

CHATHAM HOSPITAL, INC.
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YEARS ENDED JUNE 30, 2011 AND 2010

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
Chatham Hospital, Inc.
Siler City, North Carolina

We have audited the accompanying balance sheets of Chatham Hospital, Inc. (the "Hospital") as of June 30, 2011 and 2010 and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of June 30, 2011 and 2010, and the results of its operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 30, 2011, on our consideration of the Hospital'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 the internal control over financial reporting or on compliance. Accordingly, we express no such opinion. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

LarsonAllen LLP
LarsonAllen LLP

Charlotte, North Carolina
August 30, 2011



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An independent member of Nisus International

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CHATHAM HOSPITAL, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010

Overview

The Management's Discussion and Analysis section of Chatham Hospital, Inc.'s annual financial report is designed to provide a general overview of the financial position and operating results for the years ended June 30, 2011 and 2010. This analysis should be read in conjunction with the financial statements and related notes which follow this discussion and analysis.

Chatham Hospital, Inc. (the "Hospital") is a private, not-for-profit health care organization located in Siler City, North Carolina. The facility is a 25-bed critical access hospital. The Hospital has a 70-year history of providing quality health services. The Hospital provides comprehensive care, including emergency, general surgery, intensive care, lab, CT, MRI, nuclear medicine, pharmacy, cardiopulmonary, cardiac rehabilitation, physical therapy, and diabetes education on its campus.

Current Year Events

The economic downturn continued to hit Chatham County hard during the year ended June 30, 2011. Inpatient utilization and payer mix have declined resulting in lower than anticipated revenues. Growing pains, negatively impacting cash flow, were experienced with the implementation of a new Meditech Module for Billing/Patient Accounts Receivable as of July 1, 2010. Additionally, a large bad debt write-off was taken as a result of the cleanup of old patient accounts receivable in conjunction with the system conversion.

Despite these challenging conditions, positive things are happening at the Hospital. A newly constructed 31,000 square foot Medical Office Building opened in February 2011. The Hospital's diabetes education, physical therapy, cardiac rehabilitation, business office and information services departments are permanently housed there. Tenants leasing clinic space in the building include Chatham Primary Care, an ENT physician group and a podiatrist. Subsequent to year end, a UNC General Surgery Clinic was started one day a week with procedures to be performed at the Hospital. Also housed within the Medical Office Building are crew quarters for a University of North Carolina Health Care System ("UNCHCS") helicopter based at the Hospital.

Another service enhancement strategy aimed at increasing medical admissions is the development of a seven-day per week hospitalist program. The Hospital has historically only had hospitalist coverage on the weekends. Community physicians have remarked they sometimes refer patients for admission to other area hospitals because they are unable to take time away from their office practices to make hospital rounds. Responding to this need, the Hospital began a seven-day a week hospitalist program in July 2011 utilizing UNC HCS physicians. Additionally, a UNC HCS cardiologist will be on-site four days a week performing consults and providing medical direction for the Cardiac Rehabilitation program.

The eighteen-month Hospital Information Systems implementation continued with the go live of Laboratory, Emergency Department, Pharmacy, Surgical Services, Imaging, Cardiopulmonary, Nursing Documentation, Order Entry and Health Information Management modules during 2011. Upcoming modules scheduled for implementation include Physician Order Entry, Electronic Medical Records, and Data Repository.

CHATHAM HOSPITAL, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010

Using this Financial Report

The Hospital's financial statements report information by using accounting methods similar to those used by private-sector health organizations. These statements offer short-term and long-term financial information about its activities.

Balance Sheet

The balance sheet includes all of the Hospital's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to the Hospital's creditors (liabilities). The balance sheet also provides the basis for evaluating the capital structure of the Hospital and assessing the liquidity and financial flexibility of the Hospital.

Statement of Revenues, Expenses and Changes in Net Assets

All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses and changes in net assets. This statement measures the success of the Hospital operation over the past year and can be used to determine whether the Hospital has successfully recovered all of its costs through its fees and other sources of revenue, profitability and credit worthiness.

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 operating, investing and capital and related financing activities. It also provides answers to such questions as where cash comes from, what cash was used for and what the change in the cash balance was during the reporting period.

Notes to the Financial Statements

Notes to the financial statements are designed to give the reader additional information concerning the Hospital and further supports the statements noted above.

Financial Analysis

The statement of revenues, expenses and changes in net assets reports the net assets of the Hospital and the changes affecting them. The Hospital's net assets, the difference between assets and liabilities, are a way to measure financial health or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth and new or changed governmental legislation.

CHATHAM HOSPITAL, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010

Condensed Balance Sheets

The following condensed balance sheets show the financial position of the Hospital at June 30, 2011, 2010 and 2009:

	2011	2010	2009
ASSETS			
Current Assets	\$ 10,513,916	\$ 14,021,322	\$ 10,920,488
Capital Assets, Net	29,883,383	25,999,023	26,346,238
Noncurrent Assets	5,500,033	10,330,843	7,821,092
Total Assets	\$ 45,877,332	\$ 50,351,188	\$ 44,887,818
LIABILITIES			
Long-Term Debt, Including Current Portion	\$ 30,019,382	\$ 32,804,236	\$ 34,037,218
Other Liabilities	2,912,587	3,633,399	4,872,188
Total Liabilities	32,931,949	36,537,635	38,709,406
NET ASSETS			
Invested in Capital Assets, Net of Related Debt	4,285,453	(1,948,386)	101,841
Restricted	78,840	608,276	426,980
Unrestricted	6,601,090	15,153,643	5,649,591
Total Net Assets	12,945,383	13,813,553	6,178,412
Total Liabilities and Net Assets	\$ 45,877,332	\$ 50,351,188	\$ 44,887,818

Current assets decreased approximately \$3,507,000 (25%) from the prior year. The current year decrease results from a decrease in investments which were used to fund the construction of the new Medical Office Building and a decrease in net patient accounts receivable associated with a clean-up of old accounts in conjunction with the system conversion.

In 2010, current assets increased approximately \$3,101,000 (28%) over 2009. The 2010 increase resulted from an increase in net accounts receivable, estimated third-party settlements, release by HUD of the bond escrow trust fund, and capital contribution by UNCHCS, sole member of the Hospital.

In 2011, our long-term debt decreased by approximately \$2,885,000 due to payment in full of a \$2 million note payable to UNC Hospitals, regular bond payments and amortization of the bond premium. In 2010, our long-term debt decreased by approximately \$1,133,000 due to payments on the debt and amortization of the bond premium.

Net assets decreased \$868,000 (8%) during 2011 primarily due to the reductions noted above mitigated by the capital contributed by UNCHCS. For further information on this change, see the following statement of revenues, expenses and changes in net assets.

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CHATHAM HOSPITAL, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010

Capital Assets

The Hospital's investment in capital assets consisted of the following at June 30, 2011, 2010 and 2009:

	2011	2010	2009
Land	\$ 444,983	\$ 444,983	\$ 444,983
Buildings and Improvements	31,888,468	28,927,322	25,871,462
Equipment and Fixtures	7,407,701	8,395,861	5,859,560
Total Capital Assets	39,739,152	33,768,166	32,176,005
Accumulated Depreciation	(9,875,789)	(7,769,143)	(5,829,767)
Total Capital Assets, Net	\$ 29,863,363	\$ 25,999,023	\$ 26,346,238

The increase in the Hospital's investment in capital assets in 2011 and 2010 represents purchases of capital assets, net of disposals and depreciation expense, primarily the Meditech Hospital Information System and the newly completed Medical Office Building.

Condensed Statements of Revenues, Expenses and Changes in Net Assets

While the balance sheet shows the financial position of the Hospital, the following statements of revenues, expenses and changes in net assets provide answers to the nature and source of these changes for the years ended June 30, 2011, 2010 and the nine-month period ended June 30, 2009:

	2011	2010	2009 (nine-months)
Operating Revenues	\$ 17,249,347	\$ 19,897,957	\$ 15,244,538
Operating Expenses	23,988,018	21,985,841	15,796,373
Operating Loss	(6,738,671)	(2,087,884)	(551,835)
Non-Operating Income	350,301	251,388	184,832
Deficit of Revenues Under Expenses	(6,388,370)	(1,836,496)	(366,903)
Other Changes in Net Assets	5,500,200	9,471,637	478,488
Increase (Decrease) in Net Assets	(868,170)	7,635,141	1,111,585
Net Assets - Beginning of Year	13,813,553	6,178,412	6,066,827
Net Assets - End of Year	\$ 12,945,383	\$ 13,813,553	\$ 6,178,412

Operating Loss

Gross patient revenues were approximately \$41,341,000, \$43,777,000 and \$33,228,000 for the years ended June 30, 2011, 2010 and the nine-month period ended June 30, 2009, respectively. Under GASB, bad debts are presented as a deduction from revenues. Other significant changes in operating expenses in 2011 include an increase of 24.4% in supplies (mostly non-capital equipment to furnish the new Medical Office Building); an increase of 23.0% in contracted services (mostly clinical and administrative services purchased from UNCHCS); an increase of 4.7% in salaries and wages; and, an increase of 6.0% in benefits.

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**CHATHAM HOSPITAL, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010**

Operating revenues and expenses consisted of the following for the years ended June 30, 2011, 2010 and the nine-month period ended June 30, 2009:

	2011	2010	2009 (nine-months)
Operating Revenues	\$ 17,249,347	\$ 18,887,957	\$ 15,244,538
Salaries and Wages	10,809,174	10,298,842	7,415,764
Medical Supplies and Other	9,445,528	7,870,237	5,498,452
Depreciation and Amortization	2,181,249	2,084,101	1,321,064
Interest	1,366,057	1,308,274	1,132,500
Other	168,010	428,387	428,593
	<u>23,998,018</u>	<u>21,985,841</u>	<u>15,798,373</u>
Operating Loss	<u>\$ (6,718,671)</u>	<u>\$ (2,087,884)</u>	<u>\$ (551,835)</u>

Non-Operating Revenues

Non-operating revenues consisted of the following for the years ended June 30, 2011, 2010 and the nine-month period ended June 30, 2009:

	2011	2010	2009 (nine-months)
Investment Income	\$ 169,958	\$ 140,114	\$ 117,907
Physician's Office Rental, Net	144,745	89,205	29,998
Noncapital Grants and Contributions	34,009	29,000	34,771
Other	1,589	13,069	2,256
Total Non-Operating Revenues	<u>\$ 350,301</u>	<u>\$ 251,388</u>	<u>\$ 184,932</u>

Other Changes in Net Assets

Other changes in net assets in the current year include contributed capital from UNCHCS of \$5,500,000. In 2010, other changes in net assets include capital contributions of approximately \$488,000 and contributed capital from UNCHCS of approximately \$8,984,000 (approximately \$6,744,000 for the construction of the new medical office building and approximately \$2,240,000 for the remaining commitment for future development of health care services as specified in the July 2008 Acquisition Agreement).

