SINGING RIVER HEALTH SYSTEM

(A Component Unit of Jackson County, Mississippi)

Basic Financial Statements and Schedule

September 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

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Management's Discussion and Analysis

September 30, 2012 and 2011

This discussion and analysis of Singing River Health System's (the Health System) financial performance provides an overall review of the financial activities for the fiscal years ended September 30, 2012 and 2011. The combined intent of this discussion and analysis is to provide further information regarding the Health System's financial performance as a whole; readers should also review the audited financial statements and the notes to the basic financial statements to further enhance their understanding of the Health System's financial performance. The annual report referenced in this management's discussion and analysis also includes the accounts of Singing River Ambulatory Services, Inc. (Ambulatory Services). However, most of this management's discussion and analysis focuses on the operations of Singing River Hospital and Ocean Springs Hospital, which account for approximately 97% of Health System total operating revenue.

Industry Highlights

The hospital industry has undergone a number of significant challenges over the past several years, and it is critical that a reader of these financial statements have a working knowledge of the environment in which the Health System operates, both nationally and locally. The Health System operates under a strategic plan, which is updated on an ongoing basis and is designed to address both national and local issues in accomplishing its mission and vision in support of the community.

Nationally, many critical issues are having a significant impact on the operations of hospitals, including the Health System. They include the following:

- Reimbursements from Medicare, Medicaid, and commercial insurers do not increase at the same rate as that of labor, supply, and pharmaceuticals costs. Drug costs have continued to increase at near double-digit rates for the last several years, and a national shortage of certain healthcare workers coupled with increased demand is increasing wage rates.
- Significant competition for the few remaining profitable areas in healthcare continues to grow. For-profit providers are competing with hospitals for outpatient surgery, laboratory, magnetic resonance imaging (MRI), rehabilitation, and other areas, which historically were provided by hospitals. These competitors typically do not provide the same levels of uncompensated care required of a community hospital, nor do they typically provide unprofitable services such as emergency care/trauma or psychiatric care.
- Due to a proliferation of malpractice suits across this country, malpractice insurance rates continue to be an issue for hospitals and physicians. These costs have increased significantly and accordingly represent significant cost increases to most healthcare providers.
- There is significant regulation of healthcare providers, and the regulatory requirements to which they are subject continue to grow and become more expensive with which to comply.
- There are shortages of certain physician specialists both locally and nationally, and this shortage is expected to grow over the next several years. The issues outlined above, along with many others, result in more difficulties in attracting physicians to the field and also make local recruiting a significant challenge. Most experts also anticipate that as the baby boomer generation continues to age, the demands on the nation's healthcare providers will increase.

- The number of indigent and uninsured patients remains a significant problem for our country, and the burden of providing this care often falls on hospitals and other providers. These patients are important and should be provided all necessary and appropriate healthcare services; however, the lack of a national plan of care for these patients adds both inefficiency and cost to the healthcare delivery system.
- The cost of technology remains very high. With almost every life-saving advance in medicine comes significant additional cost in the form of equipment and/or pharmaceuticals. With the recent national attention placed on patient safety, there is considerable pressure on hospitals to make significant investments in clinical decision support systems, electronic medical records, and other related applications.
- Maintaining a comprehensive Trauma System continues to be a challenge, particularly in Mississippi, due principally to physician shortages in certain specialty areas such as neurosurgery, insufficient reimbursement for the high costs associated with maintaining a 7-day per week, 24-hour per day emergency department, and significant regulatory requirements.
- Access to capital remains a challenge for many hospitals in the country, particularly public hospitals. Meeting community expectations for high-quality services while maintaining a reasonable charge structure makes it difficult for community safety-net hospitals to generate operating results that meet the high expectations of capital markets.

On March 23, 2010, The Patient Protection and Affordable Care Act (PPACA) was signed into law. Referred to as Health Care Reform, the law expands health insurance coverage for approximately 30 million U.S. citizens and legal residents. It creates exchanges where individuals and small businesses can shop for insurance, prohibits insurers from rescinding coverage or denying care and coverage for pre-existing conditions, and imposes limits on the dollar value of benefits. The Act expands Medicaid eligibility, providing Federal funds to states to help cover the cost of the newly insured and short-term funds for primary care providers to match Medicare payment levels. It also extends the ability of children to stay on their parents' insurance until age 26.

To pay for the program, the law includes taxes and fees on drug makers, the insurance industry, medical device sales, high-cost health plans, and wages and unearned income of high-income earners/individuals. Penalties will be assessed on individuals who fail to purchase insurance coverage and employers who fail to provide coverage.

To control costs, the law reduces Medicare Advantage payments, Medicare hospital payment updates, and Medicaid and Medicare disproportionate share hospital (DSH) payments. It establishes a value-based purchasing program, and requires hospitals to meet defined standards or pay penalties for excess readmissions and hospital-acquired conditions.

The expected addition of newly-insured Americans as the reform plan rolls out over the next decade will provide obvious benefits for hospitals – an increased number of paying patients and a reduced amount of uncompensated care. However, it is important to note that a significant portion of these newly insured patients will be Medicaid recipients with relatively low levels of reimbursement.

The ultimate effect of PPACA on health care systems is unclear.

There are numerous other factors that must be considered in evaluating the financial operations and strategic plan of any healthcare provider; however, it is important to evaluate the performance of any such provider in context of the industry.

Local Issues

The Health System continues to operate a Behavioral Health Program (the Program) as a service to the community. This unit consists of an adult acute psychiatric unit, a geriatric psychiatric unit, several structured outpatient programs (SOP), a crisis intervention program, and physician office practices. The Program has expanded significantly during fiscal year 2012 with the addition of three (3) psychiatrists and the opening of additional SOP's. The Program accounts for losses on a fully costed basis and a portion of those losses are due to a significant number of Chancery Court ordered commitments, most of which are uncompensated. During fiscal year 2012, the Program accounted for less than $1.9 million in losses with full overhead costing. This compares to fully costed losses of $2.3 million in fiscal year 2011 and $2.5 million in fiscal year 2010. Several factors contributed to the improvement in operations during fiscal year 2012 including higher volume with the addition of three psychiatrists, improvement in overall payor mix, reduction in overtime worked, and collaboratively working with the Chancery Court to make improvements in patient placement. The Health System contracted with a management firm to assist with developing programs to improve operations during fiscal year 2010 but decided to bring the management in house during fiscal year 2011.

During 2009, the Mississippi Legislature enacted new technical amendments to the Medicaid program regarding hospitals' roles in financing the Medicaid program. The bill extended the Division of Medicaid until 2012 and included hospital assessments as well as safeguards. The assessments are capped for fiscal year 2010 through 2012 and represent a significant burden on the State hospitals. During fiscal year 2012, the Health System paid an assessment of $8.9 million. The safeguards provide some level of certainty that no additional cuts will be made to Medicaid payments as long as the assessments are in effect and guarantees the Health System's participation in the DSH program.

On September 1, 2012, the Mississippi Division of Medicaid (DOM) implemented a new reimbursement methodology for both inpatient as well as outpatient services. On December 20, 2012, the DOM rescinded the APC reimbursement methodology for payment of outpatient services and reverted back to cost to charge ratio's reimbursement amounts for the period September 1 – December 31, 2012.

In addition to the Medicaid issues above, there exists much uncertainty concerning future funding of Medicaid. In the summer of 2012, the Supreme Court affirmed nearly all aspects of the PPACA, the federal health care reform legislation that was passed into law March 23, 2010. One exception was a provision that required states to expand eligibility for a state's Medicaid program or face significant penalties. Under the Supreme Court ruling, states will not face penalties for not participating in Medicaid Expansion and can choose whether or not to participate in the program which will be financed principally by the federal government. In Mississippi, Medicaid expansion would provide coverage to approximately 310,000 Mississippians who do not currently qualify. At this time, Mississippi has not made a decision concerning Medicaid expansion.

Financial Highlights

During fiscal year 2012, the Health System reported a decrease in net assets of $5.0 million, compared to an increase of $8.4 million in fiscal year 2011. In fiscal year 2010, net assets increased by $.6 million. Total assets increased $3.5 million over fiscal year 2011 amounts and $65.0 million over fiscal year 2010. Total cash, cash equivalents, and funds designated by the Board for capital improvements decreased $14.1 million from fiscal year 2011 to fiscal year 2012 while net patient accounts receivable increased approximately $22.4 million. The decrease in cash, cash equivalents, and funds designated for capital improvements is caused by reductions in reimbursements due to a change in payor mix towards Government payors and backlogs in accounts receivable from the implementation of a new billing system. Gross days revenue in accounts receivable (excluding in–house collection accounts) was 71 days at September 30, 2012, compared to 58 days at September 30, 2011 and 2010. The increase in net accounts receivable and days in accounts receivable is largely attributed to the implementation of a new billing system.

Total liabilities increased by $8.3 million, current liabilities increased approximately $4.7 million, and long-term liabilities increased approximately $3.6 million from fiscal year 2011. The increase in current liabilities is due to the accrual of an additional $2.0 million in patient refunds and an additional $2.3 million in employee health claims. Long term liabilities increased as a result of the change in the net pension liability. In fiscal year 2012, the net pension liability was $24.3 million, compared to $15.4 million in fiscal year 2011, as a result of a change in actuarial assumptions.

Overview of the Financial Statements

This annual report consists of the financial statements and notes to the financial statements of the Health System. The Health System, a political subdivision of the State of Mississippi, is owned by Jackson County (the County) and organized as a county hospital under provisions of the statutes of the State of Mississippi. The Health System is exempt from federal and state income taxes.

While the County is empowered to appropriate money from its general fund, and levy property taxes to support the operations of the Health System, the Health System is self-supporting and receives no County appropriations for its operations, nor has it received any such financial support from the County in twenty-five (25) years. The legally available mills have been pledged as partial collateral against the 2009 and 2012 Revenue Bonds, but have never been assessed to support these or any other bonds.

The Board of Trustees, appointed by the County Board of Supervisors, is charged with the maintenance, operation, and management of the Health System, its finances, and staff. The Health System's primary mission is to provide healthcare services to the citizens of its service area, which includes Jackson County and the surrounding areas, through its acute, primary, and specialty care facilities.

The financial statements include the accounts and transactions of Singing River Hospital, Ocean Springs Hospital, and Ambulatory Services, which is comprised of a number of blended component units, including Mississippi Coast Endoscopy and Ambulatory Surgical Center, LLC, Ocean Springs Surgical and Endoscopy Center, LLC, and other outpatient healthcare service entities. The blended component units of Ambulatory Services are generally majority owned joint ventures with local physicians. These were developed as part of the

Health System's strategic goals of providing important medical services to the community in a delivery mode that is convenient and efficient for the patients.

The balance sheets, the statements of revenues, expenses, and changes in net assets, and the statements of cash flows present the Health System's financial position, results of its operations, and its cash flows. The balance sheets include all of the Health System's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be utilized for general purposes and which are restricted as a result of bond covenants or other purposes. The statements of revenues, expenses, and changes in net assets report all of the revenues and expenses during the time periods indicated. The statements of cash flows report the cash provided by operating activities, as well as other cash sources and uses such as investment income, debt repayment, and capital expenditures.

