

FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1
OF DICKINSON COUNTY, KANSAS
DECEMBER 31, 2011 AND 2010

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MEMORIAL HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended December 31, 2011 and 2010

Our discussion and analysis of the financial performance of Memorial Health System provides a narrative overview of the Health System's financial activities for the years ended December 31, 2011 and 2010. The analysis described in the following paragraphs for Memorial Health System refers to the column labeled "Hospital" in the financial statements. The column labeled "Component unit" refers to Abilene Housing Inc. and is not considered in the calculations made in the following paragraphs because it is legally separate from the hospital. Please read this analysis in conjunction with the accompanying basic financial statements.

Abilene Housing Inc. (Frontier Estates)

Abilene Housing Inc. was added to Memorial Health System's family of services on June 1, 2004. It is presented as a "Component unit" on the accompanying financial statements because it is a separate legal entity. The 2011 financial statements of Abilene Housing Inc. were audited by an accounting firm different from the Health System's auditors, therefore, the Health System's auditors, Wendling, Noe, Nelson, and Johnson LLC, do not express an opinion on the audit of Abilene Housing Inc. Reese & Novelly, P.A, performed the 2011 and 2010 audit of Abilene Housing Inc.

Financial highlights

The Health System's net assets increased during each of the past two years with a \$911,793 or 5.5% increase in 2011 and a \$1,064,196 or 6.9% increase in 2010.

The Health System's total operating revenue increased during each of the past two years with a \$2,654,601 or 13.4% increase in operating revenue for 2011 and a \$600,817 or 3.1% increase in operating revenue for 2010. The larger increase in total operating revenue in 2011 was primarily as a result of purchasing a physician's clinic effective November 1, 2010 and operating it for a full year in 2011.

The hospital became designated as a Critical Access Hospital (CAH) effective December 16, 2005. This classification change increased the 2006 and subsequent years total operating revenue due to contractual adjustments being reduced for Medicare related patients. During 2009, Memorial Health System secured the consulting services of Stroudwater Associates who calculated the CAH annual impact on the income statement to be an increase in net patient services revenue of approximately \$950,000. Management believes that the impact of being a CAH facility has increased in 2010 and 2011.

Memorial Health System
Management's Discussion and Analysis – Continued
Years Ended December 31, 2011 and 2010

Using these financial statements

The Health System's financial statements consist of three statements – (1) a Balance Sheet; (2) a Statement of Revenue, Expenses, and Changes in Net Assets; and (3) a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Health System, including resources held by or for the benefit of the Health System, and resources restricted for specific purposes by contributors, grantors, and indenture agreements.

One of the most important questions asked about the Health System's finances is, "Is the Health System as a whole better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the Health System's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. For purposes of these two statements, revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Health System's net assets and changes in them. The Health System's net assets – the difference between assets and liabilities – may be thought of as one way to measure its financial health, or financial position. Over time, increases or decreases in the Health System's net assets are one indicator of whether its financial health is improving or deteriorating. Consideration must also be given to other nonfinancial indicators, such as changes in the Health System's patient base and measures of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of the Health System.

The final required statement is the Statement of Cash Flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?", "What was cash used for?", and "What was the change in cash balances during the reporting period?"

Memorial Health System
Management's Discussion and Analysis – Continued
Years Ended December 31, 2011 and 2010

Assets, liabilities, and net assets

The Health System's balance sheets as of the end of each of the last three years are summarized as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Assets			
Current assets	\$5,707,328	\$4,156,195	\$4,326,235
Assets limited as to use	14,008,398	0	141,837
Capital assets, net	7,932,196	7,413,922	7,289,265
Other assets	233,296	19,364	19,414
Other investments	<u>5,432,657</u>	<u>6,078,296</u>	<u>5,170,688</u>
Total assets	<u>\$33,313,875</u>	<u>\$17,667,777</u>	<u>\$16,947,439</u>
Liabilities			
Long-term obligations	\$13,760,000	\$ 0	\$ 0
Capital asset acquisitions payable	22,955	0	0
Agency funds	14,706	19,414	19,414
Current liabilities	<u>2,120,922</u>	<u>1,164,864</u>	<u>1,508,722</u>
Total liabilities	<u>\$15,918,583</u>	<u>\$ 1,184,278</u>	<u>\$1,528,136</u>
Net assets	<u>\$17,395,292</u>	<u>\$16,483,499</u>	<u>\$15,419,303</u>

Cash and invested cash in the current asset category decreased by \$54,182 in 2011 and by \$268,653 during 2010. Although the cash balance is small for an organization with over \$33,000,000 in assets, significant additional cash is available in other investments and is held in money market accounts, certificates of deposit, and marketable securities and is readily available for day-to-day operating cash flow needs.

Assets whose use is limited by board and other investments decreased by \$645,639 in 2011 and increased by \$765,771 in 2010. The increase of other investments in 2010 was a result of profitable operations in 2010 as well as non-operating revenues in 2010. A significant portion of the decrease in 2011 (\$509,792) was due to reserve requirements for the bond issue indenture agreement.

In aggregate, the Health System's unrestricted cash, restricted cash, and investments total \$5,674,592 and \$6,374,413 as of December 31, 2011 and 2010, respectively. This represents 98 and 127 days, respectively, of average cash expenses during each of the years then ended. These cash ratio values are higher than the median value for all Kansas hospitals as reported by Ingenix.

Memorial Health System
Management's Discussion and Analysis – Continued
Years Ended December 31, 2011 and 2010

The Health System's net patient accounts receivable were 62.5% of current assets as of December 31, 2011, 68.3% of current assets as of December 31, 2010, and 60.3% of current assets as of December 31, 2009. The average number of days in accounts receivable of net patient revenue was 60 days, 55 days, and 52 days as of December 31, 2011, 2010, and 2009, respectively.

At the end of 2011, the Health System had \$7,932,196 invested in capital assets, net of accumulated depreciation. Net capital assets increased in 2011 by \$518,274. This increase included payments for design and development work in preparation for the construction project which began in November of 2011. The total cost of the construction project including monies spent on design and development is projected to be over \$24,000,000 over a two to three year period. At the end of 2010, the Health System had \$7,413,922 invested in capital assets, net of accumulated depreciation. Net capital assets increased in 2010 by \$124,657 as new capital purchases were made at a greater rate than depreciation expense taken in 2010.

