KEARNY COUNTY HOSPITAL

FINANCIAL STATEMENTS

and

ADDITIONAL INFORMATION

with

INDEPENDENT AUDITOR'S REPORT

YEARS ENDED JUNE 30, 2011 AND 2010

George, Bowerman & Noel, P.A.
Certified Public Accountants

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Kearny County Hospital
Lakin, Kansas

We have audited the financial statements, as listed in the table of contents, of Kearny County Hospital, a component unit of Kearny County, Kansas, as of June 30, 2011 and 2010, and 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 audits 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 Kearny County Hospital as of June 30, 2011 and 2010 and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

George, Bowerman & Noel, P.A.

Wichita, Kansas
February 23, 2012

KEARNY COUNTY HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Kearny County Hospital's (Facility's) financial performance provides an overview of the Facility's financial activities for the fiscal years ended June 30, 2011 and 2010. Please read it in conjunction with the Facility's financial statements, which begin on page 7.

Financial Highlights

- The Facility's net assets decreased by $782,856 or 5% in 2011 and by $1,231,127 or 8% in 2010.
- The Facility's net patient service revenue increased by $1,022,122 or 9% in 2011 and by $696,053 or 6% in 2010.
- Contractual allowances, charity care and bad debts reduced gross patient service revenue by $5,125,192 or 29% of gross patient service revenue in 2011 and by $3,970,451 or 25% of gross patient service revenue in 2010.
- The Facility reported operating losses in both 2011 ($2,348,277) and 2010 ($2,719,785). The operating loss in 2011 decreased by $371,508 or 14% over the loss reported in 2010. The operating loss in 2010 increased by $88,826 or 3% over 2009.
- Net nonoperating revenues increased by $354,267 or 30% in 2011 and decreased by $36,053 or 3% in 2010.

Using This Annual Report

The Facility's financial statements consist of three statements—a Balance Sheet; a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Facility, including resources held by the Facility but restricted for specific purposes by contributors, grantors, or enabling legislation.

Financial Statements

The Facility's financial statements are prepared using proprietary fund accounting that focuses on the determination of changes in net assets, financial position and cash flows in a manner similar to private-sector businesses. The basic financial statements include a *balance sheet*, *statement of revenue, expenses and changes in net assets*, and *statement of cash flows*, followed by notes to the financial statements and schedules of certain additional information. These statements include all restricted and unrestricted assets and all liabilities using the

accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The *balance sheet* presents information on the Facility's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may indicate whether the financial position of the Facility is improving or deteriorating.

The *statement of revenues, expenses and changes in net assets* presents both the operating revenues and expenses and nonoperating revenues and expenses along with other changes in net assets for the year. This statement is an indication of the success of the Facility's operations over the past year.

The *statement of cash flows* presents the change in cash and cash equivalents for the year resulting from operating activities, capital and related financing activities and investing activities. The primary purpose of this statement is to provide information about the Facility's cash receipts and cash payments during the year.

Financial Position

The Facility's net assets are the difference between its assets and liabilities reported in the Balance Sheets on pages 7 and 8. The Facility's net assets increased in each of the past three years as you can see from the following table.

	June 30,		
	2011	2010	2009
Assets:			
Current assets	$ 2,904,007	$ 3,318,505	$ 2,593,492
Capital assets, net	11,597,234	12,546,433	13,459,493
Other noncurrent assets	75,629	117,525	518,641
Total assets	$ 14,576,870	$ 15,982,463	$ 16,571,626
Liabilities:			
Long-term liabilities	$ 133,004	$ 28,625	$ 113,790
Other liabilities	950,955	1,678,071	950,942
Total liabilities	$ 1,083,959	$ 1,706,696	$ 1,064,732
Net assets:			
Invested in capital assets, net	$ 11,379,110	$ 12,432,642	$ 13,264,367
Restricted	534,165	523,740	478,449
Unrestricted	1,579,636	1,319,385	1,764,078
Total net assets	$ 13,492,911	$ 14,275,767	$ 15,506,894

Recent Financial Performance

The schedule below is a summary of the Facility's revenues, expenses and changes in net assets for the past three years.

