

AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION
OF
LINCOLN COUNTY HEALTH SYSTEM
LINCOLN COUNTY, TENNESSEE
Years Ended June 30, 2014 and 2013

**LINCOLN COUNTY HEALTH SYSTEM
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Years Ended June 30, 2014 and 2013

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the Lincoln County Health System as of and for the years ended June 30, 2014 and 2013, 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 opinion.

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, 2014 and 2013, 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, 2014 and 2013, 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. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that 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

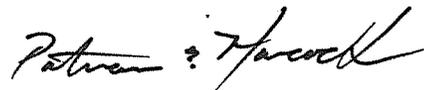
Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying financial information listed as other financial information in the table of contents is presented for purposes of additional analysis and is not a required part of the financial 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 17, 2014 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 17, 2014



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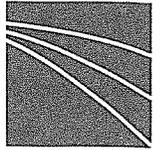
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LINCOLN COUNTY HEALTH SYSTEM



Our discussion and analysis of Lincoln County Health System's (the "System's") financial performance provides an overview of the System's financial activities for the fiscal years ended June 30, 2014 and 2013. Please read it in conjunction with the System's financial statements, which begin on page 10.

Financial Highlights

- The System's net position increased in the past year by \$36,873 or 0.2 percent in 2014 and net position decreased in 2013 by \$1,960,989 or 7.6 percent.
- The System reported an operating loss in 2014 of (\$987,459) due primarily to a decrease in inpatient volumes, which was greatly offset by a significant decrease in payroll and supply costs; as compared to an operating loss in 2013 of (\$1,662,609) due primarily to a payment methodology error made by the fiscal intermediary for laboratory payments.
- Nonoperating revenues increased by \$1,163,893 or 408.3% in 2014 compared to 2013 due to an increase in meaningful use incentive payments under the Affordable Care Act. Nonoperating expenses decreased in 2014 by \$194,219 or 30.4 percent compared to 2013.

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 increased in 2014 by \$36,873 (0.2 percent) and decreased \$1,960,989 (7.6 percent) in 2013, as presented in Table 1.

Table 1: Statement of Net Position

	<u>2014</u>	<u>2013</u> (Restated)
Assets:		
Current assets	\$ 12,929,905	\$ 12,258,259
Capital assets, net	16,968,452	18,361,942
Other noncurrent assets	<u>9,566,294</u>	<u>9,677,505</u>
Total Assets	<u>39,464,651</u>	<u>40,297,706</u>
Deferred outflows of resources:	427,532	472,589
Liabilities:		
Long-term liabilities, including total debt	12,732,005	13,622,224
Other	<u>3,441,325</u>	<u>3,466,091</u>
Total Liabilities	<u>16,173,330</u>	<u>17,088,315</u>
Net position:		
Net investment in capital assets	4,236,447	4,739,718
Restricted for debt service	1,083,772	1,083,871
Restricted for other purposes	68,878	67,533
Unrestricted	<u>18,329,756</u>	<u>17,790,858</u>
Total Net Position	<u>\$ 23,718,853</u>	<u>\$ 23,681,980</u>

A significant component of the change in the System’s assets is the change in cash and cash equivalents. Cash increased \$295,961 or 4.7 percent in 2014 primarily due to decreased payroll costs, supply costs and an increase in Meaningful Use incentive payments as discussed in financial highlights above; which was reduced by a drop in patient volumes. Cash decreased \$1,182,588 or 15.8% in 2013.

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

	<u>2014</u>	<u>2013</u>
Operating Revenues:		
Net patient service revenues	\$ 36,653,089	\$ 38,172,872
Other operating revenues	<u>1,083,617</u>	<u>1,074,537</u>
Total operating revenues	37,736,706	39,247,409
 Operating Expenses:		
Salaries and benefits	22,226,063	24,167,351
Fees to individuals and organizations	5,871,002	5,509,710
Medical supplies and drugs	4,366,672	4,635,975
Depreciation	2,055,036	2,154,046
Other operating expenses	<u>4,205,392</u>	<u>4,442,936</u>
Total operating expenses	<u>38,724,165</u>	<u>40,910,018</u>
(Loss) From Operations	<u>(987,459)</u>	<u>(1,662,609)</u>
 Nonoperating Revenues and (Expenses):		
Investment income	68,531	92,358
Interest expense	(418,295)	(590,012)
Amortization	(26,657)	(47,126)
Noncapital grants, contributions and incentive payments	1,316,820	192,733
Other nonoperating revenues and expenses, net	<u>63,633</u>	<u>(2,033)</u>
Total nonoperating revenues (expenses)	<u>1,004,032</u>	<u>(354,080)</u>
 Excess (deficiency) of revenues over expenses before capital grants and contributions	 16,573	 (2,016,689)
 Grants and contributions:		
Capital grants and contributions	<u>20,300</u>	<u>55,700</u>
Change in net position	36,873	(1,960,989)
Net position beginning of year	<u>23,681,980</u>	<u>25,642,969</u>
Net position end of year	<u>\$ 23,718,853</u>	<u>\$ 23,681,980</u>

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 (\$987,459) in 2014. Operating income in 2014 increased by \$675,150 from a loss reported in 2013 of (\$1,662,609). The operating income (loss) in 2013 decreased \$1,868,266 from 2012.

The primary components of these changes in operating income (losses) are:

- A decrease in inpatient volumes occurred in 2014 as shown by a drop in adult and pediatric inpatient admissions of 393.
- A decrease in payroll costs in 2014 of \$1,941,288 from prior year.
- A decrease in supply costs of \$269,303 from 2013 to 2014.

Total operating revenues decreased by \$1,510,703 in 2014 compared to 2013 primarily due to a drop in patient volumes that exceeded a prior year recoupment of lab payments by the fiscal intermediary due to an error in processing lab payments. Other contributors to the reduction were sequestration and overall decreasing reimbursement from most payors.

