

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Auditor's Report and Financial Statements
December 31, 2014 and 2013

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A Component Unit of the City of Lawrence, Kansas
December 31, 2014 and 2013

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Independent Auditor's Report

Board of Trustees
The Lawrence Memorial Hospital
Lawrence, Kansas

We have audited the accompanying financial statements of The Lawrence Memorial Hospital (Hospital) and its discretely presented component unit (The Lawrence Memorial Hospital Endowment Association), collectively a component unit of the City of Lawrence, Kansas, as of and for the years ended December 31, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of The Lawrence Memorial Hospital Endowment Association, which represent 100% of the assets, net assets and revenues of the discretely presented component unit. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for The Lawrence Memorial Hospital Endowment Association, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the *Kansas Municipal Audit and Accounting Guide*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinions

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The Lawrence Memorial Hospital and of its discretely presented component unit as of December 31, 2014 and 2013, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

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

BKD, LLP

Kansas City, Missouri
April 6, 2015

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Management's Discussion and Analysis
Years Ended December 31, 2014 and 2013

Introduction

This management's discussion and analysis of the financial performance of The Lawrence Memorial Hospital (the "Hospital") provides an overview of the Hospital's financial activities for the years ended December 31, 2014 and 2013. It should be read in conjunction with the accompanying financial statements of the Hospital. Unless otherwise indicated, the information and financial data relates solely to the Hospital and does not include its discretely presented component unit, The Lawrence Memorial Hospital Endowment Association. Dollar amounts are in thousands.

Financial Highlights

- Due partially to its financial strength and performance, the Hospital was honored as one of Truven Health Analytics 100 Top hospitals nationally in both 2014 and 2013.
- Cash and investments totaled \$130,637 as of December 31, 2014, an increase of 13.5% over 2013 balances of \$115,096, which was a 2.5% decrease from 2012 balances of \$118,026. The decrease from 2012 to 2013 was attributable to the retirement of long-term debt and a reduction in current liabilities.
- The Hospital's net position increased in each of the past two years with an \$11,918 or 6.6% increase in 2014 and \$8,565 or 4.9% increase in 2013.
- The Hospital reported operating income in 2014 of \$12,199 and in 2013 of \$9,085. The operating income in 2014 increased by \$3,114 or 34.3% when compared to the operating income in 2013. The operating income for 2013 decreased by \$2,518 or 21.7% when compared to the operating income reported in 2012.
- Investment income in 2014 was \$1,483, an increase of \$42 or 2.9% over earnings of \$1,441 in 2013, which represented a decrease of \$2,164 or 60.0% when compared to 2012.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net position; and a statement of cash flows. These statements, along with the accompanying notes provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB).

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Position

The Balance Sheet and the Statement of Revenues, Expenses and Changes in Net Position report information about the Hospital's resources and its activities in a way that helps the user determine its overall financial condition. These statements include all restricted and unrestricted assets, all liabilities and all deferred outflows of resources using the accrual basis of accounting. Under 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.

These two statements report the Hospital's net position and changes during the period. The Hospital's total net position—the difference between assets, liabilities and deferred outflows of resources—is one measure of the Hospital's financial health or financial position. Over time, increases in the Hospital's net position are one indicator that its financial health is improving. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in medical staff, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. This statement provides the user an understanding of the various sources and uses of cash for the Hospital.

Net Position

The Hospital's net position is the difference between its assets, liabilities and deferred outflows of resources reported in the Balance Sheet. The Hospital's net position has shown consistent increases over time as illustrated in Table 1 below. The increases were attributable to positive financial operating results for the respective years.

Table 1: Assets, Deferred Outflows of Resources, Liabilities and Net Position

	2014	2013	2012
Assets			
Patient accounts receivable, net	\$ 27,471	\$ 25,093	\$ 24,218
Other current assets	36,475	30,379	24,340
Noncurrent cash and investments	106,496	97,282	102,024
Capital assets, net	104,464	110,379	110,091
Other noncurrent assets	791	776	675
Total assets	<u>275,697</u>	<u>263,909</u>	<u>261,348</u>
Deferred Outflows of Resources -			
Deferred amount on refunding	541	619	854
Total assets and deferred outflows of resources	<u>\$ 276,238</u>	<u>\$ 264,528</u>	<u>\$ 262,202</u>
Liabilities			
Long-term debt	\$ 59,491	\$ 62,136	\$ 66,330
Other current and noncurrent liabilities	22,923	20,486	22,531
Total liabilities	<u>82,414</u>	<u>82,622</u>	<u>88,861</u>
Net Position			
Net investment in capital assets	45,608	48,982	45,203
Restricted expendable	1,490	2,152	1,344
Unrestricted	146,726	130,772	126,794
Total net position	<u>193,824</u>	<u>181,906</u>	<u>173,341</u>
Total liabilities and net position	<u>\$ 276,238</u>	<u>\$ 264,528</u>	<u>\$ 262,202</u>

Net patient accounts receivable increased by \$2,378 (9.5%) at December 31, 2014 compared to December 31, 2013 and increased by \$875 (3.6%) at December 31, 2013 versus December 31, 2012. Net patient service revenues increased by \$9,615 (5.5%) in 2014 compared to 2013 and in 2013 by 5,889 (3.5%) when compared to 2012. Days' revenue in hospital accounts receivable was 49.8 at December 31, 2014 compared to 47.7 at December 31, 2013 and 49.8 at December 31, 2012, reflecting consistent collection activity.

Net investment in capital assets was lower in 2014 than in recent years. Capital additions were \$4,555 in 2014, \$11,115 in 2013 and \$11,283 in 2012. These amounts are offset by increases in accumulated depreciation and the retirement of assets.

Long-term debt decreased \$2,645 or 4.3% in 2014, solely do to the scheduled debt principal payments. In 2013, long-term debt decreased \$4,194 (6.3%), the net result of retiring \$9,390 of Series 2003 revenue bonds and issuing \$6,685 of Series 2013 bonds to finance capital equipment purchases.

Excess of Revenues Over Expenses and Changes in the Hospital's Net Position

The Hospital's Excess of Revenues over Expenses for 2014 was \$11,647 for a net margin of 6.2%. This increase from prior year's performance is a result of several factors that are discussed below. The Excess of Revenues over Expenses is the principle factor in the increase in net position of \$11,918, as shown in Table 2. The Hospital's increase in net position from 2012 to 2013 was \$8,565.