	Year ended June 30		
	2011	2010	2009
Operating revenue	$12,876,757	$11,853,915	$11,154,058
Operating expenses:			
Salaries	7,972,734	7,876,014	7,896,452
Supplies and other	5,930,697	5,393,873	4,542,804
Depreciation	1,321,603	1,303,813	1,345,761
Total operating expenses	15,225,034	14,573,700	13,785,017
Operating loss	(2,348,277)	(2,719,785)	(2,630,959)
Nonoperating revenues:			
Taxes	1,328,984	961,583	975,573
Investment income	11,794	3,389	9,137
Interest expense	(23,086)	(15,163)	(10,825)
Grants and contributions	76,526	64,396	88,905
Other, net	150,545	176,291	163,759
Total nonoperating revenues	1,544,763	1,190,496	1,226,549
Excess of expenses over revenue before capital grants and contributions	(803,514)	(1,529,289)	(1,404,410)
Capital grants and contributions	20,658	298,162	23,793
Decrease in net assets	$ (782,856)	$(1,231,127)	$(1,380,617)
Net assets at end of year	$13,492,911	$14,275,767	$15,506,894

Operating Losses

The first component of the overall change in the Facility's net assets is its operating income (loss)—generally, the difference between net patient service and the expenses incurred to perform those services. The Facility reported operating losses of $2,348,277, $2,719,785 and $2,630,959 in 2011, 2010 and 2009, respectively.

The primary components of the changes in operating losses are:

- Increases in salary and employee benefit costs for the Facility's employees of $354,732 or 4% in 2011 and $1,067,473 or 12% in 2010.

- A increase in supplies and other expenses of $278,812 or 8% in 2011 and a decrease in supplies and other expenses of $236,842 9% in 2010.

- Contractual allowances, charity care and bad debt expense increased by $1,154,741 in 2011 and by $550,898 in 2010.

The rate of healthcare inflation has a direct effect on the cost of services provided by the Facility. A component of the Facility's costs are expenses for medical supplies and prescription drugs. Some of the major factors contributing to the increased medical supply and drug costs include the introduction of new drugs that cannot be obtained in generic form, and changes in therapeutic mix.

Nonoperating Revenues and Expenses

Nonoperating revenues consist primarily of property taxes levied by the County, investment earnings, and grants and contributions.

The Facility's Cash Flows

Changes in the Facility's cash flows are consistent with changes in operating losses and nonoperating revenues and expenses, discussed earlier.

Capital Assets

The Facility had $11,379,110, $12,432,642 and $13,264,367 invested in capital assets, net of accumulated depreciation and related debt, at June 30, 2011, 2010 and 2009, respectively, as detailed in Note 6 to the financial statements. The Facility had expenditures of approximately $372,000 and $391,000 for equipment in 2011 and 2010, respectively.

Debt

At June 30, 2011, the Facility had capitalized lease obligations outstanding of $218,124 for imaging and patient monitoring equipment and an electronic health record system, as detailed in Note 7 to the financial statements.

Other Economic Factors

Management expects the current economic conditions to continue over the next year.

Issues Facing the Facility

There are issues facing the Facility that could result in material changes in its financial position in the long term. Among these issues are:

- Risks related to Medicare and Medicaid reimbursement. A significant portion of the Facility's revenues are derived from the Medicare program, which provides certain healthcare benefits to beneficiaries who are over 65 years of age or disabled, and the Medicaid program, funded jointly by the federal government and the states, which provides medical assistance to certain needy individuals and families. The funding of these programs by the federal and state governments face increasing pressure due to the significant increases in the costs of providing healthcare services in recent years.

- Employment and labor issues. The Facility is a major employer within the community, employing a complex mix of professional, technical, clerical, maintenance, dietary, and other workers. Risks include personal tort actions, work-related injuries and exposure to hazardous materials. A relative shortage of nursing and other medical professional/technical employees within the state, is an issue that is causing salary and benefits costs to increase at significant rates.

- Technology and services. Scientific and technological advances, new procedures, drugs and appliances, preventive medicine, and outpatient healthcare delivery may reduce utilization and revenues for the Facility in the future. Technological advances continue to accelerate the need to acquire sophisticated and expensive equipment and services for diagnosis and treatment of illnesses and diseases.

- Increasing numbers of uninsured and underinsured patients. Due to the significant increases and high cost of healthcare insurance premiums in recent years, increasing numbers of patients of the Facility are finding it more and more difficult to obtain or maintain adequate health insurance coverage. This trend could increase the levels of uncompensated care provided by the Facility.

Contacting The Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital Administration Department, at Kearny County Hospital, 500 N. Thorpe St., Lakin, Kansas 67860.

