HENDERSON COUNTY
HOSPITAL CORPORATION

2007 BUDGET

FOR THE YEAR ENDED
SEPTEMBER 30, 2007

Pardee

AS APPROVED BY THE
BOARD OF DIRECTORS

SEPTEMBER 27, 2006

Annual Report to the Henderson County Commissioners March 2007

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HENDERSON COUNTY HOSPITAL CORPORATION

2007 OPERATING BUDGET - KEY ASSUMPTIONS

1 Inpatient volumes are budgeted at current year levels. Adding two new Nursing Units; Medical Detox, opened July 2006 with 8 beds and Progressive Care Unit opening October 2006 with 5 beds. The severity of patients, as measured by the case mix index, is consistent with 2006. The budget assumes the payor mix will also remain the same.

	Projected 2006	Budget 2007	Variance
Admissions	8,313	8,788	5.72%
Inpatient Days			
Current Nursing Units	35,455	35,378	-0.22%
Medical Detox	459	2,373	417.11%
Progressive Care Unit	-	638	N/A
Total Inpatient Days	35,914	38,389	6.89%
Average Length of Stay	4.32	4.37	1.11%
Case Mix Index - All Patients	1.132	1.132	0.00%
Outpatient Visits			
Endoscopy	4,856	2,962	-39.00%
All Other	86,014	88,038	2.35%
Total Outpatient Visits	90,870	91,000	0.14%

2 The budget assumes a 9% increase in charges for the Hospital and Pardee Care Center. Urgent Care and Western Carolina Medical Center charges are determined using a multiple of the Medicare fee schedule.

3 Assumes BCBSNC contract negotiations will result in a contract with rates and annual payment escalators similar to the existing contract.

4 Assumes a Medicaid Reimbursement Initiative of $870,000 for 2007.

5 Bad debt expense, as a percentage of gross revenues, is projected to be 5.43% (FY 2006 is 5.23%), in keeping with recent trends.
Charity is budgeted at 1% of gross revenues, consistent with prior years.

6 Average wage increase is projected to be 3.5%.

7 Budget assumes a continued clinical recruitment initiative to convert contract labor to employee status at the hospital and Pardee Care Center.

8 Price increases for billable supplies and pharmaceuticals have been determined based on the industry's inflationary indices of 5% and 9%, respectively.

9 Phase I of the Meditech Clinical system, which will replace Cerner Clinicals, is scheduled to go live in February 2007.

10 The Hospital's income statement for each year presented has been adjusted to include the revenues and expenses for the Auxiliary, as presented in the audited financial statements. Previously, Auxiliary contributions were reflected on the income statement as Grants and Donations.

HENDERSON COUNTY HOSPITAL CORPORATION

2007 OPERATING BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

		FY 2005 Actual	FY 2006 Projection	FY 2007 Budget	FY07 Budget to FY06 Proj	FY07 Budget to FY06 Proj
	GROSS PATIENT REVENUE					
1	Inpatient Revenue	$ 113,531,588	$ 125,512,439	$ 143,647,441	$ 18,135,002	14.45%
2	Outpatient Revenue	113,806,061	131,841,100	149,729,739	17,888,639	13.57%
3	**Total Gross Patient Revenue**	227,337,649	257,353,539	293,377,180	36,023,641	14.00%
	REVENUE DEDUCTIONS					
4	Bad Debt	12,260,698	13,467,558	15,914,630	2,447,072	18.17%
5	Contractual Deductions	100,272,640	123,490,739	149,203,774	25,713,035	20.82%
6	Charity	1,774,009	2,394,425	2,894,056	499,631	20.87%
7	Other Deductions	2,691,269	1,749,948	2,110,451	360,503	20.60%
8	**Total Revenue Deductions**	116,998,616	141,102,670	170,122,910	29,020,240	20.57%
9	**Net Patient Service Revenue**	110,339,033	116,250,869	123,254,270	7,003,401	6.02%
10	Other Operating Income	2,088,092	2,226,271	2,289,102	62,831	2.82%
11	**Total Operating Revenue**	112,427,125	118,477,140	125,543,372	7,066,232	5.96%
	OPERATING EXPENSES		full year on Cayo			
12	Salaries and Wages	46,597,512	48,318,437	* 51,747,967	3,429,530	7.10%
13	Employee Benefits	13,702,788	13,520,796	14,489,841	969,045	7.17%
14	Contract Labor	3,115,825	1,909,114	1,229,275	(679,839)	-35.61%
15	Physician Fees	1,136,077	1,261,678	1,058,676	(203,002)	-16.09%
	Contract Fees	10,085,701	7,882,295	7,968,698	86,403	1.10%
17	Billable Supplies	13,619,954	15,181,118	15,894,265	713,147	4.70%
18	Other Supplies	6,966,327	6,900,926	7,131,390	230,464	3.34%
19	Minor Equipment	303,679	299,749	360,380	60,631	20.23%
20	Training & Travel	330,851	452,897	585,950	133,053	29.38%
21	Utilities	2,217,875	2,533,409	2,566,455	33,046	1.30%
22	Maintenance & Repairs	4,031,099	4,545,713	5,277,298	731,585	16.09%
23	Insurance	2,197,526	1,662,520	1,659,460	(3,060)	-0.18%
24	Rentals & Leases	815,943	1,020,580	1,209,478	188,898	18.51%
25	Other Expense	1,703,566	1,541,366	1,678,850	137,484	8.92%
26	**Total Operating Expenses**	106,824,723	107,030,598	112,857,983	5,827,385	5.44%
27	**Gross Operating Margin**	5,602,402	11,446,542	12,685,389	1,238,847	10.82%
28	Depreciation	11,307,382	11,373,782	11,468,402	94,620	0.83%
29	Interest	486,652	731,915	750,000	18,085	2.47%
30	**Net Operating Margin**	(6,191,632)	(659,155)	466,987	1,126,142	170.85%
31	Investment Activity	444,382	636,305	699,950	63,645	10.00%
32	Grants and Donations	1,318,562	1,272,250	1,523,431	251,181	19.74%
33	Contributions to Foundation	(416,895)	(423,107)	(512,351)	(89,244)	21.09%
34	Gain on Sale of Asset	-	198,787	-	(198,787)	-100.00%
35	**Total Non-Operating Income**	1,346,050	1,684,235	1,711,030	26,795	1.59%
36	**Net Income (Loss)**	$ (4,845,582)	$ 1,025,080	$ 2,178,017	$ 1,152,937	112.47%
	t Oper Margin to Total Oper Rev	-5.51%	-0.56%	0.37%		
	Net Income to Total Operating Rev	-4.31%	0.87%	1.73%		
39	**Avg FTE's (Employee and Contract)**	1,130.0	1,142.2	1,174.0	31.7	2.78%

HENDERSON COUNTY HOSPITAL CORPORATION
2007 OPERATING BUDGET LINE ITEM PERCENTAGE ANALYSIS

		FY 2005			FY 2006			FY 2007		
		"A"	Actual	"B"	"A"	Projection	"B"	"A"	Budget	"B"
	GROSS PATIENT REVENUE									
1	Inpatient Revenue	49.9%	$ 113,531,588		48.8%	$ 125,512,439		49.0%	$ 143,647,441	
2	Outpatient Revenue	50.1%	113,806,061		51.2%	131,841,100		51.0%	149,729,739	
3	**Total Gross Patient Revenue**	**100.0%**	227,337,649		**100.0%**	257,353,539		**100.0%**	293,377,180	
	REVENUE DEDUCTIONS									
4	Bad Debt	5.4%	12,260,698		5.2%	13,467,558		5.4%	15,914,630	
5	Contractual Deductions	44.1%	100,272,640		48.0%	123,490,739		50.9%	149,203,774	
6	Charity	0.8%	1,774,009		0.9%	2,394,425		1.0%	2,894,056	
7	Other Deductions	1.2%	2,691,269		0.7%	1,749,948		0.7%	2,110,451	
8	**Total Revenue Deductions**	51.5%	116,998,616		54.8%	141,102,670		58.0%	170,122,910	
9	**Net Patient Service Revenue**	48.5%	110,339,033		45.2%	116,250,869		42.0%	123,254,270	
10	Other Operating Income	0.9%	2,088,092		0.9%	2,226,271		0.8%	2,289,102	
11	**Total Operating Revenue**	49.5%	112,427,125	**100.0%**	46.0%	118,477,140	**100.0%**	42.8%	125,543,372	**100.0%**
	OPERATING EXPENSES									
12	Salaries and Wages	20.5%	46,597,512	41.4%	18.8%	48,318,437	40.8%	17.6%	51,747,967	41.2%
13	Employee Benefits	6.0%	13,702,788	12.2%	5.3%	13,520,796	11.4%	4.9%	14,489,841	11.5%
14	Contract Labor	1.4%	3,115,825	2.8%	0.7%	1,909,114	1.6%	0.4%	1,229,275	1.0%
15	Physician Fees	0.5%	1,136,077	1.0%	0.5%	1,261,678	1.1%	0.4%	1,058,676	0.8%
16	Contract Fees	4.4%	10,085,701	9.0%	3.1%	7,882,295	6.7%	2.7%	7,968,698	6.3%
17	Billable Supplies	6.0%	13,619,954	12.1%	5.9%	15,181,118	12.8%	5.4%	15,894,265	12.7%
18	Other Supplies	3.1%	6,966,327	6.2%	2.7%	6,900,926	5.8%	2.4%	7,131,390	5.7%
19	Minor Equipment	0.1%	303,679	0.3%	0.1%	299,749	0.3%	0.1%	360,380	0.3%
	Training & Travel	0.1%	330,851	0.3%	0.2%	452,897	0.4%	0.2%	585,950	0.5%
	Utilities	1.0%	2,217,875	2.0%	1.0%	2,533,409	2.1%	0.9%	2,566,455	2.0%
22	Maintenance & Repairs	1.8%	4,031,099	3.6%	1.8%	4,545,713	3.8%	1.8%	5,277,298	4.2%
23	Insurance	1.0%	2,197,526	2.0%	0.6%	1,662,520	1.4%	0.6%	1,659,460	1.3%
24	Rentals & Leases	0.4%	815,943	0.7%	0.4%	1,020,580	0.9%	0.4%	1,209,478	1.0%
25	Other Expense	0.7%	1,703,566	1.5%	0.6%	1,541,366	1.3%	0.6%	1,678,850	1.3%
26	**Total Operating Expenses**	47.0%	106,824,723	95.0%	41.6%	107,030,598	90.3%	38.5%	112,857,983	89.9%
27	**Gross Operating Margin**	2.5%	5,602,402	5.0%	4.4%	11,446,542	9.7%	4.3%	12,685,389	10.1%
28	Depreciation	5.0%	11,307,382	10.1%	4.4%	11,373,782	9.6%	3.9%	11,468,402	9.1%
29	Interest	0.2%	486,652	0.4%	0.3%	731,915	0.6%	0.3%	750,000	0.6%
30	**Net Operating Margin**	-2.7%	(6,191,632)	-5.5%	-0.3%	(659,155)	-0.6%	0.2%	466,987	0.4%
31	Investment Activity	0.2%	444,382	0.4%	0.2%	636,305	0.5%	0.2%	699,950	0.6%
32	Grants and Donations	0.6%	1,318,562	1.2%	0.5%	1,272,250	1.1%	0.5%	1,523,431	1.2%
33	Contributions to Foundation	-0.2%	(416,895)	-0.4%	-0.2%	(423,107)	-0.4%	-0.2%	(512,351)	-0.4%
34	Gain on Sale of Asset		-		0.1%	198,787	0.2%		-	
35	**Total Non-Operating Income**	0.6%	1,346,050	1.2%	0.7%	1,684,235	1.4%	0.6%	1,711,030	1.4%
36	**Net Income (Loss)**	-2.1%	$ (4,845,582)	-4.3%	0.4%	$ 1,025,080	0.9%	0.7%	$ 2,178,017	1.7%
37	**Net Oper Margin to Total Oper Rev**		-5.51%			-0.56%			0.37%	
38	**Net Income to Total Operating Rev**		-4.31%			0.87%			1.73%	
39	**Avg FTE's (Employee and Contract)**		1,130.0			1,142.2			1,174.0	

'A" Percentage of item as compared to Total Gross Patient Revenues
'B" Percentage of item as compared to Total Operating Revenues

MARGARET R PARDEE MEMORIAL HOSPITAL

2007 OPERATING BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

		FY 2005 Actual	FY 2006 Projection	FY 2007 Budget	FY07 Budget to FY06 Proj	FY07 Budget to FY06 Proj
	GROSS PATIENT REVENUE					
1	Inpatient Revenue	$ 104,955,094	$ 115,925,642	$ 133,233,269	$ 17,307,627	14.93%
2	Outpatient Revenue	108,621,747	126,323,287	144,489,433	18,166,146	14.38%
3	**Total Gross Patient Revenue**	213,576,841	242,248,929	277,722,702	35,473,773	14.64%
	REVENUE DEDUCTIONS					
4	Bad Debt	11,944,728	13,097,043	15,533,062	2,436,019	18.60%
5	Contractual Deductions	97,748,057	119,814,606	145,157,212	25,342,606	21.15%
6	Charity	1,774,009	2,383,619	2,881,114	497,495	20.87%
7	Other Deductions	2,606,385	1,749,948	2,110,451	360,503	20.60%
8	**Total Revenue Deductions**	114,073,179	137,045,216	165,681,838	28,636,622	20.90%
9	**Net Patient Service Revenue**	99,503,662	105,203,713	112,040,864	6,837,151	6.50%
10	Other Operating Income	1,985,274	2,103,005	2,165,852	62,847	2.99%
11	**Total Operating Revenue**	101,488,936	107,306,718	114,206,716	6,899,998	6.43%
	OPERATING EXPENSES					
12	Salaries and Wages	38,886,468	40,576,892	44,437,116	3,860,224	9.51%
13	Employee Benefits	11,552,745	11,225,949	12,341,462	1,115,513	9.94%
14	Contract Labor	2,773,325	1,480,389	1,014,275	(466,114)	-31.49%
1	Physician Fees	1,124,077	1,261,678	1,058,676	(203,002)	-16.09%
	Contract Fees	9,727,126	7,374,256	7,596,667	222,411	3.02%
1	Billable Supplies	12,969,603	14,449,693	15,138,265	688,572	4.77%
18	Other Supplies	6,395,651	6,331,245	6,547,840	216,595	3.42%
19	Minor Equipment	280,470	277,893	332,880	54,987	19.79%
20	Training & Travel	279,133	407,332	533,400	126,068	30.95%
21	Utilities	1,944,054	2,243,044	2,271,035	27,991	1.25%
22	Maintenance & Repairs	3,946,118	4,464,002	5,193,503	729,501	16.34%
23	Insurance	2,172,026	1,641,167	1,645,156	3,989	0.24%
24	Rentals & Leases	565,779	753,628	991,036	237,408	31.50%
25	Other Expense	1,571,177	1,479,394	1,639,450	160,056	10.82%
26	**Total Operating Expenses**	94,187,752	93,966,562	100,740,761	6,774,199	7.21%
27	**Gross Operating Margin**	7,301,184	13,340,156	13,465,955	125,799	0.94%
28	Depreciation	10,980,061	11,048,500	11,168,234	119,734	1.08%
29	Interest	486,652	731,915	750,000	18,085	2.47%
30	**Net Operating Margin**	(4,165,529)	1,559,741	1,547,721	(12,020)	-0.77%
31	Investment Activity	444,382	636,305	699,950	63,645	10.00%
32	Grants and Donations	1,318,562	1,272,250	1,523,431	251,181	19.74%
33	Contributions to Foundation	(416,895)	(423,107)	(512,351)	(89,244)	21.09%
34	Gain on Sale of Asset	-	198,787	-	(198,787)	-100.00%
35	**Total Non-Operating Income**	1,346,050	1,684,235	1,711,030	26,795	1.59%
36	**Net Income (Loss)**	$ (2,819,479)	$ 3,243,976	$ 3,258,751	$ 14,775	0.46%
	et Oper Margin to Total Oper Rev	-4.10%	1.45%	1.36%		
	Net Income to Total Operating Rev	-2.78%	3.02%	2.85%		
39	**Avg FTE's (Employee and Contract)**	940.4	950.8	991.7	40.8	4.30%

MARGARET R PARDEE MEMORIAL HOSPITAL
2007 OPERATING BUDGET ROLL FORWARD
FAVORABLE (UNFAVORABLE)

1	**Projected 2006 Excess of Revenues Over Expenses**	$	**3,243,976**
2	Net Patient Revenue: 9% rate increase		5,000,000
3	Net Patient Revenue: Volume growth		3,000,000
4	Net Patient Revenue: Change in OR and Recovery Room charge structure		1,420,000
5	Net Patient Revenue: Loss of Endoscopy Procedures		(1,900,000)
6	Net Patient Revenue: Medicaid Reimbursement Initiative (MRI) Adjustment		(730,000)
7	Sublease income from Doctor's offices in Fletcher		45,000
8	Salaries: average wage increase of 3.5% and market adjustments		(1,650,000)
9	Salaries and Benefit expense: New Positions and restructures Medical Detox $650,000, (9 FTE's for 2007) Progressive Care Unit $540,000, (7 FTE's)		(1,680,000)
10	Conversion of clinical Contract Labor to employee status Additional salary and benefit expense of $308,000 Reduction in Contract Labor of $466,000		158,000
11	Conversion of collections from contract to employee status in July 2006 Additional salary and benefit expense of $500,000 (14 FTE's for 2007) Reduction of Contract Fees of $1,100,000		600,000
12	Health insurance and other employee benefits		(630,000)
13	Contract Fees Physician Guarantees for attracting new doctors $480,000 Hendersonville Family Health Center MAHEC Contract $223,000 Medical Contracts - PET Scans, Cardiac Cath, Rad Therapy, Radiology $320,000 Audit, Compliance and Consulting Fees $200,000 Online Patient Payment System $98,000		(1,322,000)
14	Supplies - Surgical supplies increased by 5% $340,000 Pharmaceuticals increased by 9% $365,000, All other supplies $200,000		(905,000)
15	Minor Equipment		(55,000)
16	Training and Travel		(126,000)
17	Utility Expense - 1% increase. New electric boiler installed		(28,000)
18	Maintenance Contracts - IT $350,000, Linear Accelerator $330,000		(730,000)
19	Rentals & Leases - Includes patient equipment, Linear Accelerator $132,000, Fletcher lease expense from Urgent Care to Hospital $63,000		(237,000)
20	Other Expense - Physician Verification, Marketing, Patient Education		(160,000)
21	Depreciation Expense		(120,000)
22	Other		64,775
23	**Budgeted 2007 Excess of Revenues Over Expenses**	$	**3,258,751**

PARDEE CARE CENTER

2007 OPERATING BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

		FY 2005 Actual	FY 2006 Projection	FY 2007 Budget	FY07 Budget to FY06 Proj	FY07 Budget to FY06 Proj
	GROSS PATIENT REVENUE					
1	Inpatient Revenue	$ 8,576,494	$ 9,586,797	$ 10,414,172	$ 827,375	8.63%
2	**Total Gross Patient Revenue**	8,576,494	9,586,797	10,414,172	827,375	8.63%
	REVENUE DEDUCTIONS					
3	Bad Debt	156,405	105,212	126,004	20,792	19.76%
4	Contractual Deductions	854,478	1,883,984	2,256,314	372,330	19.76%
5	Charity	-	10,806	12,942	2,136	19.77%
6	Other Deductions	72,518	-	-	-	0.00%
7	**Total Revenue Deductions**	1,083,401	2,000,002	2,395,260	395,258	19.76%
8	**Net Patient Service Revenue**	7,493,093	7,586,795	8,018,912	432,117	5.70%
9	Other Operating Income	101,673	122,734	122,500	(234)	-0.19%
10	**Total Operating Revenue**	7,594,766	7,709,529	8,141,412	431,883	5.60%
	OPERATING EXPENSES					
11	Salaries and Wages	4,552,220	4,871,068	4,985,017	113,949	2.34%
12	Employee Benefits	1,269,280	1,447,851	1,466,788	18,937	1.31%
13	Contract Labor	335,794	423,000	214,000	(209,000)	-49.41%
14	Physician Fees	12,000	-	-	-	0.00%
	Contract Fees	41,609	73,274	58,500	(14,774)	-20.16%
	Billable Supplies	491,144	555,601	591,400	35,799	6.44%
17	Other Supplies	430,830	440,948	457,300	16,352	3.71%
18	Minor Equipment	14,630	16,981	20,500	3,519	20.72%
19	Training & Travel	5,781	9,399	13,800	4,401	46.82%
20	Utilities	190,005	221,530	235,770	14,240	6.43%
21	Maintenance & Repairs	60,646	53,578	61,810	8,232	15.36%
22	Insurance	-	-	-	-	0.00%
23	Rentals & Leases	30,075	34,235	30,900	(3,335)	-9.74%
24	Other Expense	19,300	27,207	11,350	(15,857)	-58.28%
25	**Total Operating Expenses**	7,453,314	8,174,672	8,147,135	(27,537)	-0.34%
26	**Gross Operating Margin**	141,452	(465,143)	(5,723)	459,420	98.77%
27	Depreciation	243,043	241,606	235,935	(5,671)	-2.35%
28	Interest	-	-	-	-	0.00%
29	**Net Operating Margin**	(101,591)	(706,749)	(241,658)	465,091	65.81%
30	**Net Income (Loss)**	$ (101,591)	$ (706,749)	$ (241,658)	$ 465,091	65.81%
31	**Net Oper Margin to Total Oper Rev**	-1.34%	-9.17%	-2.97%		
32	**Net Income to Total Operating Rev**	-1.34%	-9.17%	-2.97%		
33	**Avg FTE's (Employee and Contract)**	139.2	144.9	146.0	1.2	0.80%

PARDEE CARE CENTER
2007 OPERATING BUDGET ROLL FORWARD
FAVORABLE (UNFAVORABLE)

1	**Projected 2006 Loss of Revenues Over Expenses**	**$**	**(706,749)**
2	Net Patient Revenue Includes a rate increase, Medicaid case mix index improvement and optimize Medicare reimbursement.		432,000
3	Salaries: average wage increase of 3.5%		(168,000)
4	Conversion of Contract Labor to employees and Baylor System implementation Reduction in overtime salary and benefit expense of $60,000 Reduction in Contract Labor of $209,000		269,000
5	Health insurance and other employee benefits		(25,000)
6	Contract Fees - Reduction in consulting		15,000
	Billable supplies		(36,000)
8	All other supplies		(16,000)
9	Minor Equipment expenses		(3,500)
10	Utility expense increase - mainly due to rise in fuel costs		(14,000)
11	Maintenance and Repairs		(8,000)
12	Other Expense - DFS Deficiencies		16,000
13	Depreciation		5,700
14	Other		(2,109)
15	**Budgeted 2007 Loss of Revenues Over Expenses**	**$**	**(241,658)**