Table 2: Operating Results and Changes in Net Position

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Operating Revenues			
Net patient service revenue	\$ 185,862	\$ 176,247	\$ 170,358
Other operating revenues	2,426	3,232	4,712
Total operating revenues	<u>188,288</u>	<u>179,479</u>	<u>175,070</u>
Operating Expenses			
Salaries and wages and employee benefits	90,359	89,242	85,141
Purchased services and professional fees	26,789	23,507	22,728
Depreciation and amortization	10,435	10,786	10,749
Other operating expenses	48,506	46,859	44,849
Total operating expenses	<u>176,089</u>	<u>170,394</u>	<u>163,467</u>
Operating Income	<u>12,199</u>	<u>9,085</u>	<u>11,603</u>
Nonoperating Revenues (Expenses)			
Investment income	1,483	1,441	3,605
Contributions and other	99	98	89
Interest expense	(2,744)	(3,196)	(3,542)
Equity in net gains of affiliate	610	668	546
Total nonoperating revenues (expenses)	<u>(552)</u>	<u>(989)</u>	<u>698</u>
Excess of Revenues over Expenses	11,647	8,096	12,301
Contributions Restricted for Acquisition of Capital Assets	<u>271</u>	<u>469</u>	<u>823</u>
Increase in Net Position	<u>\$ 11,918</u>	<u>\$ 8,565</u>	<u>\$ 13,124</u>

Operating Income

The first component of the overall change in the Hospital's net position is its operating income or loss—generally, the difference between operating revenues and the expenses incurred to perform those services.

For 2014, operating income was \$12,199 compared to \$9,085 in 2013, an increase of \$3,114 or 34.3% over the prior year. Net patient service revenue of \$185,862 increased by \$9,615 (5.5%) when compared to net patient service revenue produced in 2013.

Hospital inpatient revenues increased by approximately 8.6% in 2014 when compared to inpatient revenues generated in 2013. Adult and pediatric discharges increased by 2.6% in 2014 when compared to the previous year and patient days for 2014 increased by 1.0% compared to 2013. Laboratory and pharmacy services are utilized by nearly all hospitalized patients so these revenues increased due to the higher inpatient days. CT Scan and MRI inpatient diagnostic procedures were utilized more in 2014 and contributed to increased revenues for these services.

Revenues for hospital outpatient services increased by 12.9% in 2014 when compared to 2013. Pharmacy services contributed significantly to the revenue growth due to increased use of chemotherapy agents, consistent with the overall increase in oncology services provided during the year. CT Scan and other imaging related services continued to grow in 2014 with the increased number of providers on the medical staff ordering outpatient procedures. With newer and faster CT Scan technology in place, volumes have increased because more scans may be performed on a daily basis, resulting in safer, more timely patient care.

Overall physician practice revenue increased by 18.0% in 2014 when compared to the total physician practice revenue produced in 2013. The internal medicine group practice experienced a 34.4% revenue increase due to increased infusion therapy services provided at the clinic. The new Total Family Care practice was operational for a full twelve months in 2014 and experienced significant growth. The specialty physician practices for Obstetrics and Gynecology (OB/Gyn), Neurology and Cardiology all continued to grow in 2014 as a result of the successful physician recruitment activities in recent years. The certified nurse midwifery program in the OB/Gyn clinic allowed for increased patient volumes and revenue for the group with the addition of new providers early in the year.

Although Hospital patient revenues increased by approximately 12.3% in 2014, net patient revenues increased only 5.5% when compared to the prior year. The Hospital implemented a targeted rate increase in late 2013 and an overall 5.0% rate increase on January 1, 2014. The result meant gross rates for 2014 increased by approximately 10.0%, but governmental and managed care payers do not typically increase payments accordingly so contractual adjustments negate much of the impact of a rate increase resulting in the lower increase in net revenue.

Total operating expenses increased by \$5,695 or 3.3% when compared to expenses in 2013. Salaries, wages and employee benefits increased by 1.3% in 2014. Salaries and wages increased by 3.1% primarily due to annual wage increases for all hospital employees. This increase was offset by a 6.4% reduction in Employee Benefits expenses due to significantly lower health insurance claims experience in the Hospital's self-funded employee health plan for 2014. Purchased services and professional fees expenses increased by 14.0% in 2014 when compared to the prior year. In 2014, the Hospital transitioned dining services to an outside service which provided opportunities to improve the Hospital dining experience to include healthier meal options using fresh and locally grown or raised ingredients for both cafeteria and patient meals. The in-room patient meal service was enhanced to allow for personalized meal time options and foods prepared to meet individuals' tastes. In light of recent growth in the number of employed providers and the need to update patient billing software for the physician clinics, the Hospital engaged an outside party to assume physician practice billing activities resulting in increased purchased services expense. Supplies expense for 2014 increased by 5.4% due primarily to the increased cost and quantity of pharmacy and oncology drugs used for patients during the year.

The 2013 operating income was \$9,085 compared to \$11,603 in 2012. Net Patient Service Revenue of \$176,247 increased by \$5,889 or 3.5% when compared to 2012.

Hospital gross inpatient revenues increased by approximately 10.4% in 2013 when compared to the previous year. Contrary to the negative national trend, the Hospital experienced a 0.4% increase in adult and pediatric discharges over 2012. This was accompanied by a 1.9% increase in patient days over the same period. Respiratory therapy and laboratory services increased in 2013 with the growth of the pulmonary program and having specialist physicians on staff to care for patients requiring more intensive services than the Hospital had been able to provide in previous years. Inpatient CT Scan revenue increased late in the year with the addition of new technology to allow more enhanced cardiology exams and other new diagnostic services. Inpatient surgery cases increased in 2013 by 4.5% due in part to successful physician recruitment in bringing a new surgeon to the community.

In 2013, outpatient revenues grew by 7.5% and emergency room revenue by 10.0%. Outpatient surgery cases for 2013 increased by 322 cases or 10.8% over the previous year. Pharmacy and CT Scan services contributed to the increase in revenues over the prior year due to providing pharmaceutical drugs for IV infusion therapy and enhanced CT Scan services available with the new technology implemented during the year.

Physician practice revenue grew by 14.8% over the prior year. The Lawrence OB/Gyn Specialist's practice recruited new physicians to the group and established a nurse midwifery program to help address the growing need in the community for these services. The Lawrence Pulmonary Specialists physician practice experienced significant growth as a result of a full year of operations with the two new pulmonologists who joined the practice in 2012. Endoscopy outpatient revenue and physician practice revenue grew in 2013 due to increased patient volumes for the Lawrence GI Consultants physician group.

