

Fredonia Regional Hospital
A Component Unit of the City of Fredonia, Kansas
Independent Accountants' Report and Financial Statements
December 31, 2011 and 2010



Fredonia Regional Hospital
A Component Unit of the City of Fredonia, Kansas
December 31, 2011 and 2010

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Independent Accountants' Report

Board of Trustees
Fredonia Regional Hospital
Fredonia, Kansas

We have audited the accompanying balance sheets of Fredonia Regional Hospital, a component unit of the City of Fredonia, Kansas, as of December 31, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the 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 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, the financial statements referred to above present fairly, in all material respects, the financial position of Fredonia Regional Hospital as of December 31, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

BKD, LLP

May 3, 2012

Fredonia Regional Hospital
A Component Unit of the City of Fredonia, Kansas
Balance Sheets
December 31, 2011 and 2010

Assets

	<u>2011</u>	<u>2010</u>
Current Assets		
Cash and cash equivalents	\$ 2,969,581	\$ 2,962,531
Restricted cash and investments - current	380,725	351,517
Patient accounts receivable, net	1,510,032	1,345,421
Estimated amounts due from third-party payers	865,000	680,000
Supplies	319,638	311,259
Physician receivable	138,696	163,092
Prepaid expenses and other	<u>217,060</u>	<u>180,020</u>
Total current assets	<u>6,400,732</u>	<u>5,993,840</u>
Noncurrent Cash and Investments		
Designated by Board of Trustees	1,806,039	1,793,850
Restricted by donors for capital acquisitions and specific operating activities	-	10,000
Held by trustee for debt service	<u>1,012,169</u>	<u>1,012,169</u>
Total noncurrent cash and investments	<u>2,818,208</u>	<u>2,816,019</u>
Capital Assets, Net	<u>10,706,516</u>	<u>11,615,196</u>
Other Assets		
Deferred financing costs	208,184	220,537
Physician receivable	<u>100,573</u>	<u>239,269</u>
Total other assets	<u>308,757</u>	<u>459,806</u>
Total assets	<u><u>\$ 20,234,213</u></u>	<u><u>\$ 20,884,861</u></u>

Liabilities and Net Assets

	<u>2011</u>	<u>2010</u>
Current Liabilities		
Current maturities of long-term debt	\$ 341,733	\$ 319,619
Accounts payable	613,429	417,359
Accrued salaries and wages	76,046	70,185
Accrued vacation benefits	262,098	225,687
Accrued physician payable	127,031	134,622
Accrued interest payable	237,713	241,369
	<hr/>	<hr/>
Total current liabilities	1,658,050	1,408,841
Long-term Debt	<u>10,515,589</u>	<u>10,842,793</u>
Total liabilities	<u>12,173,639</u>	<u>12,251,634</u>
Net Assets		
Invested in capital assets, net of related debt	57,378	673,321
Restricted - expendable for		
Debt service	1,392,894	1,363,686
Capital acquisitions	-	4,108
Specific operating activities	-	5,892
Unrestricted	6,610,302	6,586,220
	<hr/>	<hr/>
Total net assets	8,060,574	8,633,227
Total liabilities and net assets	<u>\$ 20,234,213</u>	<u>\$ 20,884,861</u>

Fredonia Regional Hospital
A Component Unit of the City of Fredonia, Kansas
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating Revenues		
Net patient service revenue	\$ 10,941,187	\$ 10,968,251
Other	<u>251,678</u>	<u>223,576</u>
	<u>11,192,865</u>	<u>11,191,827</u>
Operating Expenses		
Salaries and wages	4,279,271	4,195,244
Supplies and other	6,119,986	5,853,735
Depreciation and amortization	<u>1,364,676</u>	<u>1,250,252</u>
Total operating expenses	<u>11,763,933</u>	<u>11,299,231</u>
Operating Loss	<u>(571,068)</u>	<u>(107,404)</u>
Nonoperating Revenues (Expenses)		
Property and sales taxes	499,599	537,431
Investment income	81,535	106,772
Interest expense	(667,911)	(676,532)
Noncapital grants and gifts	<u>85,192</u>	<u>24,649</u>
Total nonoperating revenues	<u>(1,585)</u>	<u>(7,680)</u>
Deficiency of Revenue Over Expenses Before Capital Grants and Gifts	(572,653)	(115,084)
Capital Grants and Gifts	<u>-</u>	<u>79,000</u>
Decrease in Net Assets	(572,653)	(36,084)
Net Assets, Beginning of Year	<u>8,633,227</u>	<u>8,669,311</u>
Net Assets, End of Year	<u><u>\$ 8,060,574</u></u>	<u><u>\$ 8,633,227</u></u>