PARDEE URGENT CARE CENTER

2007 OPERATING BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

		FY 2005 Actual	FY 2006 Projection	FY 2007 Budget	FY07 Budget to FY06 Proj	FY07 Budget to FY06 Proj
	GROSS PATIENT REVENUE					
1	Outpatient Revenue	$ 2,947,997	$ 3,155,263	$ 2,898,000	$ (257,263)	-8.15%
2	**Total Gross Patient Revenue**	2,947,997	3,155,263	2,898,000	(257,263)	-8.15%
	REVENUE DEDUCTIONS					
3	Bad Debt	161,594	230,000	219,169	(10,831)	-4.71%
4	Contractual Deductions	950,694	1,032,105	983,501	(48,604)	-4.71%
5	Charity	-	-	-	-	0.00%
6	Other Deductions	2,157	-	-	-	0.00%
7	**Total Revenue Deductions**	1,114,445	1,262,105	1,202,670	(59,435)	-4.71%
8	**Net Patient Service Revenue**	1,833,552	1,893,158	1,695,330	(197,828)	-10.45%
9	Other Operating Income	-	-	-	-	0.00%
10	**Total Operating Revenue**	1,833,552	1,893,158	1,695,330	(197,828)	-10.45%
	OPERATING EXPENSES					
11	Salaries and Wages	1,634,848	1,443,492	1,083,643	(359,849)	-24.93%
12	Employee Benefits	455,839	428,084	328,247	(99,837)	-23.32%
13	Contract Labor	3,272	252	-	(252)	-100.00%
14	Physician Fees	-	-	-	-	0.00%
	Contract Fees	119,052	184,255	154,316	(29,939)	-16.25%
	Billable Supplies	114,707	133,862	126,200	(7,662)	-5.72%
17	Other Supplies	79,151	69,037	67,450	(1,587)	-2.30%
18	Minor Equipment	3,754	250	2,500	2,250	900.00%
19	Training & Travel	24,676	20,273	23,250	2,977	14.68%
20	Utilities	13,285	13,130	8,100	(5,030)	-38.31%
21	Maintenance & Repairs	7,109	10,226	6,077	(4,149)	-40.57%
22	Insurance	16,176	12,806	8,088	(4,718)	-36.84%
23	Rentals & Leases	83,567	89,561	44,500	(45,061)	-50.31%
24	Other Expense	88,882	21,589	17,500	(4,089)	-18.94%
25	**Total Operating Expenses**	2,644,318	2,426,817	1,869,871	(556,946)	-22.95%
26	**Gross Operating Margin**	(810,766)	(533,659)	(174,541)	359,118	67.29%
27	Depreciation	58,872	60,811	52,223	(8,588)	-14.12%
28	Interest	-	-	-	-	0.00%
29	**Net Operating Margin**	(869,638)	(594,470)	(226,764)	367,706	61.85%
30	**Net Income (Loss)**	$ (869,638)	$ (594,470)	$ (226,764)	$ 367,706	61.85%
31	**Net Oper Margin to Total Oper Rev**	-47.43%	-31.40%	-13.38%		
32	**Net Income to Total Operating Rev**	-47.43%	-31.40%	-13.38%		
33	**Avg FTE's (Employee and Contract)**	25.2	24.4	18.9	(5.5)	-22.42%

PARDEE URGENT CARE CENTER
2007 OPERATING BUDGET ROLL FORWARD
FAVORABLE (UNFAVORABLE)

1	**Projected 2006 Loss of Revenues Over Expenses**	**$**	**(594,470)**
2	Net Patient Revenues		101,000
3	Salaries: average wage increase of 3.5% and restructure		(27,000)
4	Health insurance and other employee benefits		(12,000)
5	Contract Fees - Mysis terminated		6,500
6	Supply expense		(10,000)
7	Minor Equipment		(2,300)
8	Training and Travel		(8,000)
9	Facility lease payment		(2,500)
10	Depreciation		1,900
11	Close Fletcher location - 4/15/06		322,000
12	Other		(1,894)
13	**Budgeted 2007 Excess of Revenues Over Expenses**	**$**	**(226,764)**

WESTERN CAROLINA MEDICAL ASSOCIATES

2007 OPERATING BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

		FY 2005 Actual	FY 2006 Projection	FY 2007 Budget	FY07 Budget to FY06 Proj	FY07 Budget to FY06 Proj
	GROSS PATIENT REVENUE					
1	Outpatient Revenue	$ 2,236,317	$ 2,362,550	$ 2,342,306	$ (20,244)	-0.86%
2	**Total Gross Patient Revenue**	2,236,317	2,362,550	2,342,306	(20,244)	-0.86%
	REVENUE DEDUCTIONS					
3	Bad Debt	(2,029)	35,303	36,395	1,092	3.09%
4	Contractual Deductions	719,411	760,044	806,747	46,703	6.14%
5	Charity	-	-	-	-	0.00%
6	Other Deductions	10,209	-	-	-	0.00%
7	**Total Revenue Deductions**	727,591	795,347	843,142	47,795	6.01%
8	**Net Patient Service Revenue**	1,508,726	1,567,203	1,499,164	(68,039)	-4.34%
9	Other Operating Income	1,145	532	750	218	40.98%
10	**Total Operating Revenue**	1,509,871	1,567,735	1,499,914	(67,821)	-4.33%
	OPERATING EXPENSES					
11	Salaries and Wages	1,523,976	1,426,985	1,242,191	(184,794)	-12.95%
12	Employee Benefits	424,924	418,912	353,344	(65,568)	-15.65%
13	Contract Labor	3,434	5,473	1,000	(4,473)	-81.73%
14	Physician Fees	-	-	-	-	0.00%
	Contract Fees	197,914	250,510	159,215	(91,295)	-36.44%
	Billable Supplies	44,500	41,962	38,400	(3,562)	-8.49%
	Other Supplies	60,695	59,696	58,800	(896)	-1.50%
18	Minor Equipment	4,825	4,625	4,500	(125)	-2.70%
19	Training & Travel	21,261	15,893	15,500	(393)	-2.47%
20	Utilities	70,531	55,705	51,550	(4,155)	-7.46%
21	Maintenance & Repairs	17,226	17,907	15,908	(1,999)	-11.16%
22	Insurance	9,324	8,547	6,216	(2,331)	-27.27%
23	Rentals & Leases	136,522	143,156	143,042	(114)	-0.08%
24	Other Expense	24,207	13,176	10,550	(2,626)	-19.93%
25	**Total Operating Expenses**	2,539,339	2,462,547	2,100,216	(362,331)	-14.71%
26	**Gross Operating Margin**	(1,029,468)	(894,812)	(600,302)	294,510	32.91%
27	Depreciation	25,406	22,865	12,010	(10,855)	-47.47%
28	Interest	-	-	-	-	0.00%
29	**Net Operating Margin**	(1,054,874)	(917,677)	(612,312)	305,365	33.28%
30	**Net Income (Loss)**	$ (1,054,874)	$ (917,677)	$ (612,312)	$ 305,365	33.28%
31	**Net Oper Margin to Total Oper Rev**	-69.87%	-58.54%	-40.82%		
32	**Net Income to Total Operating Rev**	-69.87%	-58.54%	-40.82%		
33	**Avg FTE's (Employee and Contract)**	25.3	22.2	17.4	(4.8)	-21.62%
34	**Estimated Enterprise Value**	2,500,000	3,580,000			

WESTERN CAROLINA MEDICAL ASSOCIATES
2007 OPERATING BUDGET ROLL FORWARD
FAVORABLE (UNFAVORABLE)

1	**Projected 2006 Loss of Revenues Over Expenses**	$	**(917,677)**
2	Net Patient Revenues		46,500
3	Salaries: average wage increase of 3.5%		(23,000)
4	Salaries: restructure of staffing and revised compensation contracts		106,000
5	Health insurance and other employee benefits		(9,000)
6	Contract Fees - Mysis terminated		48,000
7	Supply expense		(1,100)
8	Utilities		(2,600)
	Depreciation		4,200
10	Close Etowah Office - 5/1/06		136,022
11	Other		343
12	**Budgeted 2007 Loss of Revenues Over Expenses**	$	**(612,312)**

HENDERSON COUNTY HOSPITAL CORPORATION

HIGHLIGHT STATISTICS

2007 BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

	Description	Actual 2005	Projection 2006	Budget 2007	Bud 2007 to Proj 2006
1	Admissions	8,340	8,313	8,788	5.7%
2	Patient Days Total - No Observation	35,905	35,914	38,389	6.9%
3	Observation Hours Total	78,601	66,623	67,613	1.5%
4	Average Length of Stay	4.31	4.32	4.37	1.1%
5	Case Mix Index	1.115	1.132	1.132	0.0%
6	Total Births	559	533	535	0.4%
7	Emergency Room - Visits	29,530	30,143	30,163	0.1%
8	Cardiac Cath - Procedures	126	181	187	3.3%
9	Operating Room - Cases	6,678	6,665	6,820	2.3%
10	Inpatient Cases	2,345	2,133	2,182	2.3%
11	Outpatient Cases	4,333	4,532	4,638	2.3%
12	Endoscopy Cases	4,613	4,880	2,986	-38.8%
13	Outpatient Visits	93,940	90,870	91,000	0.1%
14	Radiology - Procedures	35,207	32,882	33,313	1.3%
15	CT - Procedures	18,043	17,962	18,370	2.3%
16	MRI - Procedures	7,022	6,953	7,078	1.8%
17	PET Scans - Procedures	-	108	144	33.3%
18	Mammograpy - Procedures	10,445	10,652	11,387	6.9%
19	Radiation Therapy - Procedures	14,386	12,577	12,830	2.0%
20	Laboratory - Procedures	364,068	358,395	359,925	0.4%
21	Cardiology - Procedures	5,686	5,636	5,800	2.9%
22	Health Education Center - Visits	50,829	48,988	55,000	12.3%
23	Home Health - Episodes of Care	1,367	1,318	1,347	2.2%
24	Family Practice - Visits	18,012	20,358	23,156	13.7%
25	Adult Day Center - Visits	5,789	6,480	6,800	4.9%
26	Pardee Care Center - Patient Days	42,950	43,567	43,800	0.5%
27	Urgent Care Four Seasons - Visits	22,331	22,649	23,000	1.5%
28	WCMA - Hendersonville	16,021	15,437	16,994	10.1%
29	WCMA - Fletcher	2,968	3,132	3,350	7.0%

HENDERSON COUNTY HOSPITAL CORPORATION

CAPITAL BUDGET FY 2007

Type	Department	Description	Funded by Operations	Grants and Donations	FY 2007 Budget
IT	IT	Meditech Clinicals Continuation	$ 1,740,000		$ 1,740,000
Project	Engineering	Medical Recs/Education "Rollover"	720,141	479,859	1,200,000
Project	Engineering	Upfit projects/ A&E / SOC	500,000		500,000
Project	OR 2nd Flr Ste	OR 2nd Floor Suite	500,000		500,000
Project	Engineering	Cardiac Rehab/Diabetes Education "Rollover"	261,000	150,000	411,000
Other	Nursing Admin	Hill-Rom Bed - VersaCare with Air	384,834		384,834
Biomed	Anesthesia	Epidural/PCA Pumps	-	256,180	256,180
Biomed	Operating Room	Orthopedic Arthroscopy Towers	249,503		249,503
Project	Mammography	Breast Care Center Renovations "Rollover"	50,000	150,000	200,000
Biomed	Operating Room	Orthopedic Fracture Table	198,392		198,392
IT	IT	Network Hardware	190,845		190,845
IT	IT	All PC's, Monitors, Printers	175,000		175,000
IT	Family Way	Phillips OB Tracevue Upgrade	170,684		170,684
IT	IT	Network Upgrade & Expansion-Various SW	138,000		138,000
Project	Engineering	Stentofon Interocm Alphacom Upgrade	135,400		135,400
Project	Nutrition	Renovation of the current cafeteria	105,000		105,000
Biomed	MRI	1.5T EXCITE HD Magnet, Equip & Upgrade	100,000		100,000
Project	Engineering	Replacement of Orthopaedic Roof	100,000		100,000
Biomed	Laboratory	Vitek Auto Identification Susceptibility instrument	91,300		91,300
[illegible]	Rad Therapy	Ultrasound Unit - Prostate Seed Implants	-	90,000	90,000
Biomed	Respiratory	Puritan Bennett 840 Ventilator w/ Accessories	87,415		87,415
Biomed	Operating Room	Imaging Table/Vascular OR Table	-	77,312	77,312
IT	IT	GE RHIO Hardware & Interfaces	75,000		75,000
IT	Radiology	PACS Upgrade & Replacement	68,000		68,000
IT	IT	Kronos - Timekeeping Upgrade	66,500		66,500
Biomed	ICU	GE Bedside Monitors	65,836		65,836
Biomed	Laboratory	BacTAlert automated blood culture instrument	65,050		65,050
IT	IT	Synergy Client Access Licenses	60,000		60,000
Other	Radiology	OUI Dictation Equipment	53,000		53,000
IT	Accounting	Financial SW Package - Meditech to Excel/Budgets	45,000		45,000
Project	Engineering	Add public bathrooms - old Med Recs Area	40,000		40,000
Project	Radiology	Renovation of current Radiology Dept	38,850		38,850
IT	Pharmacy	Pyxis Additions - Capital Lease Various Upgrades	37,725		37,725
Biomed	Laboratory	Tissue Tek SCA Converslipper w/ Fume Controller	34,500		34,500
Biomed	Radiology	Aycan Paper Printer	34,120		34,120
IT	IT	Data Center Cable Upgrade	31,700		31,700
IT	Medical Records	Medical Records Dictation Server	22,150		22,150
Project	Engineering	Replace L Shaped Courtyard Roof	20,000		20,000
IT	IT	Boston Workstation - Site License for unlimited use	18,000		18,000
Biomed	Rad Therapy	Adac Pet Fusion Software & Dicom License	17,594		17,594
Biomed	Radiology	Defibrillator & Monitor	17,400		17,400
Biomed	Operating Room	Hip Arthroscopy System	16,344		16,344
[illegible]	Security	Gatekeeper Software Upgrade	15,000		15,000
Biomed	Mammography	Mammotome Breast Biopsy System	-	14,000	14,000
Other	Pharmacy	Video surveillance equipment	14,000		14,000
Biomed	Operating Room	Explant Removal System	12,940		12,940
IT	Medical Records	San Storage for Medical Records Chart Scanning	12,205		12,205

HENDERSON COUNTY HOSPITAL CORPORATION

CAPITAL BUDGET FY 2007

Type	Department	Description	Funded by Operations	Grants and Donations	FY 2007 Budget
Biomed	Laboratory	Blood Bank Refrigerator	9,000		9,000
Other	Environmental	Floor Scrubber	8,700		8,700
Biomed	Central Sterile	Cleaning machine for surgical instrument	8,500		8,500
IT	HR	Badge 10 System	8,000		8,000
Biomed	1 West	Transport Monitor	7,730		7,730
IT	IT	Compliance Checker Upgrade	7,500		7,500
Other	ICU	Mobile Storage System (Shelving)	7,000		7,000
Other	Education	ALS Skillmaster 4000 (Complete)	6,609		6,609
Other	Education	Bar Code/Magnetic Stripe Wizard w/Handheld	5,500		5,500
IT	Family Way	Meditech ADT Interface	5,000		5,000
Biomed	Pharmacy	4ft Commercial Fridge w/alarm	5,000		5,000
Other	Engineering	Expansion of Telephone Ports	5,000		5,000
IT	IT	Door Entry Card Swipe Readers	4,500		4,500
Other	Med Wellness	Bar Coding - Patient Tracker/Billing System/Software	4,400		4,400
Biomed	Family Way	Neo Blue LED Phototherapy Light	3,995		3,995
Biomed	PCC - PT	Nu-Step Recumbent Stepper	3,800		3,800
Biomed	Adult Day	Dinamap Pro 100	3,750		3,750
Biomed	PT - O/P	Cybex - Upper Body Ergometer	3,700		3,700
Biomed	Family Way	Neo Blue LED Phototherapy Light, Cozy 110V	3,495		3,495
med	Family Practice	Spirometric Flowmate V	3,185		3,185
ther	Engineering	Circuit packs on the phone system	3,000		3,000
Biomed	PT - O/P	QCS-550 Multi-Hip w/ Adjustable Start Range	2,700		2,700
Biomed	Family Practice	Maico Digital Pilot Audiometer	2,607		2,607
Biomed	Operating Room	Hover Mattress	2,510		2,510
Other	Education	LCD Projector PT - LB30NTU	2,300		2,300
Other	Nutrition	Ice Maker	2,050		2,050
Other	Engineering	HVAC Examiner Video Inspection Sys	1,700		1,700
Biomed	ST - O/P	Vital Stim Therapy Unit	1,595		1,595
Biomed	Family Practice	PT-INR CoaguCheck System	1,425		1,425
Other	Education	Polycom SoundStation Consoles	1,299		1,299
Project	UCC	4.1 Partner Voice Mail	1,260		1,260
Contingency	Administration	Contingency/Unbudgeted	800,000		800,000
Total Capital Budget			**7,715,238**	**1,217,351**	**8,932,589**

Project	3,251,510
Information Technology	2,890,809
Biomed	1,490,878
Other	499,392
Contingency	800,000
Total Capital Budget	8,932,589

URGENT CARE CENTER

2007 OPERATING BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

FOUR SEASONS

		FY 2005 Actual	FY 2006 Projection	FY 2007 Budget	FY07 Budget to FY06 Proj	FY07 Budget to FY06 Proj
	GROSS PATIENT REVENUE					
1	Outpatient Revenue	$ 2,343,021	$ 2,695,231	$ 2,898,000	$ 202,769	7.52%
2	**Total Gross Patient Revenue**	2,343,021	2,695,231	2,898,000	202,769	7.52%
3	**REVENUE DEDUCTIONS**					
4	Bad Debt	102,450	127,457	219,169	91,712	71.96%
5	Contractual Deductions	780,379	970,861	983,501	12,640	1.30%
6	Charity and Other Deductions	2,157	2,684	-	(2,684)	-100.00%
7	**Total Revenue Deductions**	884,986	1,101,002	1,202,670	101,668	9.23%
8	**Net Patient Service Revenue**	1,458,035	1,594,229	1,695,330	101,101	6.34%
9	Other Operating Income	-	-	-	-	0.00%
10	**Total Operating Revenue**	1,458,035	1,594,229	1,695,330	101,101	6.34%
	OPERATING EXPENSES					
11	Salaries and Wages	1,087,524	1,056,484	1,083,643	27,159	2.57%
12	Employee Benefits	303,231	314,084	328,247	14,163	4.51%
13	Contract Labor	1,613	26	-	(26)	-100.00%
14	Physician Fees	-	-	-	-	0.00%
15	Contract Fees	99,027	160,831	154,316	(6,515)	-4.05%
	illable Supplies	99,119	122,669	126,200	3,531	2.88%
	Other Supplies	62,330	60,912	67,450	6,538	10.73%
18	Minor Equipment	1,591	222	2,500	2,278	1025.92%
19	Training & Travel	22,305	15,000	23,250	8,250	55.00%
20	Utilities	8,472	8,665	8,100	(565)	-6.52%
21	Maintenance & Repairs	5,821	6,591	6,077	(514)	-7.80%
22	Insurance	8,088	8,088	8,088	-	0.00%
23	Rentals & Leases	46,575	42,036	44,500	2,464	5.86%
24	Other Expense	61,463	16,668	17,500	832	4.99%
25	**Total Operating Expenses**	1,807,160	1,812,277	1,869,871	57,594	3.18%
26	**Gross Operating Margin**	(349,125)	(218,048)	(174,541)	43,507	19.95%
27	Depreciation	53,697	54,157	52,223	(1,934)	-3.57%
28	Interest	-	-	-	-	0.00%
29	**Net Operating Margin**	(402,822)	(272,205)	(226,764)	45,441	16.69%
30	**Total Income (Loss)**	$ (402,822)	$ (272,205)	$ (226,764)	$ 45,441	16.69%
31	**Net Operating Margin to Net Income**	-27.63%	-17.07%	-13.38%		
32	**Total Income to Net Income**	-27.63%	-17.07%	-13.38%		
33	**Avg FTE's (Employee and Contract)**	17.6	17.5	18.9	1.4	7.82%

URGENT CARE CENTER

2007 OPERATING BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

FLETCHER - Closed 4/15/06

		FY 2005 Actual	FY 2006 Projection	FY 2007 Budget	FY07 Budget to FY06 Proj	FY07 Budget to FY06 Proj
	GROSS PATIENT REVENUE					
1	Outpatient Revenue	$ 604,977	$ 460,032	$ -	$ (460,032)	-100.00%
2	**Total Gross Patient Revenue**	604,977	460,032	-	(460,032)	-100.00%
3	**REVENUE DEDUCTIONS**					
4	Bad Debt	59,144	41,525		(41,525)	-100.00%
5	Contractual Deductions	170,315	119,578		(119,578)	-100.00%
6	Charity and Other Deductions	-	-		-	0.00%
7	**Total Revenue Deductions**	229,459	161,103	-	(161,103)	-100.00%
8	**Net Patient Service Revenue**	375,518	298,929	-	(298,929)	-100.00%
9	Other Operating Income	-	-	-	-	0.00%
10	**Total Operating Revenue**	375,518	298,929	-	(298,929)	-100.00%
	OPERATING EXPENSES					
11	Salaries and Wages	547,324	387,008	-	(387,008)	-100.00%
12	Employee Benefits	152,608	114,000	-	(114,000)	-100.00%
13	Contract Labor	1,659	226	-	(226)	-100.00%
14	Physician Fees	-	-	-	-	0.00%
15	Contract Fees	20,025	23,423	-	(23,423)	-100.00%
	illable Supplies	15,588	11,193	-	(11,193)	-100.00%
	Other Supplies	16,820	8,125	-	(8,125)	-100.00%
18	Minor Equipment	2,163	28	-	(28)	-100.00%
19	Training & Travel	2,371	5,273	-	(5,273)	-100.00%
20	Utilities	4,814	4,466	-	(4,466)	-100.00%
21	Maintenance & Repairs	1,288	3,635	-	(3,635)	-100.00%
22	Insurance	8,088	4,718	-	(4,718)	-100.00%
23	Rentals & Leases	36,992	47,525	-	(47,525)	-100.00%
24	Other Expense	27,419	4,921	-	(4,921)	-100.00%
25	**Total Operating Expenses**	837,158	614,542	-	(614,542)	-100.00%
26	**Gross Operating Margin**	(461,640)	(315,613)	-	315,613	-100.00%
27	Depreciation	5,175	6,654	-	(6,654)	-100.00%
28	Interest	-	-	-	-	0.00%
29	**Net Operating Margin**	(466,815)	(322,267)	-	322,267	-100.00%
30	**Total Income (Loss)**	$ (466,815)	$ (322,267)	$ -	$ 322,267	-100.00%
31	**Net Operating Margin to Net Income**	-124.31%	-107.81%	0.00%		
32	**Total Income to Net Income**	-124.31%	-107.81%	0.00%		
33	**Avg FTE's (Employee and Contract)**	7.6	6.8	-	(6.8)	-100.00%

WESTERN CAROLINA MEDICAL ASSOCIATES

2007 OPERATING BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

HENDERSONVILLE

		FY 2005 Actual	FY 2006 Projection	FY 2007 Budget	FY07 Budget to FY06 Proj	FY07 Budget to FY06 Proj
	GROSS PATIENT REVENUE					
1	Outpatient Revenue	$ 1,769,966	$ 1,914,188	$ 2,030,756	$ 116,568	6.09%
2	**Total Gross Patient Revenue**	1,769,966	1,914,188	2,030,756	116,568	6.09%
3	**REVENUE DEDUCTIONS**					
4	Bad Debt	2,574	28,341	31,627	3,286	11.60%
5	Contractual Deductions	589,756	628,225	701,070	72,844	11.60%
6	Charity and Other Deductions	10,209	-	-	-	0.00%
7	**Total Revenue Deductions**	602,539	656,566	732,697	76,131	11.60%
8	**Net Patient Service Revenue**	1,167,427	1,257,622	1,298,059	40,437	3.22%
9	Other Operating Income	1,145	532	750	218	40.98%
10	**Total Operating Revenue**	1,168,572	1,258,154	1,298,809	40,655	3.23%
	OPERATING EXPENSES					
11	Salaries and Wages	1,089,322	1,101,773	1,030,535	(71,238)	-6.47%
12	Employee Benefits	303,731	323,319	291,991	(31,328)	-9.69%
13	Contract Labor	2,036	4,407	-	(4,407)	-100.00%
14	Physician Fees	-	-	-	-	0.00%
15	Contract Fees	121,436	154,739	118,566	(36,173)	-23.38%
	Billable Supplies	38,045	31,090	31,200	110	0.36%
	Other Supplies	40,581	52,340	49,500	(2,840)	-5.43%
18	Minor Equipment	3,883	4,569	4,000	(569)	-12.46%
19	Training & Travel	7,197	9,134	10,000	866	9.48%
20	Utilities	45,856	33,574	35,500	1,926	5.74%
21	Maintenance & Repairs	13,715	10,916	11,148	232	2.13%
22	Insurance	3,108	3,108	3,108	-	0.00%
23	Rentals & Leases	92,288	71,803	71,740	(63)	-0.09%
24	Other Expense	12,165	7,149	7,200	51	0.72%
25	**Total Operating Expenses**	1,773,363	1,807,920	1,664,488	(143,432)	-7.93%
26	**Gross Operating Margin**	(604,791)	(549,766)	(365,679)	184,087	33.48%
27	Depreciation	13,707	14,915	11,084	(3,830)	-25.68%
28	Interest	-	-	-	-	0.00%
29	**Net Operating Margin**	(618,498)	(564,681)	(376,763)	187,918	33.28%
30	**Total Income (Loss)**	$ (618,498)	$ (564,681)	$ (376,763)	$ 187,918	33.28%
31	**Net Operating Margin to Net Income**	-52.93%	-44.88%	-29.01%		
32	**Total Income to Net Income**	-52.93%	-44.88%	-29.01%		
33	**Avg FTE's (Employee and Contract)**	17.6	15.5	14.0	(1.5)	-9.51%

