

MEDICINE LODGE MEMORIAL HOSPITAL

December 31, 2007 and 2006

**FINANCIAL STATEMENTS AND REPORT
OF INDEPENDENT CERTIFIED PUBLIC
ACCOUNTANTS**

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Trustees
Medicine Lodge Memorial Hospital

We have audited the accompanying basic financial statements of **Medicine Lodge Memorial Hospital** as of December 31, 2007 and 2006 as listed in the table of contents. 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 as established by the American Institute of Certified Public Accountants and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 **Medicine Lodge Memorial Hospital** as of December 31, 2007 and 2006 and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note K to the financial statements, certain errors resulting in the understatement of previously reported salaries and vacation benefits payable as of December 31, 2006, were discovered during the current year. Accordingly, an adjustment has been made to restate the 2006 financial statements to correct the error.

The Hospital has not presented a management's discussion and analysis that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements.

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July 14, 2008

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FINANCIAL STATEMENTS

Medicine Lodge Memorial Hospital

BALANCE SHEETS

December 31,

ASSETS

	<u>2007</u>	<u>2006</u> (as restated)
CURRENT ASSETS		
Cash	\$ 597,469	\$ 513,642
Accounts receivable, net	847,221	1,004,507
Other receivables	171,043	216,004
Due from Medicare	293,000	118,000
Inventories	264,149	262,736
Prepaid expenses	<u>79,159</u>	<u>72,082</u>
Total current assets	2,252,041	2,186,971
INVESTMENTS AND OTHER ASSETS		
Assets whose use is limited	779,188	658,806
Ranch land and mineral interests, at cost	<u>89,078</u>	<u>89,078</u>
	868,266	747,884
CAPITAL ASSETS, AT COST		
Land	7,579	7,579
Depreciable capital assets, net of accumulated depreciation	<u>656,292</u>	<u>717,485</u>
Total capital assets, net of accumulated depreciation	<u>663,871</u>	<u>725,064</u>
Total assets	<u><u>\$ 3,784,178</u></u>	<u><u>\$ 3,659,919</u></u>

The accompanying notes are an integral part of these statements.

LIABILITIES AND NET ASSETS

	<u>2007</u>	<u>2006</u> (as restated)
CURRENT LIABILITIES		
Capital lease obligations	\$ 61,917	\$ 59,488
Accounts payable	134,406	136,212
Salaries and vacation benefits payable	<u>492,553</u>	<u>441,565</u>
Total current liabilities	688,876	637,265
LONG-TERM CAPITAL LEASE OBLIGATIONS	<u>20,433</u>	<u>82,371</u>
Total liabilities	709,309	719,636
NET ASSETS		
Invested in capital assets, net of related debt	581,521	583,205
Restricted - expendable for specific operating activities	18,497	22,161
Unrestricted	<u>2,474,851</u>	<u>2,334,917</u>
Total net assets	<u>3,074,869</u>	<u>2,940,283</u>
Total liabilities and net assets	<u><u>\$ 3,784,178</u></u>	<u><u>\$ 3,659,919</u></u>

Medicine Lodge Memorial Hospital

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Year ended December 31,

	2007	2006 (as restated)
Operating revenues		
Net patient service revenue	\$ 6,836,123	\$ 6,143,218
Other	84,961	94,548
	6,921,084	6,237,766
Operating expenses		
Salaries	3,986,650	3,789,076
Supplies and other	3,333,179	2,787,890
Depreciation	102,199	195,853
	7,422,028	6,772,819
Loss from operations	(500,944)	(535,053)
Nonoperating revenues (expenses)		
County tax appropriations	493,634	473,928
Interest income	53,260	35,898
Ranch income (net of expense of \$18,363 in 2007 and \$52,379 in 2006)	60,712	16,970
Contributions and grants for operations	31,997	42,427
Interest expense	(4,573)	(5,354)
Other	500	-
	635,530	563,869
Excess of revenues over expenses (expenses over revenues)	134,586	28,816
Transfer of ambulance building from County	-	70,029
	134,586	98,845
Increase (decrease) in net assets	134,586	98,845
Net assets at beginning of year	2,940,283	2,841,438
Net assets at end of year	\$ 3,074,869	\$ 2,940,283

The accompanying notes are an integral part of these statements.

