

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**

Accountants' Report and Financial Statements

December 31, 2010 and 2009



**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**December 31, 2010 and 2009**

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## Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Trustees  
Fredonia Regional Hospital  
Fredonia, Kansas

We have audited the accompanying balance sheet of Fredonia Regional Hospital (Hospital), a component unit of the City of Fredonia, Kansas, as of December 31, 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Fredonia Regional Hospital as of and for the year ended December 31, 2009, were audited by other accountants whose report dated May 10, 2010, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2010 financial statements referred to above present fairly, in all material respects, the financial position of Fredonia Regional Hospital as of December 31, 2010, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

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

*BKD, LLP*

May 10, 2011

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Balance Sheets**  
**December 31, 2010 and 2009**

**Assets**

	<u>2010</u>	<u>2009</u>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 2,962,531	\$ 2,276,685
Patient accounts receivable, net	1,345,421	1,336,975
Held by trustee for debt service	351,517	333,221
Estimated amounts due from third-party payers	680,000	675,000
Supplies	311,259	305,760
Physician receivable	163,092	120,862
Prepaid expenses and other	<u>180,020</u>	<u>143,096</u>
Total current assets	<u>5,993,840</u>	<u>5,191,599</u>
<b>Noncurrent Cash and Investments</b>		
Designated by Board of Trustees	1,793,850	1,929,345
Restricted by donors for capital acquisitions and specific operating activities	10,000	1,800
Held by trustee for debt service	<u>1,012,169</u>	<u>1,011,797</u>
Total noncurrent cash and investments	<u>2,816,019</u>	<u>2,942,942</u>
<b>Capital Assets, Net</b>	<u>11,615,196</u>	<u>12,131,363</u>
<b>Other Assets</b>		
Bond issuance costs, net	220,537	233,048
Physician receivable	<u>239,269</u>	<u>431,340</u>
Total other assets	<u>459,806</u>	<u>664,388</u>
Total assets	<u><u>\$ 20,884,861</u></u>	<u><u>\$ 20,930,292</u></u>

## Liabilities and Net Assets

	<u>2010</u>	<u>2009</u>
<b>Current Liabilities</b>		
Current maturities of long-term debt	\$ 319,619	\$ 268,977
Accounts payable	417,359	444,896
Salaries payable	70,185	58,355
Vacation payable	225,687	194,419
Physician payable	134,622	184,867
Interest payable	241,369	243,419
	<hr/>	<hr/>
Total current liabilities	1,408,841	1,394,933
<b>Long-term Debt</b>	<u>10,842,793</u>	<u>10,866,048</u>
Total liabilities	<u>12,251,634</u>	<u>12,260,981</u>
<b>Net Assets</b>		
Invested in capital assets, net of related debt	452,784	999,715
Restricted-expendable for		
Debt service	1,122,317	1,345,018
Capital acquisitions	4,108	-
Specific operating activities	5,892	1,800
Unrestricted	7,048,126	6,322,778
	<hr/>	<hr/>
Total net assets	8,633,227	8,669,311
Total liabilities and net assets	<u>\$ 20,884,861</u>	<u>\$ 20,930,292</u>

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Statements of Revenues, Expenses and Changes in Net Assets**  
**Years Ended December 31, 2010 and 2009**

	<u>2010</u>	<u>2009</u>
<b>Operating Revenues</b>		
Net patient service revenue	\$ 10,968,251	\$ 10,618,729
<b>Operating Expenses</b>		
Salaries and wages	4,195,244	4,129,974
Supplies and other	5,853,735	5,637,617
Depreciation and amortization	1,250,252	1,083,135
Total operating expenses	<u>11,299,231</u>	<u>10,850,726</u>
<b>Operating Loss</b>	<u>(330,980)</u>	<u>(231,997)</u>
<b>Nonoperating Revenues (Expenses)</b>		
Tax appropriations	537,431	519,346
Interest income	106,772	85,501
Interest expense	(676,532)	(668,594)
Noncapital grants and gifts	24,649	32,169
Other	223,576	222,660
Total nonoperating revenues	<u>215,896</u>	<u>191,082</u>
<b>Deficiency of Revenue Over Expenses Before Capital Grants and Gifts</b>	(115,084)	(40,915)
<b>Capital Grants and Gifts</b>	<u>79,000</u>	<u>300,000</u>
<b>Increase (Decrease) in Net Assets</b>	(36,084)	259,085
<b>Net Assets, Beginning of Year</b>	<u>8,669,311</u>	<u>8,410,226</u>
<b>Net Assets, End of Year</b>	<u>\$ 8,633,227</u>	<u>\$ 8,669,311</u>

