

Tomball Hospital Authority

Accountants' Review Report and Balance Sheet

October 1, 2011

Tomball Hospital Authority
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Contents

Independent Accountants' Review Report 1

Financial Statement

Balance Sheet 2
Notes to Financial Statement..... 3

Independent Accountants' Review Report

Board of Directors
Tomball Hospital Authority
Tomball, Texas

We have reviewed the accompanying balance sheet of Tomball Hospital Authority as of October 1, 2011. A review includes primarily applying analytical procedures to management's financial data and making inquiries of Authority management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statement as a whole. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the financial statement in accordance with accounting principles generally accepted in the United States of America and for designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial statement.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statement. We believe that the results of our procedures provide a reasonable basis for our report.

Based on our review, we are not aware of any material modifications that should be made to the accompanying balance sheet in order for it to be in conformity with accounting principles generally accepted in the United States of America.

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

BKD, LLP

July 3, 2012

Tomball Hospital Authority

Balance Sheet

October 1, 2011

Assets

Current Assets

Cash and cash equivalents	\$ 83,033,547
Short-term investments	3,362,863
Assets held by trustee under self-insurance trust	211,282
Estimated amounts due from third-party payers	4,328,358
Prepaid expenses	768,130
Other receivables	1,688,384

Total current assets 93,392,564

Noncurrent Investments

6,249,240

Capital Assets, Net

562,810

Total assets \$ 100,204,614

Liabilities and Net Assets

Current Liabilities

Accrued expenses	\$ 4,820,590
Estimated self-insurance costs	763,374

Total current liabilities 5,583,964

Estimated Self-Insurance Costs

428,079

Total liabilities 6,012,043

Net Assets

Invested in capital assets	562,810
Unrestricted	93,629,761

Total net assets 94,192,571

Total liabilities and net assets \$ 100,204,614

Tomball Hospital Authority

Notes to Balance Sheet

October 1, 2011

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Prior to October 1, 2011, Tomball Hospital Authority (the Authority) owned and operated Tomball Regional Hospital, an acute-care hospital located in Tomball, Texas. The Authority primarily earned revenues by providing inpatient, outpatient and emergency care services to patients in Tomball, Texas, and surrounding areas. The Authority was organized under the Texas Hospital Authority Act in 1973 as a body politic and corporate and political subdivision of the state of Texas. Five of the Authority's 11 Board of Directors (the Board) are appointed by Tomball's City Council. The remaining six members are appointed by the Board.

Effective October 1, 2011, the Authority sold the hospital operations and substantially all its assets to Tomball Texas Holdings, LLC (TTH), a subsidiary of Community Health Systems, Inc. (CHS). A portion of the proceeds were used to pay in full the outstanding long-term debt of the Authority. The Authority aims to use its remaining resources to improve the access to and quality of health care for residents of Tomball, Texas and the surrounding areas.

The financial statement includes the accounts of the Authority and Tomball Hospital Holdings (THH), a wholly owned subsidiary of the Authority, as a blended component unit. The Authority became the sole member of THH on July 1, 2009. Prior to the sale of the hospital, THH was the sole owner of ASC Holdings, LLC which owned a 51% interest in Tomball Ambulatory Surgery Center d/b/a Medical Complex Surgery Center. TTH purchased ASC Holdings, LLC in conjunction with the purchase of the hospital.

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 statement. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Authority considers all liquid investments with original maturities of three months or less to be cash equivalents. At October 1, 2011, cash equivalents consisted primarily of money market accounts with brokers.

Tomball Hospital Authority

Notes to Balance Sheet

October 1, 2011

Risk Management

The Authority is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; errors and omissions; and injuries and illnesses of former employees. Commercial insurance coverage is purchased for claims arising from such matters other than medical malpractice, general liability, employee health and workers' compensation claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The Authority is self-insured for its exposure to risk of loss from medical malpractice, general liability, employee health and workers' compensation claims. CHS did not assume the obligations arising from such incidents prior to the date the hospital was sold to CHS. Estimated provisions are accrued for these claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Investments

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one-year or less at time of acquisition and in nonnegotiable certificates of deposit are carried at amortized cost. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Net Assets

Net assets of the Authority are classified in two components. Net assets invested in capital assets, consist of capital assets net of accumulated depreciation. At October 1, 2011, the Authority's only capital asset was land. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets.

Income Taxes

As a political subdivision under the laws of the state of Texas, the Authority is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. However, the Authority may be subject to federal income tax on any unrelated business taxable income. THH has been recognized as exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law.

Note 2: Deposits and Investments

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Authority's deposit policy for custodial credit risk requires compliance with the provisions of state law.

Tomball Hospital Authority

Notes to Balance Sheet

October 1, 2011

State law generally requires collateralization of all deposits with federal depository insurance, bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the state of Texas; bonds of any city, county, school district or special road district of the state of Texas having an aggregate value at least equal to the amount of the deposits.

At October 1, 2011, none of the Authority's deposits were uncollateralized. A portion of the Authority's uninsured deposits were collateralized by collateral held by the pledging financial institution's agent in the Authority's name or through a letter of credit with a financial institution backed by the U.S. Government for which the Authority is the beneficiary and the pledging financial institution is the obligor.

Investments

The Authority may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities and in bank repurchase agreements. It may also invest, to a limited extent, in corporate bonds and equity securities.