The Health System's total net assets decreased from $218 million in fiscal year 2011, to $213 million in fiscal year 2012. From fiscal year 2010 to fiscal year 2011, there was an $8.4 million increase.

The following table provides a summary of the Health System's total assets, total liabilities, and total net assets for fiscal year 2010, through fiscal year 2012.

Assets, Liabilities, and Net Assets (In millions)

		2012	2011	2010
Assets:				
Current assets	$	151.0	126.1	102.9
Designated funds and funds held by trustees		72.4	114.6	91.0
Other assets		2.2	2.5	1.4
Capital assets		200.5	179.4	162.3
Total assets	$	426.1	422.6	357.6
Liabilities:				
Current liabilities	$	57.2	52.5	46.6
Long-term debt		101.8	105.5	71.7
Capital lease obligations		1.6	1.8	2.1
Other long-term liabilities		51.7	44.2	27.2
Total liabilities	$	212.3	204.0	147.6
Minority interests	$	0.8	0.6	0.4
Net assets:				
Invested in capital assets, net of related debt	$	109.2	107.3	105.9
Restricted		12.3	14.9	10.4
Unrestricted		91.5	95.8	93.3
Total net assets		213.0	218.0	209.6
Total liabilities and net assets	$	426.1	422.6	357.6

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In fiscal year 2012, the Health System's cash, cash equivalents, and funds designated by Board for capital improvements decreased by $14.1 million from fiscal year 2011. Since fiscal year 2010, cash, cash equivalents, and funds designated by Board decreased $19.8 million. Significant increases in the Health System costs and reduced payments from Government sponsored programs, and capital expenditures have resulted in a decrease in cash, cash equivalents, and funds designated by Board for capital improvements over the three year period.

The following is a summary of the Health System's cash and cash equivalents, funds designated by Board for capital improvements and funds held by trustees for fiscal year 2010 through fiscal year 2012:

	2012	2011	2010
	(In millions)	(In millions)	(In millions)
Cash and cash equivalents	$ 3.3	3.1	2.0
Funds designated by Board	39.7	54.0	60.8
Held by trustees for debt service and self-insurance funding	34.9	65.1	33.4
Total	$ 77.9	122.2	96.2

At September 30, 2012, the Health System held cash and cash equivalents and funds designated by Board for capital improvements sufficient to cover approximately 43 days of nondepreciation expenses, including interest expense compared to 58 days at September 30, 2011, and 66 days at September 30, 2010.

Cash, cash equivalents and funds designated by Board for capital improvements were $43.0 million at the end of fiscal year 2012, $57.1 million at the end of fiscal year 2011, and $62.8 million at the end of fiscal year 2010.

Acquiring additional cash reserves continues to be an important consideration for the Health System due to the importance placed on cash on hand by credit agencies. Options for accessing capital in the marketplace will continue to be somewhat restricted until additional cash reserves are acquired. This will be a particular challenge for the Health System, due to its long-standing efforts to maintain a charge structure that is low relative to the other hospital providers on the Mississippi Gulf Coast. This strategy has been in place for many years in recognition of its role as a community hospital that did not historically place a high strategic priority in the building of cash reserves. The need to maintain state of the art facilities in a high-tech (and high-cost) industry, and pressures to increase wages to remain competitive in the face of national shortages in many healthcare professions, including nursing, have made it particularly challenging to significantly improve the Health System's cash position.

Capital Assets

During fiscal year 2012, net capital assets increased from $179 million to $200 million. During fiscal year 2012, capital expenditures were significantly higher than fiscal year 2011. Major capital additions during fiscal year 2012 included equipment, major facility renovations, and implementation of an Electronic Health Record system.

Patient safety is included as a strategic initiative for the Health System. During fiscal year 2011, in an effort to bring the latest in technology to bear on this initiative, the Health System contracted with Epic Systems Corporation as a clinical development partner and vendor for acquisition and further development of an

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information and decision support system. This includes a comprehensive electronic health record, on-line clinical orders and documentation, physician order entry, and expert decision support, to name just a few of the applications. The installation and maintenance of these products was accomplished on July 1, 2012 with other applications to go live through 2014.

Debt Administration

On April 2, 2009, the Health System completed a $35,000,000 fixed rate bond transaction (the 2009 A Bonds). The 2009 A Bonds were issued for the purpose of financing various improvements to both Ocean Springs Hospital and Singing River Hospital. The 2009 A Bonds were issued by the Mississippi Development Bank and insured by Assured Guaranty Municipal Corporation (Assured Guaranty). In addition to the bond insurance policy, the 2009 A Bonds are supported by a five mill pledge on the assessed value of real property by Jackson County. The 2009 A Bonds carry a fixed rate of interest. Interest payments are made semiannually (January 1 and July 1) and principal is paid annually (July 1). The 2009 A Bonds mature on July 1, 2039.

The bond insurance policy sets certain financial tests including cash availability, debt service coverage and additional indebtedness. These covenants are consistent with other credit providers to the Health System as well as with those of hospital credits of comparable size and financial strength.

On October 27, 2009, the Health System refinanced the $46,300,000 Special Obligation Refunding Bonds, Series 2008 A (Singing River Hospital System) with the Special Obligation Refunding Bonds Series B-1 in the amount of $48,340,000 (Jackson County, Mississippi Limited Tax Note) and the Taxable Special Obligation Refunding Bonds, Series B-2 (Jackson County, Mississippi, Limited Tax Note) in the amount of $2,395,000. In addition to the refunding of the Series 2008 A Bonds, the Series 2009 B-1 and B-2 Bonds provided funds for the International Swaps and Derivatives Association Master Agreement termination payment, funding a portion of the debt service reserve fund for the 2009 Series B Bonds and paying costs of issuance. The Series 2009 B-1 and B-2 Bonds were issued by the Mississippi Development Bank and insured by Assured Guaranty. The Jackson County five mill pledge made in connection with the Series 2008 Bonds was extended to include the Series 2009 B-1 and 2009 B-2 Bonds as were the financial covenants imposed by Assured Guaranty. The Series 2009 B-1 and B-2 Bonds carry a fixed rate of interest and mature on July 1, 2023 (Series 2009 B-1 Bonds) and July 1, 2012 (Series 2009 B-2 Bonds).

On July 26, 2011, the Health System completed a $36,610,000 million fixed rate bond transaction (the 2012 Bonds). The 2012 Bonds were issued for the purpose of financing the acquisition and implementation of an electronic medical record system, and a new chiller plant at Singing River Hospital. The 2012 Bonds were issued by the Mississippi Development Bank and insured by Assured Guaranty. In addition to the bond insurance policy, the Jackson County five mill pledge mentioned above was also extended to the 2012 bonds as well as financial covenants imposed by Assured Guaranty. The 2012 Bonds carry a fixed rate of interest and mature on July 1, 2036.

Revenues and Expenses

The table below shows revenues, expenses, and changes in net assets for fiscal year 2012, compared to fiscal years 2011 and 2010:

Revenues, Expenses, and Changes in Net Assets (In millions)

	2012	2011	2010
Operating revenues:			
Net patient service revenue	$ 363.5	376.7	362.8
Other revenue	16.7	8.4	4.1
Total operating revenues	380.2	385.1	366.9
Operating expenses:			
Professional care of patients	236.5	234.7	226.3
General, administrative, and plant services	82.4	79.2	82.3
Employee benefits	42.1	39.5	38.3
Depreciation and amortization	21.5	19.6	19.2
Total operating expenses	382.5	373.0	366.1
Operating income (loss)	(2.3)	12.1	0.8
Nonoperating revenues (expenses):			
Investment income	1.2	0.5	2.9
Interest expense	(3.0)	(3.1)	(2.2)
Minority interests	(0.9)	(1.1)	(0.8)
Other	—	—	(0.1)
Nonoperating expenses, net	(2.7)	(3.7)	(0.2)
Increase (decrease) in net assets	(5.0)	8.4	0.6
Net assets, beginning of year	218.0	209.6	209.0
Net assets, end of year	$ 213.0	218.0	209.6

Net Patient Service Revenue

Compared to fiscal year 2011, net patient service revenue in fiscal year 2012 decreased by $13.2 million or 3.5%. This decrease is due to a 2% reduction in adjusted discharges.

Effective April 1, 2001, the State of Mississippi Division of Medicaid implemented the UPL program. Through participation in the UPL program, the Health System has received reimbursements of $4.5 million, $13.2 million, and $13.3 million during 2012, 2011, and 2010, respectively. These reimbursements were used to provide services to an increasing number of Medicaid and indigent patients; however, there can be no assurance that the program will not be discontinued or materially modified in the future.

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In addition to UPL payments, the Health System received DSH payments of $21.3 million, $17.4 million, and $9.9 million for fiscal years 2012, 2011, and 2010, respectively. The Division of Medicaid and Myers & Stauffer, LC administer this program. It is designed to provide additional compensation to providers who meet the DSH threshold, which currently requires that a hospital's inpatient Medicaid utilization be 75% of the State mean. This percentage is subject to change. This is an all or none program, which means that a hospital is either fully in the program or completely excluded based on whether the hospital's Medicaid utilization meets the threshold. Based on the safeguards provided for in the 2009 agreement, the Health System's participation in the DSH program is guaranteed through 2012. The amount of the reimbursement is calculated by the Division of Medicaid based on a survey that the hospitals in Mississippi complete, designed to provide the Division of Medicaid with data that they use, along with their own information and formulas, to estimate the DSH allocation to each qualifying hospital. There is no guarantee of Health System eligibility in future years. The additional reimbursement received through the DSH program is designed to assist the hospitals in funding costs associated with providing healthcare to the indigent and underinsured.

During fiscal year 2012, payor class percentages stabilized somewhat; however, private insurance continues to decrease and government sponsored payors like Medicare continue to increase.

Below is a chart comparing payor class percentages for fiscal years 2010 through 2012 based on volume.

	2012	2011	2010
Medicare	32.6%	30.3%	29.8%
Medicaid	16.6	16.7	16.2
Blue Cross	17.5	18.9	19.2
Commercial	16.9	17.4	18.0
Hospital System health plan	3.4	3.6	3.5
Self-pay, bad debts, and charity	13.0	13.1	13.3
Total	100.0%	100.0%	100.0%

Business Activity

Inpatient days of care for the Health System remained steady for fiscal year 2012 although admissions decreased by 4% from fiscal year 2011 to fiscal year 2012. Average length of stay for acute care patients in fiscal year 2012 increased 6% from fiscal year 2011. During fiscal year 2012, outpatient observation bed days varied only slightly from fiscal year 2011 and fiscal year 2010. Observation beds are those inpatient beds utilized by certain patients for approximately two days or less and reimbursed by Medicare, Medicaid, and most insurance companies at a lower, outpatient rate. Observation days were 4,761, 4,778 and 4,731 in fiscal years 2012, 2011, and 2010, respectively.