Finance Contact

The Hospital's financial statements are designed to present users with a general overview of the Hospital's finances and to demonstrate the Hospital's accountability. If you have any questions about this report, or need additional financial information, inquiries may be sent to: Chief Financial Officer, Chatham Hospital, Inc., 475 Progress Boulevard, Siler City, North Carolina 27344.

**CHATHAM HOSPITAL, INC.
BALANCE SHEETS
JUNE 30, 2011 AND 2010**

	2011	2010
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 3,320,459	\$ 2,719,595
Restricted Assets Held by Trustee Under Indenture Agreement	-	918,540
Investments	605,709	2,564,155
Patient Accounts Receivable (Net of Allowance for Estimated Uncollectibles of Approximately \$5,790,000 in 2011 and \$4,571,000 in 2010)	3,878,973	5,518,232
Other Receivables	358,183	279,220
Unconditional Promises to Give	70,451	95,525
Estimated Third-Party Payor Settlements	1,896,655	1,442,337
Inventories	316,159	408,101
Prepaid Expenses	67,347	77,617
Total Current Assets	<u>10,513,918</u>	<u>14,021,322</u>
UNCONDITIONAL PROMISES TO GIVE, LESS CURRENT PORTION, NET		
	8,389	37,865
RESTRICTED ASSETS		
Held by Trustee Under Indenture Agreement, Less Current Portion Internally Designated for Capital Improvement	4,421,462	4,038,307
	-	5,108,884
CAPITAL ASSETS, NET	29,863,383	25,999,023
DEFERRED FINANCING COSTS, NET	1,038,511	1,113,134
OTHER ASSETS	31,681	33,053
	<u>35,363,416</u>	<u>36,329,866</u>
Total Assets	<u>\$ 45,877,332</u>	<u>\$ 50,351,188</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current Portion of Long-Term Debt	\$ 750,000	\$ 770,000
Accounts Payable	1,015,964	1,702,667
Accrued Expenses	1,896,803	1,930,732
Total Current Liabilities	<u>3,662,567</u>	<u>4,403,399</u>
LONG-TERM DEBT, Less Current Portion		
Total Liabilities	<u>29,289,382</u>	<u>32,134,236</u>
	32,931,949	36,537,635
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	4,265,453	(1,948,366)
Restricted:		
Expendable for Capital Improvements	78,840	608,276
Unrestricted	8,601,090	15,153,643
Total Net Assets	<u>12,945,383</u>	<u>13,813,553</u>
Total Liabilities and Net Assets	<u>\$ 45,877,332</u>	<u>\$ 50,351,188</u>

CHATHAM HOSPITAL, INC.
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
OPERATING REVENUES		
Net Patient Service Revenue (Net of Provision for Bad Debts of Approximately \$8,725,000 in 2011 and \$8,601,000 in 2010)	\$ 16,482,271	\$ 19,150,679
Change in Estimate in Third-Party Payor Settlements	622,318	653,897
Other Operating Revenue	134,758	93,381
Total Operating Revenues	<u>17,249,347</u>	<u>19,897,957</u>
OPERATING EXPENSES		
Salaries and Wages	8,618,317	8,231,044
Employee Benefits	2,190,857	2,067,798
Medical Supplies and Other Expenses	9,445,528	7,870,237
Depreciation and Amortization	2,181,249	2,084,101
Interest Expense	1,388,057	1,306,274
Other	186,010	426,387
Total Operating Expenses	<u>23,968,018</u>	<u>21,985,841</u>
OPERATING LOSS	(6,718,671)	(2,087,884)
NON-OPERATING REVENUES		
Investment Income	169,958	140,114
Physician's Office Rental, Net	144,745	69,205
Noncapital Gains and Contributions	34,009	29,000
Other	1,589	13,069
Total Non-Operating Revenues, Net	<u>350,301</u>	<u>251,388</u>
Deficit of Revenues Under Expenses	(6,368,370)	(1,836,496)
Capital Contributions	200	487,591
Capital Contributed from Sole Member	<u>5,500,000</u>	<u>8,984,046</u>
INCREASE (DECREASE) IN NET ASSETS	(668,170)	7,635,141
Net Assets, Beginning of Year	<u>13,813,553</u>	<u>6,178,412</u>
NET ASSETS - END OF YEAR	<u>\$ 12,945,383</u>	<u>\$ 13,813,553</u>

See accompanying Notes to Financial Statements.

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CHATHAM HOSPITAL, INC.
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Patients and Third-Party Payors	\$ 18,297,530	\$ 17,896,021
Payments to Employees for Services and Benefits	(10,830,684)	(10,202,659)
Payments to Suppliers and Contractors	(10,327,890)	(8,862,275)
Other Operating Payments	(1,565,734)	(1,336,572)
Net Cash Used in Operating Activities	<u>(4,426,778)</u>	<u>(2,505,485)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Noncapital Grants and Contributions	34,009	29,000
Other	146,334	82,274
Net Cash Provided by Noncapital Financing Activities	<u>180,343</u>	<u>111,274</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Collections on Unconditional Promises to Give	54,350	87,000
Purchases of Capital Assets	(5,685,734)	(1,592,162)
Capital Contributions	200	487,591
Capital Contributed from Sole Member	5,500,000	8,984,046
Principal Payments on Long-Term Debt	(2,784,000)	(959,421)
Net Cash Provided by (Used in) Capital and Related Financing Activities	<u>(2,925,184)</u>	<u>7,007,054</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net Change in Assets Held by Trustee Under Indenture Agreement	5,644,079	(2,272,709)
Realized Investment Income	227,363	180,587
Net Change in Investments	<u>1,901,041</u>	<u>(1,921,469)</u>
Net Cash Provided by (Used in) Investing Activities	<u>7,772,483</u>	<u>(4,013,611)</u>
NET INCREASE IN CASH	600,884	599,232
Cash and Cash Equivalents - Beginning of Year	<u>2,719,595</u>	<u>2,120,363</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 3,320,459</u>	<u>\$ 2,719,595</u>

See accompanying Notes to Financial Statements.

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CHATHAM HOSPITAL, INC.
STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED JUNE 30, 2011 AND 2010

	2011	2010
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Operating Loss	\$ (6,718,671)	\$ (2,087,884)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation	2,106,626	1,939,377
Amortization of Deferred Financing Costs	74,623	144,723
Amortization of Bond Premium	(90,854)	(173,561)
Provision for Bad Debts	8,725,194	8,601,164
Change in Discount on and Provision for Uncollectible Unconditional Promises to Give	-	-
Net Changes in Operating Assets and Liabilities:		
Patient Accounts Receivable	(7,087,935)	(9,658,071)
Other Receivables	(78,943)	476,270
Inventories	91,942	(46,634)
Prepaid Expenses	11,642	132,179
Accounts Payable	(971,965)	(1,057,310)
Accrued Expenses	(34,129)	75,910
Estimated Third-Party Payor Settlements	(454,318)	(651,648)
Net Cash Used in Operating Activities	<u>\$ (4,426,778)</u>	<u>\$ (2,505,485)</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash Paid During the Year for Interest	<u>\$ 1,378,676</u>	<u>\$ 1,325,011</u>
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Purchase of Capital Assets Included in Accounts Payable	<u>\$ 285,262</u>	<u>\$ -</u>

See accompanying Notes to Financial Statements.

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CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 1 NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Chatham Hospital, Inc. (the "Hospital"), located in Siler City, North Carolina, is a nonprofit critical access hospital providing general short-term medical and surgical patient services. The University of North Carolina Health Care System ("UNCHCS") is the sole corporate member of Chatham Hospital, Inc.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities 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.

Basis of Accounting

The accompanying financial statements are prepared and presented on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America as recommended in the American Institute of Certified Public Accountants' Audit and Accounting Guide, *Health Care Entities*, and other pronouncements applicable to health care organizations.

The Hospital utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Hospital has elected to apply to provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less when purchased, excluding amounts whose use is limited.

Investments

Investments consist of mutual funds and certificates of deposit with original maturities over three months. The mutual funds are recorded at fair market value.

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CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 1 NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Patient Receivables

Patient accounts receivable are reported at estimated net realizable amounts from patients and responsible third-party payors. Amounts owed to the Hospital are reported net of allowances for contractual adjustments and uncollectible accounts. Specific patient balances are written off at the time they are determined to be uncollectible. The process for estimating the ultimate collection of receivables involves significant assumptions and judgments. In this regard, the Hospital has implemented a standardized approach to estimate and review the collectibility of its receivables based on patient receivable aging trends. Historical collection and payor reimbursement experience is an integral part of the estimation process related to determining allowance for contractual adjustments and uncollectible accounts. In addition, the Hospital assesses the current state of its billing functions in order to identify any known collection or reimbursement issues to determine the impact, if any, on its reserve estimates, which involve judgment. Revisions in reserve estimates are recorded as an adjustment to net patient service revenue or as provision for uncollectible accounts.

Inventories

Inventories are valued at the lower of cost (first-in, first-out method) or market. Market is considered to be replacement cost or net realizable value.

Capital Assets

Capital assets are recorded at cost. 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. Donated property and equipment are recorded at the estimated fair value at the date of donation. Depreciation is computed using the straight-line method over estimated useful lives of the assets, which range from 10 to 40 years for buildings and improvements, and 3 to 25 years for equipment and fixtures.

Expenditures for repairs and maintenance are charged to expense as incurred. The costs for major renewals and betterments are capitalized and depreciated over their estimated useful lives. Upon disposition, the asset and related accumulated depreciation accounts are relieved and any gain or loss is credited or charged to non-operating revenues and expenses.

Deferred Financing Costs

Deferred financing costs on long-term debt are being amortized using the effective interest method over the life of the related long-term debt.

Restricted Assets

Restricted assets include assets that are held by trustees under indenture agreements and assets that are internally designated for capital improvements.

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 1 NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Accrued Compensated Absences

The vacation policy of the Hospital provides for the accumulation of up to 500 hours earned vacation leave with such leave being fully vested when earned and after 90 days of employment.

Net Assets

Net assets of the Hospital are classified into the following components:

Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation plus any unspent funds from outstanding borrowings and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

Restricted net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees.

Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Restricted Resources

Resources restricted by donor-imposed stipulations are used before unrestricted resources.

Grants and Contributions

From time to time, the Hospital receives grants and contributions from individuals, governments, 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 for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted for a specific operating purpose are reported as nonoperating revenues. Amounts restricted for capital acquisitions are reported after nonoperating revenues and expenses.

Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include reimbursed costs and discounted charges. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations.

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 1 NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Charity Care

The Hospital 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 Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue.