The bond issue from 1990 was paid off in full per schedule in April 2010. Additional bonds were issued in 2011 in the amount of \$13,760,000 with an additional \$10,000,000 issued in 2012 or subsequent to this audit report. These bonds are for the construction of more than 45,000 square feet of clinical inpatient and outpatient area plus renovation of existing space.

The Health System's net assets increased during each of the past two years (\$911,793 or 5.5% during 2011 and \$1,064,196 or 6.9% during 2010), primarily due to profitable operations after including non-operating revenues and contributions to capital. The percentage of total assets financed with net assets, or equity, was 52.2%, 93.3%, and 91.0% as of December 31, 2011, 2010, and 2009 respectively. The percentage increase in 2010 was due to profitable operations after including non-operating revenues. All capital purchases in 2010 were paid for with cash. The change to 52.2% of total assets financed with net assets, or equity was a result of issuing \$13,760,000 of bonds for a hospital construction project.

Memorial Health System
Management's Discussion and Analysis – Continued
Years Ended December 31, 2011 and 2010

Operating results and changes in net asset

The Health System's operating results and changes in net assets for each of the last three years are summarized as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating revenues	\$22,494,020	\$19,839,419	\$19,238,602
Operating expenses	<u>22,393,050</u>	<u>19,334,949</u>	<u>19,329,863</u>
Operating income (loss)	100,970	504,470	(91,261)
Interest expense	\$ 0	\$ 1,932	\$ 16,021
Nonoperating revenues	792,316	545,773	784,224
Gain (Loss) on disposal of capital assets	(8,308)	0	(37,176)
Capital grants and contributions	<u>26,815</u>	<u>15,885</u>	<u>35,316</u>
Increase in net assets	<u>\$911,793</u>	<u>\$1,064,196</u>	<u>\$675,082</u>

The first, and most significant, component of the overall change in the Health System's net assets is its operating income – generally, the difference between net patient service revenue and the expenses incurred to perform these services. The hospital became designated a Critical Access Hospital (CAH) effective December 16, 2005. This classification change increased the total operating revenue due to contractual adjustments being reduced for Medicare related patients. The financial impact of being designated a CAH was a positive annual amount of approximately \$950,000 as calculated by Stroudwater Associates, a consultant hired by the Health System. Management believes that the impact of being a CAH facility has increased in 2010 and 2011. Included in operating expenses in 2011 is \$247,683 of provision for impairment of property and equipment as a result of the construction project that was committed to in 2011. The impaired amount was a non-cash amount recording the lost value of capital assets that were not fully depreciated that will be destroyed in the construction project. There was no remaining debt on the impaired values written off. This is a one time reduction in capital assets relating to the construction project.

Net patient service revenue is analyzed as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Inpatient services	\$13,357,650	\$13,140,332	\$12,863,346
Outpatient services	<u>20,674,845</u>	<u>17,381,806</u>	<u>16,163,543</u>
Gross patient service revenue	<u>\$34,032,495</u>	<u>\$30,522,138</u>	<u>\$29,026,889</u>
Contractual adjustments	\$11,652,290	\$10,914,652	\$10,025,543
Provision for bad debts	622,109	546,569	505,207
Charity Care	<u>196,020</u>	<u>187,982</u>	<u>215,597</u>
Net patient service revenue	<u>\$21,562,076</u>	<u>\$18,872,935</u>	<u>\$18,280,542</u>

Memorial Health System
Management's Discussion and Analysis – Continued
Years Ended December 31, 2011 and 2010

Beginning in 2008 and forward thru 2011, the Health System experienced outpatient charges being more than 50% of total patient charges. For 2009, the outpatient charges represented 55.7% of total patient services charges, 56.9% for 2010, and 60.8% for 2011. In recent past years, the Health System grew its inpatient services due primarily to the purchase of a long term care facility on February 1, 2003 and the resulting growth of long term care services. However, beginning with 2008, the trend toward outpatient services was more pronounced and increased at a higher rate than in the past for the Health System. This is consistent with what is happening in the health care industry. The purchase of a physicians' clinic effective November 1, 2010 increased the outpatient care as the clinic was operated for the full 2011 year.

Effective January 1, 2009, the hospital increased its most prevalent acute care room rate by 5.6%. Ancillary rates were increased effective February 1, 2009 by various percentages depending on the respective department. Effective January 1, 2010, the hospital increased its most prevalent acute care room rate by 8.0%. Effective January 1, 2011, the hospital increased its most prevalent acute care room rate by 6.2%.

The Health System has agreements with various third-party payors that provide for payments to the Health System at amounts different from its established charge rates. These differences are referred to as contractual adjustments. Contractual adjustments continue to be a significant portion of the reduction in gross patient services revenue and have represented 34.2% of charges for 2011, 35.8% of charges for 2010, and 34.5% of charges for 2009.

The Health System provides care free of charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Charity care write-offs have remained stable over the past three years and has amounted to \$215,597 for 2009, \$187,982 for 2010, and \$196,020 for 2011. There is a growing trend in the health care industry to identify and report the value of charity care provided to patients. The provision for bad debts represented 1.83%, 1.79%, and 1.74% of gross patient service revenue during 2011, 2010, and 2009, respectively.

Employee salaries and wages increased by \$1,559,624 or 15.2% during 2011 and \$357,762 or 3.6% during 2010. The health system implemented pay raises commensurate with market conditions for 2011 and 2010. Supplies and other expenses increased during 2011 and decreased during 2010. The net increase in these expenses was \$1,361,753 in 2011 or 17.0% and decrease of \$280,595 in 2010 or 3.4%. The larger than usual increase in wages and supplies and other was primarily due to the purchase of a physicians' clinic effective November 1, 2010 with a full year of expenses for 2011.