Fees to individuals and organizations have increased \$361,292 or 6.6% from 2013 due to expansion of the hospitalist program and a subsidy in ER physician coverage.

Nonoperating Revenues and Expenses

Nonoperating revenues consist primarily of interest revenue, investment earnings and Medicare and Medicaid meaningful use unrestricted incentive payments. The System received \$1,288,582 incentive payments in 2014 compared to \$183,499 in 2013. The system anticipates receiving additional incentive payments totaling \$580,000 in 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 2014 of \$738,493 or 13.8 percent less than in 2013. In 2013 the System generated \$857,075 or 71.8 percent less in cash flows from operating activities than in 2012.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2014, the System had \$16,968,452 invested in capital assets, net of accumulated depreciation, as detailed in Note G to the financial statements. In 2013, the System had \$18,361,942 invested in capital assets, net of accumulated depreciation. Additions to capital assets in 2014 were \$661,546 including of \$135,992 in parking lot repaving at the Patrick Wellness Center, \$124,484 for an OB Fetal Monitoring System, \$85,000 for an ED software system, \$63,633 for a replacement telephone system and other miscellaneous equipment for the Health System.

Debt

At the end of 2014, the System had \$12,567,691 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 County's debt ratings in the past two years.

Other Economic Factors

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

Hospitals are facing many payment reductions due to the Affordable Care Act (ACA), sequestration, high deductible insurance plans, and the rising number of uninsured. One part of the ACA includes efforts to increase the number of U.S. citizens and legal aliens with health insurance which began 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, 2014 and 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 6,589,229	\$ 6,293,268
Restricted cash	33,721	42,539
Accounts receivable, net of allowance for doubtful accounts of \$1,855,296 (2014) and \$2,710,835 (2013)	4,869,748	4,346,291
Estimated third-party payor settlements receivable	373,737	565,808
Supplies, at cost	712,559	713,174
Prepaid expenses	119,093	207,917
Other assets	231,818	89,262
Total Current Assets	12,929,905	12,258,259
NONCURRENT ASSETS:		
Special Funds	9,281,015	9,244,404
Capital assets, net of accumulated depreciation	16,968,452	18,361,942
Other assets:		
Investment in insurance fund	152,995	160,915
Notes receivable, net	132,284	272,186
Total Noncurrent Assets	26,534,746	28,039,447
TOTAL ASSETS	39,464,651	40,297,706
 DEFERRED OUTFLOWS OF RESOURCES		
Deferred charge on refunding	427,532	472,589
 LIABILITIES AND NET POSITION		
CURRENT LIABILITIES:		
Current maturities of long-term debt	887,310	871,819
Accounts payable	1,178,664	1,086,068
Accrued expenses:		
Salaries and payroll taxes	898,967	878,027
Compensated absences	1,028,049	980,983
Interest	63,515	54,660
Other	238,409	343,347
Estimated third-party payor settlements payable	-	80,467
Patient trust funds	33,721	42,539
Total Current Liabilities	4,328,635	4,337,910
NONCURRENT LIABILITIES:		
Long-term debt, net of current maturities	11,844,695	12,750,405
TOTAL LIABILITIES	16,173,330	17,088,315
 NET POSITION		
Net investment in capital assets	4,236,447	4,739,718
Restricted:		
Bond indenture debt service	1,083,772	1,083,871
Other purposes	68,878	67,533
Unrestricted	18,329,756	17,790,858
TOTAL NET POSITION	\$ 23,718,853	\$ 23,681,980

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, 2014 and 2013

	<u>2014</u>	<u>2013</u>
OPERATING REVENUES:		
Net patient service revenue, net of provision for bad debts of \$4,147,133 (2014) and \$6,470,303 (2013)	\$ 36,653,089	\$ 38,172,872
Other operating revenue	1,083,617	1,074,537
Total Operating Revenues	37,736,706	39,247,409
OPERATING EXPENSES:		
Employee compensation and benefits	22,226,063	24,167,351
Fees to individuals and organizations	5,871,002	5,509,710
Supplies	4,366,672	4,635,975
Other expenses	4,205,392	4,442,936
Depreciation	2,055,036	2,154,046
Total Operating Expenses	38,724,165	40,910,018
(LOSS) FROM OPERATIONS	(987,459)	(1,662,609)
NONOPERATING REVENUES AND (EXPENSES):		
Investment income	68,531	92,358
Interest expense	(418,295)	(590,012)
Amortization	(26,657)	(47,126)
Noncapital grants, contributions and incentive payments	1,316,820	192,733
Gain/ (Loss) on disposal of capital assets	63,633	(2,033)
Nonoperating Revenues and (Expenses), net	1,004,032	(354,080)
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENSES	16,573	(2,016,689)
Capital Contributions	20,300	55,700
CHANGE IN NET POSITION	36,873	(1,960,989)
Total Net Position, at beginning of year as restated	23,681,980	25,642,969
TOTAL NET POSITION, AT END OF YEAR	\$ 23,718,853	\$ 23,681,980