Income Taxes

The Hospital is incorporated as a nonprofit organization under the laws of the state of North Carolina and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

NOTE 2 INVESTMENTS AND RESTRICTED ASSETS

Investments are stated at fair value and are comprised of the following at June 30, 2011 and 2010:

	2011	2010
Mutual Funds	\$ 506,408	\$ 475,086
Money Market Funds	-	1,999,000
Certificates of Deposit	89,301	90,069
	<u>\$ 605,709</u>	<u>\$ 2,564,155</u>

As of June 30, 2011 and 2010, the Hospital has certain investments held by a trustee which include investments restricted for the construction of capital assets and debt service fund in accordance with the 2007 bond issue. Assets are invested in money market funds and are stated at fair value. The composition of restricted assets at June 30, 2011 and 2010 is set forth in the following table:

	2011	2010
Held by Trustee Under Indenture Agreement		
Restricted for the Construction of Capital Assets	\$ -	\$ 918,540
Mortgage Reserve Fund	1,003,983	605,217
Debt Service Reserve Fund	3,417,469	3,433,090
	4,421,452	4,956,847
Less Current Portion	-	(918,540)
Total	<u>\$ 4,421,452</u>	<u>\$ 4,038,307</u>
Internally Designated for Capital Improvement	<u>\$ -</u>	<u>\$ 5,108,684</u>

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 2 INVESTMENTS AND RESTRICTED ASSETS (CONTINUED)

Interest Rate Risk – The Hospital has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk – The Hospital's investment policy allows it to invest in (i) interest bearing time deposits, certificates of deposit or other approved forms of deposits, (ii) corporate notes and bonds and (iii) equity securities.

Investment income is comprised of the following for the years ended June 30, 2011 and 2010:

	2011	2010
Interest and Dividends	\$ 81,231	\$ 110,012
Realized Gains, Net	57,405	40,463
Unrealized Gains (Losses), Net	31,322	(10,351)
	<u>\$ 169,958</u>	<u>\$ 140,114</u>

NOTE 3 ACCOUNTS RECEIVABLE, ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Patient Accounts Receivable

The Hospital provides services primarily to the residents of Chatham County and surrounding counties without collateral or other proof of ability to pay. Concentrations of credit risk with respect to patient accounts receivable are limited due to the large number of patients served and the formalized agreements with third-party payors. The Hospital has significant accounts receivable for which collectibility is dependent upon the performance of certain governmental programs, primarily Medicare and Medicaid. Management does not believe there are significant credit risks associated with these governmental programs. An allowance for uncollectible accounts is provided in an amount equal to the estimated losses to be incurred in collection of patient receivables. The allowance is based on historical collection experience and a review of the current status of existing receivables.

The mix of receivables from patients and third-party payors as of June 30, 2011 and 2010 is as follows:

	2011	2010
Medicare	\$ 2,114,831	\$ 5,523,729
Medicaid	425,042	537,831
Blue Cross	418,334	706,779
Other Third-Party Payors	935,832	327,183
Patients	7,865,699	6,349,234
Gross Patient Accounts Receivable	11,559,738	13,444,756
Less Contractual Allowances	(1,890,793)	(3,357,085)
Less Allowance for Estimated Uncollectibles	(5,789,972)	(4,571,439)
	<u>\$ 3,878,973</u>	<u>\$ 5,516,232</u>

CHATHAM HOSPITAL, INC.
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2011 AND 2010

CHATHAM HOSPITAL, INC.
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2011 AND 2010

NOTE 3 ACCOUNTS RECEIVABLE, ACCOUNTS PAYABLE, AND ACCRUED EXPENSES
 (CONTINUED)

Accounts Payable and Accrued Expenses

Accounts payable (including accrued expenses) reported as current liabilities by the Hospital as of June 30, 2011 and 2010 is as follows:

	2011	2010
Payable to Suppliers	\$ 897,087	\$ 1,083,804
Payable to UNCHCS	118,877	818,863
Payable to Employees (Including Payroll Taxes)	1,308,344	1,327,854
Bond Interest Expense Payable	590,259	602,878
Total Accounts Payable and Accrued Expenses	<u>\$ 2,912,567</u>	<u>\$ 3,633,399</u>

NOTE 4 UNCONDITIONAL PROMISES TO GIVE

Unconditional promises to give are recorded after discounting to the present value the expected future cash flows. The following is a summary of unconditional promises to give as of June 30, 2011 and 2010:

	2011	2010
Receivable in Less than One Year	\$ 105,675	\$ 85,525
Receivable in One to Five Years	10,000	74,500
	115,675	170,025
Less Discounts to Net Present Value (at 4.9%)	(1,611)	(7,035)
Less Allowance for Uncollectible Promises to Give	(35,224)	(29,800)
Unconditional Promises to Give, Net	<u>\$ 78,840</u>	<u>\$ 133,190</u>

NOTE 5 NET PATIENT SERVICE REVENUE

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare

The Hospital is classified as a critical access hospital where inpatient acute and non-acute services, certain outpatient services, and defined capital and medical education costs related to Medicare program beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for cost-reimbursable items at an interim rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

NOTE 5 NET PATIENT SERVICE REVENUE (CONTINUED)

Medicare (continued)

The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. Approximately 61% and 56% of the Hospital's net patient service revenue was derived from Medicare for the years ended June 30, 2011 and 2010, respectively.

Medicaid

Inpatient services rendered to Medicaid program beneficiaries are paid for at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Hospital is reimbursed at an interim rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by Medicaid. Approximately 11% and 9% of the Hospital's net patient service revenue was derived from Medicaid for the years ended June 30, 2011 and 2010, respectively.

Laws and regulations governing the Medicare and Medicaid programs are 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.

At June 30, 2011 audits or desk reviews of reimbursements for fiscal year 2007 and prior years have been completed for both Medicare and Medicaid. The amount included on the balance sheet for estimated third-party payor settlements is based upon tentative settlements for the prior year and an estimated settlement for the year ended June 30, 2011.

Prior to 2006, the Hospital participated in a voluntary Medicaid disproportionate share program (the "Program"). The Program allowed the Hospital to receive additional annual Medicaid funding. Prior to 2001, funding was received prior to final approval of the Program by the Centers for Medicare and Medicaid Services ("CMS") and was subject to final settlement by the state of North Carolina once approved by CMS. In general, the Hospital's policy was to defer 25% of receipts, until CMS approved the Program, at which time the Hospital recognized the portion deferred as revenue. Payments under this program required regulatory approval prior to disbursement and were subject to audit by the fiscal intermediary. During 2006, the state of North Carolina reached a final settlement with the Hospital for the Program years 1997 through 2002. In accordance with the terms of the settlement, the Hospital was not required to refund any of the amounts received that related to those years, and the Hospital recognized all deferred balances relating to those years as income in 2006. During 2008, a final settlement for 2003 was reached with no repayment required.

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 5 NET PATIENT SERVICE REVENUE (CONTINUED)

Due to the fact that the payments in connection with the Program for the years 2004 through 2006 are still subject to final settlement by the state of North Carolina, refunding of the amounts received may be required. No reserve was considered necessary by management at June 30, 2011 and 2010.

The Hospital also has payment arrangements with certain commercial insurance carriers.

A summary of gross and net patient service revenue for the years ended June 30, 2011 and 2010 follows:

	2011	2010
Gross Patient Service Revenue	\$ 41,341,037	\$ 43,776,940
Less Provision for:		
Contractual Adjustments	(16,123,572)	(16,025,097)
Provision for Bad Debts	(8,725,194)	(8,601,164)
Net Patient Service Revenue	<u>\$ 16,492,271</u>	<u>\$ 19,150,679</u>

NOTE 6 CAPITAL ASSETS

Capital assets for the years ended June 30, 2011 and 2010 are as follows:

	Balance June 30, 2010	Additions	Transfers/ Retirements	Balance June 30, 2011
Non-Depreciable Assets				
Land	\$ 444,883	\$ -	\$ -	\$ 444,883
Construction-in-Progress	1,419,740	4,959,146	(6,378,886)	-
Depreciable Assets				
Buildings and Improvements	25,507,582	-	6,378,886	31,886,468
Equipment and Fixtures	5,395,861	1,011,840	-	7,407,701
	33,766,166	5,970,866	-	39,739,152
Less Accumulated Depreciation	(7,769,143)	(2,106,628)	-	(9,875,769)
Capital Assets, Net	<u>\$ 25,999,023</u>	<u>\$ 3,864,380</u>	<u>\$ -</u>	<u>\$ 29,883,383</u>
	Balance June 30, 2009	Additions	Transfers/ Retirements	Balance June 30, 2010
Non-Depreciable Assets				
Land	\$ 444,883	\$ -	\$ -	\$ 444,883
Construction-in-Progress	315,954	1,103,786	-	1,419,740
Depreciable Assets				
Buildings and Improvements	25,496,119	9,463	-	25,507,582
Equipment and Fixtures	5,918,948	478,913	-	6,395,861
	32,178,004	1,582,182	-	33,768,186
Less Accumulated Depreciation	(6,829,767)	(1,939,377)	-	(7,769,143)
Capital Assets, Net	<u>\$ 26,346,237</u>	<u>\$ (347,215)</u>	<u>\$ -</u>	<u>\$ 25,999,023</u>

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 7 LONG-TERM DEBT

On February 8, 2007, the Hospital issued FHA Insured North Carolina Medical Care Commission (the "Commission") Mortgage Revenue Bonds, Series 2007 of \$30,540,000. The bonds were issued pursuant to the Health Care Facilities Finance Act, Chapter 131A of the General Statutes of North Carolina, as amended, and a trust indenture dated as of February 1, 2007, between the Commission and The Bank of New York Trust Company, N.A., as trustee. Concurrently with the issuance of the bonds, the Commission entered into a loan agreement dated February 1, 2007.

To provide a source of repayment of such loan, the Hospital executed a Deed of Trust Note dated February 8, 2007. Payment made pursuant to the Loan Agreement and on the Series 2007 Note, together with funds available under the indenture, are required to be sufficient to pay the principal, premium, and interest on the bonds as they become due and payable. The bonds will be limited obligations of the Commission, payable solely from money received from the Hospital pursuant to the terms of the Loan Agreement and the Series 2007 Note, from payment of the FHA mortgage insurance benefit in the event of a default with respect to the Series 2007 Note and from amounts deposited in certain funds and accounts pursuant to the indenture.

The Hospital's obligations under the Loan Agreement and the Series 2007 Note are secured by: 1) a deed of trust and assignment of rents, profits and income, dated February 8, 2007, granting to a deed of trust trustee named therein, for the benefit of the Trustee, a first lien on the Hospital's interest in certain real property, and 2) a Security Agreement granting a security interest in certain personal property of the Hospital. The Department of Housing and Urban Development (HUD), acting by and through FHA, insures the advances of funds secured by the mortgage pursuant to the Section 242 of Title II of the National Housing Act, as amended. The Hospital has entered into an FHA Regulatory Agreement, a building loan agreement with the trustee, and certain other documents delivered to FHA and the Trustee, as beneficiary under the mortgage, relating to the FHA security.