Although the Hospital experienced an overall increase of approximately 9.3% in gross patient revenues, net patient revenues increased only 3.5% after deducting contractual adjustments for payments from governmental and insurance payers and deductions for bad debt and self-pay account adjustments. This disparity is a result of the fact that the majority of the Hospital's contracted payment arrangements with governmental and commercial payers are at fixed rates. As a result, the annual charge increase of 5% resulted in a 5% increase in gross revenue, but the vast majority of that increase was absorbed in contractual allowances rather than an increase in net revenue. Also contributing to this was a shift in payer mix from managed care and commercial payers to Medicare and self-pay.

Other operating revenue decreased \$1,480 or 31.4% in 2013 when compared to 2012 as a result of the expected decrease in HITECH funds for meaningful use of electronic health records (Meaningful Use) in 2013. The methodology for paying funds to providers was designed to provide higher payments in the initial years of the program and decreased payments for subsequent years. The Hospital recorded revenue of \$1,287 for Meaningful Use in 2013 compared to \$2,576 in 2012.

Total operating expenses increased by \$6,927 (4.2%) in 2013 compared to the previous year. Salaries, wages and employee benefits increased 4.8% due to the recruitment of new employed physicians and related employment of support staff for the physician practices. Other factors contributing to the increase were salary increases given to Hospital employees at the beginning of the year and an increase in costs associated with the employee health insurance plan. Purchased services and professional fees increased by \$777 or 3.4% compared to 2012. The Hospital incurred consulting expenses and other technical service expenses to prepare for government mandated changes to billing under ICD-10 and to meet the requirements for Stage II of Meaningful Use. Other operating expenses increased by 4.5% due to increased supply costs for pharmacy drugs, surgical implants and other medical supplies.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment earnings on its fixed income and equity portfolios, income from the Hospital's investment in the Lawrence Surgery Center, LLC and interest expense on bond financing. Investment income in 2014 increased by \$42 or 2.9% over 2013 as compared to the decrease of \$2,164 or 60.0% in 2013 over earnings in 2012 due to the increase in cash balances available for investment. Interest expense decreased by 14.1% in 2014 compared to 2013 due to the prior year retirement of the outstanding balance on the Series 2003 Bonds. Equity in the net gains from the Hospital's investment in Lawrence Surgery Center, LLC decreased by \$58 or 8.7% in 2014, compared to the increase of \$122 or 22.3% in 2013.

Capital Grants and Gifts

The Hospital received contributions restricted for capital assets of \$271 from The Lawrence Memorial Hospital Endowment Association during 2014 compared to \$469 in 2013 and \$823 in 2012. The funds were used to fund capital equipment purchases for clinical and support departments throughout the Hospital. These contributions were expended and are reflected in unrestricted net position as of December 31, 2014 and 2013.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating income and nonoperating revenues and expenses for 2014 and 2013, discussed earlier.

Capital Assets

At the end of 2014, the Hospital had \$104,464 invested in capital assets, net of accumulated depreciation as detailed in *Note 6* to the financial statements, a decrease of \$5,915 (5.4%) compared to the balance at the end of 2013. The decrease represents the net result of asset additions of \$4,555 offset by a decrease of \$2,513 from the disposal of old, fully depreciated furnishings and equipment and a decrease of \$7,957 for the change in accumulated depreciation recorded for the year. Some of the major fixed asset purchases were for improvements to the heating and air conditioning systems for the Hospital; new ultrasound technology; vital signs monitors; computer software, servers and device replacements; furniture and fixtures for renovations of the Family Medicine of Baldwin City clinic and the Hospital's education department meeting rooms.

At the end of 2013, the Hospital had \$110,379 invested in capital assets, net of accumulated depreciation as detailed in *Note 6* to the financial statements, an increase of \$288 (0.3%) over the 2012 year-end balance. In 2013, the Hospital incurred construction costs to finish space on the third floor of the Fourth Street Medical Office Building to house Total Family Care, a new primary care physician practice. The Hospital acquired new clinical treatment and diagnostic technology with the purchase of a DaVinci surgical robot, state-of-the-art CT Scan equipment and an ophthalmic laser. Patient Accounting, Accounting and Administrative offices were relocated to renovated space on the first floor of the main hospital to be more centrally located and accessible to patients and hospital staff. The Hospital continued to invest in clinical information technology to improve quality and patient safety and to meet new data requirements mandated by government agencies.

Debt

At December 31, 2014, the Hospital had \$61,430 in revenue bonds outstanding compared to \$63,960 in 2013 and \$67,835 in 2012.

In June 2013, the Hospital retired \$9,390 of Series 2003 revenue bonds and in July 2013, issued \$6,685 of Series 2013 bonds at a much lower rate of interest to finance capital equipment purchases and minor renovations during the year. In June 2012, the Hospital issued 2012 series revenue bonds totaling \$10,500 to refinance the 2011 series bonds which were originally issued to finance construction projects and capital equipment purchases. In July 2006, the Hospital issued the 2006 series revenue bonds totaling \$51,845 to refinance \$15,043 of outstanding 1999 and 1997 series bonds and to fund the facility expansion project that began in 2006.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional information should be directed to the Chief Financial Officer by telephoning 785.505.6133.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Balance Sheets
December 31, 2014 and 2013

Assets and Deferred Outflows of Resources

	<u>2014</u>	<u>2013</u>
Current Assets		
Cash and cash equivalents	\$ 20,202,399	\$ 13,907,160
Current portion of assets held by trustee	3,939,170	3,906,773
Patient accounts receivable, net of allowance for doubtful accounts; 2014 – \$12,595,210, 2013 – \$10,602,821	27,471,446	25,092,671
Due from third-party payers	2,589,620	1,546,321
Accounts receivable – other	406,155	2,163,611
Supplies	3,592,172	3,114,936
Prepaid expenses and other	<u>5,745,104</u>	<u>5,740,239</u>
 Total current assets	 <u>63,946,066</u>	 <u>55,471,711</u>
Noncurrent Cash and Investments		
Held by trustee for debt service	6,601,298	7,295,752
Internally designated for capital improvements	4,292,038	4,292,038
Other long-term investments	<u>99,541,762</u>	<u>89,601,331</u>
	110,435,098	101,189,121
Less amount required to meet current obligations	<u>3,939,170</u>	<u>3,906,773</u>
	<u>106,495,928</u>	<u>97,282,348</u>
 Capital Assets, net of accumulated depreciation	 <u>104,464,050</u>	 <u>110,379,406</u>
 Other Assets	 <u>791,277</u>	 <u>776,094</u>
 Total assets	 <u>275,697,321</u>	 <u>263,909,559</u>
Deferred Outflows of Resources		
Deferred amount on refunding	<u>540,591</u>	<u>619,137</u>
 Total assets and deferred outflows of resources	 <u>\$ 276,237,912</u>	 <u>\$ 264,528,696</u>