At October 1, 2011, the Authority had the following investments and maturities:

Type	Fair Value	Maturities in Years			
		Less Than 1	1-5	6-10	More Than 10
Money market mutual funds	\$ 5,477,297	5,477,297	\$ -	\$ -	\$ -
U.S. Treasury or agency obligations	<u>6,249,240</u>	<u>-</u>	<u>-</u>	<u>3,242,892</u>	<u>3,006,348</u>
	<u>\$ 11,726,537</u>	<u>\$ 5,477,297</u>	<u>\$ -</u>	<u>\$ 3,242,892</u>	<u>\$ 3,006,348</u>

- Interest Rate Risk** – As a means of limiting its exposure to fair value losses arising from rising interest rates, the Authority's investment policy limits the maximum weighted-average maturity of its investment portfolio to two years. The money market mutual funds are presented as an investment with a maturity of less than one-year because they are redeemable in full immediately.
- Credit Risk** – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the Authority's policy to limit its investments in commercial bonds and equity securities to the top three ratings issued by nationally recognized statistical rating organizations (NRSROs). At October 1, 2011, the Authority's investments in U.S. agencies obligations not directly guaranteed by the U.S. Government were rated "AA+" by Standard & Poor's. The Authority's investments in money market mutual funds were rated "AAAm" by Standard & Poor's.

Tomball Hospital Authority

Notes to Balance Sheet

October 1, 2011

- **Custodial Credit Risk** – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The Authority’s investment policy requires all securities underlying repurchase agreements be pledged to the Authority, held in the Authority’s name and deposited at the time the investment is made with the Authority or with a third-party selected and approved by the Authority. The Authority held no securities under repurchase agreements as of October 1, 2011.
- **Concentration of Credit Risk** – The Authority places no limit on the amount that may be invested in any one issuer.
- **Foreign Currency Risk** – This risk relates to adverse effects on the fair value of an investment from changes in exchange rates. Foreign currency investments are not permitted under the Authority’s investment policy.

Summary of Carrying Values

The carrying value of deposits and investments shown on the previous page are included in the balance sheet as follows:

Carrying value	
Deposits	\$ 81,130,395
Investments	<u>11,726,537</u>
	<u>\$ 92,856,932</u>

Included in the following balance sheet captions:

Cash and cash equivalents	\$ 83,033,547
Short-term investments	3,362,863
Assets held by trustee under self-insurance trust	211,282
Noncurrent investments	<u>6,249,240</u>
	<u>\$ 92,856,932</u>

Tomball Hospital Authority
Notes to Balance Sheet
October 1, 2011

Note 3: Accrued Expenses

Accrued liabilities included in current liabilities at October 1, 2011 consisted of:

Payable to suppliers and contractors	\$ 1,157,006
Payable to employees (including payroll taxes and benefits)	<u>3,663,584</u>
	<u>\$ 4,820,590</u>

Note 4: Risk Management

As discussed in *Note 1*, the Authority's obligations for general and malpractice claims and claims arising under the Authority's self-insurance program for employee health and workers' compensation claims for incidents occurring prior to October 1, 2011, were not assumed by CHS.

As a unit of government covered by the Texas Tort Claims Act (the Act), the Authority's liability for general and malpractice claims is limited to \$100,000 per person and \$300,000 per occurrence, with no annual limit. The Authority is self-insured for amounts not limited by the Act. Losses from asserted and unasserted claims identified under the Authority's incident reporting system are accrued based on estimates that incorporate the Authority's past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. Accrued malpractice and general liability losses have been estimated by professional insurance consultants and are discounted at 1.9%. It is reasonably possible that the Authority's estimate of losses will change by a material amount in the near term.

Substantially all of the Authority's employees and their dependents were eligible to participate in the Authority's employee health insurance plan. The Authority was self-insured for health claims of participating employees and dependents with a lifetime annual aggregate limit per employee of \$1,000,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount.

The Authority was also self-insured for workers' compensation claims costs. A provision is accrued for self-insured employee health and workers' compensation claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Authority's estimate will change by a material amount in the near term.

Tomball Hospital Authority
Notes to Balance Sheet
October 1, 2011

At October 1, 2011, the Authority's accrued liabilities for these self-insured programs were as follows:

General and malpractice claims	\$	500,992
Employee health claims		617,630
Workers compensation claims		72,831
		72,831
	\$	1,191,453

Note 5: Commitments and Contingencies

Executive Severance Plan

Prior to the sale of the hospital, the Authority had an Executive Severance Benefit Plan for the officers of the Hospital, whereby the officers were credited 12% – 15% of their annual compensation for each year served, payable upon retirement or termination. The benefits were subject to a three-year, noncompete agreement and are payable in quarterly installments over a 36-month period. This obligation was not assumed by CHS. The liability for this plan is unfunded and totaled \$2,027,262 at October 1, 2011. The obligation was paid subsequent to October 1, 2011, and is classified as a component of accrued expenses in the accompanying balance sheet.

Purchase Indemnification

Under the asset purchase agreement (the agreement) between the Authority and TTH, the Authority is liable for any misrepresentation or breach of warranty made in the agreement if total losses to TTH exceed \$1,000,000. The Authority is liable for any single claim in excess of \$15,000 up to an overall limit equal to 15% of the purchase price. At October 1, 2011, no liability has been recorded.

Litigation

In the normal course of business, the Authority is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Authority's self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Authority evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.