Medicine Lodge Memorial Hospital

STATEMENTS OF CASH FLOWS

Year ended December 31,

Increase (decrease) in cash and cash equivalents

	2007	2006 (as restated)
Cash flows from operating activities		
Cash received from patients and third-party payors	\$ 6,818,409	\$ 6,353,814
Cash received from others	82,402	90,513
Cash paid to employees	(3,935,662)	(3,727,347)
Cash paid to suppliers	(3,343,475)	(2,783,968)
Net cash used in operating activities	(378,326)	(66,988)
Cash flows from noncapital financing activities		
Tax appropriations	538,629	449,166
Contributions and grants for operations	31,997	42,427
Net cash provided by noncapital financing activities	570,626	491,593
Cash flows from capital and related financing activities		
Principal payments on capital lease obligations	(59,509)	(58,729)
Purchase of capital assets	(41,006)	(86,186)
Interest paid	(4,573)	(5,354)
Proceeds from sale of assets	500	-
Net cash used in capital and related financing activities	(104,588)	(150,269)
Cash flows from investing activities		
Ranch operations	60,712	(11,359)
Interest income	55,785	36,729
Decrease in Board-designated certificates of deposit	-	536,159
Net cash provided by investing activities	116,497	561,529
Net increase in cash and cash equivalents	204,209	835,865
Cash and cash equivalents at beginning of year	1,172,448	336,583
Cash and cash equivalents at end of year	\$ 1,376,657	\$ 1,172,448
Reconciliation of cash and cash equivalents		
Cash in current assets	\$ 597,469	\$ 513,642
Cash and cash equivalents in Board-designated assets	760,691	636,644
Cash in grantor restricted assets	18,497	22,162
	\$ 1,376,657	\$ 1,172,448

Medicine Lodge Memorial Hospital

STATEMENTS OF CASH FLOWS - CONTINUED

Year ended December 31,

	<u>2007</u>	<u>2006</u> (as restated)
Reconciliation of loss from operations to net cash used in operating activities		
Loss from operations	\$ (500,944)	\$ (535,053)
Adjustments to reconcile loss from operations to net cash used in operating activities		
Depreciation	102,199	195,853
Provision for doubtful accounts	356,572	192,537
Change in assets and liabilities		
Accounts receivable	(199,286)	(177,791)
Other receivables	(2,559)	(4,035)
Due from Medicare	(175,000)	195,850
Inventories	(1,413)	(14,585)
Prepaid expenses	(7,077)	(7,528)
Accounts payable and accrued expenses	<u>49,182</u>	<u>87,764</u>
Net cash used in operating activities	<u>\$ (378,326)</u>	<u>\$ (66,988)</u>

Supplemental schedule of noncash capital and related financing activities

The County transferred an ambulance building to the Hospital in 2006 with a cost of \$70,029.

The accompanying notes are an integral part of these statements.

Medicine Lodge Memorial Hospital

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Medicine Lodge Memorial Hospital is owned by Medicine Lodge Township and governed by a Board of Trustees who are appointed by the Medicine Lodge City Council and the Township Board of Medicine Lodge Township and is a component unit of the Township. The Hospital provides short-term acute care services and outpatient services and operates a medical clinic.

1. Use of estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the 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.

2. Proprietary fund accounting

The Hospital's financial statements are comprised solely of an enterprise fund that uses proprietary fund accounting. The Hospital utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

3. Cash and cash equivalents

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

4. Accounts receivable net/net patient service revenue

Accounts receivable net/net patient service revenue is recorded at list price with contractual adjustments (which represent the difference between charges and the amount received or receivable from third-party payors) and administrative discounts deducted to arrive at net receivables/patient service revenue before the provision and allowance for doubtful accounts. The allowance for doubtful accounts is provided for all accounts receivable greater than 120 days old. The allowance for contractual adjustments has been estimated by logging claims paid after year end and by applying the current payment rates. When individual accounts are determined to be uncollectible, they are written off. Medicare is the Hospital's most significant third-party payer.