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A summary of inpatient days follows:

	2012	2011	2010
Medical	24,443	22,836	22,705
Surgical/Orthopedic	19,232	19,296	20,459
Psychiatric	5,546	5,304	5,522
Maternal child health	11,204	12,014	11,714
Intensive and intermediate care	12,184	12,576	12,926
General acute care days	72,609	72,026	73,326
Rehab	6,214	6,283	6,242
Nursery	3,355	3,869	3,906
Total all inpatient days	82,178	82,178	83,474
Total admissions	17,995	18,824	18,426

Acute and rehabilitation admissions in fiscal year 2012 decreased 6% and 3%, respectively, from fiscal year 2011; however, the Health System experienced a 22% increase in psychiatric admissions. This resulted in a net decrease of 4% in total admissions. In fiscal year 2011, admissions increased slightly and patient days increased from fiscal year 2010 and overall length of stay decreased slightly.

For the first year since 2009, we experienced a slight decrease in outpatient volumes. Total outpatient volume decreased at a rate of 2% during fiscal year 2012, after increases of 6% during fiscal years 2011 and 2010. This is a reversal of the trend throughout the United States over the last several years where inpatient-based procedures have trended at a decline or very slow rate of growth and outpatient-based procedures have trended at an increase. Additionally, emergency room visits decreased 3% from fiscal year 2011 to fiscal year 2012.

In addition to the availability of outpatient surgery in the Health System, Mississippi Coast Endoscopy and Ambulatory Surgery Center, LLC and Ocean Springs Surgical and Endoscopy Center, LLC were developed in order to better serve patients in the community by providing an efficient and convenient alternative to hospital based surgery. The combined volumes of the two decreased by 6% from fiscal year 2011; surgical volumes at the Health System also decreased by 2% from fiscal year 2011 to fiscal year 2012.

The Medicare case mix for the hospitals is a measure of Medicare inpatient acuity and has an effect on Medicare inpatient payments. During the past three fiscal years, both facilities increased significantly from fiscal year 2008 levels due to improvements in documentation in the patient medical record. Over the last three fiscal years, case mix levels have leveled off and remain consistent.

A summary of Medicare case mix indices follows:

	2012	2011	2010
Singing River Hospital	1.55	1.56	1.57
Ocean Springs Hospital	1.67	1.58	1.58

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Deductions from Revenue

Contractual and other adjustments (not including charity and bad debts) expressed as a percentage of gross revenues, were 67.9% for fiscal year 2012 compared to 66.2% for fiscal year 2011 and 64.7% for fiscal year 2010. Even though reimbursement from Medicare, Medicaid, and payment rates from third-party insurers is typically much less than billed charges and increases in charges are not matched by increased reimbursement rates, the Health System has been able to stabilize the contractual and other adjustments by aggressively pursuing a re-design of the revenue cycle processes. The impact of Medicaid DSH and UPL payments also had offsetting influence on contractual adjustments.

Charity Care

Charity care was $92.0 million in fiscal year 2012, $74.8 million in fiscal year 2011, and $56.5 million in fiscal year 2010. Several years ago, the Health System implemented a new Board approved charity policy that provides for write-offs on a sliding scale basis. This allowed for charity write-offs of a portion of the patient's bill based on ability to pay. This process has allowed the Health System to be more exacting in its classification of patient accounts for collection purposes. During fiscal year 2012, the Health System's charity policy was reviewed and re-affirmed by Board approval. The increase in fiscal year 2012 is indicative of current economic conditions.

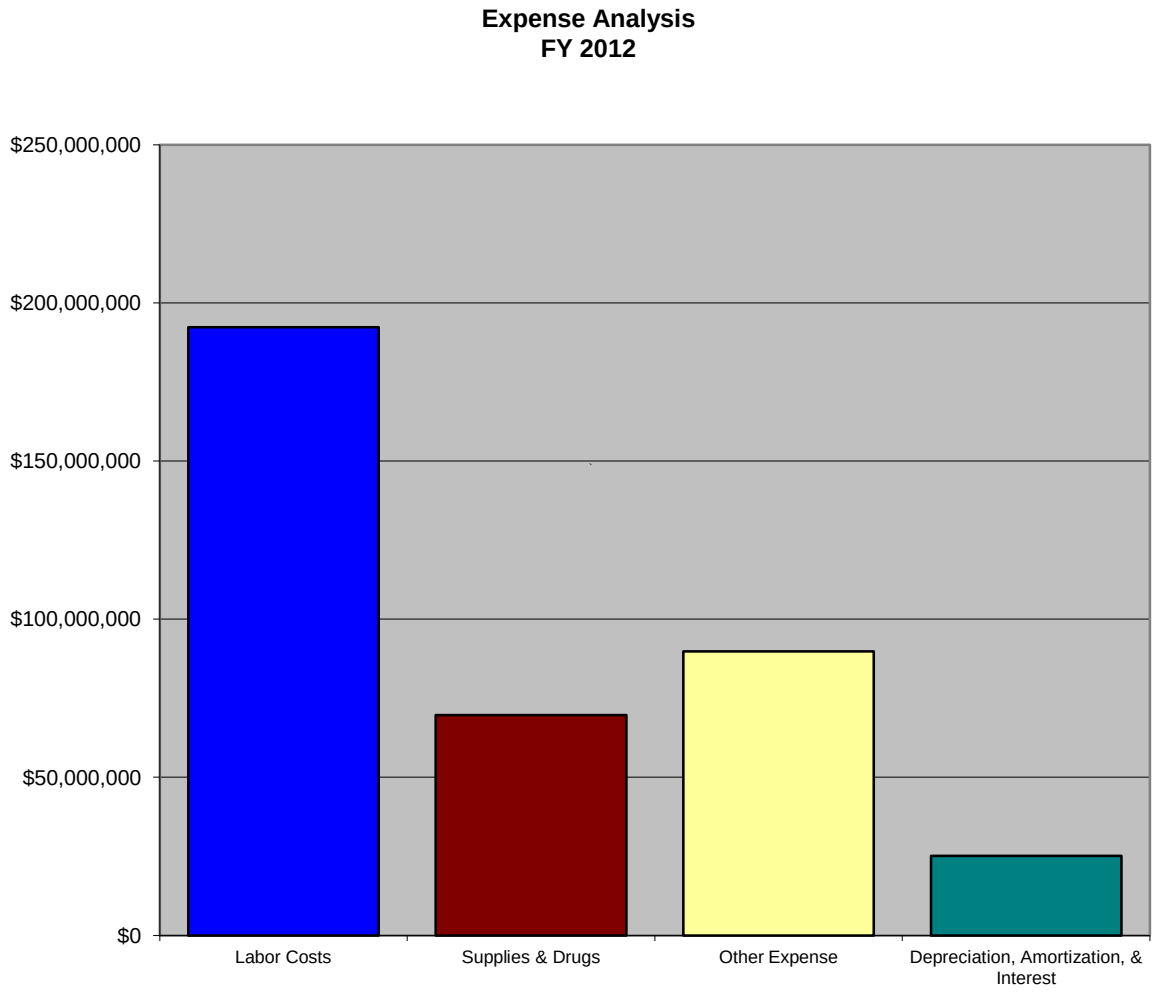
Bad Debts

Bad debt expense increased by $1.5 million in fiscal year 2012 compared to a decrease of $3.8 million in fiscal year 2011. These costs relate to patients with self-pay balances that do not qualify under the charity guidelines discussed previously and to those patients of which collection for services cannot be obtained.

The Health System maintains an in-house collection service called Financial Services, which focuses on self-pay accounts and self-pay balances after insurance. Accounts receivable schedules for these accounts are maintained and updated regularly with the estimated ability to collect on the accounts established annually based on historical trends and management estimates. These accounts, net of related allowance for doubtful accounts, are included in net patient accounts receivable.

Operating Expenses

Total operating expenses, including depreciation and amortization, increased from $373.0 million in fiscal year 2011 to $382.5 million in fiscal year 2012. Total operating expenses per adjusted discharge increased 2.1% from fiscal year 2011. The following is a graph of the Health System's fiscal year 2012, operating expenses:



Salaries, Wages, and Employee Benefits

During fiscal year 2012, total Health System salary and wages increased 2.5% over prior year levels due primarily to market rate increases for healthcare workers, and new programs. Total full time equivalents (FTEs) increased across the Health System by 17 FTEs during fiscal year 2012, (from 2,706 FTEs in fiscal year 2011 to 2,723 in fiscal year 2012).

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The net increase of FTEs during fiscal year 2012 is a combination of many factors. Tight controls were maintained on our vacancy factor; however, it was necessary to add new programs and staffing to prepare for the implementation of a new clinical information system.

Nationally, there remains a shortage of nurses and certain other healthcare professionals such as X-Ray technicians, CRNAs, pharmacists, and medical technologists. In response to these shortages, the Health System has implemented salary adjustments and various other scheduling and staffing initiatives as appropriate to address these shortages. As a result of these efforts, the Health System has been able to maintain a nurse vacancy rate of approximately 2.7%, which is much lower than the national average.

During fiscal year 2012, the total costs of employee benefits for the Health System's employees, including cost related to the Health System's pension plan, were $42.1 million compared to $39.5 million in fiscal year 2011. The increase is due to higher actuarial calculated costs for the Health System's pension plan and retiree medical costs as well as an increase in covered beneficiaries. The Health System's pension cost over the last three fiscal years has been impacted by the change in the market conditions of the plan's assets. The plan's assets have been performing in line with market returns which have resulted in annual pension cost of $8.8 million, $7.2 million, and $4.4 million in fiscal year 2012, 2011, and 2010, respectively. The increase in fiscal year 2012 is due primarily to investment experience, including continued recognition of prior asset losses.

Other Cost Factors

Supplies and pharmaceutical costs increased approximately 1.5% during fiscal year 2012. The Health System participates in national and state group purchasing programs which assure that pricing for these products is among the best available. During fiscal year 2012, drug costs benefitted from our participation in the federal 340B drug discount program and the M & D Cares drug replacement program, both of which serve indigent patients. We also implemented an employee pharmacy program which increased drug costs by $2.5 million but generated $5.1 million in other operating revenue

Labor costs (salaries and benefits) and supplies (including medical supplies, blood products, and pharmaceuticals) combine to account for over 74% of total operating costs annually.

Economic Factors and Fiscal Year 2013 Budget

The Board of Trustees approved the fiscal year 2013 operating budget at a meeting in August 2012. This budget was developed after a review of key volume indicators and consideration of many local and national factors. The budget was developed in light of the Health System's strategic plan as well as local economic factors such as population changes and local employment.

An increase in net assets was budgeted for fiscal year 2013 of $12.6 million. The budget anticipates the continued participation by the Health System both in the Federal UPL and Medicaid DSH Programs, as well as projecting additional volume increases. Healthcare is a dynamic, ever-changing industry and actual operating results in 2013 may vary from the budget based on a number of factors that cannot be fully anticipated, including but not limited to, ongoing changes in a very fluid labor market, Federal and State government initiatives, changes in managed care contracting strategies by local area employers, changes in technology, and physician turnover.

The Health System continues to update its strategic business plan and develop capital budgets designed to meet the future healthcare needs of the community. The most salient challenge in this regard is future access to the capital necessary to meet these needs. Management believes that with careful management of operational cash flow and, where warranted, prudent use of the capital markets, it can adequately put in place the assets needed to continue to excel at meeting the healthcare needs of the community.

The Health System has adopted a rolling three-year capital plan designed to complement and support the strategic plan. The capital plan is based on the identified capital needs of the Health System and supported by a detailed facility study and equipment needs analysis.