The bonds are subject to mandatory sinking fund requirements prior to their due dates. There are certain covenants associated with the Series 2007 bonds that are outlined in the master trust indenture, loan agreement, and regulatory agreement. The most restrictive of these covenants requires maintenance of a long-term debt service coverage ratio, as defined, of greater than 1.2. Management acknowledges the Hospital was in violation of certain covenants and requirements of those agreements at June 30, 2011. In accordance with the agreements, the Hospital is in the process of complying with such covenants and requirements by taking corrective action. The Hospital engaged a consultant with Critical Access Hospital expertise to assist in preparation of the Medicare and Medicaid cost report. In addition, the Hospital is consulting with expert personnel within the UNC Health Care System to improve operations. Management believes these actions will produce results to bring the Hospital in compliance with the covenants. Accordingly, the debt is classified as long-term in the balance sheet at June 30, 2011.

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 7 LONG-TERM DEBT (CONTINUED)

At the time of the February 2007 bond issue, the University of North Carolina Hospitals ("UNCH") loaned the Hospital approximately \$1,999,000 to use as a collateral cash escrow for HUD. The note required monthly payments of approximately \$37,000, including simple interest at prime plus 1% (3.25% at June 30, 2011) for 80 months once HUD terminated the escrow and released the collateral cash escrow to the Hospital. The escrow was terminated by HUD in March 2010; however, UNCH amended the agreement with the Hospital to defer the commencement of required repayments until fiscal year 2012. During the year ended June 30, 2011, the Hospital early retired the \$1,999,000 note payable with proceeds from a contribution received from UNCHCS.

Long-term debt consisted of the following as of June 30, 2011 and 2010:

	2011	2010
North Carolina Medical Care Commission FHA-Insured Mortgage Revenue Bonds, Series 2007; Serial and Term Bonds with Principal Maturing in Varying Annual Amounts through Fiscal Year 2034, and Interest Paid Semi-Annually at Rates Ranging from 4.00% to 5.25%	\$ 28,755,000	\$ 29,550,000
Promissory Note to University of North Carolina Hospitals	-	1,999,000
	28,755,000	31,549,000
Plus Unamortized Premium	1,264,382	1,355,238
Less Current Portion	(750,000)	(770,000)
	<u>\$ 29,269,382</u>	<u>\$ 32,134,236</u>

A schedule of changes in the Hospital's long-term debt for the years ended June 30, 2011 and 2010 follows:

	Balance June 30, 2010	Additions	Retirements, Net	Balance June 30, 2011	Amounts Due Within One Year
Notes Payable	\$ 1,999,000	\$ -	\$ (1,999,000)	\$ -	\$ -
Bonds Payable	29,550,000	-	(750,000)	28,755,000	750,000
Total	<u>\$ 31,549,000</u>	<u>\$ -</u>	<u>\$ (2,794,000)</u>	<u>\$ 28,755,000</u>	<u>\$ 750,000</u>
	Balance June 30, 2009	Additions	Retirements	Balance June 30, 2010	Amounts Due Within One Year
Notes Payable	\$ 2,003,421	\$ -	\$ (4,421)	\$ 1,999,000	\$ -
Bonds Payable	30,505,000	-	(855,000)	29,550,000	770,000
Total	<u>\$ 32,508,421</u>	<u>\$ -</u>	<u>\$ (859,421)</u>	<u>\$ 31,549,000</u>	<u>\$ 770,000</u>

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CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 7 LONG-TERM DEBT (CONTINUED)

Maturities of long-term debt as of June 30, 2011 are as follows:

Period Ending June 30,	Bonds	Interest
2012	\$ 750,000	\$ 1,412,482
2013	720,000	1,380,768
2014	755,000	1,346,168
2015	785,000	1,311,199
2016	830,000	1,274,812
2017-2021	4,715,000	5,795,528
2022-2026	5,985,000	4,548,964
2027-2031	7,705,000	2,788,952
2032-2034	6,510,000	587,625
	<u>\$ 28,755,000</u>	<u>\$ 20,446,478</u>

On August 17, 2010, the Department of Housing and Urban Development granted final endorsement of the Hospital's Loan Agreement and Series 2007 Note for mortgage insurance under the National Housing Act, as amended, by the Federal Housing Administration, an organizational unit of the United States Department of Housing and Urban Development. Upon final endorsement, the mortgage interest rate was reduced to a permanent rate of 4.8%, a final mortgage amortization schedule created, and remaining construction funds of approximately \$639,000 were released to the Hospital for purchase of outstanding equipment.

NOTE 8 LEASE OBLIGATIONS

The Hospital leases equipment under operating leases with various lease terms. Rent expense for the years ended June 30, 2011 and 2010 was approximately \$139,000.

The following is a summary of future minimum lease payments for operating leases that have initial or remaining non-cancelable terms in excess of one year subsequent to June 30, 2011:

Fiscal Years Ending:	
2012	\$ 138,863
2013	138,863
Total Minimum Lease Payments	<u>\$ 277,726</u>

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CHATHAM HOSPITAL, INC.
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2011 AND 2010

NOTE 9 RESTRICTED NET ASSETS

Restricted net assets consisted of the following at June 30, 2011 and 2010:

	2011	2010
"The New Chatham Hospital, Inc." to Support Construction and Equipment for the New Hospital	\$ 78,840	\$ 608,276

NOTE 10 RETIREMENT PLAN

The Hospital maintains a defined contribution pension plan covering substantially all employees who have completed 1,000 hours of service during the plan year and are employed by the Hospital on the last day of the plan year (June 30). Employer contributions to the plan are solely at the discretion of the Board of Trustees. Contributions of approximately \$83,000 have been paid and approximately \$10,000 has been accrued as of June 30, 2011. Contributions for year ended June 30, 2010 were approximately \$85,000.

NOTE 11 PROFESSIONAL LIABILITY INSURANCE

The Hospital is insured under claims-made policies for the purpose of providing professional and patient care liability insurance. These policies cover only malpractice claims reported to the insurance carrier during the policy term. Coverage includes a \$3,000,000 policy on professional liability limited to \$1,000,000 per case and an excess coverage policy for specified aggregate amounts in excess of the basic coverage. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. Although the amount of damages is uncertain, the amount could be substantial. In addition, incidents occurring through June 30, 2011, may result in the assertion of a claim. In the opinion of the Hospital's management, any liability that might be determined upon ultimate resolution of these claims will be covered by insurance or an estimate of the losses has been accrued and will not have a material effect on the Hospital's financial position.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during their terms, but reported subsequently, would be uninsured. Management anticipates that such coverage will be renewed or replaced with equivalent insurance as they expire.

CHATHAM HOSPITAL, INC.
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2011 AND 2010

NOTE 12 COMMITMENTS AND CONTINGENCIES

Laboratory Services

The Hospital has a contract with a laboratory company to provide on-site and off-site clinical laboratory services. Fees charged to the Hospital are based on a fixed fee plus reimbursement of variable expenses. For the years ended June 30, 2011 and 2010, approximately \$514,000 and \$446,000, respectively, was paid under this contract. Of these amounts, approximately \$93,000 and \$136,000 was accrued in accounts payable on the balance sheet at June 30, 2011 and 2010, respectively.

NOTE 13 CONCENTRATIONS OF CREDIT RISK

The Hospital maintains deposits at various financial institutions covered by federal depository insurance ("FDIC"). At various times throughout the year, the Hospital may maintain amounts in excess of the FDIC insured limits.

NOTE 14 CHARITY CARE

The amount of charges forgone for services and supplies furnished under the Hospital's charity-care policy aggregated approximately \$422,000 and \$224,000 for the years ended June 30, 2011 and 2010, respectively.

NOTE 15 RELATED PARTY TRANSACTIONS

Effective July 15, 2008, the Hospital restated its Articles of Incorporation providing that UNCHCS shall be the sole corporate member of the Hospital. As part of the acquisition agreement, UNCHCS assumed control of the Hospital's liabilities in the amount of \$34,700,000. During the period ended September 30, 2008, UNCHCS paid the Hospital \$2,000,000 as a closing payment to the agreement, and committed to additional future payments of \$9,300,000 to develop or facilitate the development of health care services in Chatham County over the next seven years. Use of the committed payments is to be presented to and approved by the Hospital Board of Trustees.

Effective March 18, 2008, the Hospital entered into an agreement with UNCHCS for the transfer of \$1,000,000 to the Hospital to support the provision of indigent care services in Chatham County. The agreement provided that funds be used to insure continued financial stability of the Hospital and service to patients without regard to ability to pay or payor source.

During the year ended June 30, 2011, UNCHCS made a one-time financial assistance grant of \$5.5 million to the Hospital.

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

NOTE 15 RELATED PARTY TRANSACTIONS (CONTINUED)

Physician Services

Effective January 1, 2008 the Hospital entered into a two-year contract with the University of North Carolina at Chapel Hill, School of Medicine ("UNC-CH"), and UNCHCS to provide for the recruitment and employment of a full-time physician at the Hospital. For the years ended June 30, 2011 and 2010, the Hospital incurred expenses of approximately \$0 and \$200,000 under this contract, respectively.

Hospitalists

The Hospital has a contract with UNC-CH to provide weekend hospitalists. Coverage will be provided for admissions, subsequent hospital care and discharges. The one-year contract was effective through June 30, 2011 with fees for these services to be paid monthly of approximately \$17,500. For the years ended June 30, 2011 and 2010, the Hospital incurred expenses of approximately \$210,000 and \$192,000, respectively.

Emergency Room

The Hospital has a contract with UNC-CH to provide emergency room physicians. For the years ended June 30, 2011 and 2010, approximately \$1,247,000 and \$1,096,000, respectively, was paid to the UNC-CH under this contract.

Hospital Management Services

Effective August 1, 2006, the Hospital entered into a five-year contract with UNCH which includes executive staffing and assistance with operations and planning. Additionally, the Hospital has entered into various other administrative and clinical services agreements with UNCH. Total costs incurred during the years ended June 30, 2011 and 2010 were approximately \$1,096,000 and \$820,000, respectively. Of these amounts, approximately \$108,000 and \$683,000 is included in accounts payable on the accompanying balance sheets at June 30, 2011 and 2010, respectively.

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**CHATHAM HOSPITAL, INC.
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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
Chatham Hospital, Inc.
Siler City, North Carolina

We have audited the accompanying balance sheet of Chatham Hospital, Inc. (the "Hospital") as of June 30, 2010 and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements as of and for the nine-month period ended June 30, 2009 were audited by other auditors whose report dated October 27, 2009 expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the 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 of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Chatham Hospital, Inc. as of June 30, 2010 and the results of its operations, changes in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management discussion and analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 3, 2010, on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provision of laws, regulation, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Accordingly, we express no such opinion. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

LarsonAllen LLP
LarsonAllen LLP

Charlotte, North Carolina
November 3, 2010



(1)
LarsonAllen LLP is a member of Nexia International,
a worldwide network of independent accounting and consulting firms.

(2)

**CHATHAM HOSPITAL, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2010 AND THE NINE MONTHS ENDED JUNE 30, 2009**

Overview

The Management's Discussion and Analysis section of Chatham Hospital, Inc.'s annual financial report is designed to provide a general overview of the financial position and operating results for the year ended June 30, 2010 and the nine-month period ended June 30, 2009. This analysis should be read in conjunction with the financial statements and related notes which follow this discussion and analysis.