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

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

Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third-party payors	\$ 36,517,374	\$ 38,642,424
Other operating cash receipts	2,143,283	2,139,828
Cash paid to employees for wages and benefits	(22,131,927)	(24,106,118)
Cash paid to suppliers for goods and services	(15,790,237)	(15,819,059)
Net Cash Provided by Operating Activities	<u>738,493</u>	<u>857,075</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Noncapital grants, contributions and incentive payments	<u>1,316,820</u>	<u>192,733</u>
Net Cash Provided by Noncapital Financing Activities	<u>1,316,820</u>	<u>192,733</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Additions to capital assets, net	(530,313)	(974,474)
Proceeds from disposal of capital assets	-	1,303
Capital contributions	20,300	55,700
Principal payments on long-term debt	(871,819)	(776,717)
Interest paid on long-term debt, net	(409,440)	(582,281)
Net Cash Used by Capital and Related Financing Activities	<u>(1,791,272)</u>	<u>(2,276,469)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest received	83,676	95,432
(Increase) in special funds	(51,756)	(51,359)
Net Cash Provided by Investing Activities	<u>31,920</u>	<u>44,073</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	295,961	(1,182,588)
CASH AND CASH EQUIVALENTS, beginning of year	<u>6,293,268</u>	<u>7,475,856</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 6,589,229</u>	<u>\$ 6,293,268</u>
RECONCILIATION OF OPERATING INCOME TO NET		
CASH FLOWS FROM OPERATING ACTIVITIES:		
(Loss) from operations	\$ (987,459)	\$ (1,662,609)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	2,055,036	2,154,046
Provision for bad debts	4,147,133	6,470,303
Provision for note receivable arrangements	139,902	190,097
Advances under note receivable arrangements, net	-	(28,515)
Investment in insurance funds, net	7,920	(15,790)
Changes in operating assets and liabilities:		
(Increase) in accounts receivable	(4,670,590)	(6,263,232)
Decrease in supplies	615	3,569
(Increase) decrease in prepaid expenses	88,824	(53,335)
(Increase) in other assets	(78,923)	(35,849)
Increase (decrease) in accounts payable	(38,637)	218,065
Increase (decrease) in accrued expenses	(36,932)	(115,154)
(Increase) decrease in estimated third-party payor settlements, net	111,604	(4,521)
Net Cash Provided by Operating Activities	<u>\$ 738,493</u>	<u>\$ 857,075</u>
SCHEDULE OF NONCASH FINANCING AND INVESTING ACTIVITIES:		
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)
Capital assets financed in accounts payable	131,233	-

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

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

JUNE 30, 2014 and 2013

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The accompanying financial statements present the Lincoln County Health System (the "Health System"). The Health System is owned by Lincoln County, Tennessee ("the County" and "Primary Government") and is not a legal entity separate and apart from the County. The Health System is financially accountable and there is a financial benefit/burden relationship with the County. Accordingly, it is blended as an enterprise fund as part of the County's financial statements. The Health System is governed by the Health System Committee ("the Committee"), consisting of five members appointed from the County's Board of Commissioners and two physicians appointed from the medical staff. 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 the following cost centers, the Lincoln Medical Center Auxiliary Gift Shop (the "Auxiliary") and the Physician Practices. These cost centers are not separate legal entities and they are financially accountable to the Committee. The Physician Practices are comprised of employed physicians. A summary of these cost center's assets, liabilities, net position, results of operations, and changes in net position is presented below and on the following page as of June 30, 2014.

Condensed Statement of Net Position

	<u>Auxiliary</u>	<u>Physician Practices</u>
Assets		
Cash and cash equivalents	\$ 68,878	\$ 40,109
Accounts receivables, net of allowance	-	59,170
	68,878	99,279
Liabilities	-	-
Net position		
Restricted	68,878	-
Unrestricted	-	99,279
	\$ 68,878	\$ 99,279

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Principles of Departmental Combination (Continued)

<u>Condensed Statement of Revenues, Expenses, and Changes in Net Position</u>	<u>Auxiliary</u>	<u>Physician Practices</u>
Net operating revenue	\$ 23,252	\$ 847,962
Operating expenses	<u>(12,003)</u>	<u>(1,869,918)</u>
Income (Loss) from operations	11,249	(1,021,956)
Nonoperating revenues and (expenses)	<u>(9,904)</u>	<u>27,140</u>
Excess(deficiency) revenue over expenses	1,345	(994,816)
Operating transfers from Medical Center	-	1,016,942
Total net position, at beginning of year	<u>67,533</u>	<u>77,153</u>
Total net position, at end of year	<u>\$ 68,878</u>	<u>\$ 99,279</u>

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.

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.

Special Funds

Special funds consist of restricted cash by contributors and special fund 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 special funds approximates fair value.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2014 and 2013, 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.

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.

Debt Issue Costs

Costs of issuance other than insurance are charged to expense in the period incurred. Premiums and discounts realized on debt issuances are deferred and amortized over the terms of the respective debt using a method which approximates the effective interest method.

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.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

NOTE A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Deferred outflows/inflows of resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then. The Health System has one item that qualifies for reporting in this category. It is the deferred charge on refunding reported in the statement of net position. A deferred charge on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

In addition to liabilities, the statement of net position will sometimes report a separate section for *deferred inflows of resources*. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Health System does not have any items that qualify for reporting in this category.

Amortization expense for debt premium/discount costs and debt refunding deferred charges was \$26,657 and \$47,126 for the years ended June 30, 2014 and 2013, respectively.

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.

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.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

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 2013 financial statements to conform to the 2014 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 \$8,138,307 and \$8,101,736 as of June 30, 2014 and 2013, respectively, for specific purposes such as future capital improvements, insurance and debt service as described in Note E. Such 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 \$1,060,449 and \$724,086 for the years ended June 30, 2014 and 2013, 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.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

NOTE D: NET PATIENT SERVICE REVENUE (CONTINUED)

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

Home Health 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 29 percent and 31 percent of the hospital-based departments' and Care Centers' net patient revenue, respectively, for the year ended June 30, 2014.

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, 2011.

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 53 percent of the hospital-based departments' and Care Centers' net patient revenue, respectively, for the year ended June 30, 2014.