Medicine Lodge Memorial Hospital

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Revenue under third-party payor agreements is subject to audit and retroactive adjustment. Provisions for estimated third-party payor settlements are provided in the period the related services are rendered. Differences between the estimated amounts accrued and interim and final settlements are reported in operations in the year of settlement.

5. Inventories

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

6. Assets whose use is limited

Assets whose use is limited include assets designated 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. Assets whose use is limited also includes assets restricted by donors and by grantors.

7. Capital assets

Capital assets are reported at historical cost. Contributed capital assets are reported at their estimated fair value at the time of donation. Depreciation, including amortization of capital leases, is provided using the straight-line method over the following estimated useful lives:

Land improvements	10-40 years
Buildings	5-50 years
Fixed equipment	5-40 years
Movable equipment	3-23 years

Maintenance, repairs and renewals which neither materially add to the value of the property nor appreciably prolong its life are charged to expense as incurred. Gains or losses on disposition of property and equipment are included in operations. The costs of significant additions, renewals and betterments to depreciable properties are capitalized and depreciated over the remaining or extended estimated useful lives of the item or the properties.

8. Restricted net assets

Restricted net assets are those whose use by the Hospital has been limited by donors or grantors to a specific time period or purpose (Note B).

9. Operations

Operating revenues consist of patient services and other revenue. Other operating revenue includes therapy service sold, meal and other miscellaneous revenue. All other revenues are considered nonoperating and consist of County tax appropriations, contributions and grants, ranch income and interest income. Nonoperating expense consists of interest expense.

Medicine Lodge Memorial Hospital

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE A - NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

10. Tax appropriation

The Hospital received approximately 7% in 2007 and 2006 of its financial support from county property taxes and city and township sales taxes. These funds were used to support operations. Property taxes are levied by the county on the Hospital's behalf on January 1 and are intended to finance the Hospital's activities of the same calendar year. Amounts levied are based on assessed property values as of the preceding July 1.

11. Income taxes

The Hospital is exempt from income taxes pursuant to Section 115 of the Internal Revenue Service Code.

12. Net assets

Net assets of the Hospital are classified in three components. Net assets invested in capital assets, net of related debt, consist of capital assets net of accumulated depreciation and reduced by outstanding borrowings used to finance capital assets. Restricted expendable net assets are noncapital assets that must be used for specific operating expenses specified by donors. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the above conditions.

13. 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.

NOTE B - CASH AND ASSETS WHOSE USE IS LIMITED

Kansas statutes require deposits in excess of FDIC coverage to be collateralized by securities issued by the United States of America or an agency thereof or by authorized securities issued by municipalities of the State of Kansas.

All certificates of deposit have maturities of less than one year and are reported at cost, which approximates fair value.

Medicine Lodge Memorial Hospital

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE B - CASH AND ASSETS WHOSE USE IS LIMITED - Continued

The Hospital's bank balances at December 31 were as follows:

	<u>2007</u>	<u>2006</u>
FDIC insured collateral	\$ 200,000	\$ 337,421
Collateralized by securities held by the pledging financial institution in the Hospital's name	<u>1,277,793</u>	<u>952,658</u>
	<u>\$ 1,477,793</u>	<u>\$1,290,079</u>
Carrying value	<u>\$ 1,375,757</u>	<u>\$1,171,547</u>

The carrying amounts of deposits shown above are included in the following balance sheet captions at December 31 as follows:

	<u>2007</u>	<u>2006</u>
Carrying amount		
Cash	\$ 1,375,757	\$ 852,468
Certificates of deposit	<u>-</u>	<u>319,079</u>
	<u>\$ 1,375,757</u>	<u>\$1,171,547</u>
Included in the following balance sheet captions		
Cash	\$ 596,569	\$ 512,741
Assets whose use is limited		
By Board	760,691	636,644
By others	<u>18,497</u>	<u>22,162</u>
	<u>779,188</u>	<u>658,806</u>
	<u>\$ 1,375,757</u>	<u>\$1,171,547</u>

NOTE C - NET ACCOUNTS RECEIVABLE

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

Medicare

The Hospital is licensed as a Critical Access Hospital. Under this reimbursement system, inpatient acute care and swing-bed services rendered to Medicare program beneficiaries are paid under cost reimbursement methodologies. Outpatient services related to Medicare beneficiaries are paid based on a combination of fee schedules and cost reimbursement methodologies. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of an annual cost report by the Hospital and audit thereof by the Medicare fiscal intermediary.