Certified Public Accountants
and Management Consultants

Brian J. Florea, CPA
Derek H. Hart, CPA
John R. Helms, CPA
Darrell D. Loyd, CPA
Eric L. Otting, CPA

Jere Noe, CPA
John E. Wendling, CPA
Gary D. Knoll, CPA
Adam C. Crouch, CPA
Heather R. Eicheim, CPA

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors
Memorial Hospital of Hospital District #1
of Dickinson County, Kansas

We have audited the accompanying financial statements of the business-type activity and discretely presented component unit of Memorial Hospital of Hospital District #1 of Dickinson County, Kansas, as of and for the years ended December 31, 2011 and 2010, which collectively comprise the Hospital's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the 2011 and 2010 financial statements of Abilene Housing, Inc., a discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the 2011 and 2010 amounts included for Abilene Housing, Inc., is based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activity and discretely presented component unit of Memorial Hospital of Hospital District #1 of Dickinson County, Kansas, as of December 31, 2011 and 2010, and their respective results of operations, changes in net assets, and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Wendling Roe Nelson & Johnson LLC

Topeka, Kansas
April 19, 2012

FINANCIAL STATEMENTS

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

BALANCE SHEETS

December 31,

ASSETS

	2011		2010	
	Hospital	Component unit	Hospital	Component unit
CURRENT ASSETS				
Cash and invested cash	\$ 241,935	\$ 124,951	\$ 296,117	\$ 116,647
Investments		32,717		32,489
Patient accounts receivable, net of allowance for doubtful accounts of \$595,069 in 2011 and \$606,277 in 2010	3,567,796		2,839,801	
Accounts receivable - other	417,413		86,019	
Interest receivable	31,848		34,457	
Estimated settlements due from third-party payors	278,000		302,000	
Assets whose use is limited by indenture agreement - required for current liabilities	509,792			
Inventories	323,329		282,207	
Prepaid expenses	337,215	13,624	315,594	13,009
Total current assets	5,707,328	171,292	4,156,195	162,145
ASSETS WHOSE USE IS LIMITED				
By Board of Directors		12,391		32,541
By indenture agreement	14,518,190			
Tenant security deposits		24,981		24,097
	14,518,190	37,372	-	56,638
Less amounts required for current liabilities	509,792			
Noncurrent assets whose use is limited	14,008,398	37,372	-	56,638
OTHER INVESTMENTS	5,432,657	84,593	6,078,296	87,077
CAPITAL ASSETS - NET	7,932,196	761,310	7,413,922	804,982
OTHER ASSETS				
Agency funds	14,706		19,364	
Prepaid expenses	12,852			
Deferred financing costs	205,738			
Organizational costs		1,371		1,571
	233,296	1,371	19,364	1,571
	<u>\$33,313,875</u>	<u>\$1,055,938</u>	<u>\$17,667,777</u>	<u>\$1,112,413</u>

The accompanying notes are an integral part of these statements.

LIABILITIES AND NET ASSETS

	2011		2010	
	<u>Hospital</u>	<u>Component unit</u>	<u>Hospital</u>	<u>Component unit</u>
CURRENT LIABILITIES				
Accounts payable	\$ 539,020	\$ 16,536	\$ 344,265	\$ 11,146
Accrued salaries, wages, and related withholding taxes payable	457,230	2,789	432,004	3,568
Accrued vacation pay	474,096		365,515	
Capital asset acquisitions payable	598,694			
Accrued interest payable	38,796	3,552		3,923
Current installments of long- term debt		75,929		71,341
Current portion of deferred revenue	13,086		23,080	
Total current liabilities	<u>2,120,922</u>	<u>98,806</u>	<u>1,164,864</u>	<u>89,978</u>
 LONG-TERM DEBT, excluding current installments	<u>13,760,000</u>	<u>606,006</u>	<u>-</u>	<u>681,937</u>
 CAPITAL ASSET ACQUISITIONS PAYABLE, excluding current portion	<u>22,955</u>	<u>-</u>	<u>-</u>	<u>-</u>
 DEFERRED REVENUE, excluding current portion	<u>-</u>	<u>19,256</u>	<u>-</u>	<u>19,051</u>
 AGENCY FUNDS	<u>14,706</u>	<u>-</u>	<u>19,414</u>	<u>-</u>
Total liabilities	<u>15,918,583</u>	<u>724,068</u>	<u>1,184,278</u>	<u>790,966</u>
 NET ASSETS				
Invested in capital assets - net of related debt	7,808,504	79,375	7,413,922	51,704
Restricted for capital asset acquisitions	46,787			
Unrestricted	9,540,001	252,495	9,069,577	269,743
Total net assets	<u>17,395,292</u>	<u>331,870</u>	<u>16,483,499</u>	<u>321,447</u>
 TOTAL LIABILITIES AND NET ASSETS	<u>\$ 33,313,875</u>	<u>\$ 1,055,938</u>	<u>\$ 17,667,777</u>	<u>\$ 1,112,413</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
 STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS
 Year ended December 31,

	2011		2010	
	Hospital	Component unit	Hospital	Component unit
Operating revenues				
Net patient service revenue	\$ 21,562,076	\$ -	\$ 18,872,935	\$ -
Other	931,944	454,017	966,484	451,376
Total operating revenues	22,494,020	454,017	19,839,419	451,376
Operating expenses				
Salaries and wages	11,824,404	62,029	10,264,780	57,137
Supplies and other	9,356,142	277,871	7,994,389	252,229
Depreciation and amortization	964,821	72,292	1,075,780	72,867
Provision for impairment of property and equipment	247,683			
Total operating expenses	22,393,050	412,192	19,334,949	382,233
Operating income	100,970	41,825	504,470	69,143
Nonoperating revenues (expenses)				
Tax levy	269,523		268,260	
Contributions	182,274	14,803	131,122	21,173
Investment income (loss)	101,889	(1,520)	146,391	3,301
Interest expense		(44,685)	(1,932)	(49,021)
Insurance recovery, net of impairment of property and equipment	223,722			
Loss on disposal of assets	(8,308)			
Other	14,908			
Nonoperating revenues (expenses), net	784,008	(31,402)	543,841	(24,547)
Excess of revenues over expenses before capital contributions	884,978	10,423	1,048,311	44,596
Capital contributions	26,815		15,885	
Increase in net assets	911,793	10,423	1,064,196	44,596
Net assets at beginning of year	16,483,499	321,447	15,419,303	276,851
Net assets at end of year	\$ 17,395,292	\$ 331,870	\$ 16,483,499	\$ 321,447