Fredonia Regional Hospital
A Component Unit of the City of Fredonia, Kansas
Statements of Cash Flows
Years Ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating Activities		
Receipts from and on behalf of patients	\$ 10,591,576	\$ 10,954,805
Payments to suppliers and contractors	(5,972,991)	(5,925,745)
Payments to employees	(4,236,999)	(4,152,146)
Other receipts	251,678	223,576
	<u>633,264</u>	<u>1,100,490</u>
Net cash provided by operating activities		
Noncapital Financing Activities		
Property and sales taxes supporting operations	499,599	537,431
Payments (receipts) under physician guarantee contract	7,710	(8,568)
Noncapital grants and gifts	85,192	24,649
	<u>592,501</u>	<u>553,512</u>
Net cash provided by noncapital financing activities		
Capital and Related Financing Activities		
Purchases of capital assets	(266,241)	(484,927)
Principal paid on long-term debt	(334,701)	(280,096)
Interest paid on long-term debt	(667,911)	(676,532)
Proceeds from issuance of long-term debt	-	179,000
Capital grants and gifts	-	79,000
	<u>(1,268,853)</u>	<u>(1,183,555)</u>
Net cash used in capital and related financing activities		
Investing Activities		
Investment income	81,535	106,772
Purchases of investments	(50,436)	(50,475)
	<u>31,099</u>	<u>56,297</u>
Net cash provided by investing activities		
Increase (Decrease) in Cash and Cash Equivalents	(11,989)	526,744
Cash and Cash Equivalents, Beginning of Year	<u>3,292,400</u>	<u>2,765,656</u>
Cash and Cash Equivalents, End of Year	<u>\$ 3,280,411</u>	<u>\$ 3,292,400</u>

Fredonia Regional Hospital
A Component Unit of the City of Fredonia, Kansas
Statements of Cash Flows (Continued)
Years Ended December 31, 2011 and 2010

	2011	2010
Reconciliation of Cash and Cash Equivalents to the Balance Sheets		
Cash and cash equivalents in current assets	\$ 2,969,581	\$ 2,962,531
Restricted cash in current assets	8,138	-
Cash in designated by Board of Trustees	302,692	319,869
Cash restricted by donors	-	10,000
	<u>\$ 3,280,411</u>	<u>\$ 3,292,400</u>
Reconciliation of Operating Loss to Net Cash Provided by Operating Activities		
Operating loss	\$ (571,068)	\$ (107,404)
Depreciation and amortization	1,364,676	1,250,252
Provision for uncollectible accounts	954,840	986,714
Changes in operating assets and liabilities		
Patient accounts receivable	(1,119,451)	(995,160)
Estimated amounts due to and from third-party payers	(185,000)	(5,000)
Supplies	(8,379)	(5,499)
Prepaid expenses and other	(37,040)	(36,924)
Accounts payable	196,070	(27,537)
Accrued expenses	38,616	41,048
	<u>\$ 633,264</u>	<u>\$ 1,100,490</u>
Supplemental Cash Flows Information		
Capital lease obligations incurred for capital assets	\$ 29,611	\$ 128,483

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Notes to Financial Statements
December 31, 2011 and 2010

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

Nature of Operations and Reporting Entity

Fredonia Regional Hospital (Hospital) is a municipal hospital located in Fredonia, Kansas. The Hospital is a component unit of the City of Fredonia, Kansas (City). The Hospital receives funds from the City's 1% sales tax. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services. It also operates a geriatric psych unit and physician clinics. The Hospital is licensed as a critical access hospital (CAH).

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions. Government-mandated nonexchange transactions that are not program specific, property taxes, interest income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) including those issued on or after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Use of Estimates

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

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2011 and 2010, cash equivalents consisted primarily of certificates of deposit.

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Property and Sales Taxes

The Hospital received approximately 4% and 5% in 2011 and 2010, respectively, of its financial support from property and sales taxes.

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Investments and Investment Income

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition and in nonnegotiable certificates of deposit are carried at amortized cost.

Investment income includes dividend and interest income and realized gains and losses on investments carried at other than fair value.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, 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.