Medicine Lodge Memorial Hospital

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE C - NET ACCOUNTS RECEIVABLE - Continued

Medicaid

In 2006, inpatient and outpatient services rendered to Medicaid program beneficiaries are paid based on a combination of prospectively determined and fee schedule reimbursement methodologies. Effective October 2007, inpatient and outpatient services rendered to Medicaid program beneficiaries are paid on a cost based reimbursement methodology.

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

Net accounts receivable recorded net of allowance for doubtful accounts and contractual adjustments at December 31 is as follows:

	2007	2006
Accounts receivable, gross	\$ 2,268,587	\$ 2,145,278
Allowance for uncollectible accounts	(1,240,886)	(847,956)
Allowance for contractual adjustments	(180,480)	(292,815)
Accounts receivable, net	\$ 847,221	\$ 1,004,507

NOTE D - CAPITAL ASSETS

Capital asset activity for the years ended December 31 is as follows:

	2007			
	Beginning balance	Additions	Deletions	Ending balance
Land	\$ 7,579	\$ -	\$ -	\$ 7,579
Land improvements	65,457	-	-	65,457
Building	1,470,337	24,786	-	1,495,123
Fixed equipment	835,267	-	-	835,267
Movable equipment	1,748,065	16,220	(40,308)	1,723,977
Total cost	4,126,705	41,006	(40,308)	4,127,403
Less accumulated depreciation				
Land improvements	57,596	3,183	-	60,779
Building	1,009,246	35,225	-	104,471
Fixed equipment	768,942	10,429	-	779,371
Movable equipment	1,565,857	53,362	(40,308)	1,578,911
Total accumulated depreciation	3,401,641	102,199	(40,308)	3,463,532
Capital assets, net	\$ 725,064	\$ (61,193)	\$ -	\$ 663,871

Medicine Lodge Memorial Hospital

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE D - CAPITAL ASSETS - Continued

	2006			
	Beginning balance	Additions	Deletions	Ending balance
Land	\$ 7,579	\$ -	\$ -	\$ 7,579
Land improvements	65,457	-	-	65,457
Building	1,400,307	70,030	-	1,470,337
Fixed equipment	815,474	20,011	(218)	835,267
Movable equipment	<u>1,721,305</u>	<u>66,174</u>	<u>(39,414)</u>	<u>1,748,065</u>
Total cost	4,010,122	156,215	(39,632)	4,126,705
Less accumulated depreciation				
Land improvements	54,412	3,184	-	57,596
Building	973,516	35,730	-	1,009,246
Fixed equipment	757,227	11,933	(218)	768,942
Movable equipment	<u>1,460,265</u>	<u>145,006</u>	<u>(39,414)</u>	<u>1,565,857</u>
Total accumulated depreciation	<u>3,245,420</u>	<u>195,853</u>	<u>(39,632)</u>	<u>3,401,641</u>
Capital assets, net	<u>\$ 764,702</u>	<u>\$ (39,638)</u>	<u>\$ -</u>	<u>\$ 725,064</u>

NOTE E - CAPITAL LEASE OBLIGATIONS

Capital lease obligation activity for 2007 and 2006 is as follows:

	Beginning balance	Additions	Deletions	Ending balance	Amounts due within one year	Long-term portion
2007	\$ 141,859	\$ -	\$ (59,509)	\$ 82,350	\$ 61,917	\$ 20,433
2006	\$ 200,588	\$ -	\$ (58,729)	\$ 141,859	\$ 59,488	\$ 82,371

The following is an analysis of the financial presentation of the capital leases at December 31:

	2007	2006
Movable equipment	\$ 290,000	\$ 290,000
Less accumulated depreciation	<u>(273,750)</u>	<u>(268,750)</u>
	<u>\$ 16,250</u>	<u>\$ 21,250</u>

Medicine Lodge Memorial Hospital

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE E - CAPITAL LEASE OBLIGATIONS - Continued

Scheduled principal and interest payments on capital lease obligations are as follows:

	<u>Principal</u>	<u>Interest</u>
Year ending December 31		
2008	\$ 61,917	\$ 2,157
2009	<u>20,433</u>	<u>162</u>
	<u>\$ 82,350</u>	<u>\$ 2,319</u>

NOTE F - TRANSFER OF BUILDING FROM COUNTY

The Hospital has an agreement with the County to provide ambulance service in the northern part of the County. Under this agreement, the County constructed a building and transferred it to the Hospital for ambulance parking during 2006.