WESTERN CAROLINA MEDICAL ASSOCIATES

2007 OPERATING BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

FLETCHER

		FY 2005 Actual	FY 2006 Projection	FY 2007 Budget	FY07 Budget to FY06 Proj	FY07 Budget to FY06 Proj
	GROSS PATIENT REVENUE					
1	Outpatient Revenue	$ 199,647	$ 286,812	$ 311,550	$ 24,738	8.63%
2	**Total Gross Patient Revenue**	199,647	286,812	311,550	24,738	8.63%
3	**REVENUE DEDUCTIONS**					
4	Bad Debt	(830)	3,962	4,767	806	20.34%
5	Contractual Deductions	57,107	87,818	105,677	17,859	20.34%
6	Charity and Other Deductions	-	-	-	-	0.00%
7	**Total Revenue Deductions**	56,277	91,780	110,444	18,664	20.34%
8	**Net Patient Service Revenue**	143,370	195,032	201,106	6,074	3.11%
9	Other Operating Income	-	-	-	-	0.00%
10	**Total Operating Revenue**	143,370	195,032	201,106	6,074	3.11%
	OPERATING EXPENSES					
11	Salaries and Wages	191,149	186,322	211,655	25,334	13.60%
12	Employee Benefits	53,297	54,302	61,353	7,051	12.98%
13	Contract Labor	1,012	605	1,000	395	65.26%
14	Physician Fees	-	-	-	-	0.00%
15	Contract Fees	37,975	52,700	40,649	(12,051)	-22.87%
	Billable Supplies	6,787	7,022	7,200	178	2.54%
	Other Supplies	13,627	5,663	9,300	3,637	64.23%
18	Minor Equipment	649	56	500	444	788.42%
19	Training & Travel	5,402	5,000	5,500	500	10.00%
20	Utilities	15,837	15,327	16,050	723	4.72%
21	Maintenance & Repairs	1,921	4,640	4,760	120	2.59%
22	Insurance	3,108	3,108	3,108	-	0.00%
23	Rentals & Leases	44,019	71,169	71,302	133	0.19%
24	Other Expense	6,453	4,523	3,350	(1,173)	-25.94%
25	**Total Operating Expenses**	381,236	410,437	435,727	25,291	6.16%
26	**Gross Operating Margin**	(237,866)	(215,405)	(234,621)	(19,217)	-8.92%
27	Depreciation	3,349	1,568	926	(641)	-40.91%
28	Interest	-	-	-	-	0.00%
29	**Net Operating Margin**	(241,215)	(216,972)	(235,548)	(18,575)	-8.56%
30	**Total Income (Loss)**	$ (241,215)	$ (216,972)	$ (235,548)	$ (18,575)	-8.56%
31	**Net Operating Margin to Net Income**	-168.25%	-111.25%	-117.13%		
32	**Total Income to Net Income**	-168.25%	-111.25%	-117.13%		
33	**Avg FTE's (Employee and Contract)**	3.4	3.4	3.4	0.0	0.29%

WESTERN CAROLINA MEDICAL ASSOCIATES

2007 OPERATING BUDGET VERSUS 2006 PROJECTION and 2005 ACTUAL

ETOWAH - Closed 5/1/06

		FY 2005 Actual	FY 2006 Projection	FY 2007 Budget	FY07 Budget to FY06 Proj	FY07 Budget to FY06 Proj
	GROSS PATIENT REVENUE					
1	Outpatient Revenue	$ 266,704	$ 161,550	$ -	$ (161,550)	-100.00%
2	**Total Gross Patient Revenue**	266,704	161,550	-	(161,550)	-100.00%
3	**REVENUE DEDUCTIONS**					
4	Bad Debt	(3,773)	3,000	-	(3,000)	-100.00%
5	Contractual Deductions	72,548	44,000	-	(44,000)	-100.00%
6	Charity and Other Deductions	-	-	-	-	0.00%
7	**Total Revenue Deductions**	68,775	47,000	-	(47,000)	-100.00%
8	**Net Patient Service Revenue**	197,929	114,550	-	(114,550)	-100.00%
9	Other Operating Income	-	-	-	-	0.00%
10	**Total Operating Revenue**	197,929	114,550	-	(114,550)	-100.00%
	OPERATING EXPENSES					
11	Salaries and Wages	243,505	138,890	-	(138,890)	-100.00%
12	Employee Benefits	67,896	41,291	-	(41,291)	-100.00%
13	Contract Labor	387	461	-	(461)	-100.00%
14	Physician Fees	-	-	-	-	0.00%
15	Contract Fees	38,504	43,071	-	(43,071)	-100.00%
	Billable Supplies	(332)	3,851	-	(3,851)	-100.00%
	Other Supplies	6,486	1,694	-	(1,694)	-100.00%
18	Minor Equipment	293	-	-	-	0.00%
19	Training & Travel	8,662	1,759	-	(1,759)	-100.00%
20	Utilities	8,838	6,805	-	(6,805)	-100.00%
21	Maintenance & Repairs	1,590	2,351	-	(2,351)	-100.00%
22	Insurance	3,108	2,331	-	(2,331)	-100.00%
23	Rentals & Leases	216	184	-	(184)	-100.00%
24	Other Expense	5,590	1,504	-	(1,504)	-100.00%
25	**Total Operating Expenses**	384,742	244,190	-	(244,190)	-100.00%
26	**Gross Operating Margin**	(186,813)	(129,640)	-	129,640	-100.00%
27	Depreciation	8,350	6,382	-	(6,382)	-100.00%
28	Interest	-	-	-	-	0.00%
29	**Net Operating Margin**	(195,163)	(136,022)	-	136,022	-100.00%
30	**Total Income (Loss)**	$ (195,163)	$ (136,022)	$ -	$ 136,022	-100.00%
31	**Net Operating Margin to Net Income**	-98.60%	-118.74%	0.00%		
32	**Total Income to Net Income**	-98.60%	-118.74%	0.00%		
33	**Avg FTE's (Employee and Contract)**	4.2	3.3	-	(3.3)	-100.00%

HENDERSON COUNTY HOSPITAL CORPORATION

ENTITIES AND MAJOR SERVICES

Margaret R. Pardee Memorial Hospital

- Acute Inpatient and Outpatient Services
  - Center for Joint Replacement
  - Mental Health Unit
  - Medical Detoxification Unit
  - Family Way Unit
  - Surgical Services
  - Emergency Room
  - Radiology Services
  - Comprehensive Cancer Center
  - Laboratory Services
  - Cardiology Services
  - Sleep Center
  - Cardiac Catheterization
  - Cardiac Rehabilitation
  - Rehab and Sports Therapy
  - Care Management Services
  - Nutrition Services
- Non-Acute Services
  - Perspectives Diabetes Education Services
  - Home Health Services
  - Adult Day Pavilion
  - Lifeline
  - Hendersonville Family Heath Center
  - Women's Health Center
  - Health Education Center

Pardee Care Center - Long Term Center

- Subacute Facility - 20 Beds
- Skilled Nursing Facility - 110 Beds

Urgent Care Center

- Four Seasons Location

Western Carolina Medical Associates

- Hendersonville Location
- Fletcher Location

Margaret R. Pardee Memorial Hospital

2006 Audit Results and Report to the Board of Trustees

January 22, 2007

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NOTICEABLY DIFFERENT

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Larson, Allen, Weishair & Co., LLP

CPAs, Consultants & Advisors
www.larsonallen.com

To the Members of the Board of Trustees
Margaret R. Pardee Memorial Hospital
Kenansville, North Carolina

We are pleased to present the results of our audit of the consolidated financial statements of Henderson County Hospital Corporation, Inc. D/B/A Margaret R. Pardee Memorial Hospital ("Pardee") for the year ended September 30, 2006.

This report to the Board of Trustees summarizes our audit, the scope of our engagement, the reports issued and various analyses and observations related to Pardee's financial position and results of operations. The document also includes communications required by our professional standards, as well as current accounting issues that are or will be affecting Pardee.

The completion of this year's audit was accomplished through the effective support and the assistance of Pardee's finance, operational, and administrative personnel. As always, we strive to continuously improve the quality of our audit service. This meeting is a forum for you to provide feedback on ways we can continue to meet and exceed your expectations.

We appreciate this opportunity to meet with you. If you have any questions or comments, please call me at (704) 998-5229.

Sincerely,

LARSON, ALLEN, WEISHAIR & CO., LLP

Steve Stang

Steve Stang, CPA
Partner
(704) 998-5229
(704) 998-5250 (fax)
sstang@larsonallen.com

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Audit results

Auditor Independence

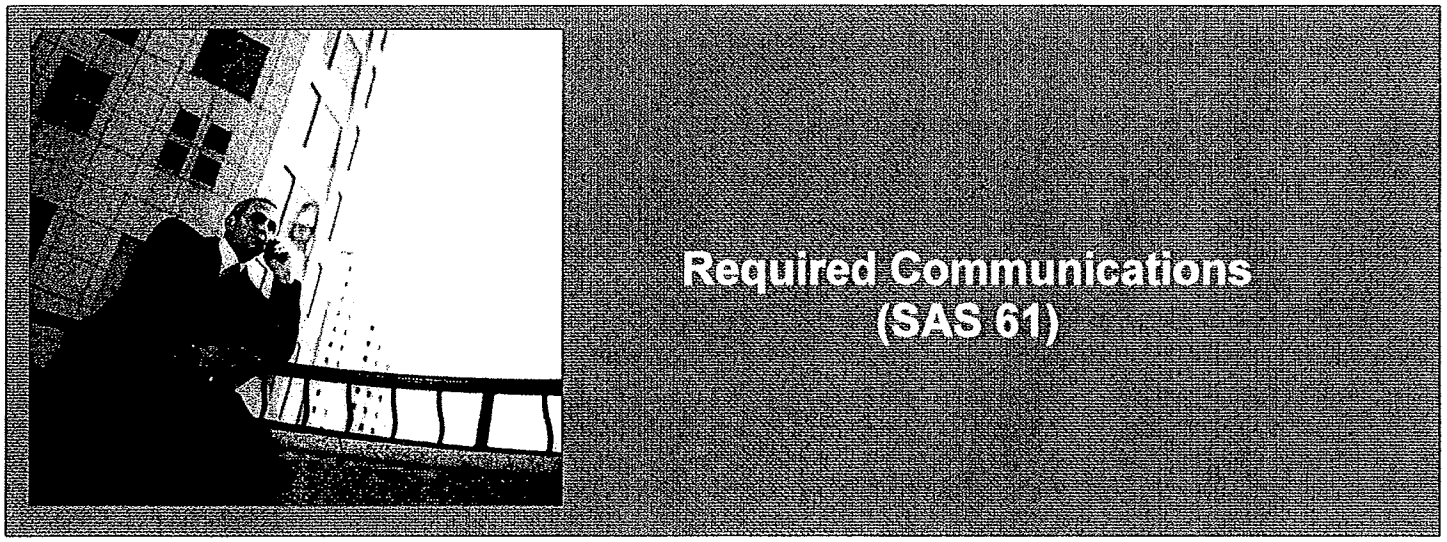
Looking ahead to next year

Accounting Trends:

- Statement of Auditing Standards (SAS) 103: Audit Documentation
- Statement of Auditing Standards (SAS) 104 – 111: Risk Assessment Audit Standards
- Statement of Auditing Standards (SAS) 112: Communicating Internal Control Related Matters Identified in an Audit

Industry Trends:

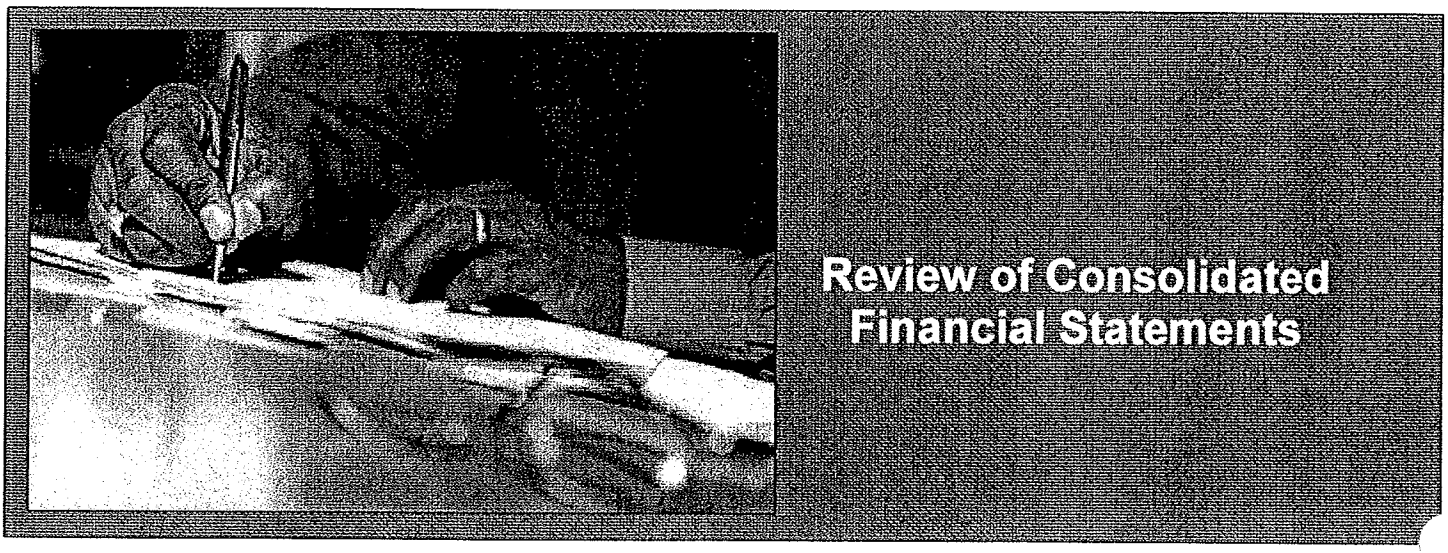
- Intermediate sanctions
- Strategic capital planning
- Organization of audit committee
- Information security considerations—risk management
- Governance
- Investment policies
- Risk assessment for health care
- Nonprofit tax update


Required Communications
(SAS 61)

Area	Comments
Our responsibility under Generally Accepted Auditing Standards	• Plan and perform audit to obtain reasonable, not absolute, assurance the consolidated financial statements are free of material misstatement • Review internal accounting controls • Risk based audit approach, based on internal controls, determined nature timing and extent of tests • Goal of audit: Express opinion on consolidated financial statements
Other information in documents containing audited financial statements	• Financial statements may only be used in their entirety • Require approval of our audit report in a client prepared document • No obligations or procedures beyond those related to the financial statements.
Significant accounting policies	• Management is responsible for accounting policies • Outlined in Note 1 to consolidated financial statements • No significant changes in accounting policies or new policies adopted • No significant or unusual transactions
Management judgments and accounting estimates	• Based on management's knowledge and experience • Contractual and bad debt allowances, third-party payor settlements

Significant audit adjustments	• Three audit adjustments with a net impact of *increasing* revenues over expenses by approximately $151,000. The most significant was:
	  • $144,000 to reduce PTO liabilities
	• Four management proposed adjustments with a net impact of *decreasing* revenues over expenses by approximately $68,000. The most significant were:
	  • $264,000 to reduce litigation reserves
	  • $ 60,000 to adjust accrued expenses
	  • $272,000 to record accounts payable
	• One uncorrected adjustment was noted for $293,550 of cash that was received in the lockbox at September 30, 2006, but not recorded to the general ledger. This adjustment would have had *no effect* on revenues over expenses

Disagreements with management	• No disagreements with management regarding accounting or reporting matters
Difficulties encountered in performing the audit	• No difficulties encountered in performing the audit
Consultations with other independent accountants	• No consultations with other independent accountants
Issues discussed prior to retention as independent auditors	• No issues discussed prior to retention as independent auditors



Review of Consolidated Financial Statements

HENDERSON COUNTY HOSPITAL CORPORATION, INC.
D/B/A MARGARET R. PARDEE MEMORIAL HOSPITAL
AND AFFILIATES
(A COMPONENT UNIT OF HENDERSON COUNTY)

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED SEPTEMBER 30, 2006 AND 2005

HENDERSON COUNTY HOSPITAL CORPORATION, INC. D/B/A
MARGARET R. PARDEE MEMORIAL HOSPITAL AND AFFILIATES
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YEARS ENDED SEPTEMBER 30, 2006 AND 2005

LarsonAllen[SM]

Larson, Allen, Weishair & Co., LLP

CPAs, Consultants & Advisors
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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Henderson County Hospital Corporation, Inc. d/b/a
Margaret R. Pardee Memorial Hospital and Affiliates
Hendersonville, North Carolina

We have audited the accompanying consolidated balance sheet of Henderson County Hospital Corporation, Inc. d/b/a Margaret R. Pardee Memorial Hospital and Affiliates ("Pardee") as of September 30, 2006, and the related consolidated statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These consolidated financial statements are the responsibility of Pardee's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The financial statements of Henderson County Hospital Corporation, Inc. d/b/a Margaret R. Pardee Memorial Hospital and Affiliates as of September 30, 2005 were audited by other auditors, whose report dated November 18, 2005, expressed an unqualified opinion.

We conducted our audit in accordance with U.S. generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Henderson County Hospital Corporation, Inc. d/b/a Margaret R. Pardee Memorial Hospital and Affiliates as of September 30, 2006, and its consolidated changes in financial position and cash flows for the year then ended.

The management's discussion and analysis included on pages 2 through 5 is not a required part of the basic consolidated financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Larson, Allen, Weishair & Co., LLP

LARSON, ALLEN, WEISHAIR & CO., LLP

Charlotte, North Carolina
December 1, 2006

Our discussion and analysis of the consolidated financial performance of Margaret R. Pardee Memorial Hospital and Affiliates ("Pardee") provides an overview of Pardee's financial activities for the fiscal years ended September 30, 2006 and 2005. Please read this information in conjunction with the Pardee consolidated financial statements.

OVERVIEW OF THE CONSOLIDATED FINANCIAL STATEMENTS

Pardee presents three basic financial statements: consolidated balance sheets; consolidated statements of revenues, expenses and changes in net assets; and consolidated statements of cash flows. These consolidated financial statements and related notes provide information about the activities of Pardee.

The financial position is measured in terms of resources (assets) owned and obligations (liabilities) owed on a given date (the end of the fiscal year). This information is reported on the consolidated balance sheets, which reflects the Pardee assets in relation to its debts to bondholders, suppliers, employees and other creditors. The excess of assets over liabilities is the equity, or net assets.

Information regarding the results of operations during the year is reported in the consolidated statements of revenues, expenses and changes in net assets. These statements show how much the overall net assets increased or decreased during the year as a result of operations and for other reasons (for example, contributions received).

The consolidated statements of cash flows show the flow of cash resources into and out of Pardee during the year. It reflects all the cash flows received during the year (from operations, contributions, and other sources) and how those funds were used (for example, payment of expenses, repayment of debt, purchases of new property and equipment, and additions to our investment pool).

FINANCIAL HIGHLIGHTS

- Pardee's net assets increased for the year by approximately $2.1 million due to changes in the charge structure and services provided. Total inpatient days increased from the prior year by 5,729 days. Emergency room visits increased by 1,050 visits and outpatient visits increased by 3,445 visits.
- Total operating revenues increased by approximately $8.8 million due to increased charges, offset by increased contractual adjustments.
- Total operating expenses increased by $2.5 million and are discussed in more detail on Page 5.
- As a result of the improvement in operating revenues and containment of operating expense growth, there was an improvement in income from operations of approximately $6.3 million from 2005 to 2006.

FINANCIAL SUMMARY

HENDERSON COUNTY HOSPITAL CORPORATION, INC.
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2006 AND 2005

	2006	2005
ASSETS		
Current Assets	$ 29,733,202	$ 26,638,531
Restricted Assets	2,362,188	1,556,555
Capital Assets, Net	82,003,275	85,675,905
Other Assets, Net	22,091,915	21,389,282
Total Assets	$ 136,190,580	$ 135,260,273
LIABILITIES		
Current Liabilities	$ 17,944,083	$ 18,404,526
Long-Term Debt, Net of Current Portion	12,745,000	13,305,000
Obligations Under Capital Leases, Net of Current Portion	1,645,605	1,747,592
Total Liabilities	32,334,688	33,457,118
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	65,727,057	67,957,684
Restricted:		
Debt Service	420,000	401,250
Bond Proceeds to be Used for Capital Projects	39,109	20,935
Capital Projects	706,704	653,777
Other Specific Purposes	1,232,375	511,467
Unrestricted	35,730,647	32,258,042
Total Net Assets	103,855,892	101,803,155
Total Liabilities and Net Assets	$ 136,190,580	$ 135,260,273

Total net assets increased by approximately $2.1 million as detailed in the following discussion:

- Current assets increased approximately $3.1 million primarily from an increase in net patient receivables of approximately $3.2 million.
- Capital assets declined by approximately $3.7 million, the net of new capital acquisitions totaling approximately $8.3 million, offset by increases in accumulated depreciation and amortization of approximately $11.4 million and retirements with a net book value of approximately $600,000.
- Board-designated investments increased by approximately $0.9 million to further fund the acquisition of new capital assets.
- Current liabilities decreased by approximately $0.5 million due to decreases in the current portion of obligations under capital leases and accounts and contracts payable and increases in accrued salaries, taxes and benefits and estimated third-party payor settlements.

HENDERSON COUNTY HOSPITAL CORPORATION, INC.
CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006	2005
OPERATING REVENUES		
Gross Patient Service Revenues	$ 259,467,615	$ 227,396,177
Less Reductions to Revenue for:		
Charity Care	(2,752,402)	(1,774,010)
Provision for Bad Debts	(15,263,812)	(12,260,697)
Contractual and Other Adjustments	(123,344,509)	(102,962,085)
Net Patient Service Revenues	118,106,892	110,399,385
Other Operating Revenues	2,752,426	1,689,067
Total Operating Revenues	120,859,318	112,088,452
OPERATING EXPENSES		
Compensation, Benefits and Contracted Services	74,065,756	75,135,400
Supplies and Other Expenses	35,283,055	31,772,534
Depreciation and Amortization	11,439,685	11,360,589
Total Operating Expenses	120,788,496	118,268,523
OPERATING INCOME (LOSS)	70,822	(6,180,071)
NONOPERATING INCOME (EXPENSES)		
Contributions - Individuals and Other	1,217,790	1,232,099
Investment Income	1,207,895	913,886
Interest Expense	(663,213)	(490,475)
Other Nonoperating Income	202,787	-
Total Nonoperating Income (Expense)	1,965,259	1,655,510
REVENUES OVER (UNDER) EXPENSES BEFORE CAPITAL CONTRIBUTIONS	2,036,081	(4,524,561)
CAPITAL CONTRIBUTIONS	16,656	522,944
INCREASE (DECREASE) IN NET ASSETS	2,052,737	(4,001,617)
Net Assets - Beginning of Year	101,803,155	105,804,772
NET ASSETS - END OF YEAR	$ 103,855,892	$ 101,803,155

The consolidated statement of revenues, expenses and changes in net assets reflects a profit from operations for fiscal year 2006 of approximately $71,000 as compared to a loss from operations of approximately $6.2 million in 2005, as detailed by (all changes approximate):

- Operating revenues increased by $8.8 million over 2005 as the Medicare average case mix index increased from 1.2664 to 1.2767, coupled with a rate increase effective October 1, 2005, and changes to the charge structure during 2006. These changes were also impacted by the change in volumes referred to earlier.