Supplies

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Physician Guarantees

Physician receivables on the balance sheet include guarantee contracts and represent the estimated future benefit to be received over the contractual life of the guarantee contracts. Physician payable represents the estimated remaining liability to the Hospital over the contractual life of the guarantee contract.

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Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Land improvements	10 – 20 years
Buildings and leasehold improvements	10 – 40 years
Fixed equipment	5 – 20 years
Major moveable equipment	3 – 10 years

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the interest method.

Compensated Absences

Hospital policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Expense and the related liability for sick leave benefits are recognized when earned to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Sick leave benefits expected to be realized as paid time off are recognized as expense when the time off occurs and no liability is accrued for such benefits employees have earned but not yet realized. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

Net Assets

Net assets of the Hospital 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 outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose, as specified by creditors, grantors or donors external to the Hospital, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt or restricted expendable.

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Notes to Financial Statements
December 31, 2011 and 2010

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy 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 reported as revenue.

Income Taxes

As an essential government function of the City, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law.

Subsequent Events

Subsequent events have been evaluated through the date of the Independent Accountants' Report, which is the date the financial statements were available to be issued.

Reclassifications

Certain reclassifications have been made to the 2010 financial statements to conform to the 2011 presentation. The reclassifications had no effect on the changes in financial position.

Note 2: Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

Medicare. The Hospital is recognized as a CAH. Under CAH rules, inpatient acute care, skilled swing-bed and outpatient services rendered to Medicare program beneficiaries are paid at one hundred one percent (101%) of cost subject to certain limitations. Inpatient geriatric psych services rendered to Medicare program beneficiaries are paid based on a blend of prospective payment rates and cost subject to certain limitations. The Hospital is

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reimbursed for most services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Administrative Contractor.

Medicaid. The Medicaid State Plan provides for a cost reimbursement methodology for inpatient and outpatient services rendered to beneficiaries who are not part of a Medicaid managed care network. The Hospital is reimbursed at tentative rates with final settlements determined after submission of annual cost reports by the Hospital and reviews thereof by the Kansas Department of Health and Environment. The Hospital is reimbursed on a prospective payment methodology for inpatient and outpatient services rendered to beneficiaries who are part of a Medicaid managed care network.

Approximately 79% and 81% of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2011 and 2010, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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 and prospectively determined daily rates.

Net patient service revenue is computed as follows for the years ended December 31:

	<u>2011</u>	<u>2010</u>
Gross patient service revenue	\$ 16,966,425	\$ 16,641,576
Less contractual adjustments		
Medicare	(2,966,240)	(2,986,251)
Medicaid	(685,602)	(470,200)
Other contractals and adjustments	(1,072,998)	(894,635)
Charity care	(174,329)	(167,261)
Administrative discounts	(171,229)	(168,264)
Provision for uncollectible accounts	<u>(954,840)</u>	<u>(986,714)</u>
	<u>\$ 10,941,187</u>	<u>\$ 10,968,251</u>

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Note 3: Deposits and Investments

Deposits

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

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

The Hospital maintains its bank deposits with financial institutions which, at times exceed federally insured limits. For purposes of evaluating credit risk, the stability of financial institutions conducting business with the Hospital is periodically reviewed and management of the Hospital believes it is not exposed to any significant credit risk on these balances.

The Hospital had bank balances as follows at December 31:

	<u>2011</u>	<u>2010</u>
Insured (FDIC)	\$ 500,000	\$ 1,685,389
Collateralized by securities held by pledging institutions in the Hospital's name	<u>4,401,058</u>	<u>4,150,744</u>
Balance per bank statements	<u>\$ 4,901,058</u>	<u>\$ 5,836,133</u>
Carrying amount	<u>\$ 4,783,758</u>	<u>\$ 4,766,381</u>

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The carrying value is included in the following balance sheet captions at December 31:

	<u>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 2,969,581	\$ 2,962,531
Restricted cash and investments - current	8,138	-
Noncurrent cash and investments		
Designated by Board of Trustees	1,806,039	1,793,850
Restricted by donors for capital acquisitions and specific operating activities	-	10,000
	<u>\$ 4,783,758</u>	<u>\$ 4,766,381</u>

Investments

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

All of the Hospital's held by trustee for debt service investments were invested in short-term U.S. treasuries at December 31, 2011 and 2010.