The accompanying notes are an integral part of these statements.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

STATEMENTS OF CASH FLOWS

Year ended December 31,

	2011		2010	
	Hospital	Component unit	Hospital	Component unit
Cash flows from operating activities				
Receipts from and on behalf of patients	\$ 20,858,081	\$ -	\$ 18,767,736	\$ -
Payments to or on behalf of employees	(11,690,597)	(62,808)	(10,133,422)	(55,599)
Payments to suppliers	(9,236,982)	(273,096)	(8,360,000)	(252,635)
Other receipts and payments	<u>916,629</u>	<u>454,222</u>	<u>1,107,620</u>	<u>451,594</u>
Net cash provided by operating activities	<u>847,131</u>	<u>118,318</u>	<u>1,381,934</u>	<u>143,360</u>
Cash flows from noncapital financing activities				
Tax levy	269,523		268,260	
Noncapital contributions	<u>173,636</u>	<u>14,803</u>	<u>140,637</u>	<u>21,173</u>
Net cash provided by noncapital financing activities	<u>443,159</u>	<u>14,803</u>	<u>408,897</u>	<u>21,173</u>
Cash flows from capital and related financing activities				
Purchase of capital assets	(1,191,192)	(28,420)	(1,251,156)	(31,206)
Contributions for purchase of capital assets	26,815		47,193	
Proceeds from sale of assets	10,475			
Insurance recoveries	25,624			
Issuance of long-term debt	13,760,000			
Payment of deferred financing costs	(208,091)			
Repayment of long-term debt		(71,343)	(150,000)	(67,031)
Interest paid		(45,056)	(5,620)	(49,370)
Net cash provided (used) by capital and related financing activities	<u>12,423,631</u>	<u>(144,819)</u>	<u>(1,359,583)</u>	<u>(147,607)</u>
Cash flows from investing activities				
(Increase) decrease in assets whose use is limited by indenture agreement	(14,518,190)		111,341	
Decrease (increase) in assets whose use is limited by Board of Directors		20,150	141,837	(9,958)
(Increase) decrease in assets whose use is limited - tenant security deposits		(884)		326
Decrease (increase) in investments	618,747	(1,690)	(897,165)	(1,165)
(Increase) decrease in other assets	(50)		50	
Purchase of physician practice			(192,382)	
Investment income	<u>131,390</u>	<u>2,426</u>	<u>136,418</u>	<u>2,495</u>
Net cash (used) provided by investing activities	<u>(13,768,103)</u>	<u>20,002</u>	<u>(699,901)</u>	<u>(8,302)</u>

The accompanying notes are an integral part of these statements.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

STATEMENTS OF CASH FLOWS - CONTINUED

Year ended December 31,

	2011		2010	
	<u>Hospital</u>	<u>Component unit</u>	<u>Hospital</u>	<u>Component unit</u>
Net change in cash and cash equivalents	\$ (54,182)	\$ 8,304	\$ (268,653)	\$ 8,624
Cash and cash equivalents at beginning of year	<u>296,117</u>	<u>116,647</u>	<u>564,770</u>	<u>108,023</u>
Cash and cash equivalents at end of year	<u>\$ 241,935</u>	<u>\$ 124,951</u>	<u>\$ 296,117</u>	<u>\$ 116,647</u>
Reconciliation of operating income to net cash provided by operating activities				
Operating income	\$ 100,970	\$ 41,825	\$ 504,470	\$ 69,143
Adjustments to reconcile operating income to net cash provided by operating activities				
Depreciation and amortization	964,821	72,292	1,075,780	72,867
Provision for impairment of property and equipment	247,683			
(Decrease) increase in deferred revenue	(1,356)	205	(3,305)	218
Provision for bad debts	622,109		546,569	
Changes in				
Patient and other accounts receivable	(1,364,063)		(430,327)	
Inventories and prepaid expenses	(75,595)	(615)	(87,653)	(473)
Accounts payable and accrued expenses	328,562	4,611	(146,600)	1,605
Estimated settlements due from third-party payors	<u>24,000</u>		<u>(77,000)</u>	
Net cash provided by operating activities	<u>\$ 847,131</u>	<u>\$ 118,318</u>	<u>\$ 1,381,934</u>	<u>\$ 143,360</u>

The accompanying notes are an integral part of these statements.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS

December 31, 2011 and 2010

NOTE A - SUMMARY OF ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows.

1. Financial reporting entity

Memorial Hospital of Hospital District #1 of Dickinson County, Kansas (Hospital), is a municipal corporation operating an acute-care hospital located in Abilene, Kansas, with a licensed bed capacity of 25 acute care beds and 10 psychiatric beds and a long-term care facility with a licensed bed capacity of 75 beds. The Hospital is governed by an elected five-member Board of Directors.

On November 1, 2010, the Hospital purchased substantially all of the assets of a physician practice located in Abilene, Kansas. Purchased assets included a medical office building, medical equipment, patient accounts receivable, and medical records. The Hospital is operating the physician practice under the business name of Heartland Health Care Clinic.

2. Component unit

The financial statements include the financial data of the discretely presented component unit described below. The component unit is reported separately to emphasize that it is legally separate from the Hospital.

Abilene Housing, Inc. (AHI), was formed and organized as a Kansas not-for-profit corporation. AHI provides housing for elderly and handicapped persons in a 60-unit apartment project located in Abilene, Kansas, and provides services specifically designed to meet the physical, social, and psychological needs of those individuals. Effective June 1, 2004, membership of AHI's Board consists of one member of the Board of Directors of the Hospital, the Chief Executive Officer of the Hospital, the Chief Financial Officer, Chief Operating Officer, or Chief Nursing Officer of the Hospital and, before June 2009, one member elected by an Advisory Board to AHI. Before June 1, 2004, AHI's Board membership was independent of the Hospital Board and officers.

