>Additions</u>	<u>Retirements</u>	<u>Transfers</u>	<u>6/30/2013</u>
Capital assets not being depreciated:					
Land	\$ 308,092	\$ -	\$ -	\$ -	\$ 308,092
Capital assets being depreciated:					
Buildings and improvements	20,002,972	369,699	-	-	20,372,671
Equipment	<u>16,296,899</u>	<u>296,569</u>	-	-	<u>16,593,468</u>
Total capital assets being depreciated	<u>36,299,871</u>	<u>666,268</u>	-	-	<u>36,966,139</u>
Less accumulated depreciation for:					
Buildings and improvements	7,955,011	536,919	-	-	8,491,930
Equipment	<u>13,257,202</u>	<u>507,740</u>	-	-	<u>13,764,942</u>
Total accumulated depreciation	<u>21,212,213</u>	<u>1,044,659</u>	-	-	<u>22,256,872</u>
Total capital assets being depreciated, net	<u>15,087,658</u>	<u>(378,391)</u>	-	-	<u>14,709,267</u>
Capital assets, net	<u>\$ 15,395,750</u>	<u>\$ (378,391)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 15,017,359</u>

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(7) OTHER ASSETS:

The Hospital pays various fees and expenses to and on behalf of physicians who are recruited to practice at the Hospital. These expenses are recorded as assets and are amortized over the terms of the physicians' contracts. At June 30, 2013, the assets totaled \$1,255,541, net of accumulated amortization, and are included in other receivables and other assets in the consolidated statements of net position.

(8) BONDS PAYABLE:

Changes in bonds payable are summarized as follows –

	<u>Balance</u> <u>6/30/2013</u>	<u>Additions</u>	<u>Principal</u> <u>Payments/</u> <u>Transfers</u>	<u>Balance</u> <u>3/31/2014</u>
Series 2010A Bonds	\$ 3,405,000	\$ -	\$ (3,405,000)	\$ -
Series 2010A New Money Bonds	935,000	-	(935,000)	-
Series 2010B Bonds	<u>785,000</u>	-	<u>(785,000)</u>	-
Total outstanding	5,125,000	<u>\$ -</u>	<u>\$ (5,125,000)</u>	-
Less unamortized discount	-			-
Plus unamortized premium	161,128			-
Less current portion	<u>(455,000)</u>			-
Long-term portion	<u>\$ 4,831,128</u>			<u>\$ -</u>
	<u>Balance</u> <u>6/30/2012</u>	<u>Additions</u>	<u>Principal</u> <u>Payments</u>	<u>Balance</u> <u>6/30/2013</u>
Series 2010A Bonds	\$ 3,720,000	\$ -	\$ (315,000)	\$ 3,405,000
Series 2010A New Money Bonds	975,000	-	(40,000)	935,000
Series 2010B Bonds	<u>885,000</u>	-	<u>(100,000)</u>	<u>785,000</u>
Total outstanding	5,580,000	<u>\$ -</u>	<u>\$ (455,000)</u>	5,125,000
Less unamortized discount	(1,609)			-
Plus unamortized premium	170,756			161,128
Less current portion	<u>(455,000)</u>			<u>(455,000)</u>
Long-term portion	<u>\$ 5,294,147</u>			<u>\$ 4,831,128</u>

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

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

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

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(9) NOTES PAYABLE AND CAPITAL LEASES:

In 2008, the Hospital obtained two notes through Powell Valley Electric Cooperative (PVEC) as a sub recipient of the Rural Economic Development Loan and Grant Program through the Rural Business Cooperative Service of the United States Department of Agriculture. Proceeds from the unsecured notes, in the amounts of \$360,000 and \$740,000, were restricted for use in constructing and completing a medical office building. As of June 30, 2013, assets whose use is limited for construction of capital assets represents the proceeds remaining to be expended for this purpose. The notes are payable in monthly installments of \$3,000 and \$7,709, respectively, through 2018, and both notes are non-interest bearing.

Notes payable and capital lease activity for the nine months ended March 31, 2014, is summarized as follows –

	<u>Balance 6/30/2013</u>	<u>Additions</u>	<u>Principal Payments/ Transfers</u>	<u>Balance 3/31/2014</u>
PVEC	\$ 168,000	\$ -	\$ (168,000)	\$ -
PVEC	447,058	-	(447,058)	-
Capital leases	<u>619,510</u>	-	<u>(619,510)</u>	-
Total outstanding	1,234,568	<u>\$ -</u>	<u>\$(1,234,568)</u>	-
Less current portion	<u>(319,226)</u>			-
Long-term portion	<u>\$ 915,342</u>			<u>\$ -</u>

Notes payable and capital lease activity for the year ended June 30, 2013, is summarized as follows –

	<u>Balance 6/30/2012</u>	<u>Additions</u>	<u>Principal Payments</u>	<u>Balance 6/30/2013</u>
PVEC	\$ 204,000	\$ -	\$ (36,000)	\$ 168,000
PVEC	539,566	-	(92,508)	447,058
Capital leases	<u>860,437</u>	-	<u>(240,927)</u>	<u>619,510</u>
Total outstanding	1,604,003	<u>\$ -</u>	<u>\$(369,435)</u>	1,234,568
Less current portion	<u>(429,817)</u>			<u>(319,226)</u>
Long-term portion	<u>\$ 1,174,186</u>			<u>\$ 915,342</u>

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

Assets held under capital leases had a total cost of approximately \$1,193,000 and a net book value of approximately \$810,000 as of June 30, 2013. Amortization of assets under capital leases is included with depreciation expense in the accompanying financial statements.

