

Stafford County Hospital
A Component Unit of Stafford County, Kansas
Independent Accountants' Report and Financial Statements
December 31, 2011 and 2010



Stafford County Hospital
A Component Unit of Stafford County, Kansas
December 31, 2011 and 2010

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Independent Accountants' Report

Board of Directors
Stafford County Hospital
Stafford, Kansas

We have audited the accompanying balance sheets of Stafford County Hospital, a component unit of Stafford County, 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 Stafford County Hospital as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming the Hospital will continue as a going concern. As discussed in Note 10, the Hospital has suffered recurring losses from operations that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 10. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Management has omitted 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 statements in an appropriate operational, economic or historical context. Our opinion of the basic financial statements is not affected by this missing information.

BKD, LLP

October 11, 2012

Stafford County Hospital
A Component Unit of Stafford County, Kansas
Balance Sheets
December 31, 2011 and 2010

	2011	2010
Assets		
Current Assets		
Cash	\$ 187,832	\$ 148,890
Patient accounts receivable, net of allowance; 2011 - \$166,000, 2010 - \$178,000	309,317	475,357
Property tax receivable	4,315	-
Estimated amounts due from Medicare and Medicaid	210,000	126,000
Supplies	90,357	135,477
Prepaid expenses and other	10,659	29,573
Total current assets	812,480	915,297
Capital Assets, Net	514,274	679,334
Total assets	\$ 1,326,754	\$ 1,594,631
 Liabilities and Net Assets		
Current Liabilities		
Current maturities of long-term debt	\$ 37,511	\$ 59,985
Accounts payable	610,396	186,834
Accrued expenses	193,587	222,144
Total current liabilities	841,494	468,963
Long-term Debt	86,326	107,844
Total liabilities	927,820	576,807
Net Assets		
Invested in capital assets, net of related debt	390,437	511,505
Unrestricted	8,497	506,319
Total net assets	398,934	1,017,824
Total liabilities and net assets	\$ 1,326,754	\$ 1,594,631

Stafford County Hospital
A Component Unit of Stafford County, Kansas
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended December 31, 2011 and 2010

	2011	2010
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2011 - \$119,000, 2010 - \$117,000	\$ 3,609,371	\$ 4,057,107
Other	24,897	40,387
Total operating revenues	3,634,268	4,097,494
Operating Expenses		
Salaries and wages	2,045,497	2,313,661
Employee benefits	776,150	739,531
Purchased services and professional fees	763,843	720,410
Supplies and other	1,023,510	967,752
Depreciation	130,012	130,354
Total operating expenses	4,739,012	4,871,708
Operating Loss	(1,104,744)	(774,214)
Nonoperating Revenues (Expenses)		
Intergovernmental revenue	475,000	419,216
Interest income	421	10,183
Interest expense	(1,785)	(1,256)
Noncapital grants and gifts	12,218	50,361
Total nonoperating revenues (expenses)	485,854	478,504
Deficiency of Revenue Over Expenses Before Capital Grants and Gifts	(618,890)	(295,710)
Capital Grants and Gifts	-	10,000
Decrease in Net Assets	(618,890)	(285,710)
Net Assets, Beginning of Year	1,017,824	1,303,534
Net Assets, End of Year	\$ 398,934	\$ 1,017,824

Stafford County Hospital
A Component Unit of Stafford County, Kansas
Statements of Cash Flows
Years Ended December 31, 2011 and 2010

	2011	2010
Operating Activities		
Receipts from and on behalf of patients	\$ 3,691,411	\$ 2,778,480
Payments to suppliers and contractors	(1,288,550)	(1,623,238)
Payments to and on behalf of employees	(2,850,204)	(3,048,779)
Other receipts, net	36,814	40,387
Net cash used in operating activities	(410,529)	(1,853,150)
Noncapital Financing Activities		
Property taxes supporting operations	470,685	419,216
Noncapital grants and gifts	12,218	50,361
Net cash provided by noncapital financing activities	482,903	469,577
Capital and Related Financing Activities		
Principal paid on capital lease	(63,861)	(53,896)
Interest paid on capital lease	(1,785)	(1,256)
Purchase of capital assets	(11,207)	(39,682)
Proceeds from disposal of capital assets	43,000	-
Net cash used in capital and related financing activities	(33,853)	(94,834)
Investing Activities		
Maturities of short-term certificate of deposit	-	501,291
Interest income received	421	10,183
Net cash provided by investing activities	421	511,474
Increase (Decrease) in Cash	38,942	(966,933)
Cash, Beginning of Year	148,890	1,115,823
Cash, End of Year	\$ 187,832	\$ 148,890