Summary of Carrying Values

The carrying values of deposits and investments shown above are included in the balance sheets as follows:

	<u>2011</u>	<u>2010</u>
Carrying value		
Deposits	\$ 4,783,758	\$ 4,766,381
Investments	<u>1,384,756</u>	<u>1,363,686</u>
Carrying amount	<u>\$ 6,168,514</u>	<u>\$ 6,130,067</u>

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Included in the following balance sheet captions:

	<u>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 2,969,581	\$ 2,962,531
Restricted cash and investments - current	380,725	351,517
Designated by Board of Trustees	1,806,039	1,793,850
Restricted by donors for capital acquisitions and specific operating activities	-	10,000
Held by trustee for debt service	<u>1,012,169</u>	<u>1,012,169</u>
	<u>\$ 6,168,514</u>	<u>\$ 6,130,067</u>

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31 consisted of:

	<u>2011</u>	<u>2010</u>
Medicare	\$ 1,164,734	\$ 1,080,114
Medicaid	215,965	104,338
Blue Cross	154,006	108,397
Commercial	376,515	260,398
Private pay	<u>374,815</u>	<u>480,907</u>
	2,286,035	2,034,154
Less allowance for contractual adjustments	(605,532)	(449,681)
Less allowance for doubtful accounts	<u>(170,471)</u>	<u>(239,052)</u>
	<u>\$ 1,510,032</u>	<u>\$ 1,345,421</u>

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The mix of receivables from patients and third-party payers was as follows at December 31:

	<u>2011</u>	<u>2010</u>
Medicare	51%	53%
Medicaid	9%	5%
Blue Cross	7%	5%
Commercial	17%	13%
Private pay	16%	24%
	<u>100%</u>	<u>100%</u>

Note 5: Capital Assets

Capital assets activity for the years ended December 31 was:

	<u>2011</u>				
	<u>Beginning</u>				<u>Ending</u>
	<u>Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Transfers</u>	<u>Balance</u>
Land	\$ 25,474	\$ -	\$ -	\$ -	\$ 25,474
Land improvements	790,258	15,807	-	-	806,065
Buildings	11,137,021	-	-	-	11,137,021
Fixed equipment	1,070,758	-	-	-	1,070,758
Moveable equipment	3,821,374	280,046	(12,048)	-	4,089,372
	<u>16,844,885</u>	<u>295,853</u>	<u>(12,048)</u>	<u>-</u>	<u>17,128,690</u>
Less accumulated depreciation					
Land improvements	(222,909)	(54,442)	-	-	(277,351)
Buildings	(2,288,132)	(604,450)	-	-	(2,892,582)
Fixed equipment	(549,117)	(75,127)	-	-	(624,244)
Moveable equipment	(2,169,531)	(470,514)	12,048	-	(2,627,997)
	<u>(5,229,689)</u>	<u>(1,204,533)</u>	<u>12,048</u>	<u>-</u>	<u>(6,422,174)</u>
Capital assets, net	<u>\$ 11,615,196</u>	<u>\$ (908,680)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$10,706,516</u>

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	2010				Ending Balance
	Beginning Balance	Additions	Deletions	Transfers	
Land	\$ 25,474	\$ -	\$ -	\$ -	\$ 25,474
Land improvements	789,843	7,987	(7,572)	-	790,258
Buildings	11,094,542	27,605	-	14,874	11,137,021
Fixed equipment	1,062,479	25,548	(17,269)	-	1,070,758
Moveable equipment	3,424,796	576,195	(179,617)	-	3,821,374
Construction in process	37,326	9,288	-	(46,614)	-
	<u>16,434,460</u>	<u>646,623</u>	<u>(204,458)</u>	<u>(31,740)</u>	<u>16,844,885</u>
Less accumulated depreciation					
Land improvements	(173,812)	(55,197)	6,100	-	(222,909)
Buildings	(1,684,771)	(603,361)	-	-	(2,288,132)
Fixed equipment	(481,489)	(84,897)	17,269	-	(549,117)
Moveable equipment	(1,963,025)	(386,125)	179,619	-	(2,169,531)
	<u>(4,303,097)</u>	<u>(1,129,580)</u>	<u>202,988</u>	<u>-</u>	<u>(5,229,689)</u>
Capital assets, net	<u>\$ 12,131,363</u>	<u>\$ (482,957)</u>	<u>\$ (1,470)</u>	<u>\$ (31,740)</u>	<u>\$11,615,196</u>