Liabilities and Net Position

	<u>2014</u>	<u>2013</u>
Current Liabilities		
Current maturities of long-term debt	\$ 2,595,000	\$ 2,530,000
Accounts payable	7,278,739	6,845,311
Accrued expenses	9,367,177	8,648,165
Accrued interest payable	1,344,170	1,376,733
Retirement plan obligation	381,381	370,278
Due to third-party payers	1,040,835	-
	<hr/>	<hr/>
Total current liabilities	22,007,302	19,770,487
Other Long-term Liabilities	915,548	715,960
Long-term Debt	<hr/>	<hr/>
	59,490,654	62,135,961
	<hr/>	<hr/>
Total liabilities	82,413,504	82,622,408
Net Position		
Net investment in capital assets	45,608,402	48,982,368
Restricted – expendable for		
Debt service	1,489,997	1,462,951
Capital acquisitions	-	688,937
Unrestricted	146,726,009	130,772,032
	<hr/>	<hr/>
Total net position	193,824,408	181,906,288
	<hr/>	<hr/>
Total liabilities and net position	<u>\$ 276,237,912</u>	<u>\$ 264,528,696</u>

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2014 – \$12,670,300, 2013 – \$14,003,700	\$ 185,861,857	\$ 176,247,263
Other	<u>2,425,851</u>	<u>3,231,576</u>
Total operating revenues	<u>188,287,708</u>	<u>179,478,839</u>
Operating Expenses		
Salaries and wages	74,332,180	72,126,637
Employee benefits	16,026,653	17,115,552
Professional fees	15,620,983	14,840,775
Purchased services	11,167,578	8,666,247
Supplies	31,859,024	30,236,335
Utilities	2,786,906	2,670,980
Miscellaneous expenses	1,213,561	1,162,592
Licenses, taxes and Kansas provider assessment	949,951	973,218
Repairs and maintenance	8,515,650	8,465,801
Depreciation and amortization	10,434,505	10,786,238
Loss on sale or disposal of property and equipment	14,809	11,720
Insurance	656,523	672,998
Other capital costs	<u>2,510,480</u>	<u>2,665,089</u>
Total operating expenses	<u>176,088,803</u>	<u>170,394,182</u>
Operating Income	<u>12,198,905</u>	<u>9,084,657</u>
Nonoperating Revenues (Expenses)		
Investment income	1,482,538	1,441,086
Contributions and other	99,366	98,349
Interest expense	(2,744,021)	(3,195,830)
Gain on investment in equity investee	<u>610,183</u>	<u>667,917</u>
Total nonoperating revenues (expenses), net	<u>(551,934)</u>	<u>(988,478)</u>
Revenues Over Expenses	11,646,971	8,096,179
Contributions Restricted for Acquisition of Capital Assets	<u>271,149</u>	<u>468,997</u>
Increase in Net Position	11,918,120	8,565,176
Net Position, Beginning of Year	<u>181,906,288</u>	<u>173,341,112</u>
Net Position, End of Year	<u>\$ 193,824,408</u>	<u>\$ 181,906,288</u>

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Statements of Cash Flows
Years Ended December 31, 2014 and 2013

	2014	2013
Operating Activities		
Receipts from and on behalf of patients	\$ 183,480,618	\$ 171,921,717
Payments to suppliers and contractors	(75,368,246)	(70,129,088)
Payments to employees	(89,429,130)	(88,281,232)
Other receipts, net	4,183,307	2,089,087
Net cash provided by operating activities	22,866,549	15,600,484
Noncapital Financing Activities		
Noncapital gifts	99,366	98,349
Net cash provided by noncapital financing activities	99,366	98,349
Capital and Related Financing Activities		
Proceeds from issuance of long-term debt	-	6,685,000
Payment of financing costs	(50,307)	(94,640)
Principal paid on long-term debt	(2,530,000)	(10,560,000)
Interest paid on long-term debt	(2,698,038)	(3,208,956)
Purchase of capital assets	(4,516,239)	(13,955,060)
Capital gifts	271,149	468,997
Proceeds from sale of capital assets	21,198	28,342
Net cash used in capital and related financing activities	(9,502,237)	(20,636,317)
Investing Activities		
Interest and dividends on investments	2,065,861	2,259,475
(Purchases) proceeds of investments, net	(10,478,147)	4,368,818
Distributions from affiliates	595,000	567,031
Net cash provided by (used in) investing activities	(7,817,286)	7,195,324
Increase in Cash and Cash Equivalents	5,646,392	2,257,840
Cash and Cash Equivalents, Beginning of Year	17,336,709	15,078,869
Cash and Cash Equivalents, End of Year	\$ 22,983,101	\$ 17,336,709
Reconciliation of Cash and Cash Equivalents to the Balance Sheets		
Cash and cash equivalents in current assets	\$ 20,202,399	\$ 13,907,160
Cash and cash equivalents in noncurrent cash and investments	2,780,702	3,429,549
	\$ 22,983,101	\$ 17,336,709

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Statements of Cash Flows (Continued)
Years Ended December 31, 2014 and 2013

	2014	2013
Reconciliation of Net Operating Revenues to Net Cash Provided by Operating Activities		
Operating income	\$ 12,198,905	\$ 9,084,657
Depreciation and amortization	10,434,505	10,786,238
Loss on sale or disposal of property and equipment	14,809	11,720
Changes in operating assets and liabilities		
Patient accounts receivable, net	(2,378,775)	(874,294)
Other accounts receivable	1,757,456	(1,102,009)
Estimated amounts due from and to third-party payers	(2,464)	(3,451,252)
Accounts payable and accrued expenses	1,324,214	2,724,128
Supplies	(477,236)	(176,596)
Prepaid expenses	(4,865)	(1,402,108)
	\$ 22,866,549	\$ 15,600,484
 Supplemental Cash Flows Information		
Capital asset acquisitions included in accounts payable	\$ 537,125	\$ 498,208
Decrease in fair value of investments	(471,847)	(806,775)

The Lawrence Memorial Hospital Endowment Association
A Component Unit of The Lawrence Memorial Hospital
Statements of Financial Position
December 31, 2014 and 2013