The capital plan is supplemented by a Strategic Facilities Master Plan, which was developed in conjunction with healthcare architects/facility planners in order to address future needs with regard to the Health System facilities. Generally, the Facilities Master Plan addresses: (1) age of plant issues at Singing River Hospital and the recommendation to move the remaining patient care floors, principally surgical beds and women's and children's units, out of the South Tower; and (2) capacity issues at Ocean Springs Hospital. These issues have been addressed in the Health System's three-year capital plan.

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188 East Capitol Street
Jackson, MS 39201-2127

Independent Auditors' Report

The Board of Trustees
Singing River Health System:

We have audited the accompanying balance sheets of Singing River Health System (the System) (a component unit of Jackson County, Mississippi) as of September 30, 2012 and 2011, 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 System'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 standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. 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 Singing River Health System as of September 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 21, 2013 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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 audits.

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis on pages 1 through 14 and Schedules of Fund Progress on pages 41 and 43 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board (GASB) who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements.

We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The 2012 supplementary information included in Schedule 1 (Surety Bonds for Officials and Employees) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

KPMG LLP

June 21, 2013

SINGING RIVER HEALTH SYSTEM
(A Component Unit of Jackson County, Mississippi)

Balance Sheets

September 30, 2012 and 2011

Assets		2012	2011
Current assets:			
Cash and cash equivalents	$	3,306,011	3,130,360
Trusteed bond funds – required for current liabilities		2,284,065	4,407,801
Patient accounts receivable, net of allowance for doubtful accounts of approximately $51,455,000 in 2012 and $34,962,000 in 2011		122,013,007	99,624,994
Other receivables		4,710,717	4,551,772
Due from third-party payors		10,627,000	6,457,000
Inventories		5,496,677	5,444,576
Prepaid expenses		2,562,354	2,462,983
Total current assets		150,999,831	126,079,486
Funds designated by Board for capital improvements		39,685,632	53,952,699
Trusteed bond funds		31,272,293	59,319,389
Held by trustee for self-insurance funding		1,403,377	1,400,970
Capital assets, net		200,548,842	179,397,245
Other assets		2,186,830	2,487,843
Total assets	$	426,096,805	422,637,632
Liabilities and Net Assets			
Current liabilities:			
Current installments of long-term debt	$	4,544,223	5,147,393
Current installments of capital lease obligations		545,235	598,323
Current installments of other long-term liability		3,425,762	4,012,891
Accounts payable		26,152,662	22,090,520
Accrued payroll and employee benefits		21,224,163	17,512,586
Due to third-party payors		—	1,985,000
Other accrued expenses		1,294,270	1,191,514
Total current liabilities		57,186,315	52,538,227
Long-term debt, excluding current installments		101,790,181	105,477,036
Capital lease obligations, excluding current installments		1,585,561	1,776,368
Other long-term liability		2,792,489	6,218,250
Accrued workers' compensation and professional and general liability costs		3,855,000	4,049,000
Net pension liability		24,263,831	15,445,331
Net postemployment benefit obligation		20,828,864	18,541,462
Total liabilities		212,302,241	204,045,674
Minority interests		788,928	566,184
Net assets:			
Invested in capital assets, net of related debt		109,233,254	107,395,576
Restricted for debt service		12,347,121	14,852,531
Unrestricted		91,425,261	95,777,667
Total net assets		213,005,636	218,025,774
Total liabilities and net assets	$	426,096,805	422,637,632

See accompanying notes to basic financial statements.

SINGING RIVER HEALTH SYSTEM
(A Component Unit of Jackson County, Mississippi)

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended September 30, 2012 and 2011

	2012	2011
Operating revenues:		
Net patient service revenue, net of provision for bad debts of approximately $79,628,000 in 2012 and $78,100,000 in 2011	$ 363,513,556	376,703,477
Other revenue	16,739,417	8,411,543
Total operating revenues	380,252,973	385,115,020
Operating expenses:		
Professional care of patients	236,556,647	234,706,318
General and administrative services	63,643,001	60,941,593
Dietary services	6,401,743	5,360,114
Household and plant operations	12,362,110	12,916,127
Employee benefits	33,280,606	32,304,426
Annual pension cost	8,818,500	7,208,112
Depreciation and amortization	21,466,883	19,558,003
Total operating expenses	382,529,490	372,994,693
Operating income (loss)	(2,276,517)	12,120,327
Nonoperating revenues (expenses):		
Net investment income	1,220,244	518,776
Interest expense	(3,076,436)	(3,074,291)
Minority interests	(911,090)	(1,077,715)
Gain on disposal of capital assets	23,661	—
Nonoperating expenses, net	(2,743,621)	(3,633,230)
Increase (decrease) in net assets	(5,020,138)	8,487,097
Net assets, beginning of year	218,025,774	209,538,677
Net assets, end of year	$ 213,005,636	218,025,774

See accompanying notes to basic financial statements.

SINGING RIVER HEALTH SYSTEM
(A Component Unit of Jackson County, Mississippi)

Statements of Cash Flows

Years ended September 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Receipts from and on behalf of patients and third party payors	$ 334,970,543	358,006,598
Other cash receipts	16,580,472	8,577,585
Payments to suppliers and employees	(342,528,400)	(343,351,536)
Net cash provided by operating activities	9,022,615	23,232,647
Cash flows from noncapital financing activities:		
Distributions of capital made to minority owners of Ambulatory Services	(688,346)	(953,174)
Minority interest in gains of Ambulatory Services	911,090	1,077,715
Net cash provided by noncapital financing activities	222,744	124,541
Cash flows from capital and related financing activities:		
Proceeds from long-term debt	—	36,680,000
Bond premium (discount)	—	1,239,090
Proceeds from sale of capital assets	608,426	31,232
Capital expenditures	(38,874,853)	(20,024,103)
Repayment of long-term debt	(5,113,378)	(5,014,491)
Repayment of other long-term liability	(4,012,890)	(3,760,922)
Payment of bond issue costs	—	(982,597)
Repayment of capital lease obligations	(653,036)	(571,475)
Interest payments	(6,324,665)	(4,780,979)
Net cash provided by (used in) capital and related financing activities	(54,370,396)	2,815,755
Cash flows from investing activities:		
Purchases of investments	(88,357,988)	(32,841,645)
Proceeds from sale of investments	105,731,722	42,909,812
Investment income received	439,246	280,071
Net distributions	—	(4,587)
Net cash provided by investing activities	17,812,980	10,343,651
Net increase (decrease) in cash and cash equivalents	(27,312,057)	36,516,594
Cash and cash equivalents, beginning of year	57,515,229	20,998,635
Cash and cash equivalents, end of year	$ 30,203,172	57,515,229
Supplemental disclosures of cash flow information:		
Capital assets acquired under capital lease obligations	$ 409,141	328,107
Capital assets acquired and funded through other long-term liability	—	13,992,063

(Continued)

SINGING RIVER HEALTH SYSTEM
(A Component Unit of Jackson County, Mississippi)

Statements of Cash Flows

Years ended September 30, 2012 and 2011

		2012	2011
Reconciliation of operating income (loss) to net cash provided by operating activities:			
Operating income (loss)	$	(2,276,517)	12,120,327
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:			
Depreciation and amortization		21,466,883	19,558,003
Provision for bad debts		79,628,078	78,100,452
Changes in operating assets and liabilities:			
Patient accounts receivable		(102,016,091)	(99,438,331)
Due from/to third-party payors		(6,155,000)	2,641,000
Inventories and other current assets		(310,417)	(105,237)
Net pension liability		8,818,500	7,208,112
Net postemployment benefit obligation		2,287,402	3,296,345
Accounts payable and other accrued expenses		7,773,777	(535,024)
Accrued workers' compensation and professional and general liability costs		(194,000)	387,000
Net cash provided by operating activities	$	9,022,615	23,232,647
Reconciliation of cash and cash equivalents to the balance sheets:			
Cash and cash equivalents in current assets	$	3,306,011	3,130,360
Cash and cash equivalents in funds designated by Board for capital improvements		13,980,891	19,028,956
Cash and cash equivalents in trusteed bond funds		11,512,893	33,954,943
Cash and cash equivalents held by trustee for self-insurance funding		1,403,377	1,400,970
Total cash and cash equivalents	$	30,203,172	57,515,229

See accompanying notes to basic financial statements.

(1) Organization and Summary of Significant Accounting Policies

Singing River Health System (the System) is a multidimensional healthcare system consisting of:

- Singing River Hospital, a 435-bed hospital and related outpatient care and other facilities principally located in Pascagoula, Mississippi,
- Ocean Springs Hospital, a 136-bed hospital and related outpatient care and other facilities principally located in Ocean Springs, Mississippi, and
- Singing River Ambulatory Services, Inc. (Ambulatory Services), a not-for-profit entity consisting principally of 51% interests in certain outpatient ambulatory care businesses.

The System is a component unit of Jackson County, Mississippi, as defined by Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*. The System's component unit relationship to the County is principally due to financial accountability as defined in GASB Statement No. 14. The System is operated by a nine-member board of trustees, seven of whom are appointed by the Board of Supervisors of Jackson County, Mississippi. Additionally, the chief-of-staff of the System serves on the Board.

Ambulatory Services is a component unit of the System principally due to the System's financial accountability for Ambulatory Services as defined in GASB Statement No. 14. Ambulatory Services is operated by a board of directors, all of whom are appointed by the System's Board. Ambulatory Services is a blended component unit of the System because its board is substantively the same as the System's board.

The significant accounting policies used by the System in preparing and presenting its financial statements follow:

(a) Presentation

The financial statements include the accounts of the System. All material intercompany accounts and transactions have been eliminated.

(b) Cash Equivalents

The System considers investments in highly-liquid debt instruments with an original maturity of three months or less to be cash equivalents.

(c) Inventories

Inventories, consisting principally of medical supplies and pharmaceuticals, are stated at the lower of cost (first-in, first-out) or replacement market.

(d) Designated Funds and Funds Held by Trustees

Designated funds include funds designated by the Board for capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes. Funds held by trustees include funds held for debt service and self-insurance funding.

(Continued)

Funds held by trustees for debt service under debt agreements that are required for obligations classified as current liabilities are reported as current assets.

(e) Investments and Investment Income

Investments are carried at fair value, principally based on quoted market prices. Investment income from investments is reported as nonoperating revenue.

(f) Capital Assets

Capital assets are recorded at cost or, if donated, at fair value at the date of receipt. Depreciation is provided over the useful life of each class of depreciable asset using the straight-line method. Capital assets under capital lease obligations are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Major renewals and renovations are capitalized. Costs for repairs and maintenance are expensed when incurred. When assets are retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and the gain or loss, if any, is included in nonoperating revenues (expenses) in the statements of revenues, expenses, and changes in net assets.

All capital assets other than land are depreciated (or amortized in the case of capital leases) using these useful lives:

Land improvements	5 to 25 years
Buildings and improvements	10 to 40 years
Fixed equipment	5 to 25 years
Movable equipment	3 to 20 years

(g) Statement of Revenues, Expenses, and Changes in Net Assets

For purposes of presentation, transactions deemed by management to be ongoing, major or central to the provision of healthcare services, other than financing costs, are reported as operating revenues and operating expenses. Peripheral or incidental transactions, such as net investment income, interest expense, minority interests, grants from others and gain (loss) on disposal of capital assets, are reported as nonoperating revenues and expenses.