KEARNY COUNTY HOSPITAL

BALANCE SHEETS

ASSETS

	June 30, 2011	June 30, 2010
Current assets:		
Cash (Notes 1 and 3)	$ 25,152	$ 69,168
Assets whose use is limited (Notes 1 and 3)	686,515	759,942
Accounts receivable, net of allowance for doubtful accounts of $484,771 in 2011 and $396,165 in 2010 (Notes 1 and 4)	1,555,467	1,537,198
Current portion of employee receivables	49,743	31,667
Due from third-party insurance programs (Note 2)	216,108	555,395
Inventories (Note 1)	244,341	219,237
Prepaid expenses and other	126,681	145,898
Total current assets	2,904,007	3,318,505
Long-term portion of employee receivables	75,629	117,525
Property and equipment, at cost (Notes 1 and 6):		
Land	97,298	97,298
Land improvements	634,019	634,019
Buildings and fixed equipment	18,005,205	17,995,470
Movable equipment	3,751,261	3,587,855
Projects in progress	199,263	–
	22,687,046	22,314,642
Less accumulated depreciation	11,089,812	9,768,209
Property and equipment, net of accumulated depreciation	11,597,234	12,546,433
Total assets	$14,576,870	$15,982,463

The accompanying notes are an integral part of the financial statements.

LIABILITIES AND NET ASSETS

	June 30, 2011	June 30, 2010
Current liabilities:		
Accounts payable	$ 243,272	$ 356,555
Salaries payable	268,011	235,156
Compensated absences payable (Note 1)	256,481	244,261
Payroll taxes payable	15,199	13,729
Other accrued expenses	64,443	30,759
Current portion of capitalized lease obligations (Note 7)	85,120	85,166
Note payable to bank (Note 8)	18,429	712,445
Total current liabilities	950,955	1,678,071
Capitalized lease obligations (Note 7)	133,004	28,625
Total liabilities	1,083,959	1,706,696
Net assets (Notes 1 and 3):		
Invested in capital assets, net of related debt	11,379,110	12,432,642
Restricted:		
Expendable for capital asset acquisition	534,165	523,740
Unrestricted	1,579,636	1,319,385
Total net assets	13,492,911	14,275,767
Total liabilities and net assets	$14,576,870	$15,982,463

KEARNY COUNTY HOSPITAL

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

	Year ended June 30,	
	2011	2010
Operating revenues:		
Net patient service revenue (Note 1)	$12,854,041	$11,831,919
Other	22,716	21,996
Total operating revenue	12,876,757	11,853,915
Operating expenses:		
Salaries	7,972,734	7,876,014
Supplies and other	5,930,697	5,393,873
Depreciation (Note 1)	1,321,603	1,303,813
Total operating expenses	15,225,034	14,573,700
Operating loss	(2,348,277)	(2,719,785)
Nonoperating revenues:		
Tax revenues	1,328,984	961,583
Investment income	11,794	3,389
Interest expense	(23,086)	(15,163)
Noncapital grants and contributions	45,240	64,396
Transfers from Kearny County for operations	31,286	–
Other	150,545	176,291
Total nonoperating revenues	1,544,763	1,190,496
Excess of expenses over revenues before contributions for capital assets	(803,514)	(1,529,289)
Increase (decrease) in beneficial interest in charitable trust (Note 3)	–	60,025
Transfers from Kearny County for capital assets	20,658	238,137
Decrease in net assets	(782,856)	(1,231,127)
Net assets at beginning of year	14,275,767	15,506,894
Net assets at end of year	$13,492,911	$14,275,767

The accompanying notes are an integral part of the financial statements.

KEARNY COUNTY HOSPITAL

STATEMENTS OF CASH FLOWS

	Year ended June 30,	
	2011	2010
Cash flows from operating activities:		
Receipts from and on behalf of patients	$ 13,175,059	$ 11,558,865
Payments to suppliers and contractors	(6,009,962)	(5,390,766)
Payments to employees	(7,927,659)	(7,863,095)
Other receipts and payments, net	22,716	21,996
Net cash flows used by operating activities	(739,846)	(1,673,000)
Cash flows from noncapital financing activities:		
Property taxes for operations	1,328,984	961,583
Grants and contributions	45,240	64,396
Transfers from Kearny County for operations	26,535	–
Other	150,545	176,291
Net cash flows provided by noncapital financing activities	1,551,304	1,202,270
Cash flows from capital and related financing activities:		
Purchases of property and equipment	(173,141)	(390,753)
Payments on capitalized lease obligations	(118,016)	(96,498)
Proceeds from note payable to bank	8,236,999	6,409,000
Payments on note payable to bank	(8,931,015)	(5,696,555)
Transfers from Kearny County for capital assets	20,658	238,137
Net cash flows provided (used) by capital and related financing activities	(964,515)	463,331
Cash flows from investing activities:		
Net change in employee receivables	23,820	(77,333)
Distributions from charitable trust	–	538,474
Investment income	11,794	3,389
Net cash flows provided by investing activities	35,614	464,530
Increase (decrease) in cash and cash equivalents	(117,443)	457,131
Cash and cash equivalents at beginning of year	829,110	371,979
Cash and cash equivalents at end of year	$ 711,667	$ 829,110

The accompanying notes are an integral part of the financial statements.