Assets

	2014	2013
Current Assets		
Cash and cash equivalents	\$ 888,412	\$ 448,669
Pledges receivable – current portion	547,318	125,845
Total current assets	1,435,730	574,514
Noncurrent Assets		
Pledges receivable, net of current portion	260,953	253,162
Investments	9,037,337	7,948,209
Total assets	\$ 10,734,020	\$ 8,775,885

Liabilities and Net Assets

Current Liabilities		
Liability to beneficiaries of split-interest agreements	\$ 10,283	\$ 10,690
Auxiliary fund payable	-	6,730
Total current liabilities	10,283	17,420
Net Assets		
Unrestricted	5,131,277	4,963,089
Temporarily restricted	4,436,334	2,791,209
Permanently restricted	1,156,126	1,004,167
Total net assets	10,723,737	8,758,465
Total liabilities and net assets	\$ 10,734,020	\$ 8,775,885

The Lawrence Memorial Hospital Endowment Association
A Component Unit of The Lawrence Memorial Hospital
Statement of Activities
Year Ended December 31, 2014

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Support and Gains				
Contributions	\$ 257,134	\$ 1,360,166	\$ 151,959	\$ 1,769,259
In-kind contributions	432,804	65,580		498,384
Special events	214,119	663,789		877,908
Interest and dividend income	101,465	98,136		199,601
Net realized and unrealized gains	81,578	78,901		160,479
Amounts released from restrictions	621,447	(621,447)		-
	<u>1,708,547</u>	<u>1,645,125</u>	<u>151,959</u>	<u>3,505,631</u>
Expenses				
Support to Hospital departments	856,388			856,388
Employee support	31,681			31,681
Stepping Out Against Breast Cancer	52,182			52,182
Watkins trust	99,366			99,366
Office expense	31,162			31,162
Special events	69,728			69,728
Salaries and employee benefits	279,715			279,715
Operating expenses	101,180			101,180
Rent	18,957			18,957
	<u>1,540,359</u>			<u>1,540,359</u>
Increase in Net Assets	168,188	1,645,125	151,959	1,965,272
Net Assets, Beginning of Year	<u>4,963,089</u>	<u>2,791,209</u>	<u>1,004,167</u>	<u>8,758,465</u>
Net Assets, End of Year	<u>\$ 5,131,277</u>	<u>\$ 4,436,334</u>	<u>\$ 1,156,126</u>	<u>\$10,723,737</u>

The Lawrence Memorial Hospital Endowment Association
A Component Unit of The Lawrence Memorial Hospital
Statement of Activities
Year Ended December 31, 2013

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Support and Gains				
Contributions	\$ 248,901	\$ 917,599	\$ 72,464	\$ 1,238,964
In-kind contributions	372,727	34,643		407,370
Special events	174,009	97,743		271,752
Capital campaign		6,337		6,337
Interest and dividend income	108,183	70,324		178,507
Net realized and unrealized gains	495,076	321,823		816,899
Amounts released from restrictions	717,140	(717,140)		-
	<u>2,116,036</u>	<u>731,329</u>	<u>72,464</u>	<u>2,919,829</u>
Expenses				
Support to Hospital departments	707,088			707,088
Employee support	28,395			28,395
Stepping Out Against Breast Cancer	139,608			139,608
Watkins trust	98,349			98,349
Capital campaign	105,931			105,931
Office expense	17,716			17,716
Special events	44,999			44,999
Salaries and employee benefits	231,941			231,941
Operating expenses	97,526			97,526
Rent	18,957			18,957
	<u>1,490,510</u>			<u>1,490,510</u>
Increase in Net Assets	625,526	731,329	72,464	1,429,319
Net Assets, Beginning of Year	<u>4,337,563</u>	<u>2,059,880</u>	<u>931,703</u>	<u>7,329,146</u>
Net Assets, End of Year	<u>\$ 4,963,089</u>	<u>\$ 2,791,209</u>	<u>\$ 1,004,167</u>	<u>\$ 8,758,465</u>

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

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

Nature of Operations and Reporting Entity

The Lawrence Memorial Hospital (the Hospital), is a component unit of the City of Lawrence, Kansas (the City), which operates a hospital, clinics and other health care facilities for the residents of Lawrence, Kansas and surrounding communities. The Hospital is governed by a Board of Trustees composed of nine members who are appointed by the City Commission and the Mayor.

In accordance with Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations are Component Units*, The Lawrence Memorial Hospital Endowment Association (the Endowment Association) is presented as a discretely presented component unit of the Hospital. See *Note 14* for additional information about the Endowment Association.

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, liabilities and deferred inflows and outflows of resources from exchange and exchange-like transactions are recognized when the exchange transaction takes place. Operating revenues and expenses include exchange transactions. Investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position 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).

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 maturities at the date of purchase of three months or less, to be cash equivalents. Cash equivalents consist primarily of repurchase agreements and money market mutual funds.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

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; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters, other than employee health care claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The Hospital purchases medical malpractice insurance under a claims-made policy. Under such policy, only claims made and reported to the insurer are covered during the policy term, regardless of when the incident giving rise to the claim occurred. Under Kansas law, the Kansas Insurance Department provides excess liability insurance through the Kansas Healthcare Stabilization Fund.

Investments and Investment Income

Investment in all debt obligations and equity securities with readily determinable fair values are carried at fair value. Fair value is determined using quoted market prices. Investments in nonnegotiable certificates of deposit are carried at amortized cost.

Investment income includes dividends and interest and the net change in the fair value of investments carried at fair value.

Noncurrent Cash and Investments

Noncurrent cash and investments include (1) assets held by trustees under bond indenture agreements, (2) internally designated unrestricted assets set aside by the Board of Trustees for future capital improvements over which the Board retains control and may, at its discretion, subsequently use for other purposes, and (3) undesignated and unrestricted investments. Amounts required to meet current liabilities of the Hospital are included in current assets. Such funds are primarily invested in U.S. Government obligations, corporate bonds, guaranteed investment contracts and money market mutual funds.

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

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

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

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 following guidelines of the American Hospital Association. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. Amortization of assets subject to capital leases is reported as part of depreciation expense. The following estimated useful lives are being used by the Hospital:

Land improvements	15 – 20 years
Buildings and leasehold improvements	20 – 40 years
Equipment	3 – 7 years

Compensated Absences

Hospital policies permit most employees to accumulate paid time off (PTO) 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 PTO 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 realized when earned to the extent the employee is expected to realize the benefit in cash, determined using the termination payment method. Short-term 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 Position

Net position of the Hospital is classified in three components. Net investment in capital assets consists 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 position is noncapital assets that must be used for a particular purpose as specified by creditors, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net position is remaining assets less remaining liabilities that do not meet the definition of net investment in capital assets or restricted expendable.