Chatham Hospital, Inc. (the "Hospital") is a private, not-for-profit health care organization located in Siler City, North Carolina. The facility is a 25-bed critical access hospital. The Hospital has a 70-year history of providing quality health services. The Hospital provides comprehensive care, including emergency, general surgery, lab, CT, MRI, nuclear medicine, pharmacy, cardio-pulmonary and intensive care on its campus. The Hospital reaches beyond the hospital setting to provide diabetes education, physical therapy, and cardiac rehabilitation in temporary leased space located in Siler City Business Park approximately 3.5 miles from the main campus.

Current Year Events

The year ended June 30, 2010 continued to be a time of transition. New executive staff included a permanent Chief Financial Officer and Human Resources Officer. Other new Director staff included Directors of Pharmacy, Cardiopulmonary, Nursing and Materials Management. The Hospital has contracted with an MD Anesthesiologist to provide professional anesthesiology services beginning June 1, 2010. Having an MD Anesthesiologist supervising the provision of Anesthesiology Services relieves the surgeon from that additional responsibility, and should encourage specialty physicians to perform procedures here.

An eighteen-month Hospital Information Systems implementation process was begun with a new Payroll System and a new General Ledger System going live on April 1, 2010. Following close behind was the go live of a new Accounts Payable/Materials Management System on July 1, 2010. In addition, July 1, 2010 saw the go live of new Meditech Hospital Information System Modules for Billing/Patient Accounts Receivable, Community Wide Scheduling and Registration. Other clinical modules including Laboratory, Emergency Department, Pharmacy, Surgical Services, Physician Order Entry, and Health Information Management will be going live during fiscal 2011.

Construction also began on a new 31,219 square foot Medical Office Building on the Hospital campus which is expected to be completed by January 2011. The Medical Office building will provide consolidated space for the permanent location of diabetes education, physical therapy, cardiac rehabilitation and business office. Chatham Primary Care will be leasing clinic space in the building. Additional clinic space is available for specialty care physicians to lease on a rotating basis. Discussions are currently underway with Plastic Surgeons, GI Proceduralists, ENT Specialists and Orthopaedic Surgeons. The vision is for these specialists to hold clinic one day a week and perform procedures in the Hospital's operating or procedure rooms one day a week. Also housed within the Medical Office Building are crew quarters for a UNC Health Care System helicopter based at the Hospital.

The Hospital's continued focus on quality initiatives has resulted in significant improvements in scores for Core Measures for pneumonia and heart failure and patient satisfaction scores remain high.

**CHATHAM HOSPITAL, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2010 AND THE NINE MONTHS ENDED JUNE 30, 2009**

Using this Financial Report

The Hospital's financial statements report information by using accounting methods similar to those used by private-sector health organizations. These statements offer short-term and long-term financial information about its activities.

Balance Sheet

The balance sheet includes all of the Hospital's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to the Hospital's creditors (liabilities). The balance sheet also provides the basis for evaluating the capital structure of the Hospital and assessing the liquidity and financial flexibility of the Hospital.

Statement of Revenues, Expenses and Changes in Net Assets

All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses and changes in net assets. This statement measures the success of the Hospital operation over the past year and can be used to determine whether the Hospital has successfully recovered all of its costs through its fees and other sources of revenue, profitability and credit worthiness.

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 operating, investing and capital and related financing activities. It also provides answers to such questions as where cash comes from, what cash was used for and what the change in the cash balance was during the reporting period.

Notes to the Financial Statements

Notes to the financial statements are designed to give the reader additional information concerning the Hospital and further supports the statements noted above.

Financial Analysis

The statement of revenues, expenses and changes in net assets reports the net assets of the Hospital and the changes affecting them. The Hospital's net assets, the difference between assets and liabilities, are a way to measure financial health or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth and new or changed governmental legislation.

**CHATHAM HOSPITAL, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2010 AND THE NINE MONTHS ENDED JUNE 30, 2009**

Condensed Balance Sheet

The following condensed balance sheet shows the financial position of the Hospital at June 30, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
ASSETS		
Current Assets	\$ 14,021,322	\$ 10,920,488
Capital Assets, Net	25,999,023	26,346,238
Noncurrent Assets	<u>10,330,843</u>	<u>7,621,092</u>
Total Assets	<u>\$ 50,351,188</u>	<u>\$ 44,887,818</u>
LIABILITIES		
Long-Term Debt, Including Current Portion	\$ 32,904,236	\$ 34,037,218
Other Liabilities	<u>3,633,399</u>	<u>4,672,188</u>
Total Liabilities	<u>36,537,635</u>	<u>38,709,406</u>
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	(1,948,366)	101,841
Restricted	608,276	426,980
Unrestricted	<u>15,153,643</u>	<u>5,649,591</u>
Total Net Assets	<u>13,813,553</u>	<u>6,178,412</u>
Total Liabilities and Net Assets	<u>\$ 50,351,188</u>	<u>\$ 44,887,818</u>

Current assets increased approximately \$3,101,000 (28%) from the prior year. The current year increase results from an increase in net accounts receivable, estimated third-party settlements, release by HUD of the bond escrow trust fund, and capital contribution by the University of North Carolina Health Care System ("UNCHCS"), sole member of the Hospital.

In 2010, our long-term debt decreased by approximately \$1,133,000 due to payments on the debt and amortization of the bond premium.

Net assets increased \$7,635,000 (124%) during 2010 primarily due to the capital contributed by UNCHCS. For further information on this change, see the following statement of revenues, expenses and changes in net assets.

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**CHATHAM HOSPITAL, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2010 AND THE NINE MONTHS ENDED JUNE 30, 2009**

Capital Assets

The Hospital's investment in capital assets consisted of the following at June 30, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Land	\$ 444,983	\$ 444,983
Buildings and Improvements	26,975,248	25,871,462
Equipment	<u>6,347,936</u>	<u>5,859,560</u>
Total Capital Assets	33,768,167	32,176,005
Accumulated Depreciation	<u>(7,769,144)</u>	<u>(5,829,787)</u>
Total Capital Assets, Net	<u>\$ 25,999,023</u>	<u>\$ 26,346,238</u>

The decrease in the Hospital's investment in capital assets in 2010 represents purchases of capital assets, net of disposals and depreciation expense, primarily the Meditech Hospital Information System and Construction in Progress for the Medical Office Building.

Condensed Statement of Revenues, Expenses and Changes in Net Assets

While the balance sheet shows the financial position of the Hospital, the following statement of revenues, expenses and changes in net assets provides answers to the nature and source of these changes for the year ended June 30, 2010 and the nine months ended June 30, 2009:

	<u>2010</u>	<u>2009</u>
Operating Revenues	\$ 19,897,957	\$ 15,244,538
Operating Expenses	<u>21,995,841</u>	<u>15,796,373</u>
Operating Loss	(2,087,884)	(551,835)
Non-Operating Income	<u>251,388</u>	<u>184,932</u>
Deficit of Revenues Under Expenses before Other Changes	(1,836,496)	(366,903)
Other Changes in Net Assets	<u>9,471,637</u>	<u>478,488</u>
Increase in Net Assets	7,635,141	111,585
Net Assets - Beginning of Year	<u>6,178,412</u>	<u>6,066,827</u>
Net Assets - End of Year	<u>\$ 13,813,553</u>	<u>\$ 6,178,412</u>

Operating Loss

Gross patient revenues were approximately \$43,777,000 and \$33,228,000 for the year ended June 30, 2010 and the nine-month period ended June 30, 2009, respectively. Under GASB, bad debts are presented as a deduction from revenues. Other significant changes in operating expenses include an increase in salaries and wages of 39%, benefits of 40% and medical supplies and other expense of 43%.

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CHATHAM HOSPITAL, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2010 AND THE NINE MONTHS ENDED JUNE 30, 2009

Operating revenues and expenses consisted of the following for the year ended June 30, 2010 and the nine months ended June 30, 2009:

	2010	2009
Operating Revenues	\$ 19,897,957	\$ 15,244,538
Salaries and Wages	10,298,842	7,415,764
Medical Supplies and Other	7,870,237	5,498,452
Depreciation and Amortization	2,084,101	1,321,064
Interest	1,306,274	1,132,500
Other	426,387	428,593
	<u>21,985,841</u>	<u>15,796,373</u>
Operating Loss	<u>\$ (2,087,884)</u>	<u>\$ (551,835)</u>

Non-Operating Revenues

Non-operating revenues consisted of the following for the year ended June 30, 2010 and the nine months ended June 30, 2009:

	2010	2009
Investment Income	\$ 140,114	\$ 117,907
Physician's Office Rental, Net	69,205	29,998
Noncapital Grants and Contributions	29,000	34,771
Other	13,068	2,256
Total Non-Operating Revenues	<u>\$ 251,388</u>	<u>\$ 184,932</u>

Other Changes in Net Assets

Other changes in net assets include capital contributions of approximately \$488,000 and contributed capital from UNCHCS of approximately \$8,984,000 (approximately \$6,744,000 for the construction of the new medical office building and approximately \$2,240,000 for the remaining commitment for future development of health care services as specified in the July 2008 Acquisition Agreement).

Finance Contact

The Hospital's financial statements are designed to present users with a general overview of the Hospital's finances and to demonstrate the Hospital's accountability. If you have any questions about this report, or need additional financial information, inquiries may be sent to: Chief Financial Officer, Chatham Hospital, Inc., 475 Progress Boulevard, Siler City, North Carolina 27344.

CHATHAM HOSPITAL, INC.
BALANCE SHEETS
JUNE 30, 2010 AND 2009

	2010	2009
ASSETS		
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 2,719,595	\$ 2,120,363
Restricted Assets Held by Trustee Under Indenture Agreement	918,540	1,582,345
Investments	2,564,155	683,139
Patient Accounts Receivable (Net of Allowance for Estimated Uncollectibles of Approximately \$4,571,000 in 2010 and \$2,909,000 in 2009)	5,516,232	4,459,325
Other Receivables	279,220	755,490
Unconditional Promises to Give	95,525	100,485
Estimated Third-Party Payor Settlements	1,442,337	648,078
Inventories	408,101	361,467
Prepaid Expenses	77,817	209,796
Total Current Assets	<u>14,021,322</u>	<u>10,920,488</u>
UNCONDITIONAL PROMISES TO GIVE, LESS CURRENT PORTION, NET		
	37,665	119,705
RESTRICTED ASSETS		
Held by Trustee Under Indenture Agreement, Less Current Portion	4,038,307	6,210,477
Internally Designated for Capital Improvement	5,108,684	-
CAPITAL ASSETS, NET	<u>25,999,023</u>	<u>26,346,238</u>
DEFERRED FINANCING COSTS, NET	<u>1,113,134</u>	<u>1,257,857</u>
OTHER ASSETS	<u>33,053</u>	<u>33,053</u>
	<u>36,329,866</u>	<u>33,967,330</u>
Total Assets	<u>\$ 50,351,188</u>	<u>\$ 44,887,818</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current Portion of Long-Term Debt	\$ 770,000	\$ 633,421
Accounts Payable	1,702,667	2,759,977
Accrued Expenses	1,930,732	1,854,822
Estimated Third-Party Payor Settlements	-	57,389
Total Current Liabilities	<u>4,403,399</u>	<u>5,305,609</u>
LONG-TERM DEBT, Less Current Portion		
Total Liabilities	<u>32,134,236</u>	<u>33,403,797</u>
	<u>36,537,635</u>	<u>38,709,406</u>
NET ASSETS		
Invested In Capital Assets, Net of Related Debt	(1,948,366)	101,841
Restricted:		
Expendable for Capital Improvements	608,276	220,190
Expendable for Health Care Programs	-	206,790
Unrestricted	15,153,643	5,849,591
Total Net Assets	<u>13,813,553</u>	<u>6,178,412</u>
Total Liabilities and Net Assets	<u>\$ 50,351,188</u>	<u>\$ 44,887,818</u>

See accompanying Notes to Financial Statements.