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Statements of Cash Flows**  
**Years Ended December 31, 2010 and 2009**

	<u>2010</u>	<u>2009</u>
<b>Operating Activities</b>		
Receipts from and on behalf of patients	\$ 10,954,805	\$ 10,801,842
Payments to suppliers and contractors	(5,925,745)	(5,644,764)
Payments to and on behalf of employees	(4,152,146)	(4,125,780)
	<u>876,914</u>	<u>1,031,298</u>
Net cash provided by operating activities		
<b>Noncapital Financing Activities</b>		
Property taxes supporting operations	537,431	519,346
Payments under physician contract	(8,567)	(39,933)
Noncapital grants and gifts	24,649	17,307
Other	223,576	222,660
	<u>777,089</u>	<u>719,380</u>
Net cash provided by noncapital financing activities		
<b>Capital and Related Financing Activities</b>		
Purchase of capital assets	(484,928)	(585,111)
Principal paid on long-term debt	(280,096)	(323,244)
Interest paid on long-term debt	(676,532)	(668,594)
Issuance of long-term debt	179,000	-
Capital grants and gifts	79,000	317,462
	<u>(1,183,556)</u>	<u>(1,259,487)</u>
Net cash used in capital and related financing activities		
<b>Investing Activities</b>		
Change in noncurrent investments - designated by board	(140,337)	291,047
Investment income	106,772	85,501
Purchase of noncurrent investments - held by trustee for debt service	(999,564)	-
Cash proceeds from sale of equipment	-	22,374
	<u>(1,033,129)</u>	<u>398,922</u>
Net cash provided by (used by) investing activities		
<b>Increase (Decrease) in Cash and Cash Equivalents</b>	(562,682)	890,113
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>4,655,849</u>	<u>3,765,736</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 4,093,167</u>	<u>\$ 4,655,849</u>

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Statements of Cash Flows (Continued)**  
**Years Ended December 31, 2010 and 2009**

	<b>2010</b>	<b>2009</b>
<b>Reconciliation of Cash and Cash Equivalents</b>		
Cash and cash equivalents in current assets	\$ 2,962,531	\$ 2,276,685
Board designated cash	756,514	1,032,346
Restricted cash	374,122	1,346,818
	\$ 4,093,167	\$ 4,655,849
<b>Reconciliation of Operating Loss to Net Cash Provided by Operating Activities</b>		
Operating loss	\$ (330,980)	\$ (231,997)
Depreciation and amortization	1,250,252	1,083,135
Provision for uncollectible accounts	986,714	583,735
Changes in operating assets and liabilities		
Patient accounts receivable, net	(995,160)	(390,622)
Estimated amounts due from third-party payers	(5,000)	(10,000)
Supplies	(5,499)	8,081
Other current assets	(36,924)	(80,890)
Accounts payable	(27,537)	70,377
Salaries payable	11,830	11,916
Vacation payable	31,268	(7,722)
Interest payable	(2,050)	(4,715)
Net cash provided by operating activities	\$ 876,914	\$ 1,031,298
<b>Supplemental Cash Flows Information</b>		
Capital lease obligations incurred for capital assets	\$ 128,483	\$ 392,691

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

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

***Nature of Operations and Reporting Entity***

The Hospital is a component unit of the City of Fredonia, Kansas (City). The Hospital receives funds from the City's 1% sales tax.