KEARNY COUNTY HOSPITAL

STATEMENTS OF CASH FLOWS - continued

	Year ended June 30, 2011	Year ended June 30, 2010
Reconciliation of cash and cash equivalents to balance sheets:		
Cash and cash equivalents in current assets:		
Cash	$ 25,152	$ 69,168
Assets whose use is limited	686,515	759,942
Total cash and cash equivalents	$ 711,667	$ 829,110
Reconciliation of operating loss to net cash provided by (used by) operating activities:		
Operating loss	$ (2,348,277)	$ (2,719,785)
Adjustments to reconcile operating loss to net cash flows used in operating activities:		
Depreciation	1,321,603	1,303,813
Provision for doubtful accounts	454,229	618,083
Operating expenses paid directly by County	4,751	–
Net (increases) decreases in current assets:		
Accounts receivable	(472,498)	(572,730)
Inventories	(25,104)	(6,153)
Estimated third-party payor settlements	339,287	(318,407)
Other	19,217	11,325
Net increases (decreases) in current liabilities:		
Accounts payable	(113,283)	59,115
Salaries and wages payable	32,855	10,279
Compensated absences payable	12,220	(11,083)
Payroll taxes payable	1,470	175
Other accrued expenses	33,684	(47,632)
Net cash used by operating activities	$ (739,846)	$ (1,673,000)

KEARNY COUNTY HOSPITAL

NOTES TO FINANCIAL STATEMENTS

June 30, 2011 and 2010

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies is presented to assist in understanding the Hospital's financial statements. The financial statements and notes are representations of the Hospital's management, which is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements.

Organization and business activity

Kearny County Hospital (Hospital) is owned by Kearny County, Kansas and is governed by a Board of Trustees. The Hospital provides acute, skilled, intermediate, assisted living, self-care, clinic and home health services. The Board of County Commissioners appoints the members of the Board of Trustees. For this reason, the Hospital is considered to be a component unit of Kearny County, Kansas.

Proprietary fund accounting

The Hospital's financial statements are comprised solely of an enterprise fund that uses proprietary accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

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, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

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 those estimates.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Operating revenues and expenses

The Hospital's statement of revenues, expenses, and changes in net assets distinguishes between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the Hospital's principal activity. Non-exchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisitions, are reported as non-operating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Cash and cash equivalents

For purposes of the statement of cash flows, the Hospital considers all highly liquid debt instruments with an original maturity of three months or less to be cash and cash equivalents.

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, payer mix trends, and existing economic conditions. As a service to patients, the Hospital bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are generally due in full when billed. If the patient is unable to pay the full amount at the time the patient is billed, the Hospital negotiates a payment plan whereby monthly payments are made by the patient on the account. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account. If future actual default rates on accounts receivable differ from those currently anticipated, the Hospital may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments are made.

Inventories

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

Capital assets

The Hospital's capital assets that are $3,000 or greater, are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using the following estimated useful lives:

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

	Estimated useful lives
Land improvements	10 - 20 years
Buildings	5 - 40 years
Fixed equipment	5 - 20 years
Movable equipment	5 - 20 years

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. When depreciable property is retired or otherwise disposed of, the related costs and accumulated depreciation are removed from the accounts and any gain or loss is reflected as non-operating revenue (expense).

Net patient service revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, per diem payments, and discounted charges. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Charity care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy based on current poverty level guidelines. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were $141,080 and $148,727 for June 30, 2011 and 2010, respectively.

Compensated absences

Employees of the Hospital are entitled to paid time off depending on length of service and whether they are full or part time. Upon resignation, termination or retirement from service with the Hospital, employees are entitled to payment for all accrued paid time off, up to the allowable maximum. The Hospital accrues the paid time off benefits as earned.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Grants and contributions

From time to time, the Hospital receives grants and contributions from government agencies, private organizations, and individuals. Revenues from grants and contributions are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as non-operating revenue. Amounts restricted to capital acquisitions are reported after non-operating revenues and expenses. When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

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 current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable net assets* are non-capital 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.*

Risk management

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; natural disasters; and employee health benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial insurance coverage in any of the three preceding years.

The Hospital pays fixed premiums for annual medical malpractice coverage under an occurrence-basis policy. The Hospital accrues the expenses of its share of malpractice claim costs, if any, of reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate cost of any incident. Based on the Hospital's own claims experience, no accrual, for medical malpractice costs has been made in the accompanying financial statements.

Subsequent events

Subsequent events have been evaluated through February 23, 2012, which is the date the financial statements were available to be issued.