Financial data of AHI are presented as of and for the years ended September 30, 2011 and 2010. Separate financial statements for AHI are not available for public distribution.

3. Basis of accounting

The Hospital utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Accounting," the Hospital has implemented all GASB pronouncements, and Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued before November 30, 1989, except those that conflict with GASB pronouncements and has elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

4. Use of estimates

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

5. Patient accounts receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payors, patients, and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information, and existing economic conditions.

6. Inventories

Inventories are stated at cost as determined on the first-in, first-out method.

7. Investments in debt and equity securities

Investments in debt and equity securities are carried at fair value. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating investment income.

8. Capital assets

Capital assets are stated at cost. Depreciation and amortization of capital assets is provided on the straight-line method over the estimated useful lives of the assets. The estimated lives used are generally in accordance with the guidelines established by the American Hospital Association.

The costs of maintenance and repairs are charged to operating expenses as incurred. The costs of significant additions, renewals, and betterments to depreciable properties are capitalized and depreciated over the remaining or extended estimated useful lives of the item or the properties. Gains and losses on disposition of capital assets are included in nonoperating revenues and expenses.

9. Costs of borrowing

Interest costs, including amortization of deferred financing costs, incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Costs incurred in connection with the issuance of long-term debt are amortized using the interest method over the term of the related debt.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

10. Net assets

Net assets are classified in three components. "Net assets invested in capital assets net of related debt" consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. "Restricted net assets" are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital. "Unrestricted net assets" are remaining net assets that do not meet the definition of "invested in capital assets net of related debt" or "restricted."

11. Operating revenues and expenses

The statement 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, which is the Hospital's principal activity. Nonexchange revenues, including taxes, 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.

12. Net patient service revenue

Net patient service revenue is reported at established charges with deductions for discounts, charity care, the provision for bad debts, and contractual adjustments, 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 final settlements are determined.

13. Charity care

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

14. Tax levy

The Hospital receives financial support from ad valorem taxes. Ad valorem taxes are assessed in November of each year and are available for use by the Hospital in the following year.

15. Income taxes

The Hospital is exempt from federal income taxes pursuant to Sections 115 and 501(a) of the Internal Revenue Code. AHI operates under Section 501(c)(3) of the Internal Revenue Code and is generally exempt from federal and state income taxes.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

16. Cash equivalents

All cash and invested cash, excluding assets whose use is limited and investments, are considered to be cash equivalents.

NOTE B - REIMBURSEMENT PROGRAMS

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established charge rates. The amounts reported on the balance sheets as estimated settlements due from third-party payors consist of the estimated differences between the contractual amounts for providing covered services and the interim payments received for those services. A summary of the payment arrangements with major third-party payors follows:

Medicare - The Hospital is a critical access hospital for purposes of the Medicare program. Inpatient and outpatient acute care services, skilled nursing swing-bed services, and rural health clinic (RHC) services rendered to Medicare beneficiaries are paid under cost reimbursement methodologies. Geriatric psychology services and skilled nursing services, provided at the Hospital's long-term care facility, rendered to Medicare beneficiaries are paid based on prospectively determined per diem rates. Physician services, other than RHC services, rendered to Medicare beneficiaries are paid based on a prospectively determined fee schedule.

The Hospital is paid for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits or reviews thereof by the Medicare administrative contractor. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Hospital's Medicare cost reports have been audited or reviewed by the Medicare administrative contractor through December 31, 2009.

Medicaid - Acute care services rendered to Medicaid beneficiaries, other than those covered under HMO plans, and RHC services rendered to Medicaid beneficiaries, including those covered under HMO plans, are paid under cost reimbursement methodologies. The Hospital is paid for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and reviews thereof by the state Medicaid agency. The Hospital's Medicaid cost reports have been reviewed by the state Medicaid agency through December 31, 2008.

Nursing facility services are paid at prospectively determined per diem rates set annually on the basis of cost information supplied by nursing facilities for the preceding calendar year.

Blue Cross and Blue Shield - All services rendered to patients who are insured by Blue Cross-Blue Shield are paid on the basis of prospectively determined rates per discharge or discounts from established charges.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE B - REIMBURSEMENT PROGRAMS - Continued

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

A summary of gross and net patient service revenue follows:

	<u>2011</u>	<u>2010</u>
Gross patient service revenue	\$34,032,495	\$30,522,138
Adjustments to patient service revenue		
Third-party contractual adjustments, discounts, and allowances	(11,652,290)	(10,914,652)
Provision for bad debts	(622,109)	(546,569)
Charity care	<u>(196,020)</u>	<u>(187,982)</u>
Net patient service revenue	<u>\$21,562,076</u>	<u>\$18,872,935</u>

Revenue from the Medicare and Medicaid programs accounted for approximately 45 percent and 13 percent, respectively, of the Hospital's net patient service revenue during 2011, and 42 percent and 11 percent, respectively, of the Hospital's net patient service revenue during 2010. 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 could change by a material amount in the near term.

NOTE C - ASSETS WHOSE USE IS LIMITED BY BOARD OF DIRECTORS

Assets whose use is limited by Board of Directors consist of invested cash to be used for replacement of capital assets or for the purchase of additional capital assets. The funds may be used for other purposes by action of the Board of Directors.