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 include 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.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

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. 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 approximately \$14,490,000 and \$12,815,000 in 2014 and 2013, respectively.

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.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payments under both programs are contingent on the Hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Hospital recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In 2014, the Hospital completed the requirements under the Medicare program and in 2013 under both the Medicare and Medicaid programs. The Hospital has recorded revenue of approximately \$323,000 and \$1,287,000 in 2014 and 2013, respectively, which is included in other revenue within operating revenues in the statements of revenues, expenses and changes in net position.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

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.** Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on 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.** Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a prospective reimbursement system.

Approximately 21% and 24% of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2014 and 2013, 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, Investments and Investment Income

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 and other acceptable collateral having an aggregate value at least equal to the amount of the deposits.

At December 31, 2014 and 2013, none of the Hospital's bank deposit balances of \$4,513,173 and \$4,958,882, respectively, were exposed to custodial credit risk.

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, bank repurchase agreements, corporate bonds and equity securities.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

At December 31, 2014 and 2013, the Hospital had the following investments and maturities:

Type	December 31, 2014		
	Fair Value	Maturities in Years	
		Less Than 1	1 – 5
Government and agency bonds	\$ 19,067,042	\$ 6,074,436	\$ 12,992,606
Corporate bonds	64,336,782	14,113,054	50,223,728
Repurchase agreements	16,160,569	16,160,569	-
Guaranteed investment contract	3,865,091	3,865,091	-
Money market mutual funds	6,959,561	6,959,561	-
Accrued interest	525,132	525,132	-
	<u>110,914,177</u>	<u>\$ 47,697,843</u>	<u>\$ 63,216,334</u>
Equity securities	<u>15,317,926</u>		
	<u>\$126,232,103</u>		

Type	December 31, 2013		
	Fair Value	Maturities in Years	
		Less Than 1	1 – 5
Government and agency bonds	\$ 33,101,856	\$ 8,412,209	\$ 24,689,647
Corporate bonds	55,711,922	7,135,023	48,576,899
Repurchase agreements	9,929,935	9,929,935	-
Guaranteed investment contract	3,767,131	3,767,131	-
Money market mutual funds	7,607,478	7,607,478	-
Accrued interest	636,624	636,624	-
	<u>\$110,754,946</u>	<u>\$ 37,488,400</u>	<u>\$ 73,266,546</u>

Interest Rate Risk. As a means of limiting its exposure to fair value losses arising from rising interest rates, the Hospital's investment policy limits its investment portfolio to maturities of five years. The money market mutual funds are presented as investments with a maturity of less than one year because they are immediately redeemable in full.

Credit Risk. Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the Hospital's policy to limit its investments in corporate bonds to those that are rated Baa, or better, by Moody's Investor Services, Inc. and to equity securities included in the Russell 1000 Value Index. At December 31, 2014 and 2013, ratings of the Hospital's investments in U.S. agencies obligations not directly guaranteed by the U.S. government, corporate bonds and money market mutual funds ranged from Baa to AAA as rated by Moody's Investor Services, Inc.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

Custodial Credit Risk. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All of the underlying securities for the Hospital's investments in repurchase agreements at December 31, 2014 and 2013 are held by the third-party custodians in the Hospital's name. The Hospital's investment policy requires that a third-party safekeeping agreement be obtained for all third-party custodians.

Concentration of Credit Risk. The Hospital places a limit on the amount that may be invested in any single non-federal debt issuer or holdings of equity securities of a single company to no more than 6% of the Hospital's portfolio value. At December 31, 2014 and 2013, the Hospital's investments not directly guaranteed by the U.S. government that constituted more than 5% of its total investments are as follows:

	<u>2014</u>	<u>2013</u>
Federal National Mortgage Association	5%	8%
Federal Home Loan Mortgage Corporation	10%	8%
Federal Home Loan Bank	0%	15%
Repurchase agreements with Commerce Bank, n.a.	13%	9%

Summary of Carrying Values

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

	<u>2014</u>	<u>2013</u>
Carrying value		
Deposits ⁽¹⁾	\$ 4,405,394	\$ 4,341,335
Investments	126,232,103	110,754,946
	<u>\$130,637,497</u>	<u>\$115,096,281</u>
Included in the following balance sheet captions		
Cash and cash equivalents	\$ 20,202,399	\$ 13,907,160
Current portion of assets held by trustee	3,939,170	3,906,773
Noncurrent cash and investments	106,495,928	97,282,348
	<u>\$130,637,497</u>	<u>\$115,096,281</u>

⁽¹⁾The Hospital utilizes an overnight repurchase agreement for its bank deposits to maximize investment return. At December 31, 2014 and 2013, the overnight repurchase agreement amounted to \$16,160,569 and \$9,929,935, respectively, and its carrying value is included in the investments above. The repurchase agreement balance is included as a cash equivalent on the balance sheets at year end.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

Investment Income

Investment income for the years ended December 31, 2014 and 2013 consisted of:

	<u>2014</u>	<u>2013</u>
Interest and dividend income	\$ 1,954,385	\$ 2,247,862
Net decrease in fair value of investments	<u>(471,847)</u>	<u>(806,776)</u>
	<u>\$ 1,482,538</u>	<u>\$ 1,441,086</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, 2014 and 2013 consisted of:

	<u>2014</u>	<u>2013</u>
Medicare	\$ 4,168,243	\$ 3,906,562
Medicaid	1,151,312	1,732,545
Other third-party payers	19,385,188	16,692,757
Patients	<u>15,361,913</u>	<u>13,363,628</u>
	40,066,656	35,695,492
Less allowance for uncollectible accounts	<u>12,595,210</u>	<u>10,602,821</u>
	<u>\$ 27,471,446</u>	<u>\$ 25,092,671</u>

Note 5: Investment in Lawrence Surgery Center, LLC

The Hospital has a 50% membership interest in Lawrence Surgery Center, LLC (LSC). The net investment totaled \$791,277 and \$776,094 at December 31, 2014 and 2013, respectively, and is included in other assets on the balance sheets. The remaining 50% membership interest is held by several physicians who are on the Hospital's active medical staff.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

Note 6: Capital Assets

Capital assets activity for the years ended December 31, 2014 and 2013 were:

	2014				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 2,448,347	\$ -	\$ -	\$ -	\$ 2,448,347
Land improvements	2,683,300	188,299	-	-	2,871,599
Buildings and leasehold improvements	120,579,646	365,897	-	101,315	121,046,858
Fixed equipment	14,429,639	208,902	(115,643)	-	14,522,898
Major movable equipment	77,932,948	2,981,633	(2,397,736)	1,617	78,518,462
Construction in progress	21,065	810,425	-	(102,932)	728,558
	<u>218,094,945</u>	<u>4,555,156</u>	<u>(2,513,379)</u>	<u>-</u>	<u>220,136,722</u>
Less accumulated depreciation					
Land improvements	1,976,316	128,200	-	-	2,104,516
Buildings and leasehold improvements	37,428,374	4,196,475	-	-	41,624,849
Fixed equipment	12,208,223	349,533	(124,654)	-	12,433,102
Major movable equipment	56,102,626	5,760,297	(2,352,718)	-	59,510,205
	<u>107,715,539</u>	<u>10,434,505</u>	<u>(2,477,372)</u>	<u>-</u>	<u>115,672,672</u>
Capital assets, net	<u>\$ 110,379,406</u>	<u>\$ (5,879,349)</u>	<u>\$ (36,007)</u>	<u>\$ -</u>	<u>\$ 104,464,050</u>
	2013				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 2,448,347	\$ -	\$ -	\$ -	\$ 2,448,347
Land improvements	2,886,162	119,489	(322,351)	-	2,683,300
Buildings and leasehold improvements	117,756,413	981,077	(231,152)	2,073,308	120,579,646
Fixed equipment	13,882,889	546,750	-	-	14,429,639
Major movable equipment	75,168,641	7,646,224	(5,366,428)	484,511	77,932,948
Construction in progress	757,267	1,821,617	-	(2,557,819)	21,065
	<u>212,899,719</u>	<u>11,115,157</u>	<u>(5,919,931)</u>	<u>-</u>	<u>218,094,945</u>
Less accumulated depreciation					
Land improvements	2,164,524	134,144	(322,352)	-	1,976,316
Buildings and leasehold improvements	33,542,762	4,116,764	(231,152)	-	37,428,374
Fixed equipment	11,847,261	360,962	-	-	12,208,223
Major movable equipment	55,254,623	6,174,368	(5,326,365)	-	56,102,626
	<u>102,809,170</u>	<u>10,786,238</u>	<u>(5,879,869)</u>	<u>-</u>	<u>107,715,539</u>
Capital assets, net	<u>\$ 110,090,549</u>	<u>\$ 328,919</u>	<u>\$ (40,062)</u>	<u>\$ -</u>	<u>\$ 110,379,406</u>

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

Note 7: Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses included in current liabilities at December 31, 2014 and 2013 consisted of:

	<u>2014</u>	<u>2013</u>
Payable to suppliers and contractors	\$ 7,278,739	\$ 6,845,311
Payable to employees (including payroll taxes and benefits)	9,129,435	8,458,893
Other	237,742	189,272
	<u>\$ 16,645,916</u>	<u>\$ 15,493,476</u>

Note 8: 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, as well as other considerations, including the nature of each claim. It is reasonably possible that this estimate could change materially in the near term.

Note 9: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self-insured for health claims of participating employees and dependents up to specific claim amounts of \$175,000 and \$150,000 per individual and \$7,332,000 and \$5,554,000 aggregate for 2014 and 2013, respectively. Commercial stop-loss insurance coverage is purchased for claims in excess of the amounts. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued employee health claims liability during 2014 and 2013 is summarized as follows:

	<u>2014</u>	<u>2013</u>
Balance, beginning of year	\$ 1,708,679	\$ 1,400,257
Claims incurred	6,663,366	7,645,397
Claims and expenses paid	<u>(6,303,769)</u>	<u>(7,336,975)</u>
Balance, end of year	<u>\$ 2,068,276</u>	<u>\$ 1,708,679</u>

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2014 and 2013

Note 10: Long-term Debt

The following is a summary of long-term debt transactions for the Hospital for the years ended December 31, 2014 and 2013:

	2014				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Revenue bonds payable					
Series 2006	\$ 47,195,000	\$ -	\$ 790,000	\$ 46,405,000	\$ 830,000
Series 2012	10,080,000	-	435,000	9,645,000	445,000
Series 2013	6,685,000	-	1,305,000	5,380,000	1,320,000
	<u>63,960,000</u>	<u>-</u>	<u>2,530,000</u>	<u>61,430,000</u>	<u>2,595,000</u>
Unamortized premiums	705,961	-	50,307	655,654	-
Total long-term debt	<u>\$ 64,665,961</u>	<u>\$ -</u>	<u>\$ 2,580,307</u>	<u>\$ 62,085,654</u>	<u>\$ 2,595,000</u>
	2013				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Revenue bonds payable					
Series 2003	\$ 9,390,000	\$ -	\$ 9,390,000	\$ -	\$ -
Series 2006	47,945,000	-	750,000	47,195,000	790,000
Series 2012	10,500,000	-	420,000	10,080,000	435,000
Series 2013	-	6,685,000	-	6,685,000	1,305,000
	<u>67,835,000</u>	<u>6,685,000</u>	<u>10,560,000</u>	<u>63,960,000</u>	<u>2,530,000</u>
Unamortized premiums	820,114	-	114,153	705,961	-
Total long-term debt	<u>\$ 68,655,114</u>	<u>\$ 6,685,000</u>	<u>\$ 10,674,153</u>	<u>\$ 64,665,961</u>	<u>\$ 2,530,000</u>

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Revenue Bonds Payable

At December 31, 2014, the City had issued Series 2006, Series 2012 and Series 2013 Hospital Revenue Bonds (Bonds) under a Bond Indenture dated June 1, 1994, as amended and supplemented, to finance expansion and renovation of Hospital facilities, acquire equipment and property, refinance prior bond issues and reimburse the Hospital for certain capital expenditures. Under related Lease and Guaranty Agreements dated June 1, 1994, as amended and supplemented, the Hospital leases its facilities and substantially all equipment from the City. The Bonds and interest thereon are special, limited obligations of the City payable solely from: (i) lease payments from the Hospital, (ii) a pledge of the Hospital's gross revenues, (iii) a pledge of most Hospital facilities and equipment and (iv) amounts on deposit with the Bond Trustee. Therefore, both the Hospital facilities and equipment and Bonds payable are recorded in the accompanying financial statements. During the year ended December 31, 2013, the Hospital retired the Series 2003 bonds.