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 \$-0- and \$4,501, from an endowment fund for the years ended June 30, 2014 and 2013, 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 \$6,589,229 and \$6,293,268 and the bank balance was \$6,665,071 and \$6,577,810 as of June 30, 2014 and 2013, respectively. The Health System's carrying amount for special funds, excluding amounts held under an indenture agreement, was \$8,230,964 and \$8,203,072 and the bank balance was \$8,219,158 and \$8,175,824 as of June 30, 2014 and 2013, respectively. The bank balances totaling \$14,884,229 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, 2014 was \$1,083,772. Generally, these investments maintain a dollar weighted average maturity at 60 days or less.

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

JUNE 30, 2014 and 2013

NOTE E: DEPOSITS AND SPECIAL FUNDS (CONTINUED)

Interest Rate Risk (Continued)

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.

Special funds are held as follows as of June 30:

	<u>2014</u>	<u>2013</u>
Internally designated for capital improvements, insurance and debt service:	\$ 8,138,307	\$ 8,101,736
Restricted by contributors	58,936	58,797
Held under an indenture agreement	1,083,772	1,083,871
Held under patient trust fund arrangements - cash	<u>33,721</u>	<u>42,539</u>
	9,314,736	9,286,943
Less amounts reclassified to meet current liabilities	<u>33,721</u>	<u>42,539</u>
	<u>\$ 9,281,015</u>	<u>\$ 9,244,404</u>

NOTE F: NOTES RECEIVABLE ARRANGEMENTS

The Medical Center has advanced money to physicians to assist in the establishment of their medical professional practices. Advances are to be repaid by cash payment or amortized by continuation of the physicians' medical practice for a certain period based upon the terms of each arrangement. Net advances to physicians totaled \$-0- and \$28,515 for the years ended June 30, 2014 and 2013, respectively. Net repayments, primarily from amortization of advances to physicians, totaled \$139,902 and \$190,097 for the years ended June 30, 2014 and 2013, respectively. As of June 30, 2014 and 2013, net advances totaling \$132,284 and \$272,186, respectively, were due under these arrangements.

NOTE G: CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2014 was as follows:

	<u>June 30,</u> <u>2013</u>	<u>Additions</u>	<u>Retirements</u>	<u>June 30,</u> <u>2014</u>
Capital assets, not being depreciated:				
Land	\$ 773,754	\$ 57,500	\$ -	\$ 831,254
Property under capitalized lease	300,000	-	-	300,000
Construction in progress	<u>238,506</u>	<u>-</u>	<u>(198,738)</u>	<u>39,768</u>
Total capital assets, not being depreciated	1,312,260	57,500	(198,738)	1,171,022
Capital assets, being depreciated:				
Ground improvements	2,308,042	135,992	(4,212)	2,439,822
Building & improvements	27,360,547	207,894	(11,325)	27,557,116
Equipment	15,865,212	458,898	(203,501)	16,120,609
Equipment under capitalized lease	<u>355,753</u>	<u>-</u>	<u>-</u>	<u>355,753</u>
Total capital assets being depreciated	45,889,554	802,784	(219,038)	46,473,300
Less accumulated depreciation for:				
Ground improvements	(945,961)	(79,240)	4,212	(1,020,989)
Buildings and improvements	(14,944,962)	(902,040)	11,325	(15,835,677)
Equipment	(12,744,055)	(1,014,556)	203,501	(13,555,110)
Equipment under capitalized lease	<u>(204,894)</u>	<u>(59,200)</u>	<u>-</u>	<u>(264,094)</u>
Total accumulated depreciation and amortization	(28,839,872)	(2,055,036)	219,038	(30,675,870)
Capital assets, net	<u>\$ 18,361,942</u>	<u>\$ (1,194,752)</u>	<u>\$ (198,738)</u>	<u>\$ 16,968,452</u>

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

JUNE 30, 2014 and 2013

NOTE G: CAPITAL ASSETS (CONTINUED)

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

	June 30, <u>2012</u>	<u>Additions</u>	<u>Retirements</u>	June 30, <u>2013</u>
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	<u>1,104,216</u>	<u>213,244</u>	<u>(5,200)</u>	<u>1,312,260</u>
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	<u>45,340,453</u>	<u>766,430</u>	<u>(217,329)</u>	<u>45,889,554</u>
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	<u>(26,899,819)</u>	<u>(2,154,046)</u>	<u>213,993</u>	<u>(28,839,872)</u>
Capital assets, net	<u>\$ 19,544,850</u>	<u>\$ (1,174,372)</u>	<u>\$ (8,536)</u>	<u>\$ 18,361,942</u>

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, 2014 and 2013 totaled \$2,055,036 and \$2,154,046, respectively. Accumulated amortization for equipment under capital lease obligations was \$264,094 and \$204,894 at June 30, 2014 and 2013, respectively.

During the current year the Health System completed its construction project for renovation at the Wellness Center. The Health System has ongoing construction projects for general improvements.

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

JUNE 30, 2014 and 2013

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, 2014:

	June 30, <u>2013</u>	<u>Additions</u>	<u>Reductions</u>	June 30, <u>2014</u>	Due Within <u>One Year</u>
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%.	\$ 4,885,000	\$ -	\$ (10,000)	\$ 4,875,000	\$ 10,000
Series 2007, General Obligation Refunding Bonds, due in installments of \$170,000 to \$220,000 through May 2021, at an interest rate of 3.93%.	1,545,000	-	(170,000)	1,375,000	170,000
Capital Lease Obligation, due in monthly installments of \$3,561 through April 2017, at an interest rate of 7.5%.	141,982	-	(33,210)	108,772	35,788
Capital Lease Obligation, due in monthly installments of \$3,917 through August 2016, at an interest rate of 5.45%	132,528	-	(38,609)	93,919	41,522
Series 2013, Hospital Facility Lease Revenue and Tax Refunding Bonds, due in installments of \$630,000 to \$730,000 through May 2023, at an interest rate of 2%.	<u>6,735,000</u>	<u>-</u>	<u>(620,000)</u>	<u>6,115,000</u>	<u>630,000</u>
Total long-term debt	13,439,510	<u>\$ -</u>	<u>\$ (871,819)</u>	12,567,691	<u>\$ 887,310</u>
Less current maturities of long-term debt	(871,819)			(887,310)	
Add unamortized bond premium	<u>182,714</u>			<u>164,314</u>	
Total noncurrent liabilities	<u>\$ 12,750,405</u>			<u>\$ 11,844,695</u>	