NOTE D - ASSETS WHOSE USE IS LIMITED BY INDENTURE AGREEMENT

Assets whose use is limited by indenture agreement consist of money market mutual funds that are held by a trustee under bond indenture agreements. Amounts that are required for obligations classified as current liabilities are reported in current assets.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE E - INVESTMENTS

Investments are summarized as follows:

	2011		2010	
	<u>Hospital</u>	<u>Component unit</u>	<u>Hospital</u>	<u>Component unit</u>
Invested cash consisting of bank certificates of deposit, bank savings accounts, and money market mutual fund	\$3,370,314	\$ 32,717	\$3,695,440	\$ 32,489
Common stock at fair value	19,908		14,782	
Equity in undistributed earnings of Mobile Clinical Services, Inc.	101,377		86,090	
Corporate bonds at fair value	1,934,924		2,128,775	
Mutual funds at fair value		84,593	147,003	87,077
Abilene Community Foundation Endowment fund	6,134		6,206	
	<u>\$5,432,657</u>	<u>\$ 117,310</u>	<u>\$6,078,296</u>	<u>\$ 119,566</u>

The Hospital received contributions from an outside trust consisting of common stock and corporate bonds. The outside trustee stipulated that the Hospital board administer the resources created by the contributions separate from public monies held by the Hospital and that the assets be invested with the goal of maximizing the benefit to the Hospital by retaining the securities in their existing form through their maturities and placing the assets in similar high-grade securities in the future. Restrictions on the use of the contributions have been met and the investments are now unrestricted as to their use by the Hospital.

In 2005, the Hospital acquired a 20 percent ownership interest in Mobile Clinical Services, Inc., (MCSI). The Hospital's equity in undistributed net earnings of MCSI since acquisition is \$101,377. Nuclear medicine and ultrasound services are provided to the Hospital through arrangements with MCSI. Total fees charged to operating expense for these services were approximately \$98,000 in 2011 and \$83,000 in 2010. Amounts payable to MCSI for these services were insignificant at December 31, 2011 and 2010.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE F - CAPITAL ASSETS

Hospital capital asset additions, retirements, and balances are as follows:

	2011			
	<u>Beginning balance</u>	<u>Additions/ transfers</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 790,483	\$ -	\$ -	\$ 790,483
Land improvements	742,932	41,712	83,996	700,648
Buildings	11,555,314	153,132	437,549	11,270,897
Major movable equipment	<u>6,245,965</u>	<u>576,464</u>	<u>273,610</u>	<u>6,548,819</u>
Totals at historical cost	<u>19,334,694</u>	<u>771,308</u>	<u>795,155</u>	<u>19,310,847</u>
Less accumulated depreciation				
Land improvements	306,854	30,406	75,117	262,143
Buildings	7,417,642	520,642	327,676	7,610,608
Major movable equipment	<u>4,639,749</u>	<u>413,773</u>	<u>269,150</u>	<u>4,784,372</u>
Total accumulated depreciation	<u>12,364,245</u>	<u>964,821</u>	<u>671,943</u>	<u>12,657,123</u>
Less reserve for impaired assets	<u>-</u>	<u>247,683</u>	<u>-</u>	<u>247,683</u>
Construction in progress and planning costs	<u>443,473</u>	<u>1,082,682</u>	<u>-</u>	<u>1,526,155</u>
Capital assets, net	<u>\$ 7,413,922</u>	<u>\$ 641,486</u>	<u>\$ 123,212</u>	<u>\$ 7,932,196</u>
	2010			
	<u>Beginning balance</u>	<u>Additions/ transfers</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 658,828	\$ 131,655	\$ -	\$ 790,483
Land improvements	742,932			742,932
Buildings	11,430,184	278,549	153,419	11,555,314
Major movable equipment	<u>5,773,276</u>	<u>495,311</u>	<u>22,622</u>	<u>6,245,965</u>
Totals at historical cost	<u>18,605,220</u>	<u>905,515</u>	<u>176,041</u>	<u>19,334,694</u>
Less accumulated depreciation				
Land improvements	276,506	30,348		306,854
Buildings	7,042,186	528,875	153,419	7,417,642
Major movable equipment	<u>4,145,814</u>	<u>516,557</u>	<u>22,622</u>	<u>4,639,749</u>
Total accumulated depreciation	<u>11,464,506</u>	<u>1,075,780</u>	<u>176,041</u>	<u>12,364,245</u>
Construction in progress and planning costs	<u>148,551</u>	<u>294,922</u>	<u>-</u>	<u>443,473</u>
Capital assets, net	<u>\$ 7,289,265</u>	<u>\$ 124,657</u>	<u>\$ -</u>	<u>\$ 7,413,922</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE F - CAPITAL ASSETS - Continued

Construction in progress and planning costs consist primarily of design, planning, and construction costs for additions to the Hospital's facilities. The total contract commitment for design and construction costs of the facility additions project was \$14,098,592. As of December 31, 2011, the outstanding contract commitment is \$13,578,066.

Most of the Hospital's operations will be moved to the newly constructed addition upon its completion and a renovation of the existing hospital building will commence. In 2011, management determined that the carrying value of the facility and related equipment then in use had been impaired. A provision for impairment of property and equipment loss was recognized in the amount of \$247,683, which represents the estimated reduction in service utility of assets that will be demolished or abandoned when the renovation project begins. The provision for impairment of property and equipment loss is included in operating expenses.

AHI capital asset additions, retirements, and balances are as follows:

	2011			
	<u>Beginning balance</u>	<u>Additions/transfers</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 106,881	\$ 533	\$ -	\$ 107,414
Building and improvements	1,345,888			1,345,888
Furniture and equipment	509,799	27,887	48,743	488,943
Totals at historical cost	<u>1,962,568</u>	<u>28,420</u>	<u>48,743</u>	<u>1,942,245</u>
Less accumulated depreciation				
Building and improvements	855,341	27,275		882,616
Furniture and equipment	302,245	44,817	48,743	298,319
Total accumulated depreciation	<u>1,157,586</u>	<u>72,092</u>	<u>48,743</u>	<u>1,180,935</u>
Capital assets, net	<u>\$ 804,982</u>	<u>\$ (43,672)</u>	<u>\$ -</u>	<u>\$ 761,310</u>
	2010			
	<u>Beginning balance</u>	<u>Additions/transfers</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 106,881	\$ -	\$ -	\$ 106,881
Building and improvements	1,331,918	13,970		1,345,888
Furniture and equipment	493,082	17,236	519	509,799
Totals at historical cost	<u>1,931,881</u>	<u>31,206</u>	<u>519</u>	<u>1,962,568</u>
Less accumulated depreciation				
Building and improvements	828,345	26,996		855,341
Furniture and equipment	257,094	45,670	519	302,245
Total accumulated depreciation	<u>1,085,439</u>	<u>72,666</u>	<u>519</u>	<u>1,157,586</u>
Capital assets, net	<u>\$ 846,442</u>	<u>\$ (41,460)</u>	<u>\$ -</u>	<u>\$ 804,982</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE G - DEFERRED FINANCING COSTS