Note 6: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

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Note 7: Physician Guarantees

During 2009, the Hospital entered into a contract with a physician to relocate to Fredonia, Kansas to establish a practice. The Hospital has advanced \$83,251 to the physician. The physician is required, for a minimum of five years, to establish and maintain an internal medicine and primary care practice on a full-time basis in Fredonia, Kansas. In the event the physician fails to perform her obligations under the contract, she is to reimburse the Hospital all sums advanced minus any amounts forgiven pursuant to the terms of the contract. This agreement also includes other advances for student loans, sign-on bonuses, relocation expenses and marketing expenses that are included in the physician receivables on the balance sheet. The physician is now in the forgiveness period of the contract. The carrying amount of the liability for the Hospital's obligations under the guarantee contract is \$127,031 and \$134,622 at December 31, 2011 and 2010, respectively.

During 2007, the Hospital entered into a contract with a physician to relocate to Fredonia, Kansas to establish a practice. The Hospital advanced \$341,336 to the physician. The physician is required, for a minimum of five years, to establish and maintain an internal medicine and primary care practice on a full-time basis in Fredonia, Kansas. In the event this physician fails to perform her obligations under the contract, she is to reimburse the Hospital all sums advanced minus any amounts forgiven pursuant to the terms of the contract. This agreement also includes other advances for student loans, sign-on bonuses and relocation expenses that are included in physician receivables, less amortization, on the balance sheet. The physician is now in the forgiveness period of the contract.

Another physician contract exists in which the Hospital has advanced \$137,479 to the physician. The physician is required to locate his practice in Fredonia, Kansas and provide professional services for residents of the Hospital service area pursuant to and in accordance with the agreement. In the event this physician fails to perform his obligations under the contract, he is to reimburse the Hospital one-half of all sums advanced, plus interest, minus any amounts forgiven pursuant to the terms of the contract. The other half of the sum advanced to the physician is to be repaid to the Hospital beginning August 2007, with a term of 60 months at an interest rate of 7.5%. The physician was given an extension of 12 months in July 2010 for repayment of the note. The Hospital signed a promissory note with the physician pursuant to the agreement. The entire amount advanced to the physician is included in physician receivables on the balance sheet less amortization and payments made by the physician.

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Note 8: Long-term Obligations

The following is a summary of long-term obligation transactions for the Hospital for the years ended December 31:

	2011					
	Beginning Balance	Additions	Deletions	Ending Balance	Current Portion	Long-term Portion
Series 2010 Hospital Revenue Bonds	\$ 179,000	\$ -	\$ 30,213	\$ 148,787	\$ 15,632	\$ 133,155
Series 2007 Hospital Revenue Bonds	10,420,000	-	150,000	10,270,000	160,000	10,110,000
Capital leases	563,412	29,611	154,488	438,535	166,101	272,434
	<u>\$11,162,412</u>	<u>\$ 29,611</u>	<u>\$ 334,701</u>	<u>\$10,857,322</u>	<u>\$ 341,733</u>	<u>\$10,515,589</u>

	2010					
	Beginning Balance	Additions	Deletions	Ending Balance	Current Portion	Long-term Portion
Series 2010 Hospital Revenue Bonds	\$ -	\$ 179,000	\$ -	\$ 179,000	\$ 15,083	\$ 163,917
Series 2007 Hospital Revenue Bonds	10,560,000	-	140,000	10,420,000	150,000	10,270,000
Capital leases	575,027	128,483	140,098	563,412	154,536	408,876
	<u>\$11,135,027</u>	<u>\$ 307,483</u>	<u>\$ 280,098</u>	<u>\$11,162,412</u>	<u>\$ 319,619</u>	<u>\$10,842,793</u>

2010 Revenue Bonds Payable

The 2010 revenue bonds payable, issued by the City, consist of United States Department of Agriculture Revenue Bonds (2010 Bonds) in the original amount of \$179,000 dated October 18, 2010, which bear interest of 3.75%. The 2010 Bonds are payable in annual installments through October 28, 2020. The Hospital is required to make monthly deposits beginning December 1, 2010, of approximately one-twelfth of the next principal and interest payment due to the debt service fund and a monthly deposit of \$150 to the debt service reserve fund both held by a financial institution. Proceeds from the issuance of these 2010 Bonds were used to purchase two ambulances. The owner of the 2010 Bonds may require and compel the Hospital to comply with the above provision of the Bond Resolution. All of the 2010 Bonds still outstanding may be redeemed at the Hospital's option at 100% of the redemption price. The 2010 Bonds are secured by the net revenues of the Hospital.