(h) 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 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.

(i) Charity Care

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

(j) Electronic Health Record Incentive Program

The Centers for Medicare & Medicaid Services (CMS) have implemented provisions of the American Recovery and Reinvestment Act of 2009 that provide incentive payments for the meaningful use of certified electronic health records (EHR) technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. The Medicare EHR incentive program provides annual incentive payments to eligible professionals, eligible hospitals, and critical access hospitals, as defined, that are meaningful users of certified EHR technology. The Medicaid EHR incentive program provides annual incentive payments to eligible professionals and hospitals for efforts to adopt, implement, upgrade and meaningfully use certified EHR technology. The System utilizes a grant accounting model to recognize EHR incentive revenues. The System records EHR incentive revenue ratably throughout the incentive reporting period when it is reasonably assured that it will meet the meaningful use objectives for the required reporting period and that the grants will be received. The EHR reporting period for eligible professionals and hospitals is based on the federal fiscal year, which coincides with the System's fiscal year of October 1 through September 30. The System believes that it and its eligible professionals that met meaningful use objectives for the fiscal year ended September 30, 2012 will continue to meet those objectives for the fiscal year ending September 30, 2013. In 2012, the System recorded EHR incentive revenues of approximately $5,300,000, comprised of $3,109,000 of Medicare revenues and $2,191,000 of Medicaid revenues. EHR incentive revenues are included in other revenue in the accompanying 2012 statement of revenues, expenses and changes in net assets. EHR incentive receivables from Medicare and Medicaid (included in due from third-party payors) totaled approximately $2,732,000 and $973,000, respectively, at September 30, 2012.

(k) Enterprise Fund Accounting

The System utilizes the enterprise fund method of accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Substantially all revenues and expenses are subject to accrual. Pursuant to and as permitted by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the System has elected to not apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989. The System applies the provisions of all relevant pronouncements of the GASB and pronouncements of the FASB issued prior to November 30, 1989 that do not conflict with or contradict GASB pronouncements.

(l) Restricted Resources

When the System has both restricted and unrestricted resources available to finance a particular program, it is the System's policy to use restricted resources before unrestricted resources.

(m) Net Assets

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

- Net assets invested in capital assets, net of related debt consist of capital assets, net of accumulated depreciation and reduced by outstanding balances of any borrowings used to finance the purchase or construction of those assets. To the extent debt has been incurred but not yet expended for capital assets, such debt is excluded from the calculation of net assets invested in capital assets, net of related debt.
- Net assets restricted for debt service are amounts deposited with trustees as required by bond indentures or debt agreements.
- Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets, net of related debt or restricted.

(n) Costs of Borrowing

Bond issuance costs, deferred loss on refunding, and bond discounts and premiums are being amortized over the terms of the related indebtedness using the interest method.

Interest cost is capitalized on qualified construction expenditures as a component of the cost of the related projects. Interest costs capitalized in 2012 and 2011 were approximately $3,348,000 and $2,052,000, respectively.

(o) Compensated Absences

The System's employees accumulate paid time off, such as vacation, holiday and sick leave, at varying rates depending upon their years of continuous service and their payroll classification, subject to maximum limitations. Upon termination of employment, employees are paid all unused accrued vacation and holiday time at their regular rate of pay up to a designated maximum number of days. Since the employees' vacation and holiday time both accumulate and vest, an accrual for this liability is included in accrued payroll and employee benefits.

(p) Income Taxes

The System is a not-for-profit entity as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from Federal and state income taxes on related income pursuant to Section 501(a) of the Code. The System is also a political subdivision of Jackson County, Mississippi and is operated as a community hospital under related statutes of the State of Mississippi.

(q) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires that management make estimates and assumptions affecting the reported amounts of assets, liabilities, revenues, and expenses, as well as disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Significant items subject to such estimates and assumptions include the determination of the allowances for doubtful accounts and contractual adjustments, reserves for general and professional liability claims, reserves for workers' compensation claims, reserves for employee healthcare claims, estimated third-party payor settlements and the actuarially determined benefit liabilities related to the System's pension plan and postemployment healthcare plan. In particular, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates related to these programs will change by a material amount in the near term.

(r) Impairment of Capital Assets

Capital assets are reviewed for impairment when service utility has declined significantly and unexpectedly. If such assets are no longer used, they are reported at the lower of carrying value or fair value. If such assets will continue to be used, the impairment loss is measured using a historical cost approach method that best reflects the diminished service utility of the capital asset. No charge related to impairment matters was required during 2012 or 2011.

(s) Reclassifications

Certain amounts in the 2011 financial statements have been reclassified to conform with the 2012 presentation.

(t) Recent Accounting Pronouncements

GASB Statement No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34* (Statement No. 61), was published in November 2010. This new accounting pronouncement modifies certain requirements for inclusion of component units in the financial reporting entity. Statement No. 61 requires that financial benefit or burden criteria be met for those entities that were previously included by meeting the fiscal dependency criteria. In addition, for organizations that do not meet the financial accountability criteria for inclusion as component units but should be included because the primary government's management has determined that it would be misleading to exclude them, Statement No. 61 clarifies the manner in which such determination should be made and the types of relationships to be considered. Furthermore, Statement No. 61 clarifies when component units should be blended or presented discretely. The provisions of Statement No. 61 are effective for financial statements for periods beginning after June 15, 2012 (the System's fiscal year ending September 30, 2013).

GASB Statement No. 62, *Codification of Accounting and Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (Statement No. 62), was published in December 2010. The primary objective of the new pronouncement is to directly incorporate the

applicable provisions of FASB and American Institute of Certified Public Accountants (AICPA) pronouncements issued on or before November 30, 1989 into the state and local government accounting and financial reporting standards. Statement No. 62 also eliminates the option provided in GASB Statement No. 20 to apply post-November 30, 1989 FASB pronouncements not in conflict with GASB pronouncements. Statement No. 62 is effective for periods beginning after December 15, 2011 (the System's fiscal year ending September 30, 2013).

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (Statement No. 63), was published in June 2011. This new accounting pronouncement requires that amounts representing deferred outflows of resources be reported in a balance sheet in a separate section following assets. Similarly, amounts that are required to be reported as deferred inflows of resources should be reported in a separate section following liabilities. Statement No. 63 further requires that the balance sheet report the residual amount as "net position" rather than "net assets". Net position represents the difference between all other elements in a balance sheet and should be displayed in three components – "net investment in capital assets", "restricted", and "unrestricted". Statement No. 63 is effective for periods beginning after December 15, 2011 (the System's fiscal year ending September 30, 2013).

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (Statement No. 65), was published in March 2012. This new accounting pronouncement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows or inflows of resources, certain items that were previously reported as assets and liabilities. The provisions of Statement No. 65 are effective for financial statements for periods beginning after December 15, 2012 (the System's fiscal year ending September 30, 2014).

While the ultimate impact of implementing GASB Statements No. 61, No. 62, No. 63 and No. 65 and other recent accounting pronouncements has not yet been determined, management believes that none of the new pronouncements will have a material impact on the System's financial statements.

(2) Net Patient Service Revenue

The System has agreements with governmental and other third-party payors that provide for reimbursement to the System at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the System's billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with major third-party payors follows:

- Medicare – Substantially all acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Certain other Medicare reimbursement items are paid based upon other retroactive-determination methodologies. The System is reimbursed for retroactively determined items at tentative rates with final settlement determined after submission of annual cost reports by the System and audits by the Medicare fiscal intermediary. The System's cost reports have been audited and settled for all fiscal years through 2006. Revenue from the Medicare

program accounted for approximately 40% and 41% of the System's net patient service revenue for the years ended September 30, 2012 and 2011, respectively.

- Medicaid – Inpatient and outpatient services rendered to Medicaid program beneficiaries are generally paid based upon prospective reimbursement methodologies established by the State of Mississippi. Revenue from the Medicaid program accounted for approximately 18% and 19% of the System's net patient service revenue for years ended September 30, 2012 and 2011, respectively.

  Effective April 2001, the State of Mississippi implemented the Medicare Upper Payment Limit (UPL) program for providers participating in the state Medicaid program. Additionally, the System participates in a voluntary contribution program (disproportionate share) available to certain qualifying hospitals in the state Medicaid program. The System has recorded a receivable, which is included in due from third-party payors in the accompanying balance sheets, of approximately $6,497,000 and $6,457,000 from these programs as of September 30, 2012 and 2011, respectively. The net benefit for the System associated with these programs totaling approximately $25,811,000 and $30,550,000 for the years ended September 30, 2012 and 2011, respectively, is recognized as a reduction in related contractual adjustments in the accompanying statements of revenues, expenses, and changes in net assets. There can be no assurance that the System will continue to qualify for future participation in this program or that the program will not ultimately be discontinued or materially modified.

During 2012 and 2011, net patient service revenue increased approximately $930,000 and $5,788,000, respectively, due to changes in estimates related to prior cost reporting periods and removal of allowances previously estimated that are no longer necessary.

During fiscal 2012, the System received a settlement totaling approximately $2,859,000 related to the appeal of the calculation of the rural floor budget neutrality adjustment of the Medicare program's inpatient prospective payment system. This settlement, in addition to the change in estimate noted above, resulted in an overall increase in net patient service revenue for the year ended September 30, 2012 of approximately $3,789,000.

The System had gross patient charges to Medicare and Medicaid patients totaling approximately $966 million and $916 million and recognized net patient service revenue from these programs totaling approximately $206 million and $220 million in 2012 and 2011, respectively. This resulted in total required contractual adjustments related to the Medicare and Medicaid programs of approximately $760 million and $696 million for 2012 and 2011, respectively, or approximately 79% and 76% of program charges in 2012 and 2011, respectively.

The System has also entered into other reimbursement arrangements providing for payment methodologies which include prospectively determined rates per discharge, per diem amounts and discounts from established charges.

The composition of net patient service revenue follows:

		2012	2011
Gross patient service revenue	$	1,572,967,011	1,489,723,323
Less provision for contractual and other adjustments		1,129,825,377	1,034,919,394
Less provision for bad debts		79,628,078	78,100,452
Net patient service revenue	$	363,513,556	376,703,477

In the spring of 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act (collectively, the Health Care Acts) were signed into law by President Obama. The impact of the Health Care Acts is complicated and difficult to predict, but the System anticipates its reimbursement in the future will be affected by major elements of the Health Care Acts designed to (1) increase insurance coverage, (2) change provider and payor behavior, and (3) encourage alternative delivery models. Many healthcare reform variables remain unknown and are, among other things, dependent on implementation by federal and state governments and reactions by providers, payors, employers, and individuals. The System continues to monitor developments in healthcare reform and participates actively in contemplating and designing new programs that are encouraged and/or required by the Health Care Acts.

(3) Charity Care

The System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. Charges foregone, based on established rates, were approximately $91,870,000 and $74,760,000 in 2012 and 2011, respectively.