2. ESTIMATED THIRD-PARTY PAYOR SETTLEMENTS

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** – Inpatient and outpatient services are paid based on cost reimbursement methodologies. The Hospital is reimbursed 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 Medicare fiscal intermediary. The Hospital's classification of patients under the Medicare program and appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital. The Hospital's Medicare cost reports have been reviewed by the Medicare fiscal intermediary through June 30, 2010.

- **Medicaid** – Inpatient acute and outpatient services rendered to program beneficiaries are reimbursed under a cost reimbursement methodology. The Hospital is reimbursed 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 Medicaid fiscal intermediary. The Hospital's Medicaid cost reports have been reviewed by the Medicaid fiscal intermediary through June 30, 2008.

  Inpatient long-term care services for the years ended June 30, 2011 and 2010 are paid at prospectively determined per diem rates that are based on the patient's acuity.

Approximately 32% and 30% of net patient service revenue is from participation in the Medicare program for the years ended June 30, 2011 and 2010, respectively. Laws and regulations governing the Medicare program 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 and other third-party payor programs. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and cost reimbursement.

3. CASH AND ASSETS WHOSE USE IS LIMITED

Cash and assets whose use is limited consisted of the following:

	June 30,	
	2011	2010
Unrestricted demand and time deposit accounts	$ 25,152	$ 69,168
Assets whose use is limited:		
By Board of Trustees:		
Savings accounts	152,350	236,202
By others:		
Expendable for capital asset acquisitions	534,165	523,740
Totals	$ 711,667	$ 829,110

Assets whose use is limited by the Board of Trustees are to be used for the replacement of capital assets or for the purchase of additional capital assets. These assets may be utilized for other purposes at the discretion of the Board.

The amounts expendable for capital asset acquisitions relate to distributions made to the Hospital from a charitable trust. The Hospital, along with other trust beneficiaries, received annual distributions of trust net income until 2010 at which time, the trust was terminated and all undistributed net income along with trust principal were distributed to the trust beneficiaries. Distributions to the Hospital are to be used for the replacement of capital assets or for the purchase of additional capital assets. Distributions may be used for other purposes upon unanimous vote of the Board of Trustees and approval by the trustee bank.

Deposits

Custodial credit risk for deposits is the risk that in the event of bank failure, the Hospital's deposits may not be returned or the Hospital will not be able to recover collateral securities in the possession of an outside party. The Hospital's policy follows applicable State statutes and requires deposits to be 100% secured by collateral (pledged securities) valued at market, less the amount of the Federal Deposit Insurance Corporation (FDIC) insurance. State statures define the allowable pledged securities.

At year end, the carrying amount of the Hospital's deposits was $711,667 with the bank balances of such accounts being $863,240. Of the bank balances, $327,736 was secured by federal depository insurance and the remaining balance of $535,504 was covered by collateral held by the Hospital's custodial bank in joint custody in the name of the Hospital and its bank. The fair value of those pledged securities held by the Hospital's custodial bank was $959,925 at June 30, 2011.

3. CASH AND ASSETS WHOSE USE IS LIMITED (continued)

Investment policies

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The Hospital's investing activities are managed under the custody of senior management. Investing is performed in accordance with investment policies adopted by the Board of Trustees and in compliance with State statutes.

Applicable state statutes authorize the Hospital to invest in (1) temporary notes or no-fund warrants issued by the Hospital (2) time deposit, open accounts or certificates of deposit, with maturities of not more than two years, in commercial banks; (3) time certificates of deposit, with maturities of not more than two years, with state or federally chartered savings and loan associations or federally chartered savings banks, (4) repurchase agreements with commercial banks, state or federally chartered savings and loan associations or federally chartered savings banks; (5) United States treasury bills or notes with maturities as the governing body shall determine, but not exceeding two years; (6) the municipal investment pool maintained by the State Treasurer's office, and (7) trust departments of commercial banks.

4. CONCENTRATIONS 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 gross accounts receivable from patients and third-party payors at June 30, 2011 and 2010 was as follows:

	June 30,	
	2011	2010
Medicare	27%	28%
Medicaid	6	5
Blue Cross	13	15
Commercial	14	8
Private pay	40	44
	100%	100%

5. PENSION PLAN

The Hospital maintains a contributory pension plan for all employees in lieu of social security. Prior to July 1, 1997, employees made contributions equal to 5% of their gross compensation. The Hospital contribution was 10% of the employees' gross compensation for those employed for two years or more and 5% for all others. Effective July 1, 1997, employees are required to contribute the same percentage required under the Social Security laws (OASDI). The Hospital is required to make a matching contribution in the same amount. An additional 3% contribution is made by the Hospital on behalf of all employees continuously employed for three years or more. Voluntary employee contributions may be made up to a specified percent of eligible compensation not to exceed $16,500 for 2011 and 2010. Benefits are funded by an annuity contract with an insurance company. The total cost of the plan was $630,972 and $618,244 for 2011 and 2010, respectively. Employee and employer contributions vest immediately.