Deferred financing costs are summarized as follows:

	<u>2011</u>	<u>2010</u>
Hospital District No. 1, Dickinson County, Kansas Lease Agreement Certificates of Participation, Series 2011	\$ 88,954	\$ -
Abilene, Kansas Public Building Commission Revenue Bonds, Series 2011	116,466	
Abilene, Kansas Public Building Commission Revenue Bonds, Series 2012	2,671	
Less accumulated amortization	<u>(2,353)</u>	
	<u>\$ 205,738</u>	<u>\$ -</u>

NOTE H - DEFERRED REVENUE

The Hospital and AHI received certain payments in advance of the performance of services. These payments are reflected as deferred revenue.

NOTE I - LONG-TERM DEBT

Hospital long-term debt consists of the following:

	<u>2011</u>	<u>2010</u>
1.50% - 4.40% Hospital District No. 1, Dickinson County, Kansas Lease Agreement Certificates of Participation, Series 2011; issued on December 1, 2011, in the original amount of \$6,000,000; due serially through December 1, 2021, with principal payments beginning on December 1, 2013	\$ 6,000,000	\$ -
1.00% - 4.30% Abilene, Kansas Public Building Commission Revenue Bonds, Series 2011; issued on December 1, 2011, in the original amount of \$7,760,000; due serially through December 1, 2028, with principal payments beginning on December 1, 2013	<u>7,760,000</u>	
	<u>\$ 13,760,000</u>	<u>\$ -</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE I - LONG-TERM DEBT - Continued

The following is a summary of changes in long-term debt:

Outstanding at January 1, 2010	\$ 150,000
Principal payments	<u>(150,000)</u>
Outstanding at December 31, 2010	-
Issuance of long-term debt	<u>13,760,000</u>
Outstanding at December 31, 2011	<u>\$13,760,000</u>

On December 1, 2011, the Abilene, Kansas Public Building Commission issued \$7,760,000 in Revenue Bonds, Series 2011 (the 2011 PBC bonds) and on January 5, 2012, issued \$10,000,000 in Revenue Bonds, Series 2012 (the 2012 PBC bonds), for the benefit of the Hospital pursuant to a Trust Indenture dated December 1, 2011. On December 1, 2011, the Hospital issued its Lease Agreement Certificates of Participation, Series 2011 (the Certificates), pursuant to a Trust Indenture dated December 1, 2011. The Certificates represent proportionate interests of the owners thereof in basic rent payments to be made by the Hospital. The proceeds of the 2011 PBC bonds, the 2012 PBC bonds, and the Certificates (collectively the project debt) will be used, together with other available funds of the Hospital, to (1) pay for renovations and additions to the Hospital's facilities, (2) purchase certain medical equipment, (3) fund a debt service reserve fund for the project debt, (4) pay interest costs during the period of construction, and (5) pay for certain costs related to issuance of the project debt.

The indenture agreement for the project debt requires the Hospital to transfer to a trustee, on a monthly basis, specified amounts which, when combined with interest earned on the respective funds held by the trustee, will provide sufficient funds to pay the project debt principal and interest on the appropriate due dates. These required transfers begin on July 1, 2013. The obligations of the Hospital under the indenture agreement are secured by a pledge of its unrestricted revenues, subject to the right of the Hospital to dispose of or encumber property as defined and permitted in the indenture agreement. The indenture agreement also includes certain restrictive covenants relating to the disposition of property, adequacy of insurance coverage, incurrence of additional indebtedness, the level of days cash on hand, and the level of fees and rates charged. The covenant in the indenture agreement regarding the level of fees and rates charged requires that fees and rates for services be set at levels sufficient for the Hospital to produce income available for debt service in each fiscal year equal to 125 percent of the debt service requirements during that fiscal year for outstanding debt. This covenant and the level of days cash on hand covenant are not in effect until the year ending December 31, 2014.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE I - LONG-TERM DEBT - Continued

Scheduled annual debt service requirements on long-term debt are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ -	\$ 465,550	\$ 465,550
2013	710,000	465,550	1,175,550
2014	720,000	455,425	1,175,425
2015	730,000	442,625	1,172,625
2016	750,000	426,468	1,176,468
2017 - 2021	4,100,000	1,769,968	5,869,968
2022 - 2026	4,910,000	959,365	5,869,365
2027 - 2031	1,840,000	109,513	1,949,513
	<u>\$13,760,000</u>	<u>\$ 5,094,464</u>	<u>\$18,854,464</u>

Total interest costs are summarized as follows:

	<u>2011</u>	<u>2010</u>
Total interest incurred	\$ 38,796	\$ 1,932
Amortization of deferred financing costs	<u>2,353</u>	<u> </u>
	41,149	1,932
Less capitalized interest costs	<u>41,149</u>	<u> </u>
Interest expense	<u>\$ -</u>	<u>\$ 1,932</u>

AHI long-term debt consists of a 6.25 percent mortgage loan with a bank. Monthly installments of principal and interest are \$9,700 with a final payment of \$520,931 due on November 15, 2013. The mortgage loan is collateralized by AHI's apartment project.

The following is a summary of changes in long-term debt:

Principal outstanding at October 1, 2009	\$ 820,309
2010 payment of debt	<u>(67,031)</u>
Principal outstanding at September 30, 2010	753,278
2011 payment of debt	<u>(71,343)</u>
Principal outstanding at September 30, 2011	<u>\$ 681,935</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE I - LONG-TERM DEBT - Continued

Scheduled annual debt service requirements on long-term debt are as follows:

<u>Years ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 75,929	\$ 40,471	\$ 116,400
2013	80,813	35,587	116,400
2014	<u>525,193</u>	<u>5,435</u>	<u>530,628</u>
	<u>\$ 681,935</u>	<u>\$ 81,493</u>	<u>\$ 763,428</u>

NOTE J - LEASES

The Hospital leases property and equipment under operating lease arrangements. Total lease expense under all operating leases was approximately \$41,000 for 2011 and \$17,000 for 2010.