NOTE G - NET PATIENT SERVICE REVENUE

Net patient revenues for the year ended December 31 are as follows:

	<u>2007</u>	<u>2006</u>
Gross patient service revenue	\$ 9,333,968	\$ 8,969,923
Less		
Medicare contractual adjustments - Hospital	659,469	916,003
Medicaid contractual adjustments - Hospital	209,341	247,825
Other contractual adjustments - Hospital	91,375	115,232
Blue Cross contractual adjustments - Hospital	429,827	504,674
Clinic contractals	740,108	835,274
Provision for doubtful accounts	356,572	192,537
Administrative discounts	<u>11,153</u>	<u>15,160</u>
Net patient service revenue	<u>\$ 6,836,123</u>	<u>\$ 6,143,218</u>

Medicine Lodge Memorial Hospital

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE H - RETIREMENT PLAN

The Hospital maintains a money purchase pension plan covering employees who have one year of continuous service, have attained the age of twenty-one and have worked over 500 hours during the plan year. Employee contributions to the plan are computed at the rate of 3.5% of the annual compensation of eligible employees. Employer contributions to the plan are computed at the rate of 4.5% of the annual compensation of eligible employees. The employer also makes supplemental contributions of up to 3% of the annual compensation of eligible employees based upon the number of years of continuous service. Pension costs for the Hospital, which are funded as accrued, were \$159,630 and \$160,157 for the years ended December 31, 2007 and 2006, respectively. Benefits vest after three years of service with 100% vesting after seven years of service.

NOTE I - MANAGEMENT AGREEMENT

The Hospital Board of Trustees has a management agreement with Great Plains Health Alliance, Inc. whereby Great Plains Health Alliance, Inc. agrees to provide specialized hospital management services to the Hospital. Fees incurred under this agreement for the years ended December 31, 2007 and 2006 were \$73,758 and \$68,469, respectively.

NOTE J - CONCENTRATION OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor arrangements. The mix of receivables from patients and third-party payors for the Hospital and clinic at December 31 are as follows:

	<u>2007</u>	<u>2006</u>
Medicare	27.79%	26.40%
Medicaid	1.94	3.89
Blue Cross	6.06	11.49
Other third-party payors	7.89	10.51
Self-pay	<u>56.32</u>	<u>47.71</u>
	<u>100.00%</u>	<u>100.00%</u>

NOTE K - RESTATEMENTS

In 2007, it was determined that salaries and vacation benefits payable were understated by \$195,155 in 2006. The beginning net assets for 2006 and prior year's balance sheet and statement of operations and changes in net assets have been restated. For individual principal financial statement line item changes, see below.

Medicine Lodge Memorial Hospital

NOTES TO FINANCIAL STATEMENTS

December 31, 2007 and 2006

NOTE K - RESTATEMENTS - Continued

Balance Sheet

Salaries and vacation benefits payable

As previously reported	\$ 246,410
Restatement	<u>195,155</u>
As restated	<u><u>\$ 441,565</u></u>

Balance Sheet and Statement of Revenues, Expenses and Changes in Net Assets

Unrestricted net assets

As previously reported	\$ 2,530,072
Restatement	<u>(195,155)</u>
As restated	<u><u>\$ 2,334,917</u></u>

Statements of Revenues, Expenses and Changes in Net Assets

Salaries

As previously reported	\$ 3,751,703
Restatement	<u>37,373</u>
As restated	<u><u>\$ 3,789,076</u></u>

Increase (decrease) in net assets

As previously reported	\$ 136,218
Restatement	<u>(37,373)</u>
As restated	<u><u>\$ 98,845</u></u>

Net assets at beginning of the year

As previously reported	\$ 2,999,220
Restatement	<u>(157,782)</u>
As restated	<u><u>\$ 2,841,438</u></u>