- Operating expenses increased by $2.5 million, or 2.0% over 2005 due primarily to supplies and salaries and wages. Supplies expense increased $2.7 million due to the increased volumes. Salaries and wages increased $3.4 million due to budgeted increases in wages and FTEs as management continued to replace contracted labor with employed associates. Both of these expenses partially offset contract labor, which decreased $1.4 million, and insurance costs, which decreased by $1.0 million.
- The closing of two facilities during fiscal 2006, as more fully described in Note 1 to the financial statements.
- Net nonoperating income and expenses totaled approximately $2.0 million, an increase of $0.3 million, or 18.7%, over 2005. This improvement is primarily attributable to higher investment income from increased investments, and a one-time gain on sale of land.

CAPITAL ASSETS AND LONG-TERM DEBT

Capital Assets

As of September 30, 2006, Pardee had $82.0 million invested in capital assets, net of accumulated depreciation and amortization. This is a decline in capital assets, net of accumulated depreciation and amortization, of $3.7 million. Expenditures for capital assets of $8.3 million that occurred during 2006 were primarily related to the renovation of facilities and new information technology projects. Although buildings and certain properties are reported on the Pardee consolidated balance sheets, the real estate and certain other assets are owned by Henderson County and leased to Pardee.

Long-Term Debt

The long-term debt consists of a revenue bond issue and the long-term portion of capital leases. These debts are described in more detail in Notes 9 and 11 to the consolidated financial statements. Additional lease obligations of $1.3 million were incurred during 2006. Excluding the current portion of long-term debt, the long-term debt from the bonds as of September 30, 2006 was $12.7 million. In addition the long-term portion of capital leases is $1.6 million.

HENDERSON COUNTY HOSPITAL CORPORATION, INC. D/B/A
MARGARET R. PARDEE MEMORIAL HOSPITAL AND AFFILIATES
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2006 AND 2005

ASSETS	2006	2005
CURRENT ASSETS		
Cash and Cash Equivalents	$ 3,416,481	$ 3,389,266
Receivables:		
Patient, Net of Allowance for Uncollectible Accounts of Approximately $16,808,000 in 2006 and $8,006,000 in 2005	20,048,622	16,839,598
Other Receivables	1,246,262	1,562,259
Refundable Sales Taxes	1,683,335	1,582,347
Inventories	2,263,825	2,239,600
Prepaid Expenses	1,042,680	994,587
Restricted Cash and Cash Equivalents	31,997	30,874
Total Current Assets	29,733,202	26,638,531
RESTRICTED ASSETS		
Investments	1,919,008	1,208,203
Pledges Receivable, Net	443,180	348,352
Total Restricted Assets	2,362,188	1,556,555
CAPITAL ASSETS, AT COST	173,547,477	173,145,303
Less: Accumulated Depreciation and Amortization	(91,544,202)	(87,469,398)
Capital Assets, Net	82,003,275	85,675,905
OTHER ASSETS		
Investments Designated by Board of Directors	21,818,763	20,917,464
Other Investment	85,288	85,288
Deferred Financing Costs, Net of Accumulated Amortization of Approximately $185,000 in 2006 and $173,000 in 2005	185,064	197,414
Other Assets	2,800	189,116
Total Other Assets	22,091,915	21,389,282
Total Assets	$ 136,190,580	$ 135,260,273

See accompanying Notes to Consolidated Financial Statements.

HENDERSON COUNTY HOSPITAL CORPORATION, INC. D/B/A
MARGARET R. PARDEE MEMORIAL HOSPITAL AND AFFILIATES
CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2006 AND 2005

LIABILITIES AND NET ASSETS	2006	2005
CURRENT LIABILITIES		
Current Portion of Long-Term Debt	$ 560,000	$ 535,000
Current Portion of Obligations Under Capital Leases	1,325,613	2,130,629
Accounts and Contracts Payable	5,766,283	6,806,895
Accrued Salaries, Taxes and Benefits	7,654,122	6,683,967
Deferred Revenue	207,006	189,890
Estimated Third-Party Payor Settlements	2,431,059	2,058,145
Total Current Liabilities	17,944,083	18,404,526
LONG-TERM DEBT, NET OF CURRENT PORTION	12,745,000	13,305,000
OBLIGATIONS UNDER CAPITAL LEASES, NET OF CURRENT PORTION	1,645,605	1,747,592
Total Liabilities	32,334,688	33,457,118
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	65,727,057	67,957,684
Restricted:		
Debt Service	420,000	401,250
Bond Proceeds to be Used for Capital Projects	39,109	20,935
Capital Projects	706,704	653,777
Other Specific Purposes	1,232,375	511,467
Unrestricted	35,730,647	32,258,042
Total Net Assets	103,855,892	101,803,155
Total Liabilities and Net Assets	$ 136,190,580	$ 135,260,273

See accompanying Notes to Consolidated Financial Statements.

HENDERSON COUNTY HOSPITAL CORPORATION, INC. D/B/A
MARGARET R. PARDEE MEMORIAL HOSPITAL AND AFFILIATES
CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006	2005
OPERATING REVENUES		
Net Patient Service Revenues (Net of Provision for Bad Debts of Approximately $15,264,000 in 2006 and $12,261,000 in 2005)	$ 118,106,892	$ 110,399,385
Other Operating Revenues	2,752,426	1,689,067
Total Operating Revenues	120,859,318	112,088,452
OPERATING EXPENSES		
Salaries and Wages	49,806,528	46,879,403
Employee Benefits	13,219,194	13,918,111
Supplies	22,921,113	20,242,710
Contract Labor	1,686,040	3,115,827
Physician Fees	1,258,553	1,136,077
Contracted Fees	8,095,441	10,085,982
Minor Equipment	360,702	303,712
Repairs and Maintenance	4,616,385	4,018,691
Insurance	1,350,721	2,197,527
Rent	1,114,380	815,939
Utilities	2,557,898	2,229,877
Depreciation and Amortization	11,439,685	11,360,589
Other	2,361,856	1,964,078
Total Operating Expenses	120,788,496	118,268,523
OPERATING INCOME (LOSS)	70,822	(6,180,071)
NONOPERATING INCOME (EXPENSE)		
Contributions - Individuals and Other	1,217,790	1,232,099
Investment Income	1,207,895	913,886
Interest Expense	(663,213)	(490,475)
Other Nonoperating Income	202,787	-
Net Nonoperating Income (Expense)	1,965,259	1,655,510
REVENUES OVER (UNDER) EXPENSES BEFORE CAPITAL CONTRIBUTIONS	2,036,081	(4,524,561)
CAPITAL CONTRIBUTIONS	16,656	522,944
INCREASE (DECREASE) IN NET ASSETS	2,052,737	(4,001,617)
Net Assets - Beginning of Year	101,803,155	105,804,772
NET ASSETS - END OF YEAR	$ 103,855,892	$ 101,803,155

See accompanying Notes to Consolidated Financial Statements.

HENDERSON COUNTY HOSPITAL CORPORATION, INC. D/B/A
MARGARET R. PARDEE MEMORIAL HOSPITAL AND AFFILIATES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Patients and Third-Party Payors	$ 115,270,782	$ 111,695,788
Cash Paid to Employees	(62,055,567)	(60,230,308)
Cash Paid to Suppliers	(45,914,351)	(46,158,535)
Other Receipts from Operations	649,381	1,468,657
Net Cash Provided by Operating Activities	7,950,245	6,775,602
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from Contributions Restricted for Specific Expenditure	506,985	1,232,099
Other Nonoperating Gains	202,787	-
Net Cash Provided by Noncapital Financing Activities	709,772	1,232,099
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital Expenditures	(6,184,441)	(9,260,163)
Proceeds from Disposals of Capital Equipment	647,682	-
Interest Paid, Net of Capitalized Amounts	(663,213)	(490,475)
Principal Payments on Long-Term Debt	(535,000)	(510,000)
Principal Payments on Obligations Under Capital Lease	(2,219,959)	(2,417,767)
Proceeds from Contributions Restricted for Capital Assets	16,656	522,944
Net Cash Used by Capital and Related Financing Activities	(8,938,275)	(12,155,461)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received	1,207,895	1,155,217
Sales (Purchases) of Investments, Net	(901,299)	3,216,014
Net Cash Provided by Investing Activities	306,596	4,371,231
NET INCREASE IN CASH AND CASH EQUIVALENTS	28,338	223,471
Cash and Cash Equivalents - Beginning of Year	3,420,140	3,196,669
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 3,448,478	$ 3,420,140
CLASSIFIED AS:		
Unrestricted	$ 3,416,481	$ 3,389,266
Restricted	31,997	30,874
	$ 3,448,478	$ 3,420,140
SUPPLEMENTAL SCHEDULE OF NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES		
Accounts Payable Incurred for the Purchase of Equipment	$ 830,688	$ 749,656
Equipment Acquired Under Capital Lease Obligation	$ 1,312,956	$ 687,885
Unrealized Gains (Losses) on Investments, Net	$ 106,366	$ (241,331)

See accompanying Notes to Consolidated Financial Statements.

HENDERSON COUNTY HOSPITAL CORPORATION, INC. D/B/A MARGARET R. PARDEE MEMORIAL HOSPITAL AND AFFILIATES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006	2005
RECONCILIATION OF OPERATING (INCOME) LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Income (Loss) from Operations	$ 70,822	$ (6,180,071)
Gain on Disposal of Property and Equipment	(74,302)	(2,280)
Provision for Bad Debts	15,263,812	12,260,697
Depreciation and Amortization	11,439,685	11,360,589
Adjustments to Reconcile Income (Loss) from Operations to Net Cash Provided by Operating Activities:		
Change in Net Assets and Liabilities:		
Decrease in Patient Receivables	(18,472,836)	(11,232,267)
(Increase) Decrease in Other Receivables	315,997	(431,218)
(Increase) Decrease in Refundable Sales Taxes	(100,988)	248,403
Increase in Inventories	(24,225)	(359,831)
Increase in Prepaid Expenses	(48,093)	(245,645)
(Increase) Decrease in Other Assets	91,488	(186,316)
Increase (Decrease) in Accounts and Contracts Payable	(1,871,300)	557,361
Increase in Deferred Revenue	17,116	151,001
Increase in Accrued Salaries, Taxes and Benefits	970,155	567,206
Increase in Third-Party Settlements Payable	372,914	267,973
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 7,950,245	$ 6,775,602

See accompanying Notes to Consolidated Financial Statements.

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity and Mission

On November 1, 1998, the Board of County Commissioners of Henderson County authorized the incorporation of Henderson County Hospital Corporation, Inc. (the "Hospital Corporation") and the transfer of all assets, except real property, and liabilities of Margaret R. Pardee Memorial Hospital to the Hospital Corporation. The County has assigned the exclusive use of the real property and certain equipment to the Hospital under a lease agreement for $10 annually for a period of 25 years. If the lease is not renewed, the assignment terminates and the undepreciated residual value of the property reverts to the County. Henderson County is the sole member of Henderson County Hospital Corporation, Inc., d/b/a Margaret R. Pardee Memorial Hospital and Affiliates. Margaret R. Pardee Memorial Hospital and Affiliates are referred herein as the "Hospital."

Henderson County Hospital Corporation is the sole member of Henderson County Urgent Care Centers, Inc. and Western Carolina Medical Associates, Inc., affiliates of Margaret R. Pardee Memorial Hospital. The Hospital Corporation is included as a discretely presented component unit in the basic financial statements of the County. Under the authority of the Board of County Commissioners of Henderson County, the Hospital is operated and maintained by the Hospital Corporation as a charitable, governmental, nonprofit community hospital system. The Hospital's mission is to provide health care services to the citizens of Henderson County through its facilities. The Hospital operates facilities that include 193 licensed acute care beds, 21 licensed psychiatric beds, 8 licensed detoxification beds, and a separate 130-bed skilled nursing facility, a physicians' services group, a home health agency, an urgent care center and a variety of other community-based services. During 2006, the Hospital Corporation ceased operations at an urgent care center location and a WCMA clinic location. A loss from operations of approximately $510,000 and $662,000 (see table below) is included in the consolidated statements of revenue, expenses and changes in net assets for the years ended September 30, 2006 and 2005, respectively.

	2006			2005		
	Urgent Care	WCMA	Total	Urgent Care	WCMA	Total
Revenues	$ 252,141	$ 117,807	$ 369,948	$ 375,518	$ 197,930	$ 573,448
Expenses	(630,228)	(249,569)	(879,797)	(842,337)	(393,092)	(1,235,429)
Loss from Operations	$ (378,087)	$ (131,762)	$ (509,849)	$ (466,819)	$ (195,162)	$ (661,981)

The Board of Directors of the Hospital Corporation is selected by the Board of Commissioners of Henderson County. The Hospital Corporation is exempt from federal income taxes on related income pursuant to Section 115 of the Internal Revenue Code ("Code"). Prior to the reorganization mentioned above, the Hospital was a Section 501(c)(3) entity as defined by the Code and was exempt from income taxes pursuant to Section 501(a) of the Code.

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

Pardee Memorial Hospital Foundation, Inc.

Pardee Memorial Hospital Foundation, Inc. (the "Foundation") was organized in 1996 as a nonprofit, nonstock corporation under the laws of the State of North Carolina. The Foundation was organized to exclusively benefit the Hospital and to strengthen and further, in every useful way, the work and services of the Hospital. The Foundation is presented as a blended component unit in accordance with Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity* as amended by GASB No. 39, *Determining Whether Certain Organizations are Component Units.* Complete financial statements for the component unit may be obtained at the Foundation's office at 800 N. Justice Street, Hendersonville, NC 28791.

Principles of Consolidation

The consolidated financial statements of Henderson County Hospital Corporation, Inc. include the accounts of Margaret R. Pardee Memorial Hospital, Western Carolina Medical Associates, Inc., Henderson County Urgent Care Center, Inc. and Pardee Memorial Hospital Foundation, Inc. All significant intercompany amounts and transactions have been eliminated.

Basis of Accounting

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

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

Charity Care

The Hospital has a charity care policy whereby care to patients meeting certain established criteria is without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not included in net patient service revenues.

Cash and Cash Equivalents

The Hospital considers investments purchased with an original maturity of three months or less to be cash equivalents. The Hospital's investment in the North Carolina Capital Management Trust is not considered a cash equivalent.

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

Patient Receivables, Net

The carrying amount of patient receivables is reduced by an allowance that reflects management's best estimate of the amounts that will not be collected based on historical collection data.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market.

Pledges Receivable

Pledges are recognized when the donor makes a pledge to give to the Hospital or Foundation. Contributions that are restricted by the donor are reported as restricted net assets. Pledges are recorded after discounting to the present value of the future cash flows. The Hospital and Foundation use the allowance method to determine uncollectible pledges. The allowance is based on prior years' experience and management's analysis of specific pledges made.

Other Receivables

Other receivables consist primarily of physician loans. An allowance for physician receivables has been recorded to reflect physician receivables at their estimated net realizable values.

Capital Assets

Capital assets are stated at cost, including interest costs incurred during construction. Depreciation is computed using the straight-line method using the AHA (American Hospital Association) estimated useful life guidelines for the related assets. Routine maintenance and repairs are charged to expense. Expenditures that materially increase values, change capacities or extend useful lives are capitalized. Equipment under capital lease obligations is generally amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the related equipment. Such amortization is included in depreciation and amortization in the consolidated financial statements.

Restricted Assets

Restricted assets include assets that are subject to donor-imposed stipulations, assets held by the bond trustee under the indenture agreement, and the balance of bond proceeds that are required to be used for capital projects.

Costs of Borrowing

Interest incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Bond issuance costs are deferred and amortized over the period the bonds are outstanding.

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

Investments

Investments are carried at fair value. Realized and unrealized gains and losses, based on the specific identification method, are included in nonoperating income. Interest on investments is included in nonoperating income when earned.

Other investment consists of the Hospital's investment in a purchasing company and is stated at cost.

Impairment Losses

Impairment losses are recorded on long-lived assets when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amount. The Hospital has evaluated the carrying values of its long-lived assets and has determined that no writedowns for impairment are necessary as of September 30, 2006 or 2005.

Net Assets

Net assets are classified as invested in capital assets, net of related debt, restricted and unrestricted. Restricted net assets represent constraints on resources that are either externally imposed by creditors, grantors, contributors, or laws or regulations of governments or imposed through state statute.

Accrued Compensated Absences

The paid time off policy of the Hospital provides for the accumulation of up to 520 hours earned leave with such leave being fully vested when earned. An expense and a liability for paid time off are recorded as the leave is earned. The provision for earned paid time off not yet used is included in accrued salaries, taxes and benefits in the consolidated balance sheets.

Net Patient Service Revenues

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenues are reported at the estimated net realizable amounts, including an allowance for doubtful accounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors.

Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as settlements are determined.

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

Grants and Contributions

From time to time, the Hospital receives grants and contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating income. Amounts restricted to capital acquisitions are reported after nonoperating income and expenses.

Restricted Resources

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

Use of Estimates

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

Accounting Standards

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

Operating Revenues and Expenses

The Hospital's statements of revenues, expenses and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the Hospital's principal activity.

Nonexchange revenues, investment income, grants and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

NOTE 2 DEPOSITS

All deposits of the Hospital are made in Board-designated official depositories and are secured as required by North Carolina General Statute ("G. S.") 159-31. The Hospital may designate, as an official depository, any bank or savings and loan whose principal office is located in North Carolina. Also, the Hospital may establish time deposit accounts such as NOW and SuperNOW accounts, money market accounts and certificates of deposit.

All of the Hospital's deposits are either insured or collateralized by using one of two methods. Under the Dedicated Method all deposits exceeding the federal depository insurance coverage are collateralized with securities held by the Hospital's agent in the Hospital's name. Under the Pooling Method, which is a collateral pool, all uninsured deposits are collateralized with securities held by the State Treasurer's agent in the name of the State Treasurer. Since the State Treasurer is acting in a fiduciary capacity for the Hospital these deposits are considered to be held by the Hospital's agent in the Hospital's name. The amount of the pledged collateral is based on approved averaging method for non-interest-bearing deposits and the actual current balance for interest-bearing deposits.

At September 30, 2006, the Hospital's deposits had a carrying amount of approximately $3,448,000 and a bank balance of approximately $5,785,000. Of the bank balance, approximately $469,000 was covered by federal depository insurance and $5,316,000 was covered by collateral held under the Pooling Method.

NOTE 3 PLEDGES RECEIVABLE

Pledges receivable at September 30, 2006 and 2005 are expected to be realized in the following periods:

	2006	2005
One year or less	$ 144,977	$ 276,261
One year to five years	322,620	104,791
	467,597	381,052
Less discount	(16,600)	(6,000)
Less allowance for doubtful pledges	(7,817)	(26,700)
	$ 443,180	$ 348,352

Pledges are recorded after discounting to the present value of expected future cash flows based on the current federal lending rate.

NOTE 4 INVESTMENTS

The Hospital had the following investments, including accrued interest receivable, as of September 30, 2006 and 2005:

	2006		
	Amortized Cost	Net Unrealized Gains (Losses)	Fair Value
U.S. Government securities	$ 6,173,254	$ (66,447)	$ 6,106,807
U.S. Government agencies	6,025,320	(165,762)	5,859,558
North Carolina Capital Management Trust	7,381,046	-	7,381,046
Equity securities	1,912,382	332,370	2,244,752
Debt securities	1,152,838	6,742	1,159,580
Money market funds	403,273	-	403,273
Certificates of deposit	582,755	-	582,755
	$ 23,630,868	$ 106,903	$ 23,737,771

	2005		
	Amortized Cost	Net Unrealized Gains (Losses)	Fair Value
U.S. Government securities	$ 6,646,155	$ (74,467)	$ 6,571,688
U.S. Government agencies	8,710,462	(66,688)	8,643,774
North Carolina Capital Management Trust	3,177,887	-	3,177,887
Equity securities	1,726,477	339,569	2,066,046
Debt securities	1,200,283	(30,157)	1,170,126
Money market funds	22,141	-	22,141
Certificates of deposit	474,005	-	474,005
	$ 21,957,410	$ 168,257	$ 22,125,667

The Hospital investments had the following maturities as of September 30, 2006:

	Fair Value	Less than 1 Year	2-3 Years	4-7 Years	No Maturity Date
Investment type:					
U.S. Government securities	$ 6,106,807	$ 1,565,485	$ 4,032,472	$ 508,850	$ -
U.S. Government agencies	5,859,558	825,323	4,548,920	485,315	-
NC Capital Management Trust	7,381,046				7,381,046
Equity securities	2,244,752				2,244,752
Debt securities	1,159,580				1,159,580
Money market funds	403,273				403,273
Certificates of deposit	582,755				582,755
	$ 23,737,771	$ 2,390,808	$ 8,581,392	$ 994,165	$ 11,771,406

NOTE 4 INVESTMENTS (CONTINUED)

Interest Rate Risk. The Hospital does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk. The Hospital's investments in the NC Capital Management Trust Cash Portfolio carried a credit rating of AAAm by Standard & Poor's as of September 30, 2006. The Hospital's investment in the NC Capital Management Trust Term Portfolio is unrated. The Term Portfolio is authorized to invest in obligations of the U.S. government and agencies, and also in high-grade money market instruments as permitted under North Carolina General Statutes 159-30 as amended. The Hospital's investments in U.S. Government Agencies (Fannie Mae) are rated AAA by Standard & Poor's and Aaa by Moody's Investors Service. The Hospital has no policy on credit risk.

NOTE 5 CAPITAL ASSETS

Capital asset activity for the years ended September 30, 2006 and 2005 was as follows:

	2006				
	Balance October 1, 2005	Additions	Retirements	Transfers	Balance September 30, 2006
Non-depreciable assets:					
Land	$ 4,418,689	$ -	$ (190,000)	$ -	$ 4,228,689
Construction in progress	8,862,818	5,747,321	-	(11,766,629)	2,843,510
Depreciable assets:					
Land improvements	1,232,634	8,488	(26,744)	-	1,214,378
Buildings and fixed equipment	78,438,336	682,032	(376,104)	7,676,635	86,420,899
Movable equipment	80,192,826	1,890,244	(7,333,063)	4,089,994	78,840,001
Totals at historical cost	173,145,303	8,328,085	(7,925,911)	-	173,547,477
Less accumulated depreciation for:					
Land improvements	894,443	54,021	(22,419)	-	926,045
Buildings and fixed equipment	30,922,925	3,434,171	(112,892)	-	34,244,204
Movable equipment	55,652,030	7,939,143	(7,217,220)	-	56,373,953
Total accumulated depreciation	87,469,398	11,427,335	(7,352,531)	-	91,544,202
Capital assets, net	$ 85,675,905	$ (3,099,250)	$ (573,380)	$ -	$ 82,003,275

NOTE 5 CAPITAL ASSETS (CONTINUED)

	2005				
	Balance October 1, 2004	Additions	Retirements	Transfers	Balance September 30, 2005
Non-depreciable assets:					
Land	$ 4,418,689	$ -	$ -	$ -	$ 4,418,689
Construction in progress	4,379,431	8,100,760	-	(3,617,373)	8,862,818
Depreciable assets:					
Land improvements	1,232,634	-	-	-	1,232,634
Buildings and fixed equipment	75,725,418	53,289	-	2,659,629	78,438,336
Movable equipment	77,326,836	1,943,687	(35,441)	957,744	80,192,826
Totals at historical cost	163,083,008	10,097,736	(35,441)	-	173,145,303
Less accumulated depreciation for:					
Land improvements	838,755	55,688	-	-	894,443
Buildings and fixed equipment	27,765,529	3,157,396	-	-	30,922,925
Movable equipment	47,548,146	8,136,925	(33,041)	-	55,652,030
Total accumulated depreciation	76,152,430	11,350,009	(33,041)	-	87,469,398
Capital assets, net	$ 86,930,578	$ (1,252,273)	$ (2,400)	$ -	$ 85,675,905

NOTE 6 RESTRICTED NET ASSETS

Restricted net assets are available for the following purposes at September 30, 2006 and 2005:

	2006	2005
Donor-imposed stipulations	$ 1,939,079	$ 1,165,244
Balance of bond proceeds to be used for capital projects	39,109	20,935
Funds held by bond trustee for bond liabilities	420,000	401,250
	$ 2,398,188	$ 1,587,429

NOTE 7 AGREEMENTS WITH THIRD-PARTY PAYORS

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

Medicare/Medicaid – Inpatient acute care services rendered to Medicare and Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient non-acute services and certain outpatient services of Medicare and Medicaid beneficiaries are paid based on a cost reimbursement methodology. Medicare outpatient and home health services are reimbursed on a prospective payment system based on clinical and diagnostic factors. The Hospital is reimbursed for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the fiscal intermediary. The Hospital has recorded an estimated liability of approximately $940,000 and $407,000 for various years as of September 30, 2006 and 2005, respectively.