NOTE K - RISK MANAGEMENT

The Hospital is insured for professional liability under a comprehensive hospital liability policy provided by an independent insurance carrier with limits of \$200,000 per occurrence up to an annual aggregate of \$600,000 for all claims made during the policy year. The Hospital is further covered by the Kansas Health Care Stabilization Fund for claims in excess of its comprehensive hospital liability policy up to \$300,000 pursuant to any one judgment or settlement against the Hospital for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy year in the amount of \$900,000. All coverage is on a claims-made basis. The above policies have been renewed through January 1, 2013. The Hospital intends to renew this coverage on that date and is aware of no reason why such coverage would be denied at that time.

In addition to the risk disclosed elsewhere in these financial statements and notes thereto, the Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Hospital purchases commercial insurance for these risks.

NOTE L - DEPOSITS WITH FINANCIAL INSTITUTIONS

Kansas statutes authorize the Hospital, with certain restrictions, to deposit or invest in open accounts, time deposits, certificates of deposit, repurchase agreements, the State Treasurer's municipal investment pool, and U.S. Treasury bills and notes. Also, statutes generally require that financial institutions pledge securities with a market value equal to total deposits, except for monies acquired through the receipt of grants, donations, bequests, and gifts, in excess of F.D.I.C. coverage at any given time and the securities pledged be deposited with a Kansas state or national bank or trust company, the Federal Reserve Bank, the Federal Home Loan Bank, or the Kansas State Treasurer.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE L - DEPOSITS WITH FINANCIAL INSTITUTIONS - Continued

The carrying amount of the Hospital's deposits with financial institutions was \$2,739,657 and the bank balances were \$3,187,149 at December 31, 2011. The bank balances are categorized as follows at December 31, 2011:

Amount insured by the F.D.I.C., or collateralized with securities held by the Hospital or by its agent in the Hospital's name	\$ 491,320
Uncollateralized (amount collateralized with securities held in safekeeping by an authorized depository other than the pledging financial institution's trust department, but not in the Hospital's name)	<u>2,695,829</u>
	<u>\$ 3,187,149</u>

At September 30, 2011, the carrying amount of AHI's deposits with financial institutions was \$192,847 and the bank balances were \$200,624. Bank balances were fully insured by the F.D.I.C.

NOTE M - CONCENTRATION OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31, 2011 and 2010, is as follows:

	<u>2011</u>	<u>2010</u>
Medicare	37%	34%
Medicaid	7	9
Blue Cross	10	12
Other third-party payors	15	13
Patient	<u>31</u>	<u>32</u>
	<u>100%</u>	<u>100%</u>

NOTE N - BUDGETARY COMPARISON

Kansas statutes require that a fixed annual operating budget be legally adopted for the Hospital. All legal annual operating budgets are prepared using the modified accrual basis of accounting, modified further by the encumbrance method of accounting. Revenues are recognized when cash is received. Expenditures include disbursements, accounts payable, and encumbrances. Encumbrances are commitments by the Hospital for future payments and are supported by a document evidencing the commitment, such as a purchase order or contract. All unencumbered appropriations lapse at year-end. Actual expenditures for the year ended December 31, 2011, on the modified accrual basis of accounting and encumbrances were \$23,315,870 as compared to the legally adopted budgeted expenditures of \$48,649,166. Actual expenditures for the year ended December 31, 2010, on the modified accrual basis of accounting and encumbrances were \$19,549,191 as compared to the legally adopted budgeted expenditures of \$43,228,122.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2011 and 2010

NOTE O - DEFINED BENEFIT PENSION PLAN

The Hospital contributes to the Kansas Public Employees Retirement System (KPERS), a cost-sharing multiple-employer defined benefit pension plan as provided by K.S.A. 74-4901, et seq. KPERS provides retirement benefits, life insurance, disability income benefits, and death benefits. Kansas law establishes and amends benefit provisions. KPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to KPERS, 611 S. Kansas Avenue, Suite 100, Topeka, Kansas 66603-3869 or by calling 1-888-275-5737.

K.S.A. 74-4919 establishes the KPERS member-employee contribution rate at 4.00 percent of covered salary for employees hired prior to July 1, 2009, and 6.00 percent of covered salary for employees hired on or after July 1, 2009. The employer collects and remits member-employee contributions according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rate be determined annually based on the results of an annual actuarial valuation. KPERS is funded on an actuarial reserve basis. State law sets a limitation on annual increases in the contribution rates for KPERS employers. The employer rate established by statute for calendar years 2011 and 2010, is 7.74 percent and 7.14 percent, respectively. The Hospital employer contributions to KPERS for the years ended December 31, 2011 and 2010, were \$834,698 and \$631,019, respectively, equal to the statutory required contributions for each year.

NOTE P - INSURANCE RECOVERIES

On June 1, 2011, the Hospital's facilities, vehicles, and certain equipment sustained damage from a hail storm. An impairment loss was recognized for the reduction in service utility from the physical damage to property and equipment. Insurance proceeds recovered or recoverable at December 31, 2011, exceeded the impairment loss. The net gain from impairment of property and equipment is included in nonoperating revenues and expenses and is summarized as follows:

Insurance proceeds recovered or recoverable	\$ 328,151
Impairment loss from physical damage	<u>104,429</u>
Insurance recovery, net of impairment of property and equipment	<u>\$ 223,722</u>

NOTE Q - SUBSEQUENT EVENTS

On January 5, 2012, the Abilene, Kansas Public Building Commission issued \$10,000,000 in Revenue Bonds, Series 2012 (the 2012 PBC bonds), on behalf of the Hospital (see Note I). The 2012 PBC bonds bear interest at rates varying from 4.450 percent to 5.025 percent and are due serially through December 1, 2035. Principal payments begin on December 1, 2028.

On January 1, 2012, the Hospital entered into an asset purchase agreement to purchase substantially all of the assets of a local physician practice. The purchase price of the practice, net of liabilities assumed, was approximately \$737,000.