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

JUNE 30, 2014 and 2013

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, 2013:

	June 30, <u>2012</u>	<u>Additions</u>	<u>Reductions</u>	June 30, <u>2013</u>	Due Within <u>One Year</u>
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
Total long-term debt	14,276,227	<u>\$ 6,735,000</u>	<u>\$ (7,571,717)</u>	13,439,510	<u>\$ 871,819</u>
Less current maturities of long-term debt	(776,718)			(871,819)	
Add unamortized bond premium	-			182,714	
Total noncurrent liabilities	<u>\$ 13,499,509</u>			<u>\$ 12,750,405</u>	

The annual requirements to amortize all long-term debt outstanding as of June 30, 2014 are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2015	\$ 887,310	\$ 393,514
2016	908,222	367,901
2017	892,159	342,479
2018	870,000	320,305
2019	890,000	298,922
2020-2024	4,215,000	1,178,991
2025-2028	<u>3,905,000</u>	<u>418,740</u>
	<u>\$ 12,567,691</u>	<u>\$ 3,320,852</u>

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

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 or previously defeased as described herein.

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, 2014, \$6,625,000 of the bonds outstanding are considered defeased.

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.

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

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) 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 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.

For 2013 the Health System did not maintain the required debt service covenant ratio of 1.15:1 for the outstanding Series 2007 and Series 2013 bonds. This technical deficiency was corrected in 2014.

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

NOTE H: LONG-TERM DEBT (CONTINUED)

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 earlier in Note G. The future minimum lease payments and the net present value of these minimum lease payments are included in the annual requirements to amortize outstanding long-term debt on a previous page.

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, 15th 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.tn.gov/treasury/tcrs/PS/.

Funding Policy

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

NOTE I: PENSION PLAN (CONTINUED)

Funding Policy (Continued)

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, 2014, 2013, and 2012 were \$601,611, \$638,024, and \$679,037 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 \$24,880 and \$28,195 and \$107,442 and \$116,608 for the years ended June 30, 2014 and 2013, 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 \$100,000 per member, which includes employees and their eligible dependents. Claims are paid on a monthly basis by Blue Cross with a settlement at the end of each quarter for the excess or deficit of premiums paid by the Health System over or under claims paid by Blue Cross.

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

LINCOLN COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2014 and 2013

NOTE J: RISK MANAGEMENT (CONTINUED)

As of June 30, 2014 and 2013, the Health System accrued \$306,099 and \$141,481 respectively, for an estimated claims lag. Changes in the reported liability for 2014 and 2013 resulted from the following:

	<u>2014</u>	<u>2013</u>
Balance, beginning of year	\$ 141,481	\$ 305,464
Current year claims and settlements	2,289,325	2,580,431
Claim payments	<u>(2,124,707)</u>	<u>(2,744,414)</u>
Balance, end of year	<u>\$ 306,099</u>	<u>\$ 141,481</u>

The Committee has internally designated cash to use for payment of future insurance premiums. As of June 30, 2014, this internally designated cash, including interest earned, totaled \$158,700.

NOTE K: CONCENTRATIONS OF CREDIT RISK

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

	<u>2014</u>	<u>2013</u>
Medicare	32%	30%
Medicaid	19%	19%
Other third-party payors	21%	21%
Patients	<u>28%</u>	<u>30%</u>
	<u>100%</u>	<u>100%</u>

NOTE L: MANAGEMENT AGREEMENT

During 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 \$331,146 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 2014 and 2013 were \$781,751 and \$813,259, respectively. Total payments to QHR for 2014 and 2013 were \$783,389 and \$817,521, respectively, which includes reimbursement for travel, dues, and special personnel who provide services to the Health System.

NOTE M: CONTINGENCIES AND COMMITMENTS

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

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

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

JUNE 30, 2014 and 2013

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, 2014:

Year Ending <u>June 30,</u>	
2015	\$ 15,000
2016	15,000
2017	<u>13,750</u>
	<u>\$ 43,750</u>

Rental expense under all operating leases for 2014 and 2013 totaled \$206,502 and \$263,347, respectively.

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

Year Ending <u>June 30,</u>	
2015	\$ 147,995
2016	<u>10,593</u>
	<u>\$ 158,588</u>

Rental income received for 2014 and 2013 totaled \$271,744 and \$242,545 respectively. Rental income is included in other operating revenue in the accompanying financial statements. The cost and accumulated depreciation related to the medical office building is included in property and equipment (see Note G) as follows:

Cost	\$ 3,569,499
Accumulated depreciation	<u>(1,310,087)</u>
Net Book Value	<u>\$ 2,259,412</u>

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.

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

JUNE 30, 2014 and 2013

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, 2014.