The Hospital's Medicare cost reports have been final audited by the Medicare fiscal intermediaries through September 2002 and tentatively settled through 2004. The Hospital's Medicaid cost reports have been final audited by the Medicaid fiscal intermediaries through September 2003 and tentatively settled through 2004.

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 will change by a material amount in the near term.

Other – The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, prospectively determined daily rates and other negotiated terms.

Net patient service revenue includes a provision for contractual adjustments of approximately $123,345,000 and $102,962,000 in 2006 and 2005, respectively, to reflect the differences between normal patient charges and amounts expected to be received under the various reimbursement programs.

NOTE 7 AGREEMENTS WITH THIRD-PARTY PAYORS (CONTINUED)

The Hospital participates in the North Carolina Medicaid Reimbursement Initiative (MRI). During the years ended September 30, 2006 and 2005, the Hospital recognized MRI revenue of approximately $1,597,000 and $1,563,000, respectively. Included in the $1,597,000 recognized in 2006 is approximately $156,000 which was repaid to the program as a result of settlement of program years 1997 – 2002 and approximately $154,000 resulted from a change in estimated reserves for future settlement for the program years 2003 – 2005. The supplemental Medicaid payment program is subject to a retroactive settlement process and could result in the Hospital being required to reimburse the program for amounts previously received and reported as income. There can be no assurance that the Hospital will continue to qualify for future participation in this program or that the program will not be discontinued or materially modified. Supplemental Medicaid payments are recognized in income when earned if reasonably estimable and deemed collectible. Deferred amounts are included in estimated third-party payor settlements on the consolidated balance sheets. Funds received and deferred during the year ended September 30, 2006 and 2005 are as follows:

Program Year	Received	Deferred at September 30, 2006	Deferred at September 30, 2005
1997	$ 719,370	$ -	$ 71,937
1998	691,886	-	69,189
1999	997,799	-	99,780
2000	874,723	-	87,472
2001	714,132	-	71,413
2002	787,432	-	78,743
2003	1,077,254	107,722	107,722
2004	1,680,441	90,744	166,199
2005	1,736,521	94,945	173,655
2006	1,998,926	399,785	-
2006 Settlement Payment (1997 - 2002)	(634,543)	-	-
	$ 10,643,941	$ 693,196	$ 926,110

Through its corporate compliance audit program, the Hospital has determined that for the time period from March 1995 through February 1999 the documentation of the services provided to partial hospitalization patients did not comply with all program requirements. The Hospital has self-reported this issue to Medicare. Consequently, estimated payments to Medicare are included in estimated third-party payor settlements in the accompanying consolidated balance sheets of approximately $473,000 and $430,000 at September 30, 2006 and 2005, respectively, in settlements and approximately $325,000 and $290,000 of interest during the years ended September 30, 2006 and 2005, respectively.

NOTE 8 CONCENTRATIONS OF CREDIT RISK

Financial instruments which potentially subject the Hospital to concentrations of credit risk, in addition to demand deposits and investments discussed in Notes 2 and 4, are primarily patient accounts receivable and pledges receivable. The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements. The mix of receivables from patients and third-party payors at September 30, 2006 and 2005 was as follows:

	2006	2005
Medicare	35 %	36 %
Medicaid	5	9
Commercial/Managed Care and Other Third-Party Payors	22	24
Patients	38	31
Total	100 %	100 %

Pledges receivable from employees and directors of the Hospital and the Foundation amount to 13% and 11% of total pledges receivable at September 30, 2006 and 2005.

NOTE 9 LONG-TERM DEBT

A summary of long-term debt at September 30, 2006 and 2005 follows:

	2006	2005
County of Henderson, North Carolina, Hospital Revenue Bonds (Margaret R. Pardee Memorial Hospital Project), Series 2001 Bonds, Interest Payable Monthly at Variable Rates (3.88% at September 30, 2006) through 2022.	$ 13,305,000	$ 13,840,000
Less Current Portion	560,000	535,000
Long-Term Debt, Net	$ 12,745,000	$ 13,305,000

NOTE 9 LONG-TERM DEBT (CONTINUED)

The following is a summary of changes in the Hospital's long-term debt for the years ended September 30, 2006 and 2005:

	2006				
	Balance October 1, 2005	Additions	Retirements	Balance September 30, 2006	Amounts Due Within One Year
Series 2001 Hospital Revenue Bonds	$ 13,840,000	$ -	$ 535,000	$ 13,305,000	$ 560,000

	2005				
	Balance October 1, 2004	Additions	Retirements	Balance September 30, 2005	Amounts Due Within One Year
Series 2001 Hospital Revenue Bonds	$ 14,350,000	$ -	$ 510,000	$ 13,840,000	$ 535,000

On September 20, 2001, the Hospital issued $15,300,000 Series 2001 Bonds. The proceeds of the Series 2001 Bonds were used for the purpose of financing all or a portion of the costs of (1) expanding the emergency room facilities of the Hospital, (2) the construction of a new parking deck at the Hospital, (3) the construction of a medical office building for the Hospital, and (4) the payment of expenses incurred in connection with the issuance of the Series 2001 Bonds.

Payment of principal and interest on the Series 2001 Bonds is collateralized by an irrevocable, direct-pay letter of credit of approximately $13,400,000. This letter of credit equals the aggregate principal amount of the bonds outstanding plus accrued interest. The letter of credit has an initial expiration of September 15, 2008, subject to extension and earlier termination.

The terms of the letter of credit and reimbursement agreement and master trust indenture for the Hospital Revenue Bonds require that the Hospital comply with various covenants, the most restrictive of which requires the Hospital to maintain a minimum debt service coverage ratio and liquidity ratio.

The Hospital Revenue Bonds are payable solely from the pledged net revenues and funds held by the bond trustees under the bond indenture.

NOTE 9 LONG-TERM DEBT (CONTINUED)

Future minimum principal and interest payments under the bonds consist of the following at September 30, 2006:

Year Ending September 30,	Principal	Interest
2007	$ 560,000	$ 453,700
2008	590,000	434,604
2009	620,000	414,485
2010	650,000	393,343
2011	685,000	371,178
2012-2016	3,970,000	1,481,475
2017-2021	5,060,000	734,173
2022	1,170,000	39,897
	$ 13,305,000	$ 4,322,855

NOTE 10 INTEREST EXPENSE

The following is a summary of total interest expense and investment income on borrowed funds during the years ended September 30:

	2006			2005		
	Revenue Bond Indentures	Other	Total	Revenue Bond Indentures	Other	Total
Interest expense	$ 428,866	$ 291,098	$ 719,964	$ 288,105	$ 338,707	$ 626,812
Interest capitalized in capital assets	56,751	-	56,751	136,337	-	136,337
Interest expense, net of capitalized amounts	$ 372,115	$ 291,098	$ 663,213	$ 151,768	$ 338,707	$ 490,475

NOTE 11 LEASES

Operating Leases

At September 30, 2006, minimum rental commitments under noncancellable operating leases amounted to the following:

Year Ending September 30,	
2007	$ 893,477
2008	903,225
2009	871,473
2010	552,623
2011	517,913
2012-2016	721,290
	$ 4,460,001

Several of the above agreements contain renewal or purchase options.

Rent expense under operating leases approximated $1,114,000 and $816,000 for the years ended September 30, 2006 and 2005, respectively.

The Hospital subleases real property under a noncancelable lease agreement for five years. The lease expires September 1, 2007, and contains a renewal option. Rental income under the sublease agreement amounted to approximately $114,000 during the year ended September 30, 2006. The monthly rental amount is $9,523 at September 30, 2006 with annual increases on July 1, based on the Consumer Price Index.

NOTE 11 LEASES (CONTINUED)

Capital Leases

The Hospital leases certain medical equipment under leases classified as capital leases.

Future minimum lease payments under these leases at September 30, 2006 are summarized as follows:

Year Ending September 30,	Interest (4.0% to 8.6%) Element of Minimum Lease Payments	Principal (Present Value) Element of Minimum Lease Payments	Total Minimum Lease Payments
2007	$ 222,572	$ 1,325,613	$ 1,548,185
2008	119,262	665,767	785,029
2009	59,891	493,201	553,092
2010	27,697	360,822	388,519
2011	5,197	125,815	131,012
Total	$ 434,619	2,971,218	$ 3,405,837
Amount shown as current installments of obligations under capital leases		1,325,613	
Amount shown as obligations under capital leases, excluding current installments		$ 1,645,605	

NOTE 11 LEASES (CONTINUED)

The following are summaries of changes in the Hospital's capitalized lease obligations for the years ended September 30, 2006 and 2005:

	2006			
	Balance October 1, 2005	Additions	Retirements	Balance September 30, 2006
Branch Banking & Trust	$ 2,154,647	$ -	$ 1,453,902	$ 700,745
Wachovia	311,224	-	311,224	-
GE Capital	-	1,163,801	72,677	1,091,124
Cardinal Health	1,412,350	149,155	382,156	1,179,349
	$ 3,878,221	$ 1,312,956	$ 2,219,959	$ 2,971,218

	2005			
	Balance October 1, 2004	Additions	Retirements	Balance September 30, 2005
Branch Banking & Trust	$ 3,814,353	$ -	$ 1,659,706	$ 2,154,647
Wachovia	641,704	-	330,480	311,224
First Citizens	59,229	-	59,229	-
Cardinal Health	1,092,817	687,885	368,352	1,412,350
	$ 5,608,103	$ 687,885	$ 2,417,767	$ 3,878,221

At September 30, 2006 the cost of assets held under capital leases was approximately $15,774,000, less accumulated depreciation and amortization of approximately $10,904,000. Amortization expense related to these assets of approximately $2,773,000 is included in depreciation and amortization expense for the year ended September 30, 2006.

NOTE 12 DEFERRED COMPENSATION PLAN

The Hospital offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan is administered by an unrelated insurance company under the direction of the Hospital. The plan, available to all Hospital employees, permits participants to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, disability, retirement, death or financial hardship.

NOTE 13 POSTRETIREMENT BENEFITS

The Hospital provides group term life insurance benefits to all active full-time, part-time with benefits, and retired employees at 100% of annual earnings up to $100,000 subject to reductions upon attainment of certain ages and retirement. For all employees except those hired prior to May 1, 1988, and those hired and retired prior to May 1, 1988, the benefits terminate upon retirement. Employees hired and retired prior to May 1, 1988 receive group term insurance amounting to 100% of annual earnings up to $100,000 with the benefit reduced by 35% at age 64 and reduced by 50% at age 70. Employees hired prior to May 1, 1988 who retire after May 1, 1988 receive group term insurance amounting to $10,000 with the benefit reduced to $5,000 at age 70. The Hospital has not accrued a liability for the potential payment of these benefits. For the years ended September 30, 2006 and 2005, the Hospital made payments for postretirement life insurance premiums of approximately $7,300 and $9,000, respectively.

NOTE 14 COMMITMENTS AND CONTINGENCIES

The Hospital is subject to legal proceedings and claims that arise in the course of providing health care services. The Hospital is covered under a claims-made policy for the purpose of providing professional and patient care liability insurance. The limit of coverage during 2006 was $1,000,000 per incident with a $3,000,000 annual aggregate.

The Hospital is presently involved in litigation arising from the ordinary course of business. In the opinion of management, the Hospital has adequate legal defenses and/or insurance coverage for each of these actions and management does not expect the effect of their ultimate outcome will be material to the Hospital's operations or financial position; however, the ultimate outcome cannot presently be determined. In addition there are known incidents that may result in the assertion of claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients for whom the Hospital would be liable for a material amount.

NOTE 14 COMMITMENTS AND CONTINGENCIES (CONTINUED)

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Hospital is in compliance with fraud and abuse as well as other applicable government laws and regulations; however, the possibility for future governmental review and interpretation exists.

The Hospital has entered into contracts for capital projects for which remaining commitments totaled approximately $2,417,000 at September 30, 2006.

NOTE 15 RISK MANAGEMENT

The Hospital is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; business interruption; errors and emissions; injuries to employees; natural disasters; and medical malpractice. The Hospital carries commercial insurance for these risks of loss. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Also the Hospital's employee health insurance program is self-insured with stop-loss coverage provided by a commercial insurance company. At September 30, 2006 and 2005, respectively, the Hospital recorded a liability of approximately $1,017,000 and $929,000 for unpaid health insurance clams and health insurance claims incurred but not reported.

The following is a summary of changes in the health claims liability for the years ended September 30, 2006 and 2005:

	2006	2005
Claims liability at beginning of fiscal year	$ 929,222	$ 796,538
Incurred claims and incurred but not reported claims	7,723,753	7,746,508
Claims paid	(7,636,300)	(7,613,824)
Claims liability at end of fiscal year	$ 1,016,675	$ 929,222

NOTE 15 RISK MANAGEMENT (CONTINUED)

Beginning January 1, 2004, the Hospital's workers' compensation insurance coverage changed and the deductible became $250,000 per claim. The Hospital has third-party insurance coverage for any losses in excess of this per claim amount. The third-party workers' compensation policy has a maximum aggregate amount of $1,900,000. In addition, the Hospital has an $869,000 letter of credit as collateral for the workers' compensation insurance policy. The Hospital accrued reserves for unpaid claims amounting to approximately $222,000 and $495,000 at September 30, 2006 and 2005, respectively, which is included in accounts and contracts payable in the consolidated balance sheets.

The Hospital purchases malpractice insurance coverage on a claims-made basis from a commercial insurance company. The limit for claims paid applicable to the Hospital's coverage is $1,000,000 for any one claim and $3,000,000 for all claims annually. The annual aggregate limit for claims paid applicable to the Hospital's excess liability coverage is $9,000,000 that can be applied toward any one claim or total claims that exceed the primary coverage limits. The Hospital has recorded a reserve for estimated deductibles under its malpractice insurance for the years ended September 30, 2006 and 2005, amounting to approximately $370,000 and $267,000, respectively, which is included in accounts and contracts payable in the consolidated balance sheets.

NOTE 16 CHARITY CARE

The Hospital 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. It is not practicable for the Hospital to estimate the costs incurred to provide charity care.

The following information relates to the level of charity care provided during the years ended September 30, 2006 and 2005:

	2006	2005
Charges Foregone, Based on Established Rates	$ 2,752,402	$ 1,774,010
Equivalent Percentage of Charity Care Patients to all Patients Served	1.06%	0.78%

NOTE 17 ADJUSTMENTS TO GROSS REVENUES

Gross revenues are reduced by the following adjustments to arrive at net patient service revenues for the years ended September 30, 2006 and 2005:

	2006	2005
Contractual adjustments	$ 120,848,039	$ 100,270,815
Provision for Bad Debts	15,263,812	12,260,697
Charity care	2,752,402	1,774,010
Other	2,496,470	2,691,270
	$ 141,360,723	$ 116,996,792

NOTE 18 FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Hospital in estimating the fair value of its financial instruments:

Cash and Cash Equivalents

The carrying amount reported in the consolidated balance sheets for cash and cash equivalents approximates fair value.

Investments

These assets consist primarily of cash equivalents, U.S. government securities and interest receivable. The carrying amounts approximate their fair values.

Accounts and Contracts Payable

The carrying amount reported in the consolidated balance sheets for accounts and contracts payable approximates fair value.

Third-Party Settlements Payable

The carrying amount reported in the consolidated balance sheets for estimated third-party payor settlements approximates fair value.

Long-Term Debt

The carrying value of the Hospital's bonds approximates fair value based on the variable interest rates.

NOTE 19 DESIGNATIONS

It is the Hospital's policy to fund depreciation to the extent funds are available. At September 30, 2006 and 2005, investments totaling approximately $17,304,000 and $16,621,000, respectively were designated by the Hospital's Board of Trustees for future replacement and expansion under this policy. At September 30, 2006 and 2005, investments totaling approximately $2,999,000 and $2,776,000, respectively, were also designated as quasi-endowment funds. Such investments are included in noncurrent assets. At September 30, 2005, approximately $1,520,000 was designated for future costs of the Hospital's retirement system and was included in other noncurrent assets. These funds were used for their intended purpose during 2006.

NOTE 20 PENSION PLANS

The Hospital has a defined contribution plan in which employees are eligible to participate when they complete 1,000 hours of service, attain age 21, and have been employed at least one year. The plan provides for Hospital base contributions, ranging from 3% to 9% of employee compensation based upon age and length of employment. The plan also provides for Hospital matching contributions of 50% of employee deferrals to the deferred compensation plan up to 6% of employee compensation. Contributions are invested in participant-directed investment fund options. Contributions to the defined contribution plan amounted to approximately $2,273,000 and $2,288,000 during the years ended September 30, 2006 and 2005, respectively.

COMPLIANCE SECTION

LarsonAllen[SM]

Larson, Allen, Weishair & Co., LLP

CPAs, Consultants & Advisors
www.larsonallen.com

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

Board of Trustees
Henderson County Hospital Corporation, Inc. d/b/a
Margaret R. Pardee Memorial Hospital and Affiliates
Hendersonville, North Carolina

We have audited the consolidated financial statements of Henderson County Hospital Corporation, Inc. d/b/a Margaret R. Pardee Memorial Hospital and Affiliates as of and for the year ended September 30, 2006, and have issued our report thereon dated December 1, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Henderson County Hospital Corporation, Inc. d/b/a Margaret R. Pardee Memorial Hospital and Affiliates' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in the amounts that would be material in relation to the consolidated financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

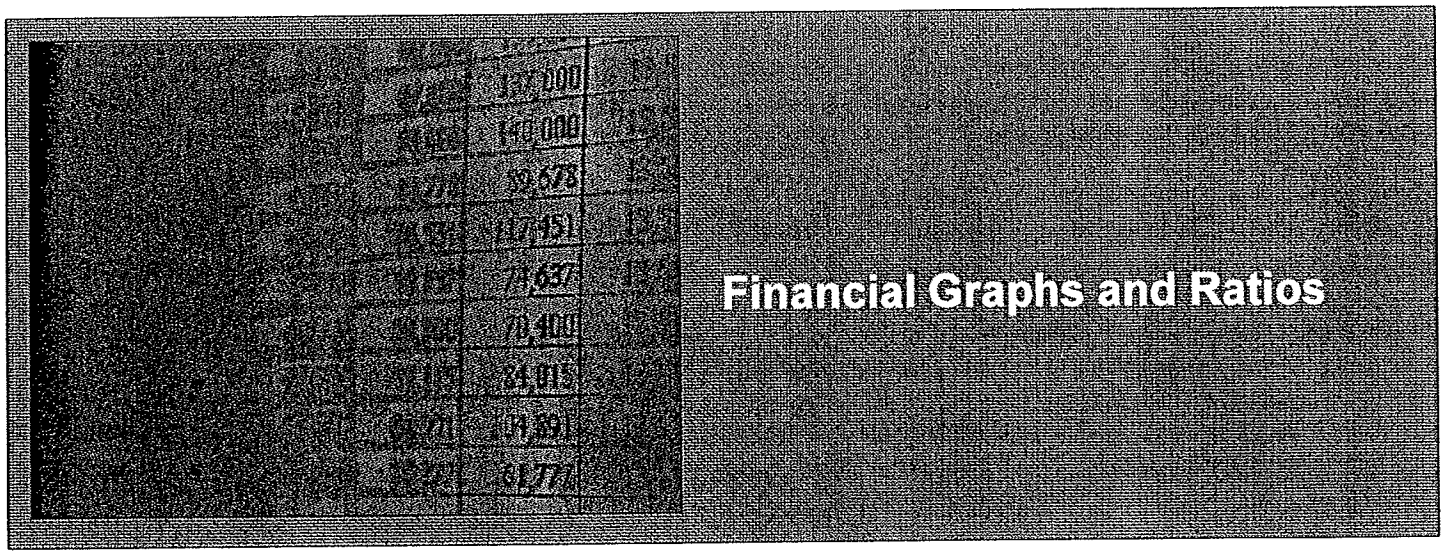
As part of obtaining reasonable assurance about whether Henderson County Hospital Corporation, Inc. d/b/a Margaret R. Pardee Memorial Hospital and Affiliates' consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of consolidated financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Finance Committee, management, the Board of Trustees, and Henderson County and is not intended to be and should not be used by anyone other than these specified parties.

Larson, Allen, Weishair & Co., LLP

LARSON, ALLEN, WEISHAIR & CO., LLP

Charlotte, North Carolina
December 1, 2006


Financial Graphs and Ratios

Margaret R. Pardee Memorial Hospital

2006 Financial Graphs and Ratios

(with S&P Comparative Data)

LarsonAllen[SM]

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NOTICEABLY DIFFERENT

Margaret R. Pardee Memorial Hospital
Financial Indicators – Liquidity Ratios

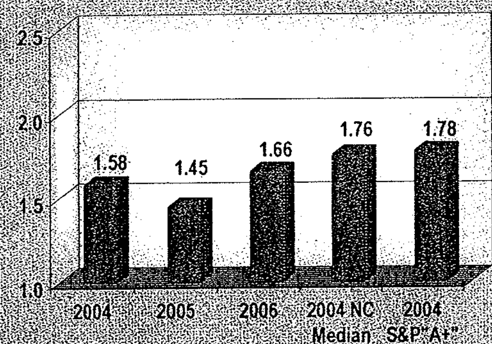
Current Ratio

Definition:

This is the number of dollars held in current assets per dollar of current liabilities.

Comments:

This ratio is the most widely used measure of liquidity. The ratio has improved since 2005 as a result of a $3,210,000 increase in patient receivables and a $805,000 decrease in the current portion of capital lease obligations.



NOTICEABLY DIFFERENT

Margaret R. Pardee Memorial Hospital
Financial Indicators - Liquidity Ratios

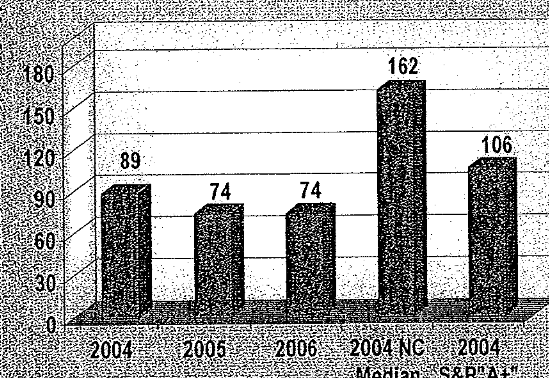
Days Cash on Hand, Unrestricted

Definition:

Days Cash on Hand measures the number of days of average cash expenses that Pardee maintains in cash and amounts reserved for capital improvements. High values usually imply a greater ability to meet both short-term obligations and long-term capital replacement needs.

Comments:

Days cash on hand is used for operating expenses, debt service and future capital requirements. This ratio is consistent with 2005, but still shows an unfavorable liquidity position in comparison to the benchmarks.