CHATHAM HOSPITAL, INC.
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2010 AND THE NINE MONTHS ENDED JUNE 30, 2009

	<u>2010</u>	<u>2009</u>
OPERATING REVENUES		
Net Patient Service Revenue (Net of Provision for Bad Debts of Approximately \$8,601,000 in 2010 and \$3,573,000 in 2009)	\$ 19,150,679	\$ 15,214,779
Other Operating Revenue	93,381	112,788
Change in Estimate in Third-Party Payor Settlements	653,897	(83,029)
Total Operating Revenues	<u>19,897,957</u>	<u>15,244,538</u>
OPERATING EXPENSES		
Salaries and Wages	8,231,044	5,936,374
Employee Benefits	2,067,798	1,479,390
Medical Supplies and Other Expenses	7,870,237	5,498,452
Depreciation and Amortization	2,084,101	1,321,064
Interest Expense	1,306,274	1,132,500
Other	428,387	428,583
Total Operating Expenses	<u>21,985,841</u>	<u>15,796,373</u>
OPERATING LOSS	<u>(2,087,884)</u>	<u>(551,835)</u>
NON-OPERATING REVENUES		
Investment Income	140,114	117,907
Physician's Office Rental, Net	69,205	29,998
Noncapital Gains and Contributions	29,000	34,771
Other	13,069	2,256
Total Non-Operating Revenues, Net	<u>251,388</u>	<u>184,932</u>
Deficit of Revenues Under Expenses	<u>(1,836,496)</u>	<u>(366,903)</u>
Capital Contributions	487,591	162,534
Capital Contributed from Sole Member	8,984,046	315,954
INCREASE IN NET ASSETS	<u>7,635,141</u>	<u>111,585</u>
Net Assets, Beginning of Year	<u>6,178,412</u>	<u>6,066,827</u>
NET ASSETS - END OF YEAR	<u>\$ 13,813,553</u>	<u>\$ 6,178,412</u>

See accompanying Notes to Financial Statements.

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CHATHAM HOSPITAL, INC.
STATEMENTS OF CASH FLOWS
YEAR ENDED JUNE 30, 2010 AND THE NINE MONTHS ENDED JUNE 30, 2009

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from Patients and Third-Party Payors	\$ 17,896,021	\$ 12,719,309
Payments to Employees for Services and Benefits	(10,202,659)	(5,274,915)
Payments to Suppliers and Contractors	(8,862,275)	(9,108,718)
Other Operating Payments	(1,336,572)	(588,144)
Net Cash Used in Operating Activities	<u>(2,505,485)</u>	<u>(2,252,468)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Noncapital Grants and Contributions	29,000	34,771
Other	82,274	32,254
Net Cash Provided by Noncapital Financing Activities	<u>111,274</u>	<u>67,025</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Collections on Unconditional Promises to Give	87,000	71,750
Purchases of Capital Assets	(1,592,162)	(348,606)
Capital Contributions	487,591	162,534
Capital Contributed from Sole Member	8,984,046	315,954
Principal Payments on Long-Term Debt	(959,421)	(50,463)
Net Cash Provided by Capital and Related Financing Activities	<u>7,007,054</u>	<u>151,169</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Net Change in Assets Held by Trustee Under Indenture Agreement	(2,272,709)	1,221,195
Realized Investment Income	180,567	117,907
Net Change in Investments	(1,921,469)	(11,095)
Net Cash Provided by Investing Activities	<u>(4,013,611)</u>	<u>1,328,007</u>
NET INCREASE (DECREASE) IN CASH	<u>599,232</u>	<u>(706,267)</u>
Cash and Cash Equivalents - Beginning of Year	<u>2,120,363</u>	<u>2,826,630</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 2,719,595</u>	<u>\$ 2,120,363</u>

See accompanying Notes to Financial Statements.

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CHATHAM HOSPITAL, INC.
STATEMENTS OF CASH FLOWS (CONTINUED)
YEAR ENDED JUNE 30, 2010 AND THE NINE MONTHS ENDED JUNE 30, 2009

	2010	2009
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Operating Loss	\$ (2,087,884)	\$ (551,835)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation	1,939,377	1,278,983
Amortization of Deferred Financing Costs	144,723	42,081
Amortization of Bond Premium	(173,561)	(51,106)
Provision for Bad Debts	8,601,164	3,573,430
Change in Discount on and Provision for Uncollectible Unconditional Promises to Give	-	(12,535)
Net Changes in Operating Assets and Liabilities:		
Patient Accounts Receivable	(9,658,071)	(5,142,219)
Other Receivables	476,270	(64,804)
Inventories	(46,634)	19,464
Prepaid Expenses	132,179	(112,721)
Accounts Payable	(1,057,310)	(854,013)
Accrued Expenses	75,910	661,459
Estimated Third-Party Payor Settlements	(851,648)	(843,652)
Conditional Asset Retirement Obligation	-	(195,000)
Net Cash Used in Operating Activities	\$ (2,505,485)	\$ (2,252,468)
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash Paid During the Year for Interest	\$ 1,325,011	\$ 761,083
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Purchase of Capital Assets Included in Accounts Payable	\$ -	\$ 995,841

See accompanying Notes to Financial Statements.

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CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 1 NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Chatham Hospital, Inc. (the "Hospital"), located in Siler City, North Carolina, is a nonprofit critical access hospital providing general short-term medical and surgical patient services. The University of North Carolina Health Care System ("UNCHCS") is the sole corporate member of Chatham Hospital, Inc.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities 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.

Basis of Accounting

The accompanying financial statements are prepared and presented on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America as recommended in the American Institute of Certified Public Accountants' Audit and Accounting Guide, *Health Care Organizations*, and other pronouncements applicable to health care organizations.

The Hospital utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Hospital has elected to apply to provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less when purchased, excluding amounts whose use is limited.

Investments

Investments consist of mutual funds and certificates of deposit with original maturities over three months. The mutual funds are recorded at fair market value.

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CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 1 NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Patient Receivables

Patient accounts receivable are reported at estimated net realizable amounts from patients and responsible third-party payors. Amounts owed to the Hospital are reported net of allowances for contractual adjustments and uncollectible accounts. Specific patient balances are written off at the time they are determined to be uncollectible. The process for estimating the ultimate collection of receivables involves significant assumptions and judgments. In this regard, the Hospital has implemented a standardized approach to estimate and review the collectibility of its receivables based on patient receivable aging trends. Historical collection and payor reimbursement experience is an integral part of the estimation process related to determining allowance for contractual adjustments and uncollectible accounts. In addition, the Hospital assesses the current state of its billing functions in order to identify any known collection or reimbursement issues to determine the impact, if any, on its reserve estimates, which involve judgment. Revisions in reserve estimates are recorded as an adjustment to net patient service revenue or as provision for uncollectible accounts.

Inventories

Inventories are valued at the lower of cost (first-in, first-out method) or market. Market is considered to be replacement cost or net realizable value.

Capital Assets

Capital assets are recorded at cost. 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. Donated property and equipment are recorded at the estimated fair value at the date of donation. Depreciation is computed using the straight-line method over estimated useful lives of the assets, which range from 10 to 40 years for buildings and improvements, 10 to 40 years for physician office properties, and 3 to 25 years for equipment and fixtures.

Expenditures for repairs and maintenance are charged to expense as incurred. The costs for major renewals and betterments are capitalized and depreciated over their estimated useful lives. Upon disposition, the asset and related accumulated depreciation accounts are relieved and any gain or loss is credited or charged to non-operating revenues and expenses.

Deferred Financing Costs

Deferred financing costs on long-term debt are being amortized using the effective interest method over the life of the related long-term debt.

Restricted Assets

Restricted assets include assets that are held by trustees under indenture agreements and assets that are internally designated for capital improvements.

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 1 NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Accrued Compensated Absences

The vacation policy of the Hospital provides for the accumulation of up to 500 hours earned vacation leave with such leave being fully vested when earned and after 90 days of employment.

Net Assets

Net assets of the Hospital are classified into the following components:

Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation plus any unspent funds from outstanding borrowings and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

Restricted net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees.

Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Restricted Resources

Resources restricted by donor-imposed stipulations are used before unrestricted resources.

Grants and Contributions

From time to time, the Hospital receives grants and contributions from individuals, governments, 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 for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted for a specific operating purpose are reported as nonoperating revenues. Amounts restricted for capital acquisitions are reported after nonoperating revenues and expenses.

Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include reimbursed costs and discounted charges. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations.

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 1 NATURE OF ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Charity Care

The Hospital 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 Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue.

Income Taxes

The Hospital is incorporated as a nonprofit organization under the laws of the state of North Carolina and is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

NOTE 2 INVESTMENTS AND RESTRICTED ASSETS

Investments are stated at fair value and are comprised of the following at June 30, 2010 and 2009, respectively:

	2010	2009
Mutual Funds	\$ 475,086	\$ -
Money Market Funds	1,999,000	-
Certificates of Deposit	90,069	683,139
	<u>\$ 2,564,155</u>	<u>\$ 683,139</u>

The Hospital has certain investments held by a trustee which include investments restricted for the construction of capital assets and debt service fund in accordance with the 2007 bond issue. Assets are invested in money market funds and are stated at fair value. The composition of restricted assets at June 30, 2010 and 2009 is set forth in the following table:

	2010	2009
Held by Trustee Under Indenture Agreement		
Restricted for the Construction of Capital Assets	\$ 918,540	\$ 1,582,345
Mortgage Reserve Fund	605,217	219,114
Debt Service Reserve Fund	3,433,090	3,992,363
Collateral Cash Escrow	-	1,999,000
	4,956,847	7,792,822
Less Current Portion	(918,540)	(1,582,345)
Total	<u>\$ 4,038,307</u>	<u>\$ 6,210,477</u>
Internally Designated for Capital Improvement	<u>\$ 5,108,684</u>	<u>\$ -</u>

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 2 INVESTMENTS AND RESTRICTED ASSETS (CONTINUED)

Interest Rate Risk – The Hospital has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk – The Hospital's investment policy allows it to invest in (i) interest bearing time deposits, certificates of deposit or other approved forms of deposits, (ii) corporate notes and bonds and (iii) equity securities.