Assets, cash and cash equivalents	<u>\$ 34,548</u>
Liabilities	<u>-</u>
Unrestricted net position	<u>\$ 34,548</u>
Support and revenue	\$ 24,600
Expenses	<u>(24,106)</u>
Excess of support and revenue over expenses	494
Unrestricted net position, beginning of year	<u>34,054</u>
Unrestricted net position, end of year	<u>\$ 34,548</u>

NOTE O: PLEDGED REVENUES

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

Operating <u>Revenues</u>	Current Year Principal and Interest Paid on <u>Revenue Bonds</u>	Percent of Current <u>Revenue</u>	Remaining Pledge based on future Principal and Interest <u>Requirements</u>	Commitment Period through <u>Fiscal Year</u>
\$ 37,736,706	\$ 987,148	<u>2.6%</u>	\$ 14,065,240	2028

NOTE P: ELECTRONIC HEALTH RECORD INCENTIVE PAYMENTS

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 Electronic Health Record (EHR) technology. The Health System received \$1,286,782 and \$183,499 in Medicare and Medicaid EHR unrestricted incentive payments for the year ended June 30, 2014 and 2013, respectively, which is reported as nonoperating revenue. The Health System anticipates receiving additional incentive payments totaling \$580,000 in the 2015 year this is the final funding year.

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.

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

JUNE 30, 2014 and 2013

NOTE Q: NET SERVICE REVENUE (CONTINUED)

The allowance for doubtful accounts ranged from 27.5% to 38.4% of accounts receivable as of June 30, 2014 and 2013, respectively. Total net write-offs decreased \$1,719,954 to \$4,521,486 for 2014 from \$6,241,440 for 2013. The decrease was as a result of the change in policy to issue a 40% discount to uninsured patients in compliance with TCA 68-11-262. For the fiscal year 2014 this discount totaled \$1,786,556. The Health System has updated its charity care and uninsured discount policies during the fiscal years 2014 as noted above.

The following schedule summarizes total revenues for the fiscal years ended June 30, 2014 and 2013:

	2014	2013
Patient service revenue (net of contractual allowances and discounts)	\$ 40,800,222	\$ 44,643,175
Provision for bad debt	<u>(4,147,133)</u>	<u>(6,470,303)</u>
Net patient revenue less provision for bad debt	36,653,089	38,172,872
Other operating revenue	<u>1,083,617</u>	<u>1,074,537</u>
Total operating revenue	<u>\$ 37,736,706</u>	<u>\$ 39,247,409</u>

NOTE R: GASB STATEMENT (GASB) NUMBER 65 IMPLEMENTATION

The Health System implemented the provisions of GASB 65, *Items Previously Reported as Assets and Liabilities*, in the current period. This statement amends the financial statement element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement 4. Among these items, the statement requires debt issuance costs, except any portion related to prepaid insurance costs, to be recognized as an expense in the period incurred. Accounting changes adopted to conform to the provisions of this Statement are to be applied retroactively by restating financial statements. The cumulative effect of applying this Statement has been reported as a restatement of beginning net position as follows:

	Lincoln Medical Center <u>Center</u>	Lincoln Medical Center <u>EMS</u>	Home Health Care <u>Care</u>	Patrick Rehab- Wellness Center <u>Center</u>	Lincoln & Donalson Care Centers <u>Centers</u>	<u>Total</u>
Net position June 30, 2012 as previously reported	\$ 5,572,647	\$ 318,953	\$ 152,442	\$ 704,322	\$ 19,033,803	\$ 25,782,167
GASB 65 implementation:						
Unamortized debt issuance costs	<u>(139,198)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(139,198)</u>
Net position June 30, 2012, restated	<u>\$ 5,433,449</u>	<u>\$ 318,953</u>	<u>\$ 152,442</u>	<u>\$ 704,322</u>	<u>\$ 19,033,803</u>	<u>\$ 25,642,969</u>

OTHER FINANCIAL INFORMATION

**LINCOLN COUNTY HEALTH SYSTEM
DEPARTMENTAL SCHEDULE OF NET POSITION**

JUNE 30, 2014

	<u>Lincoln Medical Center</u>	<u>Lincoln Medical Center EMS</u>	<u>Home Health Care</u>	<u>Patrick Rehab- Wellness Center</u>	<u>Lincoln & Donalson Care Centers</u>	<u>Total</u>
ASSETS						
CURRENT ASSETS:						
Cash and cash equivalents	\$ 831,772	\$ 100	\$ 47,823	\$ 10,838	\$ 5,698,696	\$ 6,589,229
Restricted cash	-	-	-	-	33,721	33,721
Accounts receivable - net	3,592,759	90,265	132,851	-	1,053,873	4,869,748
Estimated third-party payor settlements receivable	354,106	-	-	-	19,631	373,737
Supplies, at cost	652,438	-	-	-	60,121	712,559
Prepaid expenses	99,192	-	-	35	19,866	119,093
Due from (to) departments	(3,880,899)	-	-	-	3,880,899	-
Other assets	231,818	-	-	-	-	231,818
Total Current Assets	<u>1,881,186</u>	<u>90,365</u>	<u>180,674</u>	<u>10,873</u>	<u>10,766,807</u>	<u>12,929,905</u>
NONCURRENT ASSETS:						
Special Funds	1,242,770	-	-	-	8,038,245	9,281,015
Capital assets, net of accumulated depreciation	11,703,545	326,858	65,358	1,251,895	3,620,796	16,968,452
Other assets:						
Investment in insurance fund	103,849	-	-	-	49,146	152,995
Notes receivable, net	132,284	-	-	-	-	132,284
Total Noncurrent Assets	<u>13,182,448</u>	<u>326,858</u>	<u>65,358</u>	<u>1,251,895</u>	<u>11,708,187</u>	<u>26,534,746</u>
TOTAL ASSETS	<u>15,063,634</u>	<u>417,223</u>	<u>246,032</u>	<u>1,262,768</u>	<u>22,474,994</u>	<u>39,464,651</u>
DEFERRED OUTFLOWS OF RESOURCES						
Deferred charge on refunding	427,532	-	-	-	-	427,532
LIABILITIES AND NET POSITION						
CURRENT LIABILITIES:						
Current maturities of long-term debt	851,522	-	-	35,788	-	887,310
Accounts payable	488,615	41,387	17,729	16,582	614,351	1,178,664
Accrued expenses:						
Salaries and payroll taxes	526,263	37,359	23,188	49,146	263,011	898,967
Compensated absences	572,698	51,097	25,944	31,628	346,682	1,028,049
Interest	63,515	-	-	-	-	63,515
Other	145,966	-	-	9	92,434	238,409
Patient trust funds	-	-	-	-	33,721	33,721
Total Current Liabilities	<u>2,648,579</u>	<u>129,843</u>	<u>66,861</u>	<u>133,153</u>	<u>1,350,199</u>	<u>4,328,635</u>
NONCURRENT LIABILITIES:						
Long-term debt, net of current maturities	11,771,711	-	-	72,984	-	11,844,695
TOTAL LIABILITIES	<u>14,420,290</u>	<u>129,843</u>	<u>66,861</u>	<u>206,137</u>	<u>1,350,199</u>	<u>16,173,330</u>
NET POSITION:						
Net investment in capital assets	(919,688)	326,858	65,358	1,143,123	3,620,796	4,236,447
Restricted:						
Bond indenture debt service	1,083,772	-	-	-	-	1,083,772
Other purposes	68,878	-	-	-	-	68,878
Unrestricted (deficit)	837,914	(39,478)	113,813	(86,492)	17,503,999	18,329,756
TOTAL NET POSITION	<u>\$ 1,070,876</u>	<u>\$ 287,380</u>	<u>\$ 179,171</u>	<u>\$ 1,056,631</u>	<u>\$ 21,124,795</u>	<u>\$ 23,718,853</u>