NOTICEABLY DIFFERENT

Margaret R. Pardee Memorial Hospital

Financial Indicators - Liquidity Ratios

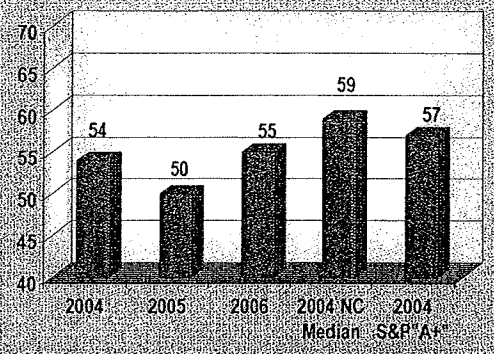
Net Days in Accounts Receivable

Definition:

Days in patient accounts receivable is defined as the average time that receivables are outstanding, or the average collection period.

Comments:

Net days increased approximately 5 days, which is consistent with other hospitals across the country as Medicare held payments to all hospitals for the last 9 days of September 2006. Pardee's ratio is slightly better than the benchmarks.



Margaret R. Pardee Memorial Hospital

Financial Indicators - Leverage Ratios

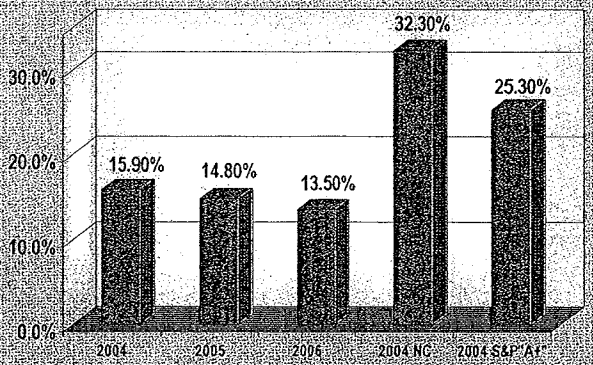
Long-Term Debt to Capitalization Ratio

Definition:

Long-Term Debt to capitalization is defined as the proportion of long-term debt and capital leases divided by long-term debt, capital leases and net assets. Higher values for this ratio imply a greater reliance on debt financing and may imply a reduced ability to carry additional debt in the future.

Comments:

Pardee has historically carried a low level of leverage. The Hospital has chosen to finance many capital expenditures with investment funds rather than borrowing new debt. This has made Pardee's leverage ratio well below the benchmarks.



Margaret R. Pardee Memorial Hospital
Financial Indicators - Revenues

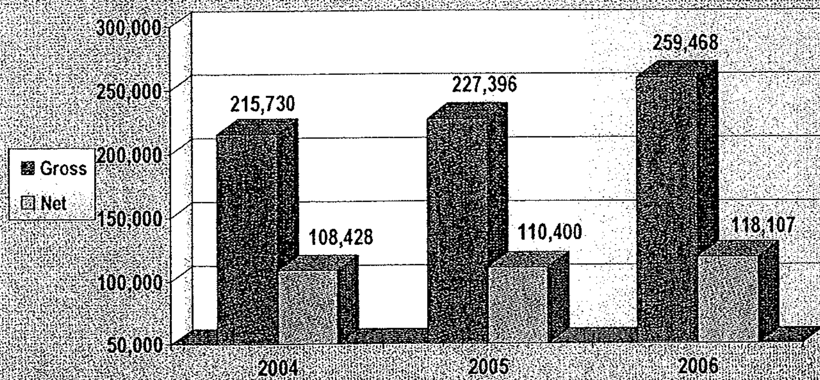
Gross and Net Patient Revenues ($000's)

Definition:

Gross revenues represent the total original charge for services prior to contractual adjustments, bad debts and charity care. Net patient service revenues is gross revenues reduced by these amounts.

Comments:

The increase noted below was primarily achieved through volume changes, changes in services provided, rate increases, change in rate structure and an increase in the Medicare case mix index.



NOTICEABLY DIFFERENT

Margaret R. Pardee Memorial Hospital
Financial Indicators - Revenues

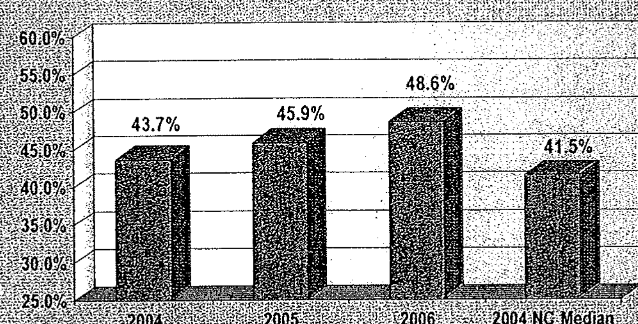
Contractual Adjustment Percentage

Definition:

Contractual Allowances represents the difference in between the charges billed at gross value and the payment received from the third-party payors based upon negotiated charges.

Comments:

The increase noted below is due to the relationship between the rate increases implemented by Pardee, recent changes in the charge structure, a $1 million increase in charity care in 2006 and the structure of the reimbursement contracts with third-party payors who are set up on prospective payments/DRGs.



NOTICEABLY DIFFERENT

Margaret R. Pardee Memorial Hospital

Financial Indicators - Profitability Ratios

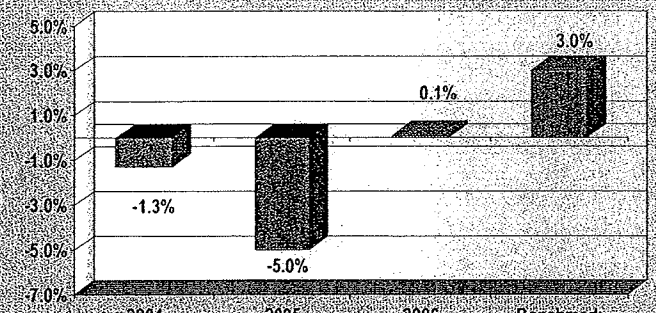
Operating Margin

Definition:

This ratio is operating income as a percentage of operating revenues. It is used to report the Corporation's return on revenues which relate to the main purpose of operations.

Comments:

The profitability of Pardee increased in 2006 primarily due to rate increases implemented by Pardee, recent changes in the charge structure, increases in the Medicare case index and the effective controlling of costs and expenditures.

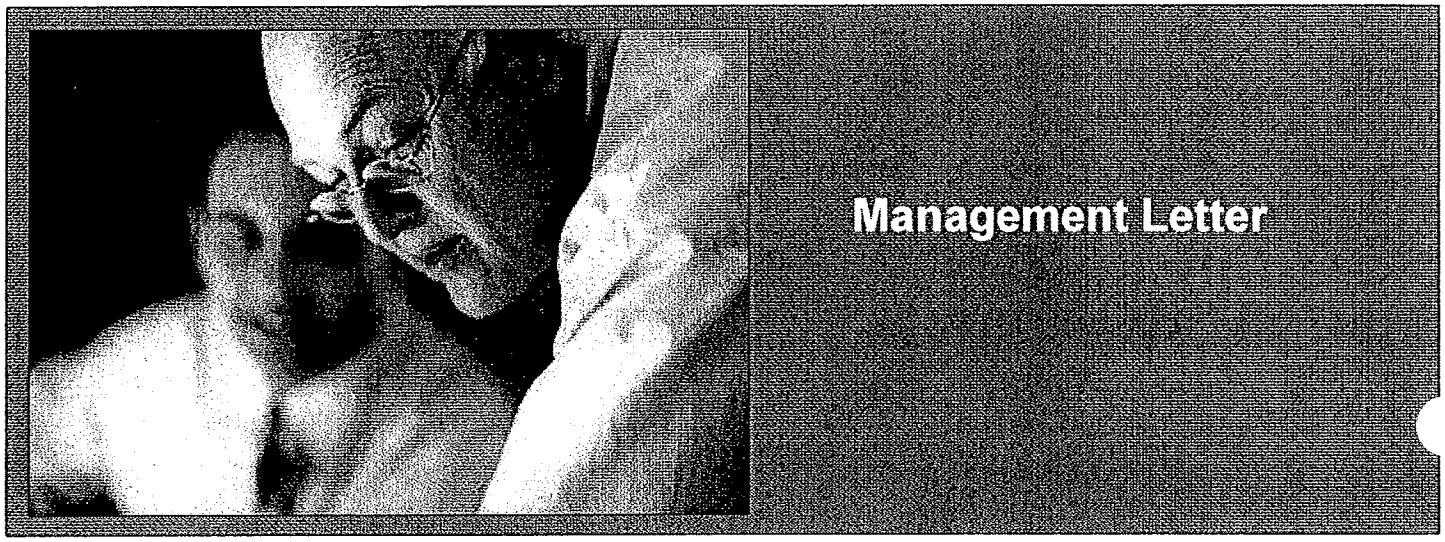


Margaret R. Pardee Memorial Hospital

Financial Indicators - Profitability Ratios

Common-Size Expense Analysis

	2006		2005	
Net Patient Revenue (excluding Bad Debts)	$ 133,371,000		$ 122,660,000	
Salaries and Wages	49,807,000	37%	46,879,000	38%
Employee Benefits	13,219,000	10%	13,918,000	11%
Supplies	22,921,000	17%	20,243,000	17%
Contract Labor	1,686,000	1%	3,116,000	3%
Physician Fees	1,259,000	1%	1,136,000	1%
Contracted Fees	8,095,000	6%	10,086,000	8%
Minor Equipment	361,000	0%	304,000	0%
Repairs and Maintenance	4,616,000	3%	4,019,000	3%
Insurance	1,878,000	1%	2,196,000	2%
Rent	1,114,000	1%	816,000	1%
Utilities	2,558,000	2%	2,230,000	2%


Management Letter

LarsonAllen[SM]

Larson, Allen, Weishair & Co., LLP

CPAs, Consultants & Advisors
www.larsonallen.com

Board of Trustees
Henderson County Hospital Corporation, Inc. and Affiliate d/b/a
Margaret R. Pardee Memorial Hospital
Hendersonville, North Carolina

In planning and performing our audit of the consolidated financial statements of Henderson County Hospital Corporation, Inc. and Affiliate d/b/a Margaret R. Pardee Memorial Hospital ("Pardee") as of and for the year ended September 30, 2006, we considered Pardee's internal controls for the purpose of expressing an opinion on the consolidated financial statements and not to provide assurance on internal control. Such consideration would not necessarily disclose all matters in Pardee's internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal controls' components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We noted no matters involving Pardee's internal control that we consider to be material weaknesses as defined above. However, we became aware of certain matters we believe are opportunities for strengthening internal controls and operating efficiency and warranted your consideration. This letter does not affect our report dated December 1, 2006 on the consolidated financial statements of Pardee as of September 30, 2006.

Investments

While testing the approximately $23,000,000 in investments, we noted a single investment account which had not been adjusted or reconciled to the appropriate investment statement for some period of time. While this particular account was the only one identified and only had a balance of approximately $39,000, we recommend all cash and investment accounts are reconciled on a monthly basis.

> *Management's Response:*
> *Management agrees that all cash and investment accounts are to be reconciled regardless of balance, and has already implemented procedures to correct for this.*

Review and Approval of Journal Entries

With the numerous instances of management overriding internal controls through the posting of unapproved journal entries (WorldCom for example), we have performed procedures at all of our clients, including Pardee, to test journal entries for proper review and approval. Due to the volume of entries posted each month at most hospitals, it is difficult for management to review and approve all entries each month. At Pardee, management does review certain key journal entries each month and also performs a detailed analysis of

the accounts each month to try and identify unusual or unexpected variances. During our testing at Pardee we did note not all journal entries are approved by individuals other than those initiating the journal entry. While we did not identify any unusual journal entries during our testing of journal entries, we recommend management continue to look at ways to possibly streamline the journal entry process to possibly create an environment were it is possible to review all journal entries.

Management's Response:
To understand this issue and the recommendation that is being made, it is necessary to separate manual journal entries into two broad categories:

- *Standard / recurring journal entries, and*
- *Non-standard / non-recurring journal entries.*

Management has always required a secondary review and approval of all non-standard and non-recurring journal entries, so this recommendation does not pertain to the existing process for such entries. However, because of the volume of the standard / recurring manual journal entries (approximately 100 each month) management's approach to these entries in the past has been to require the following:

- *Review and approval of the initial establishment of a standard entry, and*
- *Monthly review to ensure that all standard entries have been posted.*

In effort to improve the controls over these manual entries, we will implement an additional procedure to add a random review and approval of standard recurring journal entries each month, and will implement this policy immediately. In addition to this, management will continue to look for opportunities to minimize the need for manual journal entries through improved system interfaces, thereby reducing the number of manual journal entries required.

Meditech Software Challenges
There were certain instances where it was difficult to get the desired information from the Meditech software system. In addition, due to the original structure of the Meditech system, the general ledger currently has significantly more than 100,000 accounts which can be difficult to manage and monitor effectively. We understand management has been developing practices to streamline the use of the Meditech software to be more efficient and we support their continuing these efforts.

Management's Response:
Management has been working on this during the past year and has already reduced the number of general ledger accounts. Next steps include reclassifying historical data and identifying additional accounts that can be reduced as we continue the streamlining process. We have made significant progress on this project, and will continue working on this effort to complete it as quickly as possible.

Information Technology Security Comments

The Hospital does not currently maintain a hot or cold backup site for recovery of IT operations as part of the Hospital's disaster recovery plan. Documentation for resumption of IT operations is incomplete. A contract is in place with IBM to provide replacement hardware within 48 hours. We recommend the Hospital evaluate whether business continuity planning provides sufficient documentation of operating procedures in the event IT assets are unavailable for 48 hours.

Management's Response:
Management agrees, and is presently reviewing downtime procedures in conjunction with the implementation of the MEDITECH applications. Pardee has an informal agreement with CDWG to provide hardware within 48 hours in the event of a disaster. In addition, an overall technology assessment has been conducted by Everest Technologies, recommendations from which will be forthcoming and will also be considered by management in our effort to strengthen this area.

The Hospital's server administrators are housed in the data center. Support personnel are housed in a segmented part of the data center. The data center and the office space for application analysts are physically controlled via cipher lock. The office space for other IT staff (programmers, analysts, network administrator, technical services manager and IT director) is not physically restricted. We recommend reviewing to see if it is feasible for all IT staff to be housed in one physical office space, physically restricted using proximity cards that are uniquely assigned to each individual. We recommend access to the data center also be restricted by proximity cards, with access restricted only to those who require access as part of their job requirements.

Management's Response:
The Everest Technologies assessment referred to above also focused upon this issue, and management will address all recommendations related to improvements in securing the data center, IT office space and the data center.

The long range solution to house everyone together is supported by management, and will be addressed in the development of the Master Facility Plan. Proximity card access to the data center was included in the current year capital budget, and is underway.

The Hospital's data center power supply is inadequately protected. The current data center has an uninterrupted power supply (UPS) which currently runs at 95% of total capacity. The current UPS does not have an integrated power distribution unit or provide power conditioning. We recommend the data center UPS be upgraded to allow an appropriate operating capacity with an allowance for future growth. The UPS should include or tie into a proper power distribution unit with power conditioning.

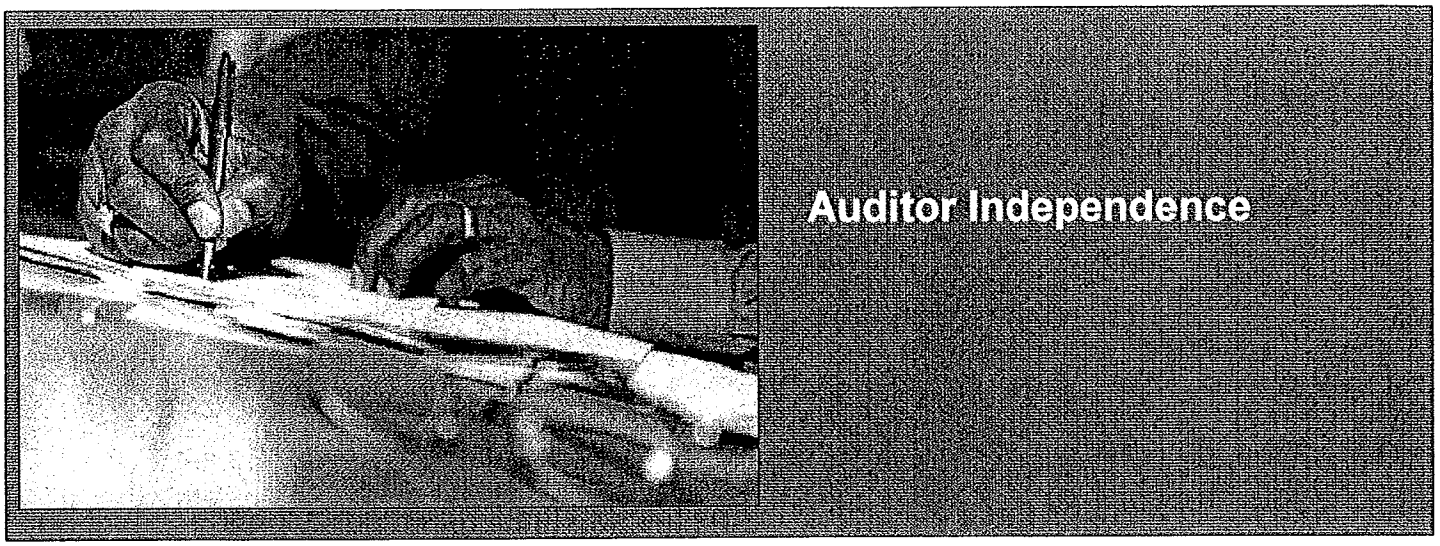
Management's Response:
Management agrees. These points are also addressed in the Everest Technologies IT assessment, and will be included in the Master Facility Plan.

We appreciate the cooperation and courtesy extended to us by Pardee's management and staff during the course of our engagement. This information is intended for use by the management of Pardee and the Board of Trustees and is not intended to be and should not be used by anyone other than these specified parties.

Larson, Allen, Weishair & Co., LLP

LARSON, ALLEN, WEISHAIR & CO., LLP

Charlotte, North Carolina
December 1, 2006

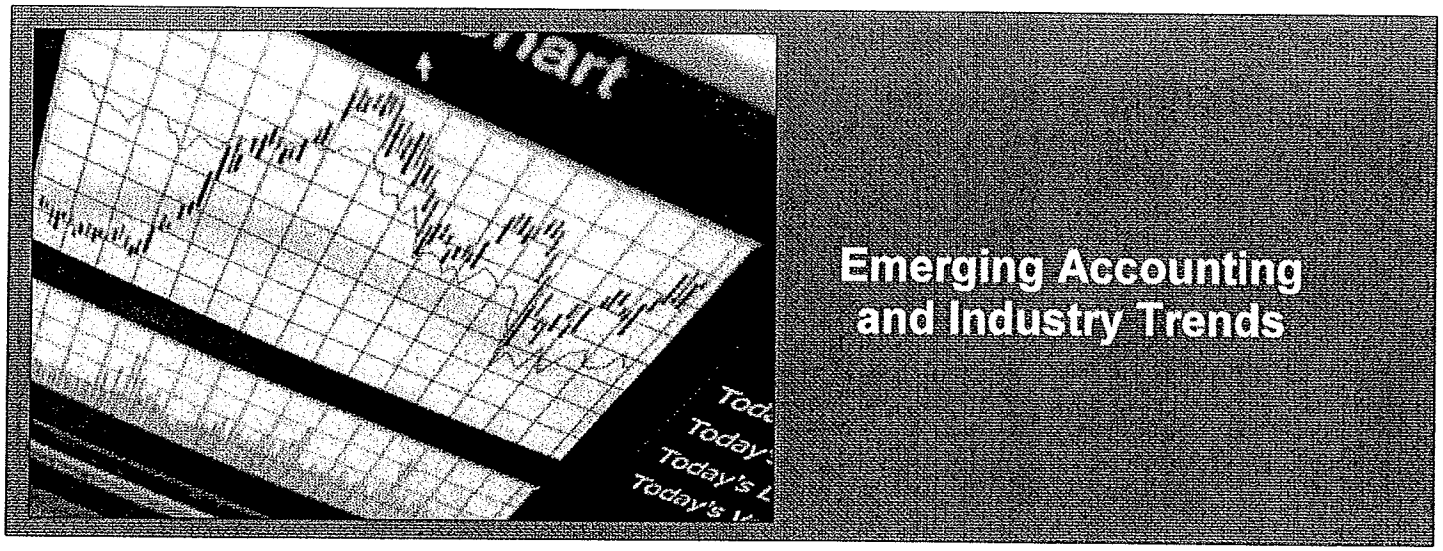


Auditor Independence

Auditor Independence

The following projects were performed by LarsonAllen for Pardee and are considered to be outside of the scope of our audit of the consolidated financial statements for the year ended September 30, 2006. We are providing this information to ensure you agree we have remained independent, both in fact and appearance. LarsonAllen does not believe the performance of these projects has impaired our independence as auditors to Pardee. We have remained, and will continue to remain independent with respect to Pardee.

- Annual audit of the consolidated financial statements of Margaret R. Pardee Memorial Hospital
- Annual audit of the financial statements of Pardee Memorial Hospital Foundation, Inc.
- Research and consulting on various tax issues and preparation of the annual tax returns
- Research and consulting on various reimbursement issues and preparation of the annual cost reports



Accounting Trends:

Statement of Auditing Standards (SAS) 103: Audit Documentation
Statement of Auditing Standards (SAS) 104 – 111: Risk Assessment Audit Standards
Statement of Auditing Standards (SAS) 112: Communicating Internal Control Related Matters Identified in an Audit

Industry Trends:

Intermediate sanctions
Strategic capital planning
Organization of audit committee
Information security considerations—risk management
Governance
Investment policies
Risk assessment for health care
Nonprofit tax update

Statement of Auditing Standards (SAS) 103: audit documentation

Informational summary

The Statement of Auditing Standards (SAS) 103 will be effective for your Hospital beginning for periods ending on or after December 15, 2006. SAS 103 supersedes the current standard, SAS 96. This new standard will change the way audits are planned, completed and dated. Auditors will be required to increase documentation for each engagement to provide sufficient detail of work performed (including the nature, timing, extent and results of work performed), the audit evidence obtained and its source and the conclusions reached.

This new standard will also affect the date of the audit report. In the past, the audit report has been dated when fieldwork has been completed. SAS 103 requires the auditors' report to be dated when the auditor has obtained sufficient audit evidence to support the opinion. Sufficient evidence includes evidence that audit documentation has been reviewed, financial statements have been prepared, and management has taken responsibility for the financial statements.

If the audit is not issued within a couple weeks of when sufficient audit evidence has been obtained, additional audit work on "subsequent events" will be required, which will likely require more time and cost.

It is critical that the provider has the core, required, audit work papers completed prior to fieldwork. In the past, this work often occurred during fieldwork and sometimes hindered the progress of the audit. If all of the requested work is completed by the start of fieldwork, management and the Hospital's staff can immediately address any additional issues that are identified during the fieldwork. This preparation, with effective meetings during the year, will help resolve all audit issues within the timeframe needed to issue the audit report in accordance with the new standard.

Providers that have the best results in preparing for and completing their audits view the audit favorably, as a type of continuous improvement process. Management is open to periodic meetings during the year to discuss their business issues, participate in effective planning meetings prior to year-end and have a clearly defined audit process and timeframe for the fieldwork and issuance of the report(s). The most financially efficient organizations also have effective month end closing procedures. If these procedures are in place and followed consistently, the probability of success at year-end and during the audit process increases dramatically.

In order to prepare for this new standard, more emphasis will be placed on planning in order to ensure all audit work papers and supporting documents are completed by management and staff prior to fieldwork. This will help the audit to be completed in a timely fashion and allow sufficient time for review and processing of the audit.