Stafford County Hospital
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Statements of Cash Flows (Continued)
Years Ended December 31, 2011 and 2010

	2011	2010
Reconciliation of Net Operating Revenues (Expenses) to		
Net Cash Used in Operating Activities		
Operating loss	\$ (1,104,744)	\$ (774,214)
Depreciation	130,012	130,354
Loss on disposal of capital assets	11,917	-
Changes in operating assets and liabilities		
Patient accounts receivable, net	166,040	354,373
Estimated amounts due from and to Medicare	(84,000)	(1,633,000)
Accounts payable and accrued expenses	406,212	86,809
Other assets	64,034	(17,472)
	\$ (410,529)	\$ (1,853,150)
 Supplemental Cash Flows Information		
Capital lease obligations incurred for capital assets	\$ 19,869	\$ 65,041
Capital asset acquisitions included in accounts payable	\$ -	\$ 11,207
Capital asset acquired through noncash capital gifts	\$ -	\$ 10,000

Stafford County Hospital
A Component Unit of Stafford County, Kansas
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

Stafford County Hospital (Hospital) is an acute care hospital located in Stafford, Kansas. The Hospital is a component unit of Stafford County, Kansas (County) and the Board of County Commissioners appoints members to the Board of Directors of the Hospital. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Stafford County area. It also operates a home health agency in the same geographic area.

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) that were issued on or before November 30, 1989, and 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.

Intergovernmental Revenue

The Hospital received approximately 12% in 2011 and 9% in 2010 of its financial support from intergovernmental revenue derived from property taxes levied by the County. One hundred percent of these funds were used to support operations.

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Property taxes are assessed by the County in November of one year and are received beginning in January of the following year. Intergovernmental revenue is recognized in full in the year in which use is first permitted.

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, except workers' compensation. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Workers' compensation coverage is provided through a fund managed by the Kansas Hospital Association. The workers' compensation premiums are subject to retrospective adjustment based upon the overall performance of the fund. Management believes adequate reserves are in place within the plan to cover claims incurred but not reported and no additional amounts have been accrued related to claims for this plan.

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.

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 – 15 years
Buildings	5 – 40 years
Fixed equipment	10 – 25 years
Major moveable equipment	5 – 20 years

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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 two 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. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt.

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.

Income Taxes

As an essential government function of the County, 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.

Stafford County Hospital
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Notes to Financial Statements
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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 Critical Access Hospital (CAH) and is paid at one hundred one percent (101%) of allowable costs for certain inpatient and outpatient services. Home health services are paid on a per-episode basis using clinical, diagnostic and other factors. The Hospital is reimbursed for certain 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 Hospital is paid for inpatient and outpatient services rendered to Medicaid program beneficiaries who are not part of a Medicaid managed care network on a cost reimbursement methodology. Medicaid managed care patients are reimbursed under a prospective reimbursement methodology. Medicaid rural health clinic services are reimbursed under a cost-based methodology. The Hospital and rural health clinic services are 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.

Approximately 76% and 80% of net patient service revenues 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.

Note 3: 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.

At December 31, 2011 and 2010, respectively, none of the Hospital's bank balances of \$103,004 and \$235,761 were exposed to custodial credit risk.

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Summary of Carrying Values

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

	<u>2011</u>	<u>2010</u>
Carrying value		
Deposits	\$ 187,332	\$ 148,390
Petty cash	500	500
	<u>\$ 187,832</u>	<u>\$ 148,890</u>
Included in the following balance sheet captions		
Cash	<u>\$ 187,832</u>	<u>\$ 148,890</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 as of December 31, 2011 and 2010, consisted of:

	<u>2011</u>	<u>2010</u>
Medicare	\$ 152,847	\$ 321,742
Medicaid	8,447	9,498
Blue Cross	41,669	31,157
Other third-party payers	74,540	77,887
Patients	197,814	213,073
	<u>475,317</u>	<u>653,357</u>
Less allowance for uncollectible accounts	<u>166,000</u>	<u>178,000</u>
	<u>\$ 309,317</u>	<u>\$ 475,357</u>

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Note 6: Medical Malpractice Coverage and Claims

The Hospital purchases medical malpractice insurance under a claims-made policy with a fixed premium which provides \$200,000 of coverage for each medical incident and \$600,000 of aggregate coverage for each policy year. The policy only covers claims made and reported to the insurer during the policy term, regardless of when the incident giving rise to the claim occurred. The Kansas Health Care Stabilization Fund provides an additional \$300,000 of coverage for each medical incident and \$900,000 of aggregate coverage for each policy year.