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

Year Ended June 30, 2014

		Lincoln Medical Center <u>EMS</u>	Home Health Care	Patrick Rehab- Wellness Center	Lincoln & Donalson Care Centers	Eliminations <u>DR/(CR)</u>	<u>Total</u>
OPERATING REVENUES:							
Net patient service revenue	\$	19,474,248	1,280,483	1,666,215	12,825,794	\$ 276,138	\$ 36,653,089
Other operating revenue		<u>1,627,925</u>	<u>3,204</u>	<u>410,069</u>	<u>102,085</u>	<u>1,059,666</u>	<u>1,083,617</u>
Total Operating Revenues		21,102,173	1,283,687	2,076,284	12,927,879	1,335,804	37,736,706
OPERATING EXPENSES:							
Employee compensation and benefits		12,165,168	677,437	1,377,047	6,865,401	18,210	22,226,063
Fees to individuals and organizations		4,408,820	357,208	60,541	1,825,457	(903,058)	5,871,002
Supplies		3,210,308	44,208	54,265	1,330,769	(332,176)	4,366,672
Other expenses		2,316,907	92,781	192,166	1,558,636	(118,780)	4,205,392
Depreciation		<u>1,571,351</u>	<u>6,846</u>	<u>91,509</u>	<u>289,620</u>	<u>-</u>	<u>2,055,036</u>
Total Operating Expenses		23,672,554	1,178,480	1,775,528	11,869,883	(1,335,804)	38,724,165
INCOME (LOSS) FROM OPERATIONS		(2,570,381)	105,207	300,756	1,057,996	-	(987,459)
NONOPERATING REVENUES AND (EXPENSES):							
Investment income		6,854	122	32	61,523	-	68,531
Interest expense		(408,773)	-	(9,522)	-	-	(418,295)
Amortization		(26,657)	-	-	-	-	(26,657)
Noncapital grants, contributions and incentive payments		1,311,471	5,334	-	15	-	1,316,820
Gain (loss) on disposal of capital assets		<u>63,633</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>63,633</u>
Nonoperating Revenues and (Expenses), net		946,528	5,456	(9,490)	61,538	-	1,004,032
Excess (Deficiency) Revenues over Expenses		(1,623,853)	110,663	291,266	1,119,534	-	16,573
Capital Contributions		<u>20,300</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>20,300</u>
Operating transfers from (to) departments, net		312,955	(92,366)	(81,286)	-	-	-
CHANGE IN NET POSITION		(1,290,598)	18,297	209,980	1,119,534	-	36,873
Total Net Position, at beginning of year, as restated		<u>2,361,474</u>	<u>307,720</u>	<u>846,651</u>	<u>20,005,261</u>	<u>-</u>	<u>23,681,980</u>
TOTAL NET POSITION, AT END OF YEAR		\$ 1,070,876	\$ 179,171	\$ 1,056,631	\$ 21,124,795	\$ -	\$ 23,718,853