Statements of Auditing Standards (SAS) 104 – 111: Risk Assessment Audit Standards

The Statements on Auditing Standards (104 – 111) will be effective for periods beginning on or after December 15, 2006. These Statements establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement (whether caused by error or fraud) in a non-issuer financial statement audit, and the design and performance of audit procedures whose nature, timing, and extent are responsive to the assessed risks. Additional, the Statements establish standards and provide guidance on planning and supervision (audit risk and materiality), the nature of audit evidence, and evaluating whether the audit evidence obtained affords a reasonable basis for an opinion regarding the financial statements under audit.

The primary objective of these Statements is to enhance the auditors' application of the audit risk model in practice by specifying, among other things:

- More in-depth understanding of the organization and its environment, including internal control, to identify the risks of material misstatement in the financial statements, and what the organization is doing to mitigate them.
- More rigorous assessment of the risks of where and how financial statements could be materially misstated based on that understanding.
- Improved linkage between the auditors' assessed risks and the nature, timing, and extent of audit procedures in response to those risks.

Statement of Auditing Standards (SAS) 112: Communicating Internal Control Related Matters Identified in an Audit

Informational summary

Internal control processes are key to providing those charged with governance of the organization with reasonable assurance regarding the achievement of the organizations objectives. Failure to adequately identify and implement controls leaves the organization exposed to serious risks including material misstatements of the financial statements and exposes the organization to losses due to fraud.

The Statement of Auditing Standards (SAS) 112 will be effective for your organization during the next fiscal year. SAS 112 replaces the current regulation SAS 60 that was in effect for your organizations last fiscal year. While this report included the identification of some internal control matters the classification and definition of these matters will likely change in future periods under the new regulation. The newly created classifications are measured on the level of severity and likelihood that the issue identified would lead to a misstatement in the entity's financial statements. The lowest of these classifications being a *deficiency*, secondly a *significant deficiency* and lastly the most sever *material weakness*. These new classifications eliminate the *reportable condition* term and provide a new definition for a *material weakness*. Due to the new definition of material weakness under the new regulation your organization will likely see many issues previously identified as reportable conditions change classification to the more sever material weaknesses classification.

In addition some control matters that have not previously been required to be disclosed will be under SAS 112 including, reporting journal entries proposed by the auditor not identified by management and the preparation of financial statements by the auditor.

The existence of significant deficiencies or material weaknesses may already be known to management or those charged with governance to accept that degree of risk because of cost or other considerations. Management is responsible of making decisions concerning costs to be incurred and related benefits. The auditor's responsibility to communicate significant deficiencies and material weaknesses in accordance with regulations exists regardless of management's decisions.

Upon request LarsonAllen would be glad to provide the detail of the statement to management and the board as well as consider improvements in the internal control process that may alleviate or lessen the severity of future communications in this area.

Intermediate sanctions

Informational summary

The IRS has indicated that it is stepping up its enforcement efforts and will be targeting certain exempt organizations for Intermediate Sanctions scrutiny. This is evident in recent comments made by the Director of the IRS Exempt Organization Division, when he said, "We'd like to increase the tension in decision making about compensation in the nonprofit area." As a result, all organizations subject to Intermediate Sanctions should review their current policies and procedures to ensure that they are in compliance with these new regulations.

What is it? Intermediate Sanctions is a tax system designed to curtail excess benefits (private inurnment) provided to individuals with substantial influence over the affairs of the organization (organizational insiders). Prior to the enactment of Intermediate Sanctions, the IRS had two choices in dealing with private inurnment: revoke the organization's exempt status, or do nothing. Intermediate Sanctions provides the IRS with a middle ground option of punishing those who participate in private inurnment (or "excess benefit") transactions by taxing the person that directly benefits (25% of the excess benefit), as well as the organizational managers (including certain officers and board members) who knowingly and willfully approve of such excess benefit transactions (10% of the excess benefit).

Why is this important to the organization? If the individual is an insider, he/she could be subject to a 25% tax (or 200% if you fail to return the excess benefit within a certain period of time). However, even if he/she do not benefit from the transaction, they could be subject to the 10% tax if they knowingly and willfully approved of a "benefit" transaction. **This means that certain officers, directors, and board members could be at risk for paying a 10% penalty on a transaction in which they do not personally benefit.**

Organizations should establish conflict of interest policies and policies for review and approval of transactions with board members, officers, management and physicians. In addition, policies should be established for determining and documenting executive compensation and benefits and Board approval.

Strategic capital planning

Informational overview

As with many health care organizations, understanding your facilities capital planning is a continued focal point. Creating tools and processes for understanding the linkage between financial performance and capital capacity is an essential element for successful planning.

There are several important issues for health care organizations to consider as they assess and manage their capital capacity. These include:

Setting organizational financial performance targets.	These targets serve as the backbone around which an organization can begin to assess and manage its capital capacity.
Getting on the front end of the capital planning process.	The most successful capital planning involves knowing from the start what you can afford. Many organizations invest significant time and energy on capital plans that are not affordable within the context of their current and future financial situation.
Working from a high-level plan.	This step helps you build the capital capacity planning process around key variables that drive financial performance. These include, but are not limited to spread, growth and cost savings. In other words the 80/20 rule also applies to capital capacity planning.
Making it easy to test multiple scenarios.	Successful planning is often a fluid process, meaning that a flexible approach to capital capacity analysis is essential to helping everyone involved understand how changes in key assumptions can affect the overall picture. Understanding the sensitivity and risks associated with future plans is a crucial part of the capital planning process.
Understanding the incremental value of strategies.	Many organizations have multiple strategic opportunities, but limited capital capacity to invest in them. By understanding the incremental value of strategies, you can make effective "apples to apples" comparisons of the relative value of competing alternatives.

Capital capacity is the lifeblood of your health care organization. Just like a patient, its condition needs to be measured and monitored to help ensure a successful outcome.

Organization of an audit committee

Informational overview

As discussed on the previous page industry trend topic, the audit committee has become an increasing focus area for many organizations due to the Sarbanes-Oxley Act of 2002. Although each organization is unique, in order for the audit committee to be effective, general requirements are essential. The following summary is intended to provide a resource to your organization to help assist you in evaluating your current audit committee:

Audit committee basic structure	• Usually made of three to six members • Should have no term limit, although the board should have a means of rotating members regardless of the term limit • The Board of Trustees should appoint audit committee members and the chairperson • The size and responsibilities should be tailored to fit the needs of the organization • Do not overload the audit committee • The audit committee should be evaluated – Individually every two to three years – To see if following the charter
Appointing the audit committee	• Characteristics of effective members – Independence – Financial literacy – The ability to read and understand basic financial statements including balance sheet, income statement, and statement of cash flows – At least one member should have an expertise in accounting or finance – Understanding of organization's economic, operating, and financial risks – Understanding of the interrelationship between operations and financial reporting – Inquiring attitude and sound judgment – Understanding of the difference between decision-making function and oversight function – Willingness to challenge management in an appropriate manner • Independence requirements – Should not be current employees – Should not be former employees during the last three years – Should not have immediate family members that are in executive positions of the organization – Should not be an executive, partner, or controlling shareholder of companies that have a business relationship – Should not have direct business relationship with the

	Organization
Educating the audit committee	• Members should have the proper background and maintain or be made aware of current knowledge about new developments in accounting, risk, controls, and auditing • The organization should provide training but make outside resources available • The organization should hold an orientation session for new members • There should be periodic briefings for all members on specific aspects of business and financial aspects of the organization • Management and the external auditor should provide updates on new accounting practices, standards, and regulatory requirements
Responsibilities of the audit committee	• Primary responsibilities – Choosing, reviewing, and replacing the external auditor – Evaluating the external audit plan – Reviewing the audited financial statements – Monitoring and overseeing the external auditor work and independence – Monitoring and overseeing the internal control of the organization – Monitoring the work of the corporate compliance officer – Completing a self-assessment – Communicate findings to management and board members • Additional responsibilities include the oversight of – Code of ethical conduct – Litigation matters – Investigations – Legal and regulatory compliance – Business risks – Expense accounts
Not-for-profit entity issues	• Trend of implementing a corporate model audit committee to provide oversight and focus on policy matters in order to free-up the CEO so that the CEO can devote more time to operations • The corporate model generates greater accountability and quality of services through maintaining effective controls over financial reporting, compliance, and operations • The responsibility and authority is essentially the same as a for-profit organization • Should pay more attention to sensitive areas such as professional fees, consulting fees, executive compensation, travel and entertainment, and donations • The number of meetings should be based primarily on how often financial statements are issued

	• Proper compliance systems help protect a organization from material criminal penalties and helps protect directors from liability
Operations/meetings of the audit committee	• General meetings – Generally hold two to four meetings annually – Adequate time should be allotted for the meetings – There should be authority to call special meetings – Chairperson should prepare an agenda with time allocations for each meeting to help maintain focus and order – Management should not organize or dictate the agenda for a meeting – Information should be distributed prior to the meeting – Minutes and attendance should be recorded – The CFO, controller, representative of the organization's financial management and internal audit should be present at each meeting – Specialists and legal counsel should attend as needed – The CEO should only attend meetings when invited • Executive sessions – Meeting with the key members of the executive management and financial management teams on a one-on-one basis – Should occur with every meeting of the audit committee but not necessarily with everyone – Minutes are not recorded – Purpose is to create a safe environment so questions are answered without intimidation – Ask open-ended questions – Follow up on answers that are not readily understood – Let it be known that you are always available

Legal liability issues	• Directors, including the audit committee, have a fiduciary responsibility to the organization and shareholders • Duty of care – Act in good faith – Use prudent judgment – Act in organization's best interest • Duty of loyalty – Must put the interest of the organization ahead of personal interest – Must disclose potential conflicts of interest • Directors may rely on information provided by officers, employees, external auditors, legal counsel, and others that the directors feel are professional or experts in the respective area • There is no differential liability for audit committee members unless rule, regulation, and/or legislation establishes it • The business judgment rule should protect the audit committee from legal liability if the audit committee works thoroughly at its duties and records evidence of its work in the minutes and other documents including the charter
Audit committee charter	• Approved by the board of directors • Lists the scope of the audit committee's responsibilities and how to carry out those responsibilities • Lists the structure, processes, and requirements for membership • A tailor-made charter will provide flexibility • Audit committee members, chairperson, internal and external auditors, legal counsel, and financial management team members should all contribute and play an active role in forming the charter • Important from a legal liability view because it helps focus and guide the committee to pay attention to legal and regulatory compliance • Should state that the external auditor is ultimately accountable to the board of directors and audit committee • The committee and board have the responsibility and authority to hire, evaluate, and replace the external auditor • The committee is responsible for making sure the external auditor submits a written statement that accounts for all relationships between the organization and external auditor and ensuring that the external auditor is independent

Information security considerations: risk management

Informational overview

Information security is a complex moving target. Connecting the Hospital's business network to the Internet presents a new level of information security risk. Viruses, worms, malicious web sites, hackers, and identity thieves all present challenges for system administrators. Sound Internet security practices are the result of an organized program that creates a "culture" of security. This culture should consist of five broad domains of security as follows:

Strong policies and procedures	Studies are very clear on this subject: companies with strong security policies detect and react favorably to more security incidents than those without policies. Strong policy that is accepted and implemented by the end user community is the backbone of security.
Secure the perimeter	Far more than simply a firewall, a secure perimeter must be monitored. Remember, it is one thing to be hacked; it is another altogether to know you have been hacked.
Minimize services	Each service you supply over the Internet has risk associated with it. Your Internet connection should supply only the services necessary for your business. Further, each service should be kept "current," with all version updates, patches, and hot fixes from your software vendor. Hackers are constantly developing new exploits for web-based services, and software vendors are constantly issuing patches and hot fixes to address them. Keeping up with patches, while difficult both administratively and operationally, is nonetheless critical.
Secure the inside	No matter how well you secure the perimeter security incidents will occur. For this reason it is essential that basic operating system security be in place for all hosts and servers within your network.
Secure confidential data in transmission	Commercial encryption tools (such as SSL and SSH) are available to secure data in transmission.

Securing Internet connections is a complex process. Often the most effective way to verify your security posture is to hack it. This process is called "penetration testing." A sound penetration test methodology uses the same tools, techniques, and tactics that actual "black hat" hackers use. For this reason it is sometimes referred to as "white hat hacking."

A penetration test is useful to:
Verify the integrity of your firewall configuration and the security configuration of other devices visible from the Internet.
Verify that all services supplied over the Internet are properly secured and up to date with all patches and hot fixes.
Verify that network monitoring capabilities are properly configured and functioning to ensure that you will be able to detect and react to a security incident on a timely basis.

Governance

Recent studies of governance effectiveness indicate all is not well with health care boards. Oversight is applied sporadically, and is often too much or too little. Also, too many board members are wondering if their role is irrelevant: "Why am I here?" "What difference do I make?" "Are we really guiding, or gliding?"

There are growing pressures for boards to be smarter, more transparent and more rigorous in their pursuit of great governance. They continue to have a responsibility to protect the public's interest with accurate accounts of resources consumed. Not-for-profit health care organizations have an added burden of preferential tax treatment for their good works. Abuse of this tax-exempt status has lead to growing government, media, and bond holder interest in board performance. This environment demands the board have bold vision, excellent strategy execution, and an enhanced alliance with other community partners.

Common board problems include; (1) dysfunction of groups: rivalries, domination by a few, one-way communication, bad chemistry, (2) disengaged: not well informed, not much desire to learn, weak participation, poor attendance, and (3) do not know roles & responsibilities, lack job description.

Following are *four deadly myths* about governance:

- Great board members are born, not made
- Great board members make great boards
- Bigger boards yield greater diversity of thought, expertise and community leverage
- Commitment to process improvement applies to clinical and administrative processes, but not to governance

There are three types of governance

Type 1: Fiduciary

The goal in this type of governance is to protect assets and ensure resources are used efficiently and effectively. Management defines problems and opportunities and develops formal plans. The board structure parallels administrative functions and the responsibilities are to listen, learn, approve, and monitor. Board meetings are process driven and the protocol rarely varies. Board presentations consist of large quantities of technical data from few sources

Type 2: Strategic

The goal of strategic governance is to guide the organization from present to preferred future.

Board and management think together to discover strategic priorities and drivers. The board structure mirrors organization's strategic priorities. Board meetings are content-driven and protocol often varies. Board and staff discuss strategic data from multiple sources.

Type 3: Thought Generative

The goal is to shape the other two modes of governance. The board defines the future, frame the questions, and look for cues and clues. There is a strategic partnership between the board and management. Meetings vary and content includes more qualitative discussions and less reports. Patients and other sources of revenues are invited to speak at board meetings.

Well functioning boards are able to adopt best practices from each type of governance.

Questions to assess types of governance

Great boards first seek great questions rather than rushing to fast answers. Boards should generate new questions by occasionally conducting different style meetings, retreats-advances, study tours, participants, town hall meetings, White Coat visits to clinical areas, "Community Plunges," Meetings-on-a-bus, etc.

The following are questions that boards can use to assess each type of governance:

Fiduciary Role Questions
What do we hold in trust, and for whom?
What are the fiduciary, but non-financial roles of our boards and committees?
How do we know the organization is fulfilling its mission?
Does a proposed initiative effectively advance our mission?
What safeguards do we have in place to avoid well publicized fiduciary failures?
If we held an annual stakeholders meeting, what would we say about the fiduciary performance and the board's effectiveness as a steward?
What is the evidence that we are a trustworthy organization? What are some examples of times in which we earned the title "trustworthy"?
What are our major financial vulnerabilities? What are we doing as an organization and a board to address them?
Even though we are not bound by Sarbanes-Oxley, are there some provisions we should adopt?

Strategic Role Questions
Is the business model of this healthcare system viable over the next 10-15 years? If not, what has to change?
What forms of healthcare should we emphasize as an organization with multiple missions (care, teaching, research, employer, capital mover)
Can we flourish in a neighborhood in decline? If not, do we move or stimulate re-development? Do we know our neighbors?
Do we remain frustrated with Stark Laws that strangle innovation with physician relationships or lobby for change in the ground rules?
How do we make an impact on health gain as well as health care when few payers pay us to do it?
How fast do we adopt new science to enhance our quality, versus invest in process improvements and optimizing use of our current technologies?
How can we assure we don't just satisfy, but actually delight our patients, visitors, physicians, payers, politicians and employees?

Thought Generative Questions
What three adjectives or short phrases best characterize this organization?
What will be the most strikingly different aspect about this organization in five years?
What do you hope will be most strikingly different aspect of this organization in five years?
On what list, which you can create, would you like this organization to rank at the top?
Five years from today, what will this organization's key constituencies consider the most important legacy of the current board?
What will be most different about the board or how we govern in five years?
How would we respond if a donor offered a $50 million endowment to the one organization in our field that has the best idea for becoming a more valuable public asset?
If we could successfully take over another organization, which one would we choose and why?
What headline would we most like to see about this organization?
What is the biggest gap between what the organization claims it is and what it actually is?
What should be atop the board's agenda for next year?
What external factors will most affect the organization in the next 24 months?
Are we using the best balanced scorecard to rack our performance?
Are we benchmarking against the right comparative players?
What is the most valuable action we could take to be a better board, committee or member?

Investment policies

Investments are significant assets for many health care organizations; however, few organizations have a strong investment policy aimed at maximizing investment returns. Best practices for an investment policy include a clearly defined investment objective, investment strategies to support the investment objective, delineation of authority and responsibility, and standards for monitoring and reporting.

Investment Objective— The investment objective should provide management with clear guidelines for targeted rate of return. An example investment objective is as follows: "The Organization will balance the investment strategies and target an annual rate of return between 7 and 10 percent."

Investment Strategies—Investment strategies include the targeted asset mix and asset range, trigger points for rebalancing, and non-permissible investments.

First, the Board of Trustees should approve a targeted asset mix and asset range. The asset range is the percentage range that each investment should fall within. Exceptions to this strategy require board approval. The following is an example of an asset mix and asset range:

	Target	Asset Mix
Asset Class	Asset Mix	Range
Cash	5%	0% to 5%
Securities A	15%	10% to 20%
Securities B	20%	15% to 25%
Securities C	30%	25% to 35%
Securities D	30%	25% to 35%

Second, the asset managers and brokers have trigger points for rebalancing and recommending investments for sale. These guidelines should be documented in an investment policy. Example guidelines for rebalancing are:

- Investments with a loss greater than 3 to 5 percent within a 3-month period should be redeemed.
- Investment managers whose organizations have undergone a significant change in leadership, such as a new executive leadership team, with a loss of 3 percent for a 5 month period should be redeemed.

Third, the Hospital may deem certain investments as not permissible within the portfolio. For example, organizations limit investments to socially conscious investments. These limits should be documented within the policy.

Monitoring and Reporting— The investment policy should include standards for monitoring and reporting performance. Asset mix, investment yield, and investment fees should be reported to the Board of Trustees using the following example as a guideline.

Asset mix

Asset Class	Target Asset Mix	Actual Asset Mix	Asset Mix Range
Cash	5%	0%	0 to 5%
Securities A	15%	18%	10% to 20%
Securities B	20%	27%	15% to 25%
Securities C	30%	25%	25% to 35%
Securities D	30%	30%	25% to 35%

Investment yield

Asset Class	Value	Yield	Goal
Cash	$ 50,000	2%	5%
Securities A	$159,000	6%	5%
Securities B	$208,000	4%	5%
Securities C	$318,000	6%	5%
Securities D	$330,000	10%	10%

Investment fees

Asset Class	Contributed Cash	Fees	Percentage
Cash	$ 50,000	NA	NA
Securities A	$150,000	$ 600	0.4%
Securities B	$200,000	$ 10,000	5.0%
Securities C	$300,000	$ 13,500	4.5%
Securities D	$300,000	$ 12,000	4.0%

Organizations should tailor the investment policy based on the significance of the investments relative to other balance sheet assets. A well defined investment policy should include an investment objective, investment strategies, authority and responsibility, and standards for monitoring and reporting.

Risk assessment for health care

In the wake of Corporate Scandals, the Sarbanes-Oxley Act of 2002 ("SOX") required that management implement processes to identify, analyze, and control risk. These processes are now viewed as best practices for all types of organizations. Health care entities across the country have adopted components of this act and are more aggressively implementing risk management techniques by performing risk assessments, adopting guidelines for audit committees, and evaluating internal controls.

Risk assessment is a set of procedures aimed at understanding and mitigating operational, financial, and regulatory risks. Management uses the results of risk assessments in two areas: to establish the internal audit project plan and to describe resource requirements during the budgeting process. A typical risk assessment includes interviews with key executives, a review of financial trends, and assessments of strategic plans. The goal is to identify sources of increased risk such as new business lines, obstacles to achieving business strategies, regulations impacting businesses, and changes in the business environment.

Health care entities should also develop an internal audit charter that specifies the audit committee's responsibilities. At least one member of the audit committee should be a financial expert and all members should be independent of the health care entity. The audit committee should be responsible for the hiring and oversight of the external auditor's work. This oversight involves meeting with the external auditors to review significant accounting pronouncements, management's policies and procedures, and audit adjustments. For organizations that have an internal audit team, the audit committee is responsible for overseeing their work and staying updated through semi-annual reports. Additionally, the audit committee should establish a process for receiving complaints regarding financial matters.

The most complex and costly element of SOX is section 404, Evaluation of Internal Controls. Several areas of internal control appear to be particularly problematic for health care organizations. These include account reconciliations, segregation of duties, authorization and approvals, and general computer controls. All organizations should assess the internal controls within these areas for significant business units and start the process of enhancing controls.

Health care organizations can better manage financial, operational, and regulatory risks by performing risk assessments, developing guidelines for their audit committees, and evaluating their internal controls. Although, health care organizations are not mandated to adopt these practices, proactive risk management is a good investment in the long-term of an organization.

Nonprofit tax update

Unrelated business income—joint ventures and UBI informational summary

Participation by tax-exempt organizations in joint ventures, especially in the health care industry, has increased significantly over the past several years. Hospitals in particular are being forced to joint venture with local physicians to avoid losing significant revenue streams. With this participation comes exposure to certain tax issues, such as Unrelated Business Income ("UBI"), and the maintenance of the organization's tax-exempt status.

In Revenue Ruling 98-15, the IRS established certain factors that should be in place to fall within a "safe harbor" structure for joint ventures that would not create UBI or jeopardize the partner's exempt status. More recently in Revenue Ruling 2004-51, the IRS issued key guidance in the joint venture area. This ruling softened the "control test" in joint ventures between tax-exempt and taxable entities. Prior to this ruling, the exempt organization had to maintain a high level of control over the affairs of a joint venture. Under this ruling, a joint venture may not have an adverse impact on the exempt status of an organization as long as it controls certain key aspects of a joint venture.

Before entering into any joint venture, a hospital would be well-advised to analyze the structure and provisions of the venture to determine the impact on exempt status.

UBI is defined by the Internal Revenue Code as gross income derived by a tax-exempt organization from an activity (regularly carried on) that is unrelated to the organization's exempt purpose. In the past, many organizations have shied away from carrying out UBI activities, resulting in lost revenue streams.

IRS tax-exempt bond audit program

Beginning in August, 2006 of this year, the IRS will send letters to some 20 or 30 issuers of qualified 501(c)(3) bonds notifying them that their bond issues have been selected for audit. The bond issues involved will be selected from bonds that were issued between May 1997 and December 1998. It is expected that two-thirds of the audits will involve hospital bonds. It appears the IRS is beginning to follow through on its previous comments to step-up enforcement in this area. The consequences can be severe for bonds not in compliance. A compliance review of tax-exempt bonds can help avoid facing such adverse consequences.

Electronic filing of form 990

Electronic filing of Form 990 will be required for large tax-exempt organizations for tax years ending on or after December 31, 2005. Almost all other hospitals will be required to file electronically beginning with tax years ending on or after December 31, 2006.

Large organizations are those with total assets of $100 million or more who file at least 250 returns including income, excise, employment tax and information returns during a calendar year, to file electronically. *Example*: If a tax-exempt organization has 245 employees, it must electronically file Form 990 because each Form W-2 and quarterly Form 941 is considered a separate return; therefore, the organization files a total of 250 returns (245 W-2s, four 941s, and one 990).