(4) Capital Assets

Capital assets and related activity for the years ended September 30, 2012 and 2011 consist of the following:

	Balance October 1, 2011	Additions	Retirements	Balance September 30, 2012
Capital assets not being depreciated:				
Land	$ 7,461,539	—	—	7,461,539
Construction in progress	37,356,932	35,616,474	(44,055,745)	28,917,661
Total capital assets not being depreciated	44,818,471	35,616,474	(44,055,745)	36,379,200
Capital assets being depreciated:				
Land improvements	5,436,801	830,085	—	6,266,886
Buildings and improvements	154,880,938	2,829,014	(608,426)	157,101,526
Fixed equipment	14,439,059	12,687	(10,573)	14,441,173
Movable equipment	185,053,836	47,399,763	(592,658)	231,860,941
Total capital assets being depreciated	359,810,634	51,071,549	(1,211,657)	409,670,526
Less accumulated depreciation for:				
Land improvements	3,115,903	243,331	—	3,359,234
Buildings and improvements	78,944,939	6,823,775	(23,661)	85,745,053
Fixed equipment	11,480,388	207,236	(10,573)	11,677,051
Movable equipment	131,690,630	13,621,574	(592,658)	144,719,546
Total accumulated depreciation	225,231,860	20,895,916	(626,892)	245,500,884
Capital assets, being depreciated, net	134,578,774	30,175,633	(584,765)	164,169,642
Capital assets, net	$ 179,397,245	65,792,107	(44,640,510)	200,548,842

(Continued)

	Balance October 1, 2010	Additions	Retirements	Balance September 30, 2011
Capital assets not being depreciated:				
Land	$ 7,492,771	—	(31,232)	7,461,539
Construction in progress	28,015,902	31,425,648	(22,084,618)	37,356,932
Total capital assets not being depreciated	35,508,673	31,425,648	(22,115,850)	44,818,471
Capital assets being depreciated:				
Land improvements	5,377,369	59,432	—	5,436,801
Buildings and improvements	146,111,627	8,769,311	—	154,880,938
Fixed equipment	14,058,162	400,829	(19,932)	14,439,059
Movable equipment	168,137,946	17,552,186	(636,296)	185,053,836
Total capital assets being depreciated	333,685,104	26,781,758	(656,228)	359,810,634
Less accumulated depreciation for:				
Land improvements	2,901,776	214,127	—	3,115,903
Buildings and improvements	72,942,306	6,002,633	—	78,944,939
Fixed equipment	11,312,173	188,147	(19,932)	11,480,388
Movable equipment	119,833,433	12,493,493	(636,296)	131,690,630
Total accumulated depreciation	206,989,688	18,898,400	(656,228)	225,231,860
Capital assets, being depreciated, net	126,695,416	7,883,358	—	134,578,774
Capital assets, net	$ 162,204,089	39,309,006	(22,115,850)	179,397,245

Construction in progress as of September 30, 2012 consists primarily of expenditures associated with the addition of a new patient care floor, neuroscience center, renovations to patient care areas, as well as the expansions of the emergency department, labor and delivery, and relocation of emergency power system electrical upgrade. The System has associated purchase commitments totaling approximately $31,309,000 at September 30, 2012, which will be funded through bond proceeds and designated funds. Completion dates are expected to range from fiscal 2013 through 2014.

(Continued)

(5) Leases

The System was obligated under several capital leases at September 30, 2012. Scheduled payments on capital lease obligations are as follows:

	Principal	Interest
2013	$ 545,235	116,278
2014	561,173	84,016
2015	524,965	50,480
2016	499,423	18,117
Total	$ 2,130,796	268,891

A schedule of changes in the System's capital lease obligations for the years ended September 30, 2012 and 2011 follows:

Description	Interest rate	Date of issuance	Balance October 1, 2011	Additions	Retired	Balance September 30, 2012	Due within one year
Subsidiary equipment leases:							
Facility Development, LLC	7.71%	10/1/2001	$ 1,850,246	—	(315,458)	1,534,788	340,658
Alcon Laboratories	10.00%	8/1/2007	27,409	—	(27,409)	—	—
Hancock Bank	6.50%	5/20/2008	57,524	—	(57,524)	—	—
Hancock Bank	7.00%	1/10/2009	1,905	—	(1,905)	—	—
Hancock Bank	6.00%	12/10/2009	24,778	—	(21,148)	3,630	3,630
Hancock Bank	6.00%	3/30/2010	6,469	—	(4,254)	2,215	2,215
Hancock Bank	5.00%	6/20/2010	16,160	—	(16,160)	—	—
Hancock Bank	5.00%	12/20/2009	15,504	—	(12,333)	3,171	3,171
Hancock Bank	6.00%	3/10/2010	91,691	—	(24,407)	67,284	25,796
Hancock Bank	5.00%	6/20/2010	16,160	—	(16,160)	—	—
Hancock Bank	5.50%	10/20/2010	59,530	—	(18,811)	40,719	19,793
Hancock Bank	5.25%	5/20/2011	42,797	—	(11,204)	31,593	11,760
Hancock Bank	4.75%	6/30/2011	14,313	—	(14,313)	—	—
Hancock Bank	5.25%	4/10/2011	119,274	—	(32,034)	87,240	33,626
Hancock Bank	5.00%	10/20/2010	7,214	—	(7,214)	—	—
Hancock Bank	5.00%	2/20/2011	9,797	—	(4,069)	5,728	4,265
Hancock Bank	4.75%	6/30/2011	13,920	—	(13,920)	—	—
Hancock Bank	5.25%	12/10/2011	—	71,899	(12,731)	59,168	16,800
Hancock Bank	5.50%	4/10/2012	—	152,275	(14,458)	137,817	34,800
Hancock Bank	5.50%	4/20/2012	—	85,184	(8,115)	77,069	19,200
Hancock Bank	5.25%	12/10/2011	—	73,285	(14,117)	59,168	16,800
Hancock Bank	5.55%	4/10/2012	—	26,498	(5,292)	21,206	12,721
			$ 2,374,691	409,141	(653,036)	2,130,796	545,235

(Continued)

Description	Interest rate	Date of issuance	Balance October 1, 2010	Additions	Retired	Balance September 30, 2011	Due within one year
Subsidiary equipment leases:							
Facility Development, LLC	7.71%	10/1/2001	$ 2,142,366	—	(292,120)	1,850,246	315,458
Alcon Laboratories	10.00%	8/1/2007	54,333	—	(26,924)	27,409	27,409
Hancock Bank	6.50%	5/20/2008	139,281	—	(81,757)	57,524	57,524
Hancock Bank	7.00%	1/10/2009	9,202	—	(7,297)	1,905	1,905
Hancock Bank	6.00%	12/10/2009	46,622	—	(21,844)	24,778	21,148
Hancock Bank	6.00%	3/30/2010	10,492	—	(4,023)	6,469	4,254
Hancock Bank	5.00%	6/20/2010	36,849	—	(20,689)	16,160	16,160
Hancock Bank	5.00%	12/20/2009	27,275	—	(11,771)	15,504	12,333
Hancock Bank	6.00%	3/10/2010	114,790	—	(23,099)	91,691	24,407
Hancock Bank	5.00%	6/20/2010	36,849	—	(20,689)	16,160	16,160
Hancock Bank	5.50%	10/20/2010	—	77,534	(18,004)	59,530	18,811
Hancock Bank	5.25%	5/20/2011	—	47,308	(4,511)	42,797	11,204
Hancock Bank	4.75%	6/30/2011	—	21,313	(7,000)	14,313	14,313
Hancock Bank	5.25%	4/10/2011	—	134,720	(15,446)	119,274	32,034
Hancock Bank	5.00%	10/20/2010	—	14,100	(6,886)	7,214	7,214
Hancock Bank	5.00%	2/20/2011	—	12,407	(2,610)	9,797	4,069
Hancock Bank	4.75%	6/30/2011	—	20,725	(6,805)	13,920	13,920
			$ 2,618,059	328,107	(571,475)	2,374,691	598,323

Capital leases at September 30, 2012 and 2011 are obligations of blended component units of Ambulatory Services.

Capital assets totaling approximately $5,774,000 and $5,464,000 are related to the above capital lease obligations at September 30, 2012 and 2011, respectively. Related accumulated amortization was approximately $4,964,000 and $4,220,000 at September 30, 2012 and 2011, respectively.

Rental expense for all operating leases was approximately $6,728,000 and $6,408,000 in 2012 and 2011, respectively. There are no significant noncancelable operating leases at September 30, 2012. Management expects that most lease agreements will be replaced, as they expire, with similar agreements.

(6) Cash, Cash Equivalents, and Investments

The System's bank balances at September 30, 2012 and 2011 follow:

	2012	2011
Insured (FDIC)	$ 1,000,000	1,000,000
Uninsured, uncollateralized, or collateralized by securities held by the pledging institution or by its trust department or agent in other than the System's name	29,900,745	57,302,895
Total	$ 30,900,745	58,302,895
Carrying amount (cash and cash equivalents)	$ 30,203,172	57,515,229

(Continued)

A summary of investments follows:

	Fair value	Percentage	Maturities	Interest rate	Credit rating
September 30, 2012:					
Mississippi Hospital Association pooled investments	$ 25,704,741	53.83%	N/A	N/A	N/A
U.S. Treasury obligation	970,000	2.03	10/4/2012	0.10%	N/A
U.S. government agency obligations	16,117,473	33.76	Various	4.80%	N/A
Wachovia repurchase agreement	3,145,160	6.59	3/1/2023	4.10%	N/A
Municipal debt securities	1,810,832	3.79	Various	2.72%	N/A
Total	$ 47,748,206	100.00%			
September 30, 2011:					
Mississippi Hospital Association pooled investments	$ 34,923,743	53.99%	N/A	N/A	N/A
U.S. Treasury obligation	99,999	0.15	10/20/2011	0.27%	N/A
U.S. government agency obligations	26,527,088	41.00	Various	2.16%	N/A
Wachovia repurchase agreement	3,145,160	4.86	3/1/2023	4.10%	N/A
Total	$ 64,695,990	100.00%			

Custodial credit risk is the risk that, in the event of a bank failure, an organization's deposits may not be returned. The System has a deposit policy for custodial credit risk that requires deposits to be collateralized by securities held by the pledging institution or its trust department or agent in other than the System's name.

The Mississippi Hospital Association pooled investments are an investment program administered by the Mississippi Hospital Association that principally invests in corporate and U.S. Government agency obligations and money market funds.

All funds designated by the Board would otherwise be classified as cash, cash equivalents, or other current assets, except for the System board of trustees' designation of such assets as held for the acquisition of long-term assets or the settlement of long-term obligations. All noncash funds designated by the Board have sufficient liquidity such that, at the discretion of the System's Board, they can be converted to cash as necessary.

The debt service trusteed funds were established in accordance with the requirements of the indentures related to the Series 2009A, Series 2009B, and Series 2012 Bonds discussed in note 7.

(Continued)

A summary of the various trusteed bond funds follows:

	2012	2011
Reserve funds	$ 10,063,054	9,921,281
Principal and interest funds	2,284,065	4,407,801
Cost of issuance funds	—	523,449
Capital improvement funds	21,209,239	48,874,659
	$ 33,556,358	63,727,190

The reserve funds are generally equal to the maximum annual principal and interest requirements (as defined) for the revenue bonds. The principal and interest funds are for the annual debt service of the revenue bonds. The capital improvement funds represent amounts to be used to fund costs of construction and installation of equipment and facilities. Deposits classified as current assets represent funds to be used to pay debt service and cost of issuance amounts classified as current liabilities at September 30.