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 future.

Note 7: Long-term Debt

The following is a summary of long-term debt transactions for the Hospital for the years ended December 31, 2011 and 2010:

	2011				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Capital lease obligations	\$ 167,829	\$ 19,869	\$ 63,861	\$ 123,837	\$ 37,511
	2010				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Capital lease obligations	\$ 156,684	\$ 65,041	\$ 53,896	\$ 167,829	\$ 59,985

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Capital Lease Obligations

The Hospital is obligated under leases for equipment that are accounted for as capital leases. Assets under capital lease as of December 31, 2011 and 2010, totaled \$151,585 and \$212,232, respectively, net of accumulated depreciation of \$41,625 and \$34,332, respectively. The following is a schedule by year of future minimum lease payments under the capital lease including interest at the rate of 8% together with the present value of the future minimum lease payments as of December 31, 2011:

Year Ending December 31,	
2012	\$ 41,126
2013	40,393
2014	34,014
2015	2,893
2016	2,893
2017 - 2021	14,464
Total minimum lease payments	<u>135,783</u>
Less amount representing interest	<u>11,946</u>
Present value of future minimum lease payments	<u><u>\$ 123,837</u></u>

Note 8: Operating Leases

A noncancellable operating lease for medical equipment expires in 2013. Future minimum lease payments at December 31, 2011, were:

2012	\$ 41,400
2013	<u>27,600</u>
Future minimum lease payments	<u><u>\$ 69,000</u></u>

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Note 9: Pension Plan

Plan Description

The Hospital contributes to the Kansas Public Employees Retirement System (KPERS), a cost-sharing multiple-employer defined benefit pension plan administered by the KPERS Board of Trustees. Pension expense is recorded for the amount the Hospital is contractually required to contribute for the year. The plan provides retirement and disability benefits, including annual cost-of-living adjustments and death benefits to plan members and their beneficiaries. The Kansas Legislature, with concurrence of the Governor, has the authority to establish and amend benefit provisions. The plan issues a publicly available financial report that includes financial statements and required supplementary information for the plan. The report may be obtained by writing to the plan at 611 South Kansas Avenue, Suite 100, Topeka, Kansas, 66603-3803, or by calling 1.888.275.5737.

Funding Policy

The authority to establish and amend requirements of plan members and the Hospital is set forth by the Kansas Legislature with concurrence of the Governor. Plan members are required to contribute 4% of their annual covered salary. The Hospital is required to contribute at an actuarially determined rate; the rate was 6.74% and 6.14% of annual covered payroll for 2011 and 2010, respectively. The Hospital's contribution to the plan for 2011 and 2010, was \$137,490 and \$138,848, respectively, which equaled the required contribution. State law limits the Hospital's future contribution rate increases to a maximum of 0.6%.

Note 10: Management's Consideration of Going Concern Matters

The Hospital has incurred losses from operations for the past three years. The financial statements have been prepared assuming the Hospital will continue as a going concern, realizing assets and liquidating liabilities in the ordinary course of business. Management is considering several alternatives for mitigating these conditions during the next year. These include evaluation of staffing patterns in the Hospital, pursuit of additional tax support, adjustments of charge rates for services to meet market conditions and other forms of financing. Although not currently planned, realization of assets in other than the ordinary course of business in order to meet liquidity needs could incur losses not reflected in these financial statements.

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Note 11: Risks and Uncertainties

Current Economic Conditions

The current protracted economic 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 government may have an adverse effect on cash flows related to the Medicare and Medicaid programs.

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 allowances for accounts receivable that could negatively impact the Hospital's ability to maintain sufficient liquidity.

Note 12: Subsequent Events

On June 1, 2012, the County authorized the issuance of \$555,000 of No-Fund Warrants from the County to the Hospital to provide additional cash to support Hospital operations and pay outstanding accounts payable. The Hospital received the funds on June 4, 2012. The warrants are general obligations of the County and do not constitute debt obligations of the Hospital.