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2007 Revenue Bonds Payable

In July 2007, the Series 2007 Hospital Revenue Bonds (2007 Bonds) were issued by the City in the original amount of \$10,745,000 dated August 7, 2007, which bear interest at 6.125%. The Bonds are payable in annual installments through August 15, 2037. The 2007 Bonds are secured by the net revenues of the Hospital. Proceeds from the issuance of these 2007 Bonds were used to fund the construction and equipping of the Hospital's expansion and partial replacement.

The indenture agreements require that certain funds be established with the trustee. Accordingly, these funds are included as assets held by trustee for debt service and restricted cash and investments - current in the balance sheets. The indenture agreements also require the Hospital to comply with certain restrictive covenants including maintaining a historical debt-service coverage of at least 1.25. The indenture agreements also require the Hospital to maintain a minimum days cash on hand of 75 days.

Capital Lease Obligations

Equipment cost and accumulated depreciation under the capitalized lease obligations are as follows for the years ended December 31:

	2011	2010
Moveable equipment	\$ 551,492	\$ 594,991
Less accumulated depreciation	(224,516)	(190,342)
	\$ 326,976	\$ 404,649

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Scheduled principal and interest payments on long-term debt and capital lease obligations are as follows:

	Long-term Debt		Capital Lease	
	Principal	Interest	Principal	Interest
2012	\$ 175,632	\$ 635,185	\$ 166,101	\$ 20,440
2013	181,235	624,799	104,698	12,661
2014	196,843	617,083	73,839	6,467
2015	207,475	602,426	73,359	1,877
2016	218,120	590,134	2,772	1,539
2017-2021	1,264,482	2,740,833	17,766	3,837
2022-2026	1,610,000	2,317,702	-	-
2027-2031	2,180,000	1,759,407	-	-
2032-2036	2,935,000	1,004,807	-	-
2037	1,450,000	88,813	-	-
	<u>\$ 10,418,787</u>	<u>\$ 10,981,189</u>	<u>\$ 438,535</u>	<u>\$ 46,821</u>

Note 9: Management/Services Agreement

The Board of Trustees has contracted with Great Plains Health Alliance, Inc. (GPHA) for various services, including management, data processing and accounting services. The terms of the agreements vary from one to seven years and can be canceled with 60 days' notice. The agreements can be renewed after the initial term has expired on a year-to-year basis. Fees incurred for the various services provided by GPHA to the Hospital for the years ended December 31, 2011 and 2010, were \$170,686 and \$162,644, respectively.

Note 10: Pension Plan

Fredonia Regional Hospital Employees' Pension Plan (the Plan) is a defined contribution pension plan that was effective as of January 1, 1992. Eligible employees are those who work 1,000 hours or more each year, have attained the age of 21 and have completed two years of service. The Hospital's share of the contribution is 4% of the covered payroll and the employees share is 3% of the covered payroll. The employees may contribute any additional amount to the Plan on a voluntary basis. The contributions are invested as each employee directs. Each participant chooses which accounts to use and may change the election once each calendar year. Contributions actually made by plan members and the Hospital aggregated \$157,624 and \$127,231 during 2011 and \$154,000 and \$120,525 during 2010, respectively.

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Note 11: Fredonia Regional Health Care Foundation, Inc.

The Fredonia Regional Health Care Foundation, Inc. (Foundation) is a nonprofit organized to perpetuate the advancement of health, health care and medical education, research and welfare services for residents of Fredonia, Kansas and its outlying regions. The Foundation is not considered a component unit of the Hospital. The Foundation contributed \$46,550 to the Hospital in 2011 that is included in noncapital grants and gifts on the statements of revenues, expenses and changes in net assets. No contributions were made to the Hospital in 2010. In connection with the issuance of the 2007 Bonds, the Foundation has provided a financial guarantee.

Note 12: Risks and Uncertainties

Current Economic Conditions

The current protracted decline continues to present hospitals with difficult circumstances and challenges, which in some cases have resulted in large and unanticipated declines in the fair value of investments and other assets, large declines in contributions, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Hospital.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Hospital's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in investment values and allowances for accounts receivable that could negatively impact the Hospital's ability to meet debt covenants or maintain sufficient liquidity.