6. CAPITAL ASSETS

Capital asset additions, disposals, and balances for the years ended June 30, 2011 and 2010 were as follows:

	Balance At June 30, 2010	Additions	Disposals	Balance At June 30, 2011
Capital assets not being depreciated:				
Land	$ 97,298	$ –	$ –	$ 97,298
Projects in progress	–	199,263	–	199,263
Total capital assets not being depreciated	97,298	199,263	–	296,561
Capital assets being depreciated:				
Land improvements	634,019	–	–	634,019
Buildings and fixed equipment	17,995,470	9,735	–	18,005,205
Movable equipment	3,587,855	163,406	–	3,751,261
Total capital assets being depreciated	22,217,344	173,141	–	22,390,485

6. CAPITAL ASSETS (continued)

	Balance At June 30, 2010	Additions	Disposals	Balance At June 30, 2011
Less accumulated depreciation for:				
Land improvements	230,450	40,289	–	270,739
Buildings and fixed equipment	7,126,781	941,756	–	8,068,537
Movable equipment	2,410,978	339,558	–	2,750,536
Total accumulated depreciation	9,768,209	1,321,603	–	11,089,812
Total capital assets being depreciated, net	12,449,135	(1,148,462)	–	11,300,673
Total capital assets, net	$12,546,433	$ (949,199)	$ –	$11,597,234

	Balance At June 30, 2009	Additions	Disposals	Balance At June 30, 2010
Capital assets not being depreciated:				
Land	$ 97,298	$ –	$ –	$ 97,298
Projects in progress	–	–	–	–
Total capital assets not being depreciated	97,298	–	–	–
Capital assets being depreciated:				
Land improvements	634,019	–	–	634,019
Buildings and fixed equipment	17,771,475	223,995	–	17,995,470
Movable equipment	3,421,097	166,758	–	3,587,855

6. CAPITAL ASSETS (continued)

	Balance At June 30, 2009	Additions	Disposals	Balance At June 30, 2010
Total capital assets being depreciated	21,826,591	390,753	–	22,317,344
Less accumulated depreciation for:				
Land improvements	189,680	40,769	–	230,450
Buildings and fixed equipment	6,195,640	931,142	–	7,126,781
Movable equipment	2,079,076	331,902	–	2,410,978
Total accumulated depreciation	8,464,396	1,303,813	–	9,768,209
Total capital assets being depreciated, net	13,362,195	(913,060)	–	12,449,135
Total capital assets, net	$13,459,493	$ (913,060)	$ –	$12,546,433

7. CAPITALIZED LEASE OBLIGATIONS

The Hospital has entered into capital lease agreements for the acquisition of certain capital assets, including a new lease for the acquisition and installation of an electronic health record (EHR) system in 2011. The lease for the EHR system is for a total principal of $400,000, of which $189,501 (net of principal repaid) had been drawn down as of June 30, 2011. The remaining available principal was drawn down subsequent to June 30, 2011. The EHR project is in progress and is expected to be completed in 2012. Interest incurred under the leases was $3,488 and $7,162 for the years ended June 30, 2011 and 2010, respectively. The following is an analysis of the financial presentation of the capital lease at June 30, 2011 and 2010:

7. CAPITALIZED LEASE OBLIGATIONS (continued)

	June 30, 2011	June 30, 2010
Movable equipment	$ 422,734	$ 422,734
Projects in progress	199,263	–
	621,997	422,734
Less accumulated depreciation	293,439	228,995
	$ 328,558	$ 193,739

The following is a schedule of future minimum lease payments under the capital lease together with the present value of the net minimum lease payments as of June 30, 2011:

Year ending June 30:	
2012	$ 93,784
2013	86,455
2014	86,455
2015	86,455
2016	86,455
Net minimum lease payments	439,604
Less amounts not drawn down at year end	189,739
Less amount representing interest	31,741
Present value of net minimum lease payments	218,124
Less current portion	85,120
Long-term portion	$ 133,004

8. NOTE PAYABLE TO BANK

The Hospital has a revolving line of credit agreement with a local bank. The maximum principal that can be borrowed is $800,000 and carries a fixed interest rate of 4.0%. Interest expense incurred on the obligation for the years ended June 30, 2011 and 2010 was $19,598 and $8,001, respectively. The note is collateralized by accounts receivable and it is management's intention to pursue the renewal of the agreement when it expires on March 1, 2012.