The System does not have its own investment strategy; however, being a governmental entity, it follows the guidelines set forth by the State of Mississippi, which include the following:

1. Liquidity – To ensure the ability to meet all expected or unexpected cash flow needs by investing in securities which can be sold readily and efficiently.

2. Cash, money market funds, and certificates of deposit that are either appropriately collateralized, insured, or issued by investment grade financial institutions.

3. Investment agreements, including guaranteed investment contracts (GIC), commercial paper, repurchase agreements, and other securities as required by the State of Mississippi.

Investment income is comprised of the following:

	2012	2011
Dividend and interest income	$ 806,680	843,188
Net increase (decrease) in the fair value of investments	413,564	(324,412)
	$ 1,220,244	518,776

(Continued)

(7) Long-term Debt

A summary of long-term debt follows:

	2012	2011
Mississippi Development Bank Special Obligation Bonds – Series 2011:	$ 36,610,000	36,610,000
Plus unamortized bond premium	1,132,157	1,218,647
	37,742,157	37,828,647
Mississippi Development Bank Special Obligation Bonds – Series 2009A:	33,590,000	34,220,000
Less unamortized bond discount	(946,634)	(1,000,365)
	32,643,366	33,219,635
Mississippi Development Bank Special Obligation Refunding Bonds – Series 2009B:	40,580,000	44,445,000
Less unamortized bond discount	(190,063)	(220,179)
Less unamortized deferred loss on refunding	(5,261,474)	(6,087,470)
	35,128,463	38,137,351
Note payable to bank, due in monthly installments of $47,320, including interest at 3.25%, final balloon payment due February 2014	784,918	1,317,266
Notes payable to banks (blended component units of Ambulatory Services), secured by equipment, due on various due dates through October 2013, interest ranging from 5.00% to 9.00%	35,500	121,530
	106,334,404	110,624,429
Less current installments	4,544,223	5,147,393
Long-term debt, excluding current installments	$ 101,790,181	105,477,036

On April 2, 2009, the System issued $35,000,000 of Special Obligation Bonds (the Series 2009A bonds) through Mississippi Development Bank. The purpose of the bonds is to provide funding for constructing, remodeling, adding to, equipping, and furnishing an addition to and expansion of the System, funding a debt service reserve fund for the Series 2009A bonds, paying accrued interest, and paying cost of issuance on the Series 2009A bonds. The bonds consist of $6,455,000 Serial Bonds and $28,545,000 Term Bonds and are at fixed rates ranging from 3.0% to 5.625%.

On October 27, 2009 the System refunded the Series 2008A bonds, outstanding in the amount of $44,000,000, with the Series 2009 B-l and 2009 B-2 bonds. The Series 2009 B-l and 2009 B-2 bonds are fixed rate bonds secured by a bond insurance policy provided by Assured Guaranty Corporation and a five mill pledge of the assessed real property by Jackson County. The Series 2009 B-l and B-2 bonds were

(Continued)

issued by the Mississippi Development Bank and pay interest semiannually (January 1 and July 1) and principal annually (July 1 with the exception of the 2023 payment which is March 1). The Series 2009 B-l bonds of $48,340,000 mature on March 1, 2023 and the Series 2009 B-2 bonds of $2,395,000 mature on July 1, 2012.

On July 27, 2011, the System issued $36,610,000 of Special Obligation Bonds (the Series 2011 bonds). The purpose of the bonds is to provide funding for constructing, remodeling, adding to, equipping and furnishing an addition to and expansion of the System, funding an electronic medical record system, funding a debt service reserve fund, paying capitalized interest, and paying costs of issuance on the Series 2011 Bonds. The bonds are fixed rate bonds secured by a bond insurance policy provided by Assured Guaranty Municipal Corporation. The Series 2011 bonds were issued by the Mississippi Development Bank and pay interest semiannually (January 1 and July 1) and principal annually (July 1), beginning July 2013. The bonds consist of $28,255,000 Serial Bonds maturing on July 1, 2023, $4,490,000 of Term Bonds maturing on July 1, 2031, and $3,865,000 of Term Bonds maturing on July 1, 2036 and are at fixed rates ranging from 3.0% to 5.375%.

Under the terms of the respective loan agreements, the System was obligated to meet certain financial covenants including tests for availability of cash, debt service coverage and additional debt. The covenants are consistent with those of hospital credits of comparable size and financial strength of the System. At September 30, 2012, the System was not in compliance with certain covenants of the respective loan agreements; however, the System subsequently received waivers for these instances of noncompliance.

Through its investment in Ambulatory Services, the System had $1,000,000 and $400,000 line of credit agreements with a bank to finance operating costs. Funds totaling $35,500 and $70,000 were advanced as of September 30, 2012 and 2011, respectively, on the $400,000 line of credit. No amounts have been advanced on the $1,000,000 line of credit as of September 30, 2012. Interest on both agreements accrues at 5.0%. The agreements mature on October 15, 2013.

Debt service requirements associated with the System's long-term debt follow:

	Principal	Interest	Total
Year ended September 30:			
2013	$ 4,544,223	5,192,561	9,736,784
2014	6,311,195	5,027,920	11,339,115
2015	6,280,000	4,819,406	11,099,406
2016	6,550,000	4,548,106	11,098,106
2017	6,835,000	4,263,194	11,098,194
2018	7,135,000	3,963,894	11,098,894
2019	7,420,000	3,677,531	11,097,531
2020	7,745,000	3,352,419	11,097,419
2021	8,105,000	2,992,019	11,097,019
2022	8,450,000	2,648,744	11,098,744
2023	8,940,000	2,159,671	11,099,671
2024	1,490,000	1,807,775	3,297,775
2025	1,565,000	1,733,275	3,298,275
2026	1,650,000	1,651,013	3,301,013
2027	1,735,000	1,564,275	3,299,275
Thereafter	26,845,000	10,000,494	36,845,494
	$ 111,600,418	59,402,297	171,002,715

A schedule of changes in the System's long-term debt balances for the years ended September 30, 2012 and 2011 follows:

Description	Date of issuance	Balance October 1, 2011	Additions	Retired	Balance September 30, 2012	Due within one year
Note payable to bank	2/26/2009	$ 1,317,266	—	(532,348)	784,918	548,723
Notes payable to banks (blended component units of Ambulatory Services)	Various	121,530	—	(86,030)	35,500	35,500
Series 2009B	10/27/2009	44,445,000	—	(3,865,000)	40,580,000	3,020,000
Series 2009A	4/2/2009	34,220,000	—	(630,000)	33,590,000	650,000
Series 2011	7/27/2011	36,610,000	—	—	36,610,000	290,000
		$ 116,713,796	—	(5,113,378)	111,600,418	4,544,223

(Continued)

Description	Date of issuance	Balance October 1, 2010	Additions	Retired	Balance September 30, 2011	Due within one year
Note payable to bank	2/26/2009	$ 1,832,479	—	(515,213)	1,317,266	530,863
Notes payable to banks (blended component units of Ambulatory Services)	Various	170,808	70,000	(119,278)	121,530	121,530
Series 2009B	10/27/2009	48,210,000	—	(3,765,000)	44,445,000	3,865,000
Series 2009A	4/2/2009	34,835,000	—	(615,000)	34,220,000	630,000
Series 2011	7/27/2011	—	36,610,000	—	36,610,000	—
		$ 85,048,287	36,680,000	(5,014,491)	116,713,796	5,147,393

(8) Information Technology Contract

The System has entered into a five-year software and services agreement with a major information technology vendor. The agreement generally commits the System to the purchase of a variety of information technology products and services from this vendor for a defined payment stream over the term of the contract. Certain software license and support fees (totaling approximately $13,992,400) were capitalized during fiscal 2011 with recognition of an associated liability related to the System's acquisition of these intangible assets. Capitalized software license and support fees of approximately $13,719,000 were included in construction in progress at September 30, 2011. Such costs are amortized as the software is placed in service. Implied training costs of approximately $273,400 are being amortized over the implicit training period of thirty months. Such costs are included in other assets in the accompanying balance sheets. Other contract costs are evaluated for capitalization or expense recognition under relevant accounting literature as associated products and/or services are provided. Software costs placed in service during 2012, including amounts associated with the software and services agreement, were approximately $28,895,000.

(Continued)

The following table summarizes the future payment commitments by year under the contract as of September 30, 2012:

	Capitalized software costs obligation
2013	$ 3,626,919
2014	1,308,816
2015	1,308,816
2016	327,204
Total	6,571,755
Less amounts representing interest at 4.6%	(353,504)
Total obligation	6,218,251
Less current portion	(3,425,762)
Long-term obligation (included as other long-term liability in the accompanying 2012 balance sheet)	$ 2,792,489

Interest paid under the agreement during the years ended September 30, 2012 and 2011 was approximately $339,000 and $357,000, respectively.

The following is a summary of the changes in the System's long-term obligation for fiscal 2012:

	2012	2011
Balance at October 1	$ 10,231,141	—
Additions	—	13,992,063
Payments	(4,012,890)	(3,760,922)
Balance at September 30	$ 6,218,251	10,231,141

(9) Pension Plan

Singing River Health System Employees' Retirement Plan and Trust (the Plan) is a single-employer defined benefit pension plan sponsored and administered by the System. The Plan provides retirement, disability, and death benefits to plan members and beneficiaries. For the years ended September 30, 2012 and 2011, cost-of-living adjustments were provided to members and beneficiaries equal to 1/2 of the percentage increase in the consumer price index, not to exceed 2.5%, multiplied by annual retirement income (as defined) times the number of plan years (as defined) since retirement. The System's board of trustees is authorized to establish and amend all provisions. The Plan issues a publicly available financial report that includes the applicable financial statements and required supplementary information. The report may be obtained at the System's offices.

(a) Funding Policy

The contribution requirements of employees and the System are established and may be amended by the System's board of trustees. Employees contribute 3% of their annual salary (maximum salary amount of $250,000 for each of the calendar years 2012 and 2011) to the Plan. The System contributes the remaining amounts necessary to fund the Plan at an actuarially determined rate.

(b) Annual Pension Cost and Net Pension Liability

A reconciliation of the System's annual pension cost and related net pension liability follows:

	2012	2011
Annual required contribution	$ 8,964,566	7,283,090
Interest on net pension liability	1,311,067	698,378
Adjustment to annual required contribution	(1,457,133)	(773,356)
Annual pension cost	8,818,500	7,208,112
Contributions	—	—
Increase in net pension liability	8,818,500	7,208,112
Net pension liability, beginning of year	15,445,331	8,237,219
Net pension liability, end of year	$ 24,263,831	15,445,331

The annual required contribution for the current year was determined as part of the October 1, 2011 actuarial valuation using the projected unit credit actuarial cost method. The actuarial assumptions included (a) 8.5% investment rate of return (net of administrative expenses) in 2012 and 2011 and (b) projected salary increases of 2.8% for 2012 and 2011. Both (a) and (b) included a cost of living adjustment of 1.0% for 2012 and 2011. The actuarial value of plan assets are valued on the basis of their fair value. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at October 1, 2011 was 28.2 years.