Investment income is comprised of the following for the year ended June 30, 2010 and the nine-month period ended June 30, 2009:

	2010	2009
Interest and Dividends	\$ 110,012	\$ 117,907
Realized Gains, Net	40,453	-
Unrealized Losses, Net	(10,351)	-
	<u>\$ 140,114</u>	<u>\$ 117,907</u>

NOTE 3 ACCOUNTS RECEIVABLE AND PAYABLES AND ACCRUED EXPENSES

Patient Accounts Receivable

The Hospital provides services primarily to the residents of Chatham County and surrounding counties without collateral or other proof of ability to pay. Concentrations of credit risk with respect to patient accounts receivable are limited due to the large number of patients served and the formalized agreements with third-party payors. The Hospital has significant accounts receivable for which collectibility is dependent upon the performance of certain governmental programs, primarily Medicare and Medicaid. Management does not believe there are significant credit risks associated with these governmental programs. An allowance for uncollectible accounts is provided in an amount equal to the estimated losses to be incurred in collection of patient receivables. The allowance is based on historical collection experience and a review of the current status of existing receivables.

The mix of receivables from patients and third-party payors as of June 30, 2010 is as follows:

	2010
Medicare	\$ 5,523,729
Medicaid	537,831
Blue Cross	706,779
Other Third-Party Payors	327,183
Patients	6,349,234
Gross Patient Accounts Receivable	13,444,756
Less Contractual Allowances	(3,357,085)
Less Allowance for Estimated Uncollectibles	(4,571,439)
	<u>\$ 5,516,232</u>

CHATHAM HOSPITAL, INC.
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2010 AND 2009

**NOTE 3 ACCOUNTS RECEIVABLE AND PAYABLES AND ACCRUED EXPENSES
 (CONTINUED)**

Accounts Payable and Accrued Expenses

Accounts payable (including accrued expenses) reported as current liabilities by the Hospital as of June 30, 2010 and 2009 are as follows:

	2010	2009
Payable to Suppliers	\$ 1,083,804	\$ 2,292,750
Payable to UNCHCS	618,863	468,863
Payable to Employees (Including Payroll Taxes)	1,327,854	1,231,671
Bond Interest Expense Payable	602,878	621,515
Total Accounts Payable and Accrued Expenses	<u>\$ 3,633,399</u>	<u>\$ 4,614,799</u>

NOTE 4 UNCONDITIONAL PROMISES TO GIVE

Unconditional promises to give are recorded after discounting to the present value the expected future cash flows. The following is a summary of unconditional promises to give as of June 30, 2010 and 2009:

	2010	2009
Receivable in Less than One Year	\$ 95,525	\$ 111,650
Receivable in One to Five Years	74,500	145,375
	170,025	257,025
Less Discounts to Net Present Value (at 4.9%)	(7,035)	(12,356)
Less Allowance for Uncollectible Promises to Give	(29,800)	(24,479)
Unconditional Promises to Give, Net	<u>\$ 133,190</u>	<u>\$ 220,190</u>

NOTE 5 NET PATIENT SERVICE REVENUE

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimates for current year estimated third-party payor settlements and revenue adjustments due to future audits, reviews and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as cost report years are no longer subject to such audits, reviews, and investigations. Laws and regulations governing the Medicare and Medicaid programs are 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. The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates.

CHATHAM HOSPITAL, INC.
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2010 AND 2009

NOTE 5 NET PATIENT SERVICE REVENUE (CONTINUED)

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

Medicare

The Hospital is a critical access hospital where inpatient acute and non-acute services, certain outpatient services, and defined capital and medical education costs related to Medicare program beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for cost-reimbursable items at an interim rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. Approximately 34% and 35% of the Hospital's net patient service revenue was derived from Medicare for the year ended June 30, 2010 and the nine months ended June 30, 2009, respectively.

Medicaid

Inpatient services rendered to Medicaid program beneficiaries are paid for at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Hospital is reimbursed at an interim rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by Medicaid. Approximately 9% and 10% of the Hospital's net patient service revenue was derived from Medicaid for the year ended June 30, 2010 and the nine-month period ended June 30, 2009, respectively.

At June 30, 2010 audits or desk reviews of reimbursements for fiscal year 2006 and prior years have been completed for Medicaid and fiscal year 2007 and prior years have been completed for Medicare. The amount included on the balance sheet for estimated third-party payor settlements is based upon tentative settlements for the prior year and an estimated settlement for the year ended June 30, 2010.

Prior to 2006, the Hospital participated in a voluntary Medicaid disproportionate share program (the "Program"). The Program allowed the Hospital to receive additional annual Medicaid funding. Prior to 2001, funding was received prior to final approval of the Program by the Centers for Medicare and Medicaid Services ("CMS") and was subject to final settlement by the state of North Carolina once approved by CMS. In general, the Hospital's policy was to defer 25% of receipts, until CMS approved the Program, at which time the Hospital recognized the portion deferred as revenue. Payments under this program required regulatory approval prior to disbursement and were subject to audit by the fiscal intermediary. During 2006, the state of North Carolina reached a final settlement with the Hospital for the Program years 1997 through 2002. In accordance with the terms of the settlement, the Hospital was not required to refund any of the amounts received that related to those years, and the Hospital recognized all deferred balances relating to those years as income in 2006. During 2008, a final settlement for 2003 was reached with no repayment required.

CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 5 NET PATIENT SERVICE REVENUE (CONTINUED)

Due to the fact that the payments in connection with the Program for the years 2004 through 2006 are still subject to final settlement by the state of North Carolina, refunding of the amounts received may be required. No reserve was considered necessary by management at June 30, 2010 and 2009.

The Hospital also has payment arrangements with certain commercial insurance carriers.

A summary of gross and net patient service revenue for the year ended June 30, 2010 and the nine-month period ended June 30, 2009 follows:

	2010	2009
Gross Patient Service Revenue	\$ 43,776,940	\$ 33,227,975
Less Provision for:		
Contractual Adjustments	(16,025,097)	(14,439,766)
Provision for Bad Debts	(8,601,184)	(3,573,430)
Net Patient Service Revenue	<u>\$ 19,150,679</u>	<u>\$ 15,214,779</u>

NOTE 6 CAPITAL ASSETS

Capital assets for the year ended June 30, 2010 and the nine-month period ended June 30, 2009 are as follows:

	Balance September 30, 2009	Additions	Transfers/ Retirements	Balance June 30, 2010
Non-Depreciable Assets				
Land	\$ 444,983	\$ -	\$ -	\$ 444,983
Construction-in-Progress	315,954	1,103,786	-	1,419,740
Depreciable Assets				
Buildings and Improvements	25,203,761	-	-	25,203,761
Equipment and Fixtures	5,859,560	488,375	-	6,347,936
Physician Office Properties	351,747	-	-	351,747
	32,176,005	1,582,162	-	33,758,167
Less Accumulated Depreciation	(5,629,767)	(1,936,377)	-	(7,566,144)
Capital Assets, Net	<u>\$ 26,346,238</u>	<u>\$ (347,215)</u>	<u>\$ -</u>	<u>\$ 25,999,023</u>
	Balance September 30, 2008	Additions	Transfers/ Retirements	Balance June 30, 2009
Non-Depreciable Assets				
Land	\$ 444,983	\$ -	\$ -	\$ 444,983
Construction-in-Progress	-	315,954	-	315,954
Depreciable Assets				
Buildings and Improvements	24,270,012	933,749	-	25,203,761
Equipment and Fixtures	5,764,816	94,744	-	5,859,560
Physician Office Properties	351,747	-	-	351,747
	30,386,575	1,344,447	-	32,176,005
Less Accumulated Depreciation	(4,550,784)	(1,278,983)	-	(5,829,767)
Capital Assets, Net	<u>\$ 26,280,774</u>	<u>\$ 65,464</u>	<u>\$ -</u>	<u>\$ 26,346,238</u>

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CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 7 LONG-TERM DEBT

On February 8, 2007, the Hospital issued FHA Insured North Carolina Medical Care Commission (the "Commission") Mortgage Revenue Bonds, Series 2007 of \$30,540,000. The bonds were issued pursuant to the Health Care Facilities Finance Act, Chapter 131A of the General Statutes of North Carolina, as amended, and a trust indenture dated as of February 1, 2007, between the Commission and The Bank of New York Trust Company, N.A., as trustee. Concurrently with the issuance of the bonds, the Commission entered into a loan agreement dated February 1, 2007.

To provide a source of repayment of such loan, the Hospital executed a Deed of Trust Note dated February 8, 2007. Payment made pursuant to the Loan Agreement and on the Series 2007 Note, together with funds available under the indenture, are required to be sufficient to pay the principal, premium, and interest on the bonds as they become due and payable. The bonds will be limited obligations of the Commission, payable solely from money received from the Hospital pursuant to the terms of the Loan Agreement and the Series 2007 Note, from payment of the FHA mortgage Insurance Benefit in the event of a default with respect to the Series 2007 Note and from amounts deposited in certain funds and accounts pursuant to the Indenture.

The Hospital's obligations under the Loan Agreement and the Series 2007 Note are secured by: 1) a deed of trust and assignment of rents, profits and income, dated February 8, 2007, granting to a deed of trust trustee named therein, for the benefit of the Trustee, a first lien on the Hospital's interest in certain real property, and 2) a Security Agreement granting a security interest in certain personal property of the Hospital. The Department of Housing and Urban Development (HUD), acting by and through FHA, insures the advances of funds secured by the mortgage pursuant to the Section 242 of Title II of the National Housing Act, as amended. The Hospital has entered into an FHA Regulatory Agreement, a building loan agreement with the trustee, and certain other documents delivered to FHA and the Trustee, as beneficiary under the mortgage, relating to the FHA security.

The bonds are subject to mandatory sinking fund requirements prior to their due dates. There are certain covenants associated with the Series 2007 bonds that are outlined in the master trust indenture, loan agreement, and regulatory agreement. The most restrictive of these covenants requires maintenance of a long-term debt service coverage ratio, as defined, of greater than 1.2. Management acknowledges the Hospital was in violation of certain covenants and requirements of those agreements at June 30, 2010. In accordance with the agreements, the Hospital is in the process of complying with such covenants and requirements by taking corrective action. The Hospital engaged a consultant with Critical Access Hospital expertise to assist in preparation of the Medicare and Medicaid cost report. In addition, the Hospital is consulting with expert personnel within the UNC Health Care System to improve operations. Management believes these actions will produce results to bring the Hospital in compliance with the covenants. Accordingly, the debt is classified as long-term in the balance sheet at June 30, 2010.