9. OTHER POST EMPLOYMENT BENEFITS

As provided by K.S.A. 12-5040, the Hospital is required to allow qualifying retirees to participate in the group health insurance plan. While each retiree is required to pay the full amount of the applicable premium, conceptually, the Hospital is subsidizing the retirees because each participant is charged a level premium regardless of age. However, the cost of the subsidy, if any, has not been quantified in these financial statements.

Under the Consolidated Omnibus Budget Reconciliation Act (COBRA), the Hospital makes health care benefits available to eligible former employees and their eligible dependents. Certain requirements are outlined by the federal government for this coverage. The premium is paid entirely by the insured and there is no cost to the Hospital under this plan.

10. FAIR VALUE OF FINANCIAL INSTRUMENTS

FASB ASC 820-10 establishes a single authoritative definition of fair value, sets a framework for measuring fair value and requires additional disclosures about fair value measurements. Financial instruments that are measured and reported at fair value are classified and disclosed in one of the following categories based on inputs:

- Level 1 – Quoted market prices are available in active markets for identical instruments as of the reporting date.
- Level 2 – Pricing inputs are observable for the instruments, either directly or indirectly, as of the reporting date, but are other than quoted prices in active markets as in Level 1.
- Level 3 – Pricing inputs are unobservable for the instrument and include situations where there is little, if any, market activity for the instrument.

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

Cash and assets whose use is limited – The carrying amounts reported in the balance sheet approximates fair value.

Accounts and other receivables – The carrying amounts reported in the balance sheet for accounts and other receivables approximates fair value because of the short-term nature of those instruments.

Estimated third-party payor settlements – The carrying amounts reported in the balance sheet for estimated third-party payor settlements approximates fair value because of the short-term nature of those instruments.

10. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Accounts and other payables – The carrying amounts reported in the balance sheet for accounts and other payables approximates its fair value.

Capitalized lease obligations – The fair value of the is estimated using discounted cash flow analyses, based on the Hospital's current incremental borrowing rates for similar types of borrowing arrangements.

The carrying amounts and fair value of the Hospital's financial instruments at June 30, 2011 and 2010 are as follows:

	June 30, 2011		June 30, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash	$ 25,152	$ 25,152	$ 69,168	$ 69,168
Assets whose use is limited	686,515	686,515	759,942	759,942
Accounts and other receivables	1,680,839	1,680,839	1,686,390	1,686,390
Estimated third-party payor settlements	216,108	216,108	555,395	555,395
Accounts and other payables	556,830	556,830	1,592,905	1,592,905
Capitalized lease obligations	218,124	218,124	113,791	113,791

ADDITIONAL INFORMATION

KEARNY COUNTY HOSPITAL

SCHEDULE OF PATIENT SERVICE REVENUE

	Year ended June 30,					
	2011			2010		
	Inpatient	Outpatient	Total	Inpatient	Outpatient	Total
Routine services:						
Acute	$ 779,748	$ –	$ 779,748	$ 592,849	$ –	$ 592,849
Swing-bed	650,159	–	650,159	586,548	–	586,548
Nursery	214,545	–	214,545	193,405	–	193,405
High Plains	3,095,863	–	3,095,863	3,143,118	–	3,143,118
Operating room	259,614	442,716	702,330	234,395	375,462	609,857
Labor and delivery	373,350	11,760	385,110	351,556	12,180	363,736
Anesthesiology	1,775	318,663	320,438	5,085	264,777	269,862
Radiology	146,215	990,873	1,137,088	81,399	853,194	934,593
Laboratory	498,312	2,374,477	2,872,789	332,912	2,006,312	2,339,224
Respiratory therapy	216,692	40,892	257,584	138,524	38,348	176,872
Physical therapy	140,384	433,584	573,968	74,360	329,647	404,007
Electrocardiology	18,130	48,405	66,535	15,762	53,935	69,697
Medical supplies	431,102	239,683	670,785	333,563	215,067	548,630
Pharmacy	844,883	432,221	1,277,104	635,798	311,017	946,815
Heart monitors and cardiac rehab	17,120	114,113	131,233	37,248	73,213	110,461
Clinic	–	3,461,774	3,461,774	–	3,078,247	3,078,247
Emergency room	18,145	757,637	775,782	19,430	735,250	754,680
Observation care	11,408	253,564	264,972	10,790	278,035	288,825
Home health	–	341,426	341,426	–	390,944	390,944
Gross patient service revenue	$ 7,717,445	$ 10,261,788	17,979,233	$ 6,786,742	$ 9,015,628	15,802,370
Less contractual adjustments			(4,529,883)			(3,203,641)
Less charity care			(141,080)			(148,727)
Less bad debts			(454,229)			(618,083)
Net patient service revenue			$ 12,854,041			$ 11,831,919