(c) Three-Year Trend Information

Fiscal year ended	Annual Pension Cost (APC)	Percentage of APC contributed	Net pension liability
September 30, 2010	$ 4,400,000	—%	$ 8,237,219
September 30, 2011	7,208,112	—	15,445,331
September 30, 2012	8,818,500	—	24,263,831

(Continued)

(d) Schedule of Funding Progress – Required Supplementary Information

Analysis of the Plan's funding progress follows:

Actuarial valuation date	Actuarial value of plan assets	Actuarial accrued liability (AAL)	Plan assets less than AAL	Funded ratio	Covered payroll	Plan assets less than AAL as a % of covered payroll
October 1, 2009	$ 146,588,322	169,112,456	(22,524,124)	86.7%	$ 112,085,995	(20.1)%
October 1, 2010	145,900,190	189,363,614	(43,463,424)	77.0	120,759,213	(36.0)
October 1, 2011	141,398,027	200,328,271	(58,930,244)	70.6	120,697,220	(48.8)

(10) Postemployment Healthcare Plan

Singing River Health System Postretirement Medical Plan (the Health Plan) is a single-employer defined benefit healthcare plan sponsored and administered by the System. The Health Plan provides medical and drug benefits to eligible retirees and their spouses. The System's board of trustees is authorized to establish and amend all provisions. The System does not issue a publicly available financial report that includes financial statements and required supplementary information for the Health Plan.

(a) Funding Policy

The contribution requirements of employees and the System are established and may be amended by the System's board of trustees. Monthly contributions are required by retirees who are eligible for coverage. The System pays for costs in excess of required retiree contributions. The required contribution for the Health Plan is based on projected pay-as-you-go financing requirements. For fiscal 2012 and 2011, the System contributed approximately $1,722,000 and $2,154,000 to the Health Plan. The Health Plan members receiving benefits contributed approximately $330,000 in fiscal 2012 and $450,000 in fiscal 2011 through their required contributions. Monthly contributions required by retirees depend on the service period at time of retirement (less than 20 years vs. 20 years or more) and the type of coverage (single or family). The following table summarizes the monthly contribution rates for 2012:

Service	Single	Family
Retired prior to February 2011:		
Less than 20 years	$ 276.79	582.53
20 years or more	130.09	262.14
Retired February 2011 and later	553.58	1,165.06

(b) Annual OPEB Cost and Net OPEB Obligation

The System's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any

unfunded actuarial liabilities (or funding excess) over a period of 28.87 years. The following table shows the components of the System's annual OPEB cost for the year, the amount actually contributed to the Health Plan, and changes in the System's net OPEB obligation:

	2012	2011
Annual required contribution and annual OPEB cost	$ 3,681,424	5,000,000
Contributions	(1,394,022)	(1,703,655)
Increase in net OPEB obligation	2,287,402	3,296,345
Net OPEB obligation, beginning of year	18,541,462	15,245,117
Net OPEB obligation, end of year	$ 20,828,864	18,541,462

(c) Three-Year Trend Information

Fiscal year ended	Annual OPEB cost	Percentage of Annual OPEB cost contributed	Net OPEB obligation
September 30, 2010	$ 6,640,203	24.9%	$ 15,245,117
September 30, 2011	5,000,000	34.1	18,541,462
September 30, 2012	3,681,424	37.9	20,828,864

(d) Funded Status and Funding Progress

As of October 1, 2011, the most recent actuarial valuation date, the plan was not funded. The actuarial accrued liability for benefits was $15,492,416, resulting in an unfunded actuarial accrued liability (UAAL) of $15,492,416. The covered payroll (annual payroll of active employees covered by the plan was $124,790,420 and the ratio of UAAL to covered payroll was 12.4%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, as presented below as required supplementary information, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

(e) Schedule of Funding Progress – Required Supplementary Information

Analysis of the Health Plan's funding status follows:

Actuarial valuation date	Actuarial value of plan assets	Actuarial accrued liability (AAL)	Plan assets less than AAL	Funded Ratio	Covered payroll	Plan assets less than AAL as of a % of covered payroll
October 1, 2009	—	$ 36,615,451	36,615,451	—%	$ 112,085,995	32.7%
October 1, 2010	—	23,183,982	23,183,982	—	117,419,669	19.7%
October 1, 2011	—	15,492,416	15,492,416	—	124,790,420	12.4%

(f) Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the October 1, 2011, actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions include a 4% investment rate of return (net of administrative expenses), which is a long-term rate of return on general account assets, and an annual inflation rate and annual healthcare cost trend rate of 9.0% in fiscal year 2012, reduced 1/2% each year until it reaches an annual rate of 5% in 2020. The initial UAAL is being amortized over a 7.54 year period on the level dollar method on an open basis. All additions to the liability, such as annual actuarial gains (losses), are amortized over 30 years.

(11) Business and Credit Concentrations

The System grants credit to patients, substantially all of whom are local area residents. The System generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross, and commercial insurance policies).

The mix of receivables from patients and third-party payors follows:

	2012	2011
Patients	48%	48%
Medicare	19	23
Commercial insurance	17	15
Blue Cross	10	9
Medicaid	6	5
	100%	100%

(Continued)

(12) Risk Management

Effective October 1, 2003, the System implemented a self-insurance program for professional and general liability risks, both with respect to claims incurred after the effective date of the program and claims incurred but not reported prior to that date. The System has not acquired any excess coverage for its self-insurance because the System is a community hospital organized in accordance with the community statutes of the State of Mississippi and, as such, is afforded sovereign immunity in accordance with the Mississippi Tort Claims Act. Presently, sovereign immunity limits losses to $500,000 per claim. Consistent with this insurance program change (and in accordance with the process described below), the System recorded an accrual for self-insured losses totaling approximately $1,925,000 and $1,500,000 as of September 30, 2012 and 2011, respectively. Prior to October 1, 2003, the System's insurance coverages for professional and general liability risks were provided under claims-made policies.

Incurred losses identified through the System's incident reporting system and incurred but not reported losses are accrued based on estimates that incorporate the System's current inventory of reported claims and historical experience, as well as considerations such as the nature of each claim or incident, relevant trend factors and advice from consulting actuaries. The System has established a self-insurance trust fund for payment of liability claims and makes deposits to the fund in amounts determined by consulting actuaries.

The following is a summary of changes in the System's self-insurance liability for professional and general liability costs for fiscal 2012 and 2011:

		2012	2011
Balance at October 1	$	1,500,000	1,563,000
Provisions for claims reported and claims incurred but not reported		438,343	(38,228)
Claims paid		(13,343)	(24,772)
Balance at September 30	$	1,925,000	1,500,000

Like many other businesses, the System is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illness; natural disasters; and professional and general liability claims and judgments. Commercial insurance coverage is purchased for most claims arising from such matters. Claims settled through September 30, 2012 have not exceeded this commercial coverage in any of the three preceding years.

Prior to 2003, the System purchased insurance to cover workers' compensation claims. During 2003, the System purchased high-deductible workers' compensation insurance, which had the effect that the System is largely self-insured.

The following is a summary of changes in the System's self-insurance liability for worker's compensation coverages for fiscal 2012 and 2011:

		2012	2011
Balance at October 1	$	3,085,000	2,960,000
Provisions for claims reported and claims incurred but not reported		205,000	661,000
Claims paid		(680,000)	(536,000)
Balance at September 30	$	2,610,000	3,085,000

At September 30, 2012 and 2011, approximately $680,000 and $536,000, respectively, of the above self-insurance liability is included in accrued payroll and employee benefits in the accompanying balance sheets.

The System is self-insured for employee health coverage, up to a limit of $500,000 per individual claim. The System maintains coverage with a third-party carrier for excess losses up to $1 million (specific lifetime reimbursement per covered person).

The following is a summary of changes in the System's self-insurance liability for employee health coverage (included in accrued payroll and employee benefits in the accompanying balance sheets) for fiscal 2012 and 2011:

		2012	2011
Balance at October 1	$	1,608,000	1,372,000
Provisions for claims reported and claims incurred but not reported		28,606,000	22,765,000
Claims paid		(26,322,000)	(22,529,000)
Balance at September 30	$	3,892,000	1,608,000

(13) Unrestricted Grants from Jackson County

Many years ago the Jackson County Board of Supervisors provided a tax levy to assist in meeting the System's operating costs of providing medical care to the County's indigent (charity) patients and court-ordered psychiatric admissions. Effective October 1, 1986, financial assistance was discontinued by the County. No funds were received in either 2012 or 2011, even though the System was required to provide free service, charity, and uncollectible care represented by established charges totaling approximately $171,498,000 and $152,860,000, respectively.

(Continued)

(14) Current Economic Environment

In light of the current sluggish recovery of the U.S. economy, System management continues to monitor economic conditions closely, both with respect to potential impacts on the healthcare provider industry and from a more general business perspective. While the System was able to achieve certain objectives of importance in the current economic environment, management recognizes that economic conditions may continue to impact the System in a number of ways, including (but not limited to) uncertainties associated with U.S. financial system reform and rising self-pay patient volumes and corresponding increases in uncompensated care.

Additionally, the general healthcare industry environment is increasingly uncertain, especially with respect to the impacts of federal healthcare reform legislation which was passed in the spring of 2010. Potential impacts of ongoing healthcare industry transformation include, but are not limited to:

- Significant (and potentially unprecedented) capital investment in healthcare information technology (HCIT);
- Continuing volatility in the state and federal government reimbursement programs;
- Lack of clarity related to the health benefit exchange framework mandated by reform legislation, including important open questions regarding the constitutionality of the legislation, exchange reimbursement levels, changes in combined state/federal disproportionate share payments, and impact on the healthcare "demand curve" as the previously uninsured enter the insurance system;
- Effective management of multiple major regulatory mandates, including achievement of meaningful use of HCIT and the transition to ICD-10; and
- Significant potential business model changes throughout the healthcare ecosystem, including within the healthcare commercial payor industry.

The business of healthcare in the current economic, legislative and regulatory environment is volatile. Any of the above factors, along with others both currently in existence and/or which may arise in the future, could have a material adverse impact on the System's financial position and operating results.

SINGING RIVER HEALTH SYSTEM
(A Component Unit of Jackson County, Mississippi)
Surety Bonds for Officials and Employees
September 30, 2012

Name	Position	Company	Amount of bond
Lawrence H. Cosper	Trustee	Western Surety Company	$ 10,000
Allen L. Cronier	Trustee	Western Surety Company	10,000
Ira S. Polk	Trustee	Western Surety Company	10,000
Michael J. Heidelberg	Trustee	Western Surety Company	10,000
Morris G. Strickland	Trustee	Western Surety Company	10,000
Michael D. Tolleson	Trustee	Western Surety Company	10,000
Eric D. Washington	Trustee	Western Surety Company	10,000
Tommy L. Leonard	Trustee	Western Surety Company	10,000
Joseph P. Vice	Trustee	Western Surety Company	10,000
G. Chris Anderson	Chief Executive Officer	Western Surety Company	10,000
Michael E. Crews	Chief Financial Officer	Western Surety Company	10,000

See accompanying independent auditors' report.