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(10) MANAGEMENT AGREEMENT:

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

(11) INCOME TAXES:

Multi-Specialty Medical, P.C. has a calendar year reporting basis for tax purposes. At December 31, 2013, this entity had net operating loss carryforwards of approximately \$2,300,000 for federal and state income tax purposes. The loss carryforwards relate to operating losses and expire in years 2021 through 2033. The loss carryforwards may be offset against future taxable income as permitted by the Internal Revenue Code and the Tennessee Code Annotated. A valuation reserve, equal to the deferred tax assets arising from the net operating losses, has been established based on an estimate that the potential tax benefits of the loss carryforwards will not be realized.

(12) PENSION PLAN:

The County and related entities, including the Hospital, participate in the Tennessee Consolidated Retirement System (TCRS) Pension Plan. The multiple-employer plan provides for both employee and employer contributions. Participating employees are required to contribute 5% of their salaries to the Plan. The Hospital is required to contribute at an actuarially determined rate, which was 5.41% of covered payroll for the nine months ended March 31, 2014 and the year ended June 30, 2013. For the nine months ended March 31, 2014, contributions by the Hospital totaled \$415,894 and contributions by participating employees totaled \$382,074. For the year ended June 30, 2013, contributions by the Hospital totaled \$616,127 and contributions by participating employees totaled \$569,526. Funding status, contribution requirements, and trends appear in the financial statements of the County and are not separately identified for the Hospital.

(13) CHARITY CARE:

The Hospital estimates that the cost of providing care under the charity care policy was approximately \$136,000 and \$140,000 during the nine months ended March 31, 2014 and the year ended June 30, 2013, respectively. This is the cost of supplies and services provided to patients for which payment was foregone under the charity care policy, based on current cost to charge ratio for the Hospital.

(14) FOUNDATION:

At June 30, 2013, the Foundation's assets totaled \$250,107 and consisted primarily of cash and inventory (there are no significant liabilities recorded). The March 31, 2014 consolidated statement of revenues, expenses and changes in net position includes Foundation contribution revenue of \$64,057, interest income of \$543 and distributions and other expenses of \$26,626. The June 30, 2013

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(14) FOUNDATION (Continued):

consolidated statement of revenues, expenses and changes in net position includes Foundation contribution revenue of \$90,479, interest income of \$793 and distributions and other expenses of \$54,684. Except for certain expenses paid directly by the Foundation, the Hospital provided administrative services and paid for operating expenses to support the Foundation's activities. Separate financial statements of the Foundation were maintained by Hospital management through March 25, 2014, the effective date of the sale of the hospital. In conjunction with the sale of the Hospital to a non-profit organization, the Foundation segregated the March 31, 2014 fund balance of \$324,669 from the Hospital. The Foundation board voted at a meeting in March 2014 to donate the gift shop to the Hospital.

(15) CONCENTRATIONS OF CREDIT RISK:

The Hospital is located in Claiborne County, Tennessee. The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements.

The mix of receivables from patients and third-party payors at June 30, 2013 follows –

	2013
Medicare	19%
Medicaid/TennCare	14
Other insurance	29
Private pay	38
	100%

(16) COMMITMENTS AND CONTINGENCIES:

Litigation –

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

Uncertain tax positions –

The Hospital accounts for uncertain tax positions related to its wholly-owned for-profit subsidiary and the Foundation with provisions of FASB ASC 740-10 "Accounting for Uncertainty in Income Taxes." ASC 740-10 provides guidance on derecognition of tax benefits, classification on the consolidated statements of net position, interest and penalties, accounting in interim periods, disclosure and transition. The Hospital believes that it has appropriate support for any tax positions taken, and as such, does not have any uncertain tax positions that are material to the consolidated financial statements. As of March 31, 2014 and June 30, 2013, the Hospital did not record any interest or penalties associated with uncertain tax positions.

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(16) COMMITMENTS AND CONTINGENCIES (Continued):

Uncertain tax positions (continued) –

The Foundation's Form 990's, *Return of Organization Exempt from Income Tax*, and Multi-Specialty Medical's Form 1120's, *U.S. Corporation Income Tax Return*, for the years 2011 and beyond remain subject to examination by the IRS, generally for three years after they were filed.

(17) DISPOSAL OF OPERATIONS:

The Hospital has adopted the provisions of GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards to record the disposal of operations for a governmental entity. Under this guidance, the government recognizes a gain or loss on the disposal of operations as a special item in the period in which the disposal occurs, based on either the effective transfer date of a transfer of operations, or the date of sale for operations that are sold. Effective March 25, 2014, Claiborne County and Claiborne Medical Center entered into a transaction agreement for purchase of the Hospital. The transaction agreement results in the sale and transfer of most assets owned by the Hospital to Covenant Medical Center. All excluded remaining assets were transferred to the County. The transfer to the County was \$10,106,819.

(18) SUBSEQUENT EVENTS:

The Hospital noted no transactions that would provide evidence about material conditions that did not exist at the balance sheet date but arose subsequently, through the date these consolidated financial statements were available to be issued, March 5, 2015.



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

**To the Board of Trustees of
Claiborne County Hospital & Nursing Home and Subsidiary
(a component unit of Claiborne 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 consolidated financial statements of Claiborne County Hospital & Nursing Home and Subsidiary (a component unit of Claiborne County, Tennessee) (the Hospital) as of and for the nine months ended March 31, 2014, and the related notes to the consolidated financial statements which collectively comprise the Hospital's consolidated financial statements and have issued our report thereon dated March 5, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Hospital'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 Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's consolidated 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the 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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Johnson, Nickey & Meacham, P.C.

Chattanooga, Tennessee
March 5, 2015