KEARNY COUNTY HOSPITAL

SCHEDULE OF OPERATING EXPENSES BY FUNCTIONAL DIVISION

Department	Year ended June 30, 2011 Salaries	Supplies and other	Depreciation	Total	Percent of total operating expenses
Routine service:					
Adult and pediatrics	$ 791,392	$ 85,720	$ 12,699	$ 889,811	5.82 %
Nursery	55,577	6,382	2,204	64,163	0.42
High Plains (intermediate, assistted living and self-care)	1,815,670	241,101	398,808	2,455,579	16.13
	2,662,639	333,203	413,711	3,409,553	22.37
Ancillary services:					
Operating room	201,572	43,252	69,062	313,886	2.06
Labor and delivery	46,327	16,189	8,626	71,142	0.47
Anesthesiology	247,270	250,221	–	497,491	3.27
Radiology	173,903	190,488	103,043	467,434	3.07
Laboratory	262,142	313,918	18,296	594,356	3.90
Respiratory therapy	48,679	16,198	–	64,877	0.43
Physical therapy	130,886	4,784	798	136,468	0.90
Speech therapy	–	5,408	–	5,408	0.04
Electrocardiology	1,272	687	751	2,710	0.02
Medical supplies	125,566	117,926	–	243,492	1.60
Pharmacy	64,014	193,991	16,846	274,851	1.81
Heart monitors and cardiac rehab	26,408	7,252	18,064	51,724	0.34
Clinic	1,895,940	309,753	10,113	2,215,806	14.55
Emergency room	119,202	261,529	5,637	386,368	2.54
Home health	138,895	22,315	875	162,085	1.06
	3,482,076	1,753,911	252,111	5,488,098	36.06
General services:					
Nursing administration	310,791	22,395	4,094	337,280	2.22
Operation of plant	177,732	526,755	2,566	707,053	4.64
Laundry	116,261	50,315	2,186	168,762	1.11
Housekeeping	202,440	38,356	–	240,796	1.58
Dietary	419,825	265,488	8,635	693,948	4.56
Medical records	162,100	56,447	12,568	231,115	1.52
Administration and general	438,870	576,357	20,924	1,036,151	6.81
Employee benefits	–	2,307,470	–	2,307,470	15.16
Depreciation - building	–	–	604,808	604,808	3.97
	1,828,019	3,843,583	655,781	6,327,383	41.57
	$ 7,972,734	$ 5,930,697	$ 1,321,603	$ 15,225,034	100.00 %

Department	Year ended June 30, 2010				
	Salaries	Supplies and other	Depreciation	Total	Percent of total operating expenses
Routine service:					
Adult and pediatrics	$ 804,195	$ 65,422	$ 14,803	$ 884,420	6.06 %
Nursery	46,594	4,659	2,702	53,955	0.37
High Plains (intermediate, assistted living and self-care)	1,844,389	256,939	378,699	2,480,027	17.02
	2,695,178	327,020	396,204	3,418,402	23.45
Ancillary services:					
Operating room	229,049	51,251	69,977	350,277	2.40
Labor and delivery	59,298	12,945	10,312	82,555	0.57
Anesthesiology	244,566	243,529	–	488,095	3.35
Radiology	165,637	169,768	104,443	439,848	3.02
Laboratory	271,272	270,545	18,296	560,113	3.84
Respiratory therapy	45,670	10,174	–	55,844	0.38
Physical therapy	113,440	10,385	867	124,692	0.86
Speech therapy	–	–	–	0	0.00
Electrocardiology	4,039	2,205	1,127	7,371	0.05
Medical supplies	123,867	104,088	242	228,197	1.57
Pharmacy	58,247	153,413	11,231	222,891	1.53
Heart monitors and cardiac rehab	23,357	4,455	22,265	50,077	0.34
Clinic	1,609,470	274,944	10,264	1,894,678	13.00
Emergency room	134,970	281,676	9,105	425,751	2.92
Home health	157,488	20,308	1,289	179,085	1.23
	3,240,370	1,609,686	259,418	5,109,474	35.06
General services:					
Nursing administration	335,531	30,470	4,094	370,095	2.54
Operation of plant	180,322	505,394	1,630	687,346	4.72
Laundry	115,234	49,292	2,669	167,195	1.15
Housekeeping	224,650	43,184	–	267,834	1.84
Dietary	419,771	271,995	10,999	702,765	4.82
Medical records	184,222	64,053	2,088	250,363	1.72
Administration and general	480,736	443,321	21,043	945,100	6.48
Employee benefits	–	2,049,458	–	2,049,458	14.06
Depreciation - building	–	–	605,668	605,668	4.16
	1,940,466	3,457,167	648,191	6,045,824	41.49
	$ 7,876,014	$ 5,393,873	$ 1,303,813	$ 14,573,700	100.00 %