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CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 7 LONG-TERM DEBT (CONTINUED)

At the time of the February 2007 bond issue, the University of North Carolina Hospitals ("UNCH") loaned the Hospital approximately \$1,999,000 to use as a collateral cash escrow for HUD. The note requires monthly payments of approximately \$37,000, including simple interest at prime plus 1% (4.25% at June 30 2010) for 60 months once HUD terminated the escrow and released the collateral cash escrow to the Hospital. The escrow was terminated by HUD in March 2010 however UNCH amended the agreement with the Hospital to defer the commencement of required repayments until fiscal year 2012. Accordingly, it has been classified as a long-term obligation as of June 30, 2010.

Long-term debt consists of the following as of June 30, 2010 and 2009:

	2010	2009
North Carolina Medical Care Commission FHA-Insured Mortgage Revenue Bonds, Series 2007; Serial and Term Bonds with Principal Maturing in Varying Annual Amounts through Fiscal Year 2033, and Interest Paid Semi-Annually at Rates Ranging from 4.00% to 5.25%.	\$ 29,550,000	\$ 30,505,000
Promissory Note to University of North Carolina Hospitals	1,999,000	1,990,000
Notes Payable in Monthly Installments of \$1,603 Including Interest at the Bank's Prime Rate	-	13,421
	31,549,000	32,508,421
Plus Unamortized Premium	1,355,236	1,528,797
Less Current Portion	(770,000)	(633,421)
	<u>\$ 32,134,236</u>	<u>\$ 33,403,797</u>

A schedule of changes in the Hospital's long-term debt for the years ended June 30, 2010 and 2009 follows:

	Balance September 30, 2009	Additions	Retirements, Net	Balance June 30, 2010	Amounts Due Within One Year
Notes Payable	\$ 2,003,421	\$ -	\$ (4,421)	\$ 1,999,000	\$ -
Bonds Payable	30,505,000	-	(955,000)	29,550,000	770,000
Total	<u>\$ 32,508,421</u>	<u>\$ -</u>	<u>\$ (959,421)</u>	<u>\$ 31,549,000</u>	<u>\$ 770,000</u>

	Balance September 30, 2008	Additions	Retirements	Balance September 30, 2009	Amounts Due Within One Year
Notes Payable	\$ 2,018,884	\$ -	\$ (15,463)	\$ 2,003,421	\$ 13,421
Bonds Payable	30,540,000	-	(35,000)	30,505,000	620,000
Total	<u>\$ 32,558,884</u>	<u>\$ -</u>	<u>\$ (50,463)</u>	<u>\$ 32,508,421</u>	<u>\$ 633,421</u>

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CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 7 LONG-TERM DEBT (CONTINUED)

Maturities of long-term debt as of June 30, 2010 are as follows:

Period Ending June 30,	Bonds	Note Payable	Interest
2011	\$ 770,000	\$ -	\$ 1,448,643
2012	685,000	335,467	1,484,441
2013	720,000	381,155	1,444,100
2014	765,000	397,873	1,392,982
2015	785,000	414,907	1,340,779
2018-2020	4,520,000	469,798	8,006,739
2021-2025	5,690,000	-	4,839,521
2028-2030	7,370,000	-	3,181,127
2031-2034	8,255,000	-	980,224
	<u>\$ 29,550,000</u>	<u>\$ 1,909,000</u>	<u>\$ 22,116,558</u>

The schedule above assumes repayment of the promissory note to the University of North Carolina Hospitals beginning in 2012 under the repayment terms noted above.

On August 17, 2010, the Department of Housing and Urban Development granted final endorsement of the Hospital's Loan Agreement and Series 2007 Note for mortgage insurance under the National Housing Act, as amended, by the Federal Housing Administration, an organizational unit of the United States Department of Housing and Urban Development. Upon final endorsement, the mortgage interest rate was reduced to a permanent rate of 4.8%, a final mortgage amortization schedule created, and remaining construction funds of approximately \$639,000 were released to the Hospital for purchase of outstanding equipment.

NOTE 8 LEASE OBLIGATIONS

The Hospital leases equipment under operating leases with various lease terms. Rent expense for the years ended June 30, 2010 and 2009 was approximately \$106,000 and \$91,000, respectively.

The following is a summary of future minimum lease payments for operating leases that have initial or remaining noncancelable terms in excess of one year subsequent to June 30, 2010:

Fiscal Years Ending:	Amount
2011	\$ 106,304
2012	106,304
2013	106,304
Total Minimum Lease Payments	<u>\$ 318,912</u>

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CHATHAM HOSPITAL, INC.
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2010 AND 2009

NOTE 9 RESTRICTED NET ASSETS

Restricted net assets consisted of the following at June 30, 2010 and 2009:

	2010	2009
"The New Chatham Hospital, Inc." to Support Construction and Equipment for the New Hospital Indigent Care	\$ 608,276	\$ 220,190
	-	206,790
	<u>\$ 608,276</u>	<u>\$ 426,980</u>

NOTE 10 RETIREMENT PLAN

The Hospital maintains a defined contribution pension plan covering substantially all employees who have completed 1,000 hours of service during the plan year and are employed by the Hospital on the last day of the plan year (September 30). Employer contributions to the plan are solely at the discretion of the Board of Trustees. Contributions of approximately \$32,000 have been paid and approximately \$55,000 has been accrued as of June 30, 2010. Contributions for the nine-month period ended June 30, 2009 were approximately \$74,000.

NOTE 11 PROFESSIONAL LIABILITY INSURANCE

The Hospital is insured under claims-made policies for the purpose of providing professional and patient care liability insurance. These policies cover only malpractice claims reported to the insurance carrier during the policy term. Coverage includes a \$3,000,000 policy on professional liability limited to \$1,000,000 per case and an excess coverage policy for specified aggregate amounts in excess of the basic coverage. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. Although the amount of damages is uncertain, the amount could be substantial. In addition, incidents occurring through June 30, 2010, may result in the assertion of a claim. In the opinion of the Hospital's management, any liability that might be determined upon ultimate resolution of these claims will be covered by insurance or an estimate of the losses has been accrued and will not have a material effect on the Hospital's financial position.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during their terms, but reported subsequently, would be uninsured. Management anticipates that such coverage will be renewed or replaced with equivalent insurance as they expire.

CHATHAM HOSPITAL, INC.
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2010 AND 2009

NOTE 12 COMMITMENTS AND CONTINGENCIES

Laboratory Services

The Hospital has a contract with a laboratory company to provide on-site and off-site clinical laboratory services. Fees charged to the Hospital are based on a fixed fee plus reimbursement of variable expenses. For the year ended June 30, 2010 and the nine-month period ended June 30, 2009, approximately \$446,000 and \$473,000, respectively, was paid under this contract. Of these amounts, approximately \$136,000 and \$62,000 was accrued in accounts payable on the balance sheet at June 30, 2010 and 2009, respectively.

Architectural Fees

On January 30, 2009 the Hospital signed a contract with an architectural firm to provide professional services related to the planned construction of a new medical office building with a contract cost of approximately \$592,000. As of June 30, 2010, approximately \$397,000 has been expended under this contract.

NOTE 13 CONCENTRATIONS OF CREDIT RISK

The Hospital maintains deposits at various financial institutions covered by federal depository insurance ("FDIC"). At various times throughout the year, the Hospital may maintain amounts in excess of the FDIC insured limits.

NOTE 14 CHARITY CARE

The amount of charges forgone for services and supplies furnished under the Hospital's charity-care policy aggregated approximately \$224,000 and \$451,000 for the year ended June 30, 2010 and the nine-month period ended June 30, 2009, respectively.

NOTE 15 RELATED PARTY TRANSACTIONS

Effective July 15, 2008, the Hospital restated its Articles of Incorporation providing that UNCHCS shall be the sole corporate member of the Hospital. As part of the acquisition agreement, UNCHCS assumed control of the Hospital's liabilities in the amount of \$34,700,000. During the period ended September 30, 2008, UNCHCS paid the Hospital \$2,000,000 as a closing payment to the agreement, and committed to additional future payments of \$9,300,000 to develop or facilitate the development of health care services in Chatham County over the next seven years. Use of the committed payments is to be presented to and approved by the Hospital Board of Trustees.

Effective March 18, 2008, the Hospital entered into an agreement with UNCHCS for the transfer of \$1,000,000 to the Hospital to support the provision of indigent care services in Chatham County. The agreement provided that funds be used to insure continued financial stability of the Hospital and service to patients without regard to ability to pay or payor source.

**CHATHAM HOSPITAL, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009**

NOTE 15 RELATED PARTY TRANSACTIONS (CONTINUED)

Physician Services

Effective January 1, 2008 the Hospital entered into a two-year contract with the University of North Carolina at Chapel Hill, School of Medicine ("UNC-CH"), and UNCHCS to provide for the recruitment and employment of a full-time physician at the Hospital. For the year ended June 30, 2010 and the nine-month period ended June 30, 2009, the Hospital incurred expenses of approximately \$200,000 and \$469,000 under this contract, respectively.

Hospitalists

The Hospital has a contract with UNC-CH to provide weekend hospitalists. Coverage will be provided for admissions, subsequent hospital care and discharges. The one-year contract was effective through June 30, 2010 with fees for these services to be paid monthly of approximately \$17,500. For the year ended June 30, 2010 and the nine-month period ended June 30, 2009, the Hospital incurred expenses of approximately \$192,000 and \$175,000, respectively, under this contract of which approximately \$0 and \$7,000 is included in accounts payable on the balance sheet of the Hospital at June 30, 2010 and 2009, respectively.

Emergency Room

The Hospital has a contract with UNC-CH to provide emergency room physicians. For the years ended June 30, 2010 and the nine-month period ended June 30, 2009, approximately \$1,096,000 and \$614,000, respectively, was paid to the UNC-CH under this contract.

Hospital Management Services

Effective August 1, 2006, the Hospital entered into a five-year contract with UNCH to provide a CEO and a CFO to manage the day-to-day operations of the Hospital. In addition to the salaries of the CEO and CFO, the Hospital paid UNCH a management fee of \$150,000 for the first-year term of the contract. This fee will increase each subsequent year by a percentage equal to the increase in the consumer price index as published by the Bureau of Labor Statistics. The management fee for the year ended June 30, 2010 and the nine-month period ended June 30, 2009 amounted to approximately \$158,000 and \$118,000, respectively. Total costs incurred during the year ended June 30, 2010 and the nine-month period ended June 30, 2009 amounted to approximately \$676,000 and \$339,000, respectively. Of these amounts, approximately \$627,000 and \$88,000 is included in accounts payable on the balance sheet at June 30, 2010 and 2009, respectively.

UNCH provides services related to the Hospital's sleep studies. For the years ended June 30, 2010 and 2009, the Hospital incurred expenses of approximately \$60,000 and \$47,000, respectively, of which approximately \$60,000 and \$7,000, is included in accounts payable on the balance sheet of the Hospital at June 30, 2010 and 2009, respectively.