For tax years ending on or after December 31, 2006, the electronic filing requirement will be expanded to include tax year 2006 returns of tax-exempt organizations with $10 million or more in total assets if they file 250 or more returns a year.

Planned Joint Venture or Partnership Activities 2006

It is clear that the evolving healthcare market place has created new obligations on hospitals to find more effective ways to work with their physicians to deliver services more efficiently. During 2006, a great deal of energy was expended reviewing possible physician/hospital ventures that appear to be win-win arrangements for both parties and assure the provision of needed services to the citizens of Henderson County.

After extensive consideration of various options, it became apparent that a venture arrangement around an eight bed sleep laboratory was a perfect service for such an effort. This project is an "under arrangements" model: one in which the hospital contracts with a third party to provide a hospital service through an arrangement under which receipt of payment by the hospital discharges the liability of the beneficiary or any other person to pay for the service.

Consideration is also being given to several other possible options for hospital/physician relationships, but no formal action has thus far been taken.

Pardee has an agreement with the Henderson County Department of Public Health to provide midwifery services to segments of the population served by the Health Department. Pardee employs 2 nurse midwives and bills and collects for their services. The Department of Public Health works with the program to provide wraparound services for these clients who are served by the hospital midwives. In addition, the hospital midwives collaborate with residents within the Hendersonville Family Health residency program in the provision of these services.

Pardee Hospital and Western Carolina University are cooperating to offer Initiatives for Integrative Aging. Initiatives for Integrative Aging provides continuing education for caregivers of older adults, educational/experiential programming for older adults seeking productive aging, and a certification program in gerontology for professionals in the field.

Henderson County Hospital Corporation
Completed Projects - October 2005 through February 2007

Project	Construction Start Date	Owner Occupancy/ Opening Date
Kayden LinAcc/CT Simulator Upfit	07/18/05	12/21/05
3West Tower Improvements (phased)	08/01/05	06/01/06
Smoking Area Awning & Privacy Walls	01/09/06	01/18/06
Mammography Equipment Replacement	02/01/06	03/01/06
Mtn.Neurological Upfit of Romeo Bldg.	02/01/06	03/02/06
Special Procedures GE Equipment Replaced	02/14/06	04/01/06
IT Equipment Rm. Fire Suppression System	03/01/06	04/01/06
Sleep Lab Move to 3-A Wing	03/01/06	05/08/06
PFS Billing Offices for 23 new staff positions	03/24/06	07/17/06
Pharmacy Staff Relocation to 1st Floor offices	04/17/06	05/15/06
Meditech Training Rooms	05/01/06	08/01/06
Pharmacy USP 797 Air-Handling Upgrades	05/01/06	05/31/06
Medical Detox Unit on 2A Wing	05/15/06	07/17/06
Medical Records/Education	05/22/06	01/08/07
Jamison Conference Room	06/15/06	09/15/06
Social Services Offices	06/15/06	07/03/06
Doctor's Lounge to old Medical Library	07/31/06	11/11/06
Kayden Center/Mammography Upgrades	08/01/06	01/24/07
Cardiopulmonary Rehab & Diabetes Education	09/19/06	01/29/07
MOB - Dr.Mandelbaum Neurology Office	11/01/06	02/15/07

Margaret R. Pardee Memorial Hospital
Environment of Care Management Program
Emergency Management of Biological, Haz-Mat and Mass Casualty Disasters
Annual Report
March 2007

Emergency Management Plan

Plan Objective:

The objective of the Emergency Management Plan is to establish and maintain a program to ensure effective response to disasters or emergencies affecting the environment of care. A complete explanation of objectives can be found in the Emergency Management Plan.

Plan Scope:

The scope of the plan was developed to comply with all required standards and regulations for which the organization is accountable for.

Plan Performance:

The Emergency Management Plan has served as the basis for the emergency preparedness activities within the organization. The plan has enabled the staff to have a focus for their efforts in improving the emergency preparedness of the organization. The plan has also served as a guide to the continued development and refinement of policies and procedures related to Emergency Management. In 2007 we will focus on developing HVAs (Hazard Vulnerability Analysis) for all facilities, training for staff performing disaster drill critiques, Alternate Care Facility Policy, and Infant Abduction.

Plan Effectiveness:

To measure the effectiveness of the Emergency Management Plan monitors were established and drills were conducted. Each of the monitors was evaluated throughout the year. The Emergency Management program was evaluated and was found effective based on the objectives.

Improvements:

- The Emergency Management Plans were continually revised this year. The effectiveness of the plans was tested during actual emergencies and through emergency preparedness drills. Testing of the Emergency Management occurred at least semi-annually. The HVA for 2006 was completed and drills were chosen according to the identified Hazards for this facility. The 2007 Hospital HVA was drafted and presented to the EOC committee in

November 2006. All facilities of the Pardee organization will present HVAs for the 2007 year in December 2006. From these HVAs our drills for 2007 will be chosen.

Dates of 2006 Drill Implementation/Actual were:

Drill	Participants	Date
• Pandemic Influenza Table Top Drill	County	03/02/06
• Infant Abduction Drill	Hospital	05/03/06
• Pandemic Flu	Hospital/State/County	05/24-25/06
• Fire Disaster	Four Seasons	07/28/06
• Loss of Phone and Computer Services	Pardee Care Center	07/20/06
• Infant Abduction	Hospital	09/01/06
• Decon Team Phone Tree Drill	Hospital	09/21/06
• Pandemic Influenza	Hospital/County	10/18-19/06
• Hazardous Materials	Hospital	11/16/06

- Staff responded well to the above listed drills. Critiques were documented and action taken for improvements noted. All areas for improvement are being addressed. Important issues identified during the drills were in the Infant Abduction Policy. A sub committee was formed to address the concerns.

- The MOB facility was designated as an Alternate Care Facility for the hospital to be used in the event of a disaster in which the hospitals capacity to see patients was overwhelmed. The ACF was approved by the Hospital, County Emergency Management and the State to be used in the event of a Disaster. An Alternate Care Facility Plan is being developed by the EOC committee and all departments and Physicians will have input. In developing this plan we have included all departments, off Campus facilities and physicians. We will continue to work on this plan with a completion date early in 2007.

- The Hospital participated in a mass flu vaccination program/drill with the Henderson County Health Department in Oct 2006.

- Following the Pandemic Flu scare, our disaster preparedness has taken on a heightened importance in the organization focus. The organization's EOC has spent much time updating and revising policies and procedures to completely change the shape and scope of our disaster plan. We have revised these to functional documents and participated in drills to test the Pandemic Flu Plan. We incorporate the Hospital Incident Command system into our disaster plan and drills to make sure staff know what to do and where to be. Our plans are detailed and each department has their own disaster response plans.

- A Pandemic Flu Plan was developed by a Pandemic Flu sub-committee and education was provided for all staff. Each department and off campus facility are required to develop a departmental Pandemic Flu plan. We will monitor this in 2007 for compliance.

- All managers were asked to take the ISO 100 online training course to comply with the NIMS/HEICS elements proposed for 2007. Many have already completed this course and will take the ISO 200 online course in 2007.

- A Decon Team was formed in 2001 to develop bioterrorism response policy and procedures. This team from various departments continued to train and upgrade their equipment and response in 2006. The Decon Team prepares for accidents involving nuclear, biological, bombings, and chemical contamination.

- In 2006 the Decon Team developed an eight-hour training course and manual for new participants. This training was conducted in August 2006 for 15 new members. The team moved into a new room located at the Decon Area which gave us the ability to meet monthly, train and store all equipment in one area.

- A phone tree for the team was purchased and programmed with all members' emergency numbers. The switchboard will activate during a Decon event.

- The Decon Area outside of the ED was sectioned off into the three required zones and permanently marked for quick and efficient set up of the equipment. New Decon position assignment sheets were developed by the team and made ready in the event of a disaster. The donning and doffing policies and procedures were revised.

- The organization operates as a team with other Henderson County Emergency response agencies. Three members of the EOC committee are members of the Local Emergency Planning Committee and attended quarterly meetings during 2006.

- Supplies were purchased through the HRSA Grant funding in 2006 to be used in the event of a disaster. Items purchased, received and stored were:

  - 48,000 N-95 Masks
  - 28,000 Isolation Gowns
  - 500 boxes of gloves
  - 50 each Folding Cots
  - 200 each Disposable Blankets
  - 265 each Disposable Sheets

INFORMATION TECHNOLOGY STRATEGIC INITIATIVES

Patient Care Initiatives

The major Patient Care initiatives include supporting the new MEDITECH systems in Pharmacy, Radiology, Laboratory, Blood Bank, Anatomical Pathology, Emergency Department, Scheduling, Dietary, Cardiology, Pulmonary, Rehab, Order Entry, Electronic Medical Records (EMR) and Nursing. These new applications bring added functionality to the clinical setting, improve patient outcomes and have an operating cost savings in excess of $1M per year. In addition, new applications during the fiscal year will include: Nursing documentation, Nursing Care Plans, Bedside Verification of medications, improved fetal monitoring system and new blood sugar monitoring with automatic updates to the patient EMR. These activities include new hardware and PCs on which to host and run the applications. Automated drug dispensing machines at nursing stations and the Emergency Department are being update to include the latest medical alerts and improve patient outcomes. The Hendersonville Family Health Center (HFHC) will begin to offer a Care Portal which will allow patients to schedule their appointments, look-up exam results through the WEB and the ability to share their patient records with other physicians.

Financial System Initiatives

Financial system initiatives include process re-engineering and utilizing existing software at other Pardee facilities and increasing organizational functionality while not impacting cost. New functionality will be provided with the updating of the Time and Attendance system and the acquisition of automated tools for charge master maintenance.

Technology Initiatives

Technology initiatives continue to include security enhancements, vulnerability mitigation and tools for auditing, intrusion detection and threat avoidance with migration to state-of-the-art hardware providing more processing power while reducing the cost of operation. A wireless network has been installed throughout the campus allowing all practitioners bedside access to patient data.

Health Insurance Portability and Accountability Act
HIPAA
Compliance

The Health Insurance Portability and Accountability Act of 1996 requires healthcare providers to comply with legislation regulating the privacy, security, and electronic transmission of health information. Pardee was in compliance with the privacy and the electronic transmission regulations by the effective dates.

The effective date of the privacy regulations was April 2004. Pardee implemented process changes to comply with the various requirements of the legislation, as well as provided comprehensive workforce and medical staff education.

The effective date for electronic transmissions was October 2003. Pardee was prepared to send and receive electronic transmissions, using its financial billing system, by the required date.

In preparation for compliance with the security regulations, Pardee has conducted two security assessments. Currently, the organization is in the process of updating its health information systems to enhance security access and login capability in order to meet the federal requirements. A security officer and a security administrator have been appointed within the Information Technology Department and are responsible for monitoring compliance with the regulations. Policies and procedures are also being updated to reflect these new requirements. Employees complete a compliance/HIPAA education program annually. As new policies are developed regarding HIPAA, all associates are informed, and the policies are available on the hospital Intranet.

Pension Plan Conversion Residuals

The hospital's non-contributory defined benefit plan was converted on January 1, 2002 to a section 401(a) defined contribution plan, with a company match for the base plan and a section 457 voluntary component for employee contributions. This change was received very positively by the staff.

After full allocation and distribution of the funds to employee and retiree accounts, fund residuals from the old 403(b) defined benefit plan were maintained in an investment account at Wachovia, with Board designation that these funds be used for the new employee pension plan. During FY 2006, with Board approval, these funds were used for their intended purpose, and the disclosure of this action was made within Note 19 of the audited financial statements.

Pardee Operated Outreach Programs

Meals on Wheels

Pardee Hospital provides the meals (food and preparation) for the Council on Aging Meals on Wheels program. Some 300-320 meals per day are prepared. Payment is received from COA, and exceeds Pardee's costs for this service. Since Pardee assumed this role, COA clients receive hot, nutritious, and appropriately modified meals in their homes.

Home Health

Pardee Home Care is a licensed home health provider, providing skilled nursing, physical therapy, occupational therapy, speech therapy, social work services, and nursing assistant services to patients in their homes. Services are rendered based on physician orders and Medicare/Medicaid eligibility criteria. Payments for services come from Medicare, Medicaid, insurance, managed care, and self-pay. Use of Home Health can reduce hospital stays and help to ensure recovery and rehabilitation from acute and chronic illnesses.

Community Alternatives for Disabled Adults

CAP/DA is a Medicaid waiver program in which clients who meet the criteria for placement in a nursing care facility at either an intermediate or skilled level are maintained at home by providing necessary services to do so. These services may include personal care, Lifeline, nutritional supplements and housekeeping. Payment comes from Medicaid, and continues as long as the client is at either intermediate or skilled need level, and costs to Medicaid for the month are lower than institutional care.

Perspectives Diabetes Program

Perspectives provides education instruction and resources to the community regarding diabetes and responsible self-care by offering a self-management education program which emphasizes a healthy lifestyle. The program does generate some Medicare and insurance revenues, and eases the burden on physician offices for diabetes education requests.

Cardiac Rehabilitation

Cardiac Rehabilitation is a comprehensive program to assist patients who have suffered a cardiac event to regain their energy and confidence while adapting to necessary changes in diet and lifestyle. The program includes monitored exercises, and education on diet, activity, medications, psychological issues, and stress management. Payment for the services comes from Medicare, Medicaid, and insurance.

Business Industry/Community Wellness and Screening

This initiative takes Pardee screening, education, and preventative programs to interested business, industries, and community groups. Through this service, work site wellness

programs can be designed and implemented that meet the needs of employees and employees in diverse settings. Payment for these services is made by the industry requesting the service.

Asthma Education

The Asthma Education program provides support and education to assist clients in managing this chronic disease. The program includes physician asthma management practices, patient asthma management education, and emergency department coordination of episodic care with supportive resources for the patient. This concept is being applied to Diabetes Management as well.

Community Based Case Management

Community Based Case Management is a patient/client system in which high risk clients are assigned an RN or social worker who ensures contacts and resources necessary to maintain the client in their home are initiated. The goal is to maintain clients at their optimal state of health and function at the lowest level of care possible. This program has been selected as a Best Practice by the South Carolina Hospital Association Geriatric Best Practices Initiative.

Community Laboratory Services

An outreach program through which specimens are collected from various sites by laboratory couriers and delivered to the hospital laboratory for testing. Results are then communicated back to the point of origin. CLS provides high quality, service oriented laboratory testing from a local source. This service provides a connection for Pardee with local physician practices, nursing care facilities, and other appropriate non-hospital care settings. Services are payable by third party payors.

Lifeline

Lifeline is an easy-to-use personal response service that ensures that older adults living at home get quick assistance whenever it is needed-24 hours a day, 365 days a year. One is not required to buy any equipment or make a long-term commitment. Lifeline clients pay a reasonable monthly rental fee. Pardee has provided the Lifeline program for 26 years.

Adult Day Health

Pardee Pavilion is an Adult Day Services Program. A unique blend of activities, health care and socialization for individuals requiring supervision is provided on a daily basis. Participants with complex medical conditions, including Parkinson's Disease, Alzheimer's or other related memory impairments or those recovering from the effects of a stroke are accommodated in a secure and comfortable setting. The program supports families in their resolve to provide love and care to the impaired adult residing at home for as long as possible. Payment is made by the participant, or assistance can be provided by the Veteran's Administration, DSS funding, Alzheimer's Association, Block Grant Funding, CAP and Land Of Sky Regional Council.

Pardee Health Education Center

Pardee Health Education Center provides health education and training via lectures, literature, screenings, and support groups for the residents of our community. Most services are offered at no charge. Screenings do involve a minimal charge to cover supplies and testing.

Land of Sky

Title 3 funding from the Home and Community Block Grant. Approximately $80,000 annually to provide personal care services and light housekeeping to residents over age 65. No physician order needed. Eligibility based on need with preference given to residents who live alone.

Pardee Hospital
Strategic Plan
2007

Pardee

Excellence...close to home!

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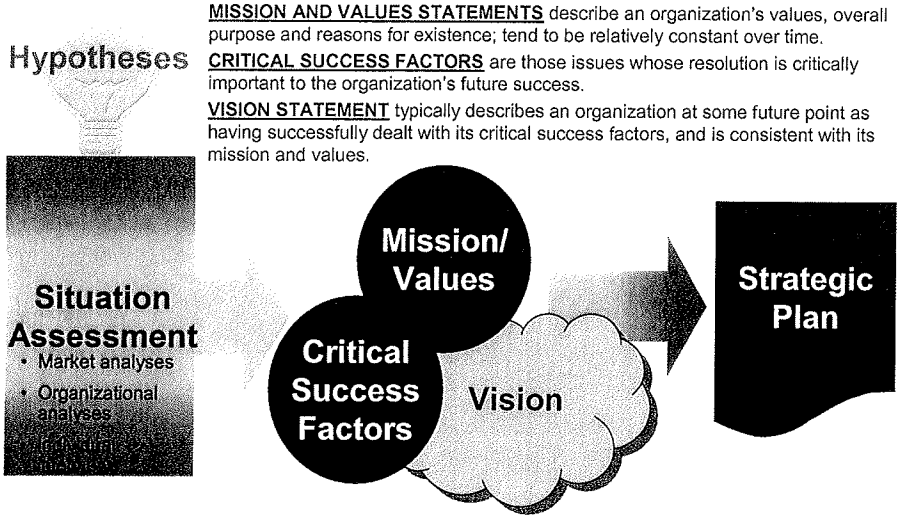
Strategic planning process and key terms

MISSION AND VALUES STATEMENTS describe an organization's values, overall purpose and reasons for existence; tend to be relatively constant over time.

CRITICAL SUCCESS FACTORS are those issues whose resolution is critically important to the organization's future success.

VISION STATEMENT typically describes an organization at some future point as having successfully dealt with its critical success factors, and is consistent with its mission and values.



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Management and Board Planning Committee agreed on the following Mission and Vision for Pardee Hospital.

Pardee Hospital Mission Statement

We provide quality, compassionate and safe services that improve the health of the communities we serve.

Pardee Hospital Vision Statement:

The best people providing the best care.

Management and Board Planning Committee agreed on the following Critical Success Factors and Goals for Pardee Hospital.

Vision Statement

The best people providing the best care.

Critical Success Factors

- Build strong physician preference for Pardee Hospital.
- Recruit, develop and retain the highest performing associates.
- Continually improve quality and safety through minimizing operational and clinical process variance.
- Grow Pardee Hospital as an ambulatory and procedurally focused provider.
- Achieve strong and predictable financial performance.

Goals

1. *To be the healthcare provider of choice in Henderson County*
2. *To meet/exceed national quality benchmarks or standards*
3. *To maximize associate engagement and commitment*
4. *To sustain strong financial performance*
5. *To gain market share in select ambulatory and procedural services*

Henderson County Hospital Corporation
Subsidiaries

All are North Carolina not-for-profit corporations.

- Partners in Health Condominium Association - April 1999
  - Purpose is to manage Partners in Health Condominium
  - Sole members are condominium owners (Pardee and Hospice)

- Henderson County Urgent Care Centers, Inc. - June 1999
  - Purpose is to operate current (and future) urgent care centers
  - Sole member is Henderson County Hospital Corporation
  - Upon dissolution – all assets go to Henderson County Hospital Corporation

- Western Carolina Medical Associates - April 2001
  - Purpose is to operate hospital owned physician practices with the exception of the Residency Pro
  - Sole member is Henderson County Hospital Corporation
  - Upon dissolution – All assets go to Henderson County Hospital Corporation

Henderson County Hospital Corporation
Liens and Indebtedness

	Principal	Balance 9/30/06
Revenue Bonds 20 years beginning 9/20/01	$ 15,300,000	$ 13,305,000
Clinical Information System #5 60 months beginning 12/28/01	$ 1,138,767	$ 152,417
Clinical Information System #6 60 months beginning 9/10/02	$ 2,081,986	$ 548,328
Pyxis 60 months beginning 7/01/04	$ 2,071,382	$ 1,179,350
Senographe DS 59 months beginning 3/01/06	$ 415,776	$ 375,183
Digital Vascular System 59 months beginning 3/29/06	$ 748,025	$ 715,940

Henderson County Hospital Corporation

Subleases

- Mountain Neurological Associates
- Hendersonville Radiological Consultants
- Western Carolina Medical Associates (WCMA)
- Blue Ridge Peaks Internal Medicine
- Pardee Hospital Foundation

Henderson County Hospital Corporation
Acquired Property

The Hospital Corporation acquired no additional property since the last report to the County Commissioners.

Henderson County Hospital Corporation
Disposition of Property and Discontinued Operations

Disposition of Assets

During FY2006, the Mills River clinic (land and building) was sold for $647,682, with a gain on sale of $202,787. This clinic was used as rental property prior to its sale, and was sold to the physician who had been leasing it.

Discontinued Operations

Also during FY2006, the Hospital Corporation ceased operations at the Urgent Care in Fletcher, and the Western Carolina Medical Associates (WCMA) office in Etowah.

The Urgent Care facility in Fletcher was part of a leased facility that continues to be leased, and sub-leased to a physician. This closure took place on 4/15/06.

The WCMA clinic in Etowah was housed in an owned facility, which continues to be owned and is now being utilized by the Hendersonville Family Health Center (HFHC). The WCMA physician who had practiced in this facility remained a Pardee physician n the community and relocated to Hendersonville. This closure took place on 5/1/06.

The Hospital Corporation did not exit these product lines, as it continues to operate an Urgent Care facility in Hendersonville, and WCMA offices in Hendersonville and Fletcher.

An excerpt from Footnote 1 of our FY2006 audited financial statements described the closure and the losses that had occurred in both FY2006 (prior to closure) and FY 2005 as follows:

> A loss from operations of approximately $510,000 and $662,000 (see table below) is included in the consolidated statements of revenue, expenses and changes in net assets for the years ended September 30, 2006 and 2005, respectively.

	2006			2005		
	Urgent Care	WCMA	Total	Urgent Care	WCMA	Total
Revenue	$ 252,141	$ 117,807	$ 369,948	$ 375,518	$ 197,930	$ 573,448
Expenses	$ (630,228)	$ (249,569)	$ (879,797)	$ (842,337)	$ (393,092)	$(1,235,429)
Operating Loss	$ (378,087)	$ (131,762)	$ (509,849)	$ (466,819)	$ (195,162)	$ (661,981)

PARTNERS IN HEALTH

The Board of Commissioners created Partners in Health Condominium. Title to one unit was conveyed to Hospice. The second unit is occupied by the long-term-care nursing facility (Pardee Care Center) operated by the Henderson County Hospital Corporation. This facility opened on May 13, 1999 and currently serves 130 residents and their families. Maintenance of and responsibility for the common areas has been delegated to Partners in Health Condominium Association which has been actively meeting. The relationship between all parties has been very effective.

Henderson County Hospital Corporation
Investment of Idle Funds

In August of 2006, the County Commissioners approved an amendment to the articles of incorporation of Henderson County Hospital Corporation. This change allowed Pardee Hospital to participate in the State Treasurer's investment program available to public hospitals in North Carolina, making it possible for the hospital to invest in equities.

On October 25, 2006, the Board of Directors of Henderson County Hospital Corporation approved changes to the Corporation's Investment Policy that allowed Pardee Hospital to invest funds in the State Treasurer's program. This policy contains guidelines to govern the asset allocation between equities and fixed income investments, with a targeted mix being 55% equities and 45% fixed (with a maximum for equities of 60%).

Our Finance Committee has started out cautiously with our investment in equities via the State Treasurer's program with an initial investment of $2,000,000 in November of 2006. This amount will be re-assessed periodically and increased over time until our target allocation of 55% equities and 45% fixed has been reached. Following a recommendation by the Finance Committee in February of 2007, another $2,000,000 will be invested with the State Treasurer's office in the coming month.

The current mix of investments, as of January 31, 2007, is as follows:

Fixed (with Wachovia)	$12,754,000	86%
Equities (with State Treasurer)	$2,114,000	14%
Total	$14,868,000	100%