The Bond Indenture requires the Hospital to meet certain measures of financial performance on an annual basis and places limitations on future borrowings.

Bond premiums and discounts are amortized over the life of the bonds using the effective interest method. Gains/losses on refunding bonds reported in the accompanying financial statements as deferred outflows of resources and are being charged to operations over the shorter of the new bond's life or the remaining life of the refunded bonds using the effective-interest method.

Additional information about the bonds follows:

	Original Balance	Interest Rates	Final Maturity
Series 2006	\$51,845,000	4.875 - 5.25%	7/1/2036
Series 2012	10,500,000	2.53%	7/1/2022
Series 2013	6,865,000	1.06%	7/1/2018

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The debt service requirements for revenue bonds as of December 31, 2014, are as follows:

Year Ending December 31,	Total to be Paid	Principal	Interest
2015	\$ 5,274,659	\$ 2,595,000	\$ 2,679,659
2016	5,280,658	2,670,000	2,610,658
2017	5,283,524	2,745,000	2,538,524
2018	5,278,669	2,815,000	2,463,669
2019	3,900,827	1,515,000	2,385,827
2020-2024	26,260,044	15,910,000	10,350,044
2025-2029	18,824,620	11,475,000	7,349,620
2030-2034	18,824,182	14,715,000	4,109,182
2035-2036	7,529,463	6,990,000	539,463
	<u>\$ 96,456,646</u>	<u>\$ 61,430,000</u>	<u>\$ 35,026,646</u>

Note 11: Assets Held in Trust

The Hospital is the recipient of investment income from a perpetual endowment fund created under the last will and testament of Elizabeth M. Watkins. The will stipulated that the corpus is to be maintained inviolate under the administration of a trustee and the net investment income is to be distributed each year to the Hospital as long as the Hospital continues to be a charitable institution. The market value of the trust approximated \$2,241,000 and \$2,288,000 at December 31, 2014 and 2013, respectively. Assets of this trust are not included in the accompanying financial statements. Trust income received is reported as other income.

Note 12: Operating Leases

Future minimum lease payments for equipment under leases with an initial term greater than one year at December 31, 2014 are as follows:

	Rental Expense
2015	\$ 455,724
2016	455,724
	<u>\$ 911,448</u>

Rental expense for equipment amounted to \$601,665 and \$695,686 in 2014 and 2013, respectively.

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Office Rental Income and Expense

The Hospital leases and rents office space to and from various third parties as a normal part of its operations. The leases to third parties are generally on a month-to-month basis. Future minimum operating lease expense at December 31, 2014 is as follows:

	Rental Expense
2015	\$ 890,775
2016	580,201
2017	263,288
2018	269,870
2019	161,360
	\$ 2,165,494

Rental income for office space amounted to \$397,257 and \$387,481 in 2014 and 2013, respectively. Rental expense for office space amounted to \$1,299,584 and \$1,452,889 in 2014 and 2013, respectively.

Note 13: Defined Contribution Plan

The Hospital sponsors a defined contribution retirement plan covering substantially all employees over age 21 with one year of service. Retirement expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by a committee appointed by the Board of Trustees. The plan provides retirement benefits to plan members. Benefit provisions are contained in the plan document and were established and can be amended by action of the Board of Trustees. Contributions actually made by plan members totaled \$3,876,827 and \$3,766,918 in 2014 and 2013, respectively, and the Hospital contributions aggregated \$2,432,434 and \$2,322,527 during 2014 and 2013, respectively. Employer contributions to the plan are based on the following contribution types:

Employer Basic Contributions

Years of Service	% of Compensation
Fewer than 5	1.5%
5 - 10 years	2.0
10 - 15 years	2.5
15 - 20 years	3.0
20 - 25 years	3.5
> 25 years	4.0

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Employer Matching Contributions

The Hospital contributes a matching percentage for all participating plan participants equal to 50% of the participant's pre-tax elective deferral contribution not to exceed 2% of the participant's compensation for the plan year.

Note 14: The Lawrence Memorial Hospital Endowment Association

The Lawrence Memorial Hospital Endowment Association is a legally separate tax-exempt component unit of the Hospital. The Endowment Association is exclusively dedicated to the support of the Hospital. The Endowment Association's operations are managed by a Board of Directors separate from the Hospital's Board.

In October 1984, the City, upon request of the Hospital, passed an ordinance granting the Hospital's Board of Trustees the power to transfer personal property and funds previously donated to the Hospital to the Endowment Association to be held in trust for the benefit of the Hospital. A trust agreement was established between the Hospital and the Endowment Association.

Although the Hospital does not control the timing or amount of receipts from the Endowment Association, the majority of the Endowment Association's resources and related income are restricted by donors for the benefit of the Hospital. Because these restricted resources held by the Endowment Association can only be used by, or for the benefit of the Hospital, the Endowment Association is considered a component unit of the Hospital and is discretely presented in the Hospital's financial statements.

During the years ended December 31, 2014 and 2013, the Endowment Association provided \$271,149 and \$468,997 of support to the Hospital, respectively. Complete financial statements of the Endowment Association may be obtained from its Administrative Office at the following address: Lawrence Memorial Hospital Endowment Association, 325 Maine Street, Lawrence, Kansas 66044.

The Endowment Association reports under the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Endowment Association's statements in the Hospital's financial reporting entity for these differences.

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Note 15: Patient Protection and Affordable Care Act

The *Patient Protection and Affordable Care Act* (PPACA) will substantially reform the United States health care system. The legislation impacts multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Starting in 2014, the legislation requires the establishment of health insurance exchanges, which provide individuals without employer provided health care coverage the opportunity to purchase insurance. It is anticipated that some employers currently offering insurance to employees will opt to have employees seek insurance coverage through the insurance exchanges. It is possible that the reimbursement rates paid by insurers participating in the insurance exchanges may be substantially different than rates paid under current health insurance products. Another significant component of the PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals. In anticipation of this expansion, payments under certain existing programs, such as Medicare disproportionate share, will be substantially decreased. Each state's participation in an expanded Medicaid program is optional.

The state of Kansas has not yet indicated whether or not it will participate in the expansion of the Medicaid program. The impact of that decision on the overall reimbursement to the Hospital cannot be quantified at this point.

The PPACA is extremely complex and may be difficult for the federal government and each state to implement. While the overall impact of the PPACA cannot currently be estimated, it is possible that it will have a negative impact on the Hospital's net patient service revenue. Additionally, it is possible the Hospital will experience payment delays and other operational challenges during PPACA's implementation.

Note 16: Contingencies

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.