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

Year Ended June 30, 2014

	Lincoln Medical Center <u>Center</u>	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	\$ 19,095,829	\$ 1,592,222	\$ 1,242,043	\$ 1,666,215	\$ 12,921,065	\$ 36,517,374
Other operating cash receipts	1,627,925	-	3,204	410,069	102,085	2,143,283
Cash paid to employees for wages and benefits	(12,090,779)	(1,119,141)	(678,593)	(1,380,503)	(6,862,911)	(22,131,927)
Cash paid to suppliers for goods and services	(10,196,811)	(321,178)	(490,098)	(378,066)	(4,404,084)	(15,790,237)
Net Cash Provided (Used) by Operating Activities	<u>(1,563,836)</u>	<u>151,903</u>	<u>76,556</u>	<u>317,715</u>	<u>1,756,155</u>	<u>738,493</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:						
Noncapital grants, contributions and incentive payments	1,311,471	-	5,334	-	15	1,316,820
Operating transfers in (out), net	312,955	(139,303)	(92,366)	(81,286)	-	-
Advances from (to) departments, net	1,238,746	-	-	-	(1,238,746)	-
Net Cash Provided (Used) by Noncapital Financing Activities	<u>2,863,172</u>	<u>(139,303)</u>	<u>(87,032)</u>	<u>(81,286)</u>	<u>(1,238,731)</u>	<u>1,316,820</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:						
Additions to capital assets, net	(227,096)	(12,500)	-	(193,658)	(97,059)	(530,313)
Capital contributions	20,300	-	-	-	-	20,300
Principal payments on long-term debt	(838,609)	-	-	(33,210)	-	(871,819)
Interest paid on long-term debt, net	(399,918)	-	-	(9,522)	-	(409,440)
Net Cash Used by Capital and Related Financing Activities	<u>(1,445,323)</u>	<u>(12,500)</u>	<u>-</u>	<u>(236,390)</u>	<u>(97,059)</u>	<u>(1,791,272)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:						
Interest received	6,854	-	122	32	76,668	83,676
(Increase) decrease in special funds	860	-	-	-	(52,616)	(51,756)
Net Cash Provided by Investing Activities	<u>7,714</u>	<u>-</u>	<u>122</u>	<u>32</u>	<u>24,052</u>	<u>31,920</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS						
	(138,273)	100	(10,354)	71	444,417	295,961
CASH AND CASH EQUIVALENTS, beginning of year	970,045	-	58,177	10,767	5,254,279	6,293,268
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 831,772</u>	<u>\$ 100</u>	<u>\$ 47,823</u>	<u>\$ 10,838</u>	<u>\$ 5,698,696</u>	<u>\$ 6,589,229</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES:						
Income (loss) from operations	\$ (2,570,381)	\$ 118,963	\$ 105,207	\$ 300,756	\$ 1,057,996	\$ (987,459)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities -						
Depreciation	1,571,351	95,710	6,846	91,509	289,620	2,055,036
Provision for bad debts	3,579,572	375,447	9,583	69,906	112,625	4,147,133
Provision for note receivable arrangements	139,902	-	-	-	-	139,902
Investment in insurance funds, net	21,206	-	-	-	(13,286)	7,920
Changes in operating assets and liabilities -						
Accounts receivable	(4,062,363)	(465,712)	(48,023)	(69,906)	(24,586)	(4,670,590)
Supplies	(447)	-	-	-	1,062	615
Prepaid expenses	60,210	-	-	-	28,614	88,824
Other assets	(114,164)	-	-	-	35,241	(78,923)
Accounts payable	(259,357)	23,836	4,099	(71,070)	263,855	(38,637)
Accrued expenses	(33,737)	3,659	(1,156)	(3,480)	(2,218)	(36,932)
Estimated third-party payor settlements, net	104,372	-	-	-	7,232	111,604
Net Cash Provided (Used) by Operating Activities	<u>\$ (1,563,836)</u>	<u>\$ 151,903</u>	<u>\$ 76,556</u>	<u>\$ 317,715</u>	<u>\$ 1,756,155</u>	<u>\$ 738,493</u>

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

June 30, 2014

Year Ending June 30,	Lincoln Medical Center Series 2007 Gen Oblig. Refg. Interest		Lincoln Medical Center Series 2007 Refg. Rev. Principal		Lincoln Medical Center Series 2013 Refg. Rev. Principal		Lincoln Medical Center Capital Lease Obligation Interest		Lincoln Medical Center Capital Lease Obligation Principal		Total
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	
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
	<u>\$ 1,375,000</u>	<u>\$ 225,383</u>	<u>\$ 4,875,000</u>	<u>\$ 2,447,340</u>	<u>\$ 6,115,000</u>	<u>\$ 627,900</u>	<u>\$ 108,772</u>	<u>\$ 12,306</u>	<u>\$ 93,919</u>	<u>\$ 7,923</u>	<u>\$ 15,888,543</u>

LINCOLN COUNTY HEALTH SYSTEM
ADMINISTRATION

June 30, 2014

The affairs of the Lincoln County Health System are governed by the Health System Committee.
The following individuals constitute the Committee at June 30, 2014:

Anthony Taylor	Fayetteville, Tennessee	Chairman
Bill Newman	Fayetteville, Tennessee	Vice Chairman
Donny Ogle	Elora, Tennessee	Secretary/Treasurer
Sharon Eubanks	Fayetteville, Tennessee	Trustee
Ben Brown	Petersburg, Tennessee	Trustee
Doug Layman, M.D.	Fayetteville, Tennessee	Medical Staff Representative
Linda Jackson, M.D.	Fayetteville, Tennessee	Medical Staff Representative

The management officials are as follows:

*Jamie Guin	Chief Executive Officer
*Mike Harbor	Chief Financial Officer
Vicky Groce	Chief Nursing Officer
Bruce Long	Controller
Carolyn Atchley & Angela Howell	Care Centers- Administrators
Gloria Medows	Patrick Rehab Wellness-Administrator
Richard Wright	EMS- Director
Susie Compton	HHH-Administrator

* Special personnel with Quorum Health Resources.

PUTMAN & HANCOCK
Certified Public Accountants

219 East College Street
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Fayetteville, Tennessee 37334

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Fax (931) 433-9290

**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, 2014, and the related notes to the financial statements, and have issued our report thereon, dated October 17, 2014.

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.

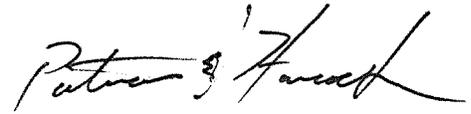
Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not 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 no instance of noncompliance or other matters that is 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 Health System's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink, appearing to read "Patricia J. Hancock". The signature is written in a cursive style with a large initial "P" and "H".

Fayetteville, Tennessee
October 17, 2014

**LINCOLN COUNTY HEALTH SYSTEM
SCHEDULE OF PRIOR YEAR FINDINGS
For the Fiscal Year Ended June 30, 2014**

Financial Statement Findings

Finding Number	Finding Title	Status
2013-001	Debt Service Covenant Ratio	Corrected