The Hospital is a municipal hospital that consists of an acute care hospital, geriatric psych unit and physician clinics. The Hospital is licensed as a critical access hospital.

***Basis of Accounting and Presentation***

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

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

***Use of Estimates***

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

***Cash Equivalents***

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2010 and 2009, cash equivalents consisted primarily of certificates of deposit.

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

***Risk Management***

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

***Patient Accounts Receivable, Net***

The Hospital reports patient accounts receivable for the services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for doubtful accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a service to the patient, the Hospital bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

***Supplies***

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

***Physician Receivable/Payable***

Physician receivables on the balance sheet include guarantee contracts and represent the estimated future benefit to be received over the contractual life of the guarantee contracts. Physician payable represents the estimated remaining liability to the Hospital over the contractual life of the guarantee contract. Refer to *Note 7* for additional information on physician guarantee contracts.

***Noncurrent Cash and Investments***

Noncurrent cash and investments – designated by Board of Trustees consist of cash and investments that has been 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. Noncurrent cash and investments – restricted by contributors and grantors consist of cash that has been restricted by contributors and grantors for various projects or medical training. Noncurrent cash and investments – held by trustee for debt service consist of cash and investments held under Revenue Bond Agreements and include a principal and interest account and a bond reserve account.

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

**Capital Assets**

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

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

**Bond Issuance Costs**

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

**Compensated Absences**

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

**Net Assets**

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

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

***Net Patient Service Revenue***

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

***Charity Care***

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

***Income Taxes***

As an essential government function of the City, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

**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 under cost reimbursement methodologies. Inpatient geriatric psych services rendered to Medicare program beneficiaries are paid based on a blend of prospective payment rates and cost subject to certain limitations. 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 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 cost reimbursement methodology for certain services and at prospectively determined rates for all other services. The Hospital is reimbursed for cost reimbursable services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid administrative contractor.

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

Approximately 70% and 68% of net patient service revenue are from participation in the Medicare and 9% in the state-sponsored Medicaid programs for the years ended December 31, 2010 and 2009, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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

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

	<u>2010</u>	<u>2009</u>
Gross patient service revenue	\$ 16,641,576	\$ 15,975,241
Less contractual adjustments		
Medicare	(2,986,251)	(2,831,776)
Medicaid	(470,200)	(570,577)
Other contractals and adjustments	(894,635)	(1,009,514)
Charity care	(167,261)	(214,565)
Administrative discounts	(168,264)	(146,345)
Provision for doubtful accounts	(986,714)	(583,735)
Net patient service revenue	<u>\$ 10,968,251</u>	<u>\$ 10,618,729</u>

**Note 3: Deposits and Investments**

***Deposits***

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

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

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

The Hospital had bank balances as follows at December 31:

	<u><b>2010</b></u>	<u><b>2009</b></u>
Insured (FDIC)	\$ 1,685,389	\$ 750,000
Collateralized by securities held by pledging institutions in the Hospital's name	<u>4,150,744</u>	<u>3,570,021</u>
Balance per bank statements	<u>\$ 5,836,133</u>	<u>\$ 4,320,021</u>
Carrying amount	<u><u>\$ 5,765,300</u></u>	<u><u>\$ 4,207,185</u></u>

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

	<u><b>2010</b></u>	<u><b>2009</b></u>
Cash and cash equivalents	\$ 2,961,886	\$ 2,276,040
Noncurrent cash and investments		
Designated by Board of Trustees	1,793,850	1,929,345
Restricted by donors	10,000	1,800
Held by trustee for debt service	<u>999,564</u>	<u>-</u>
	<u><u>\$ 5,765,300</u></u>	<u><u>\$ 4,207,185</u></u>

***Investments***

***Summary of Carrying Values***

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

	<u><b>2010</b></u>	<u><b>2009</b></u>
Carrying value		
Bank deposits	\$ 5,765,300	\$ 4,207,185
Investments	364,122	1,345,018
Cash on hand and change funds	<u>645</u>	<u>645</u>
Carrying amount	<u><u>\$ 6,130,067</u></u>	<u><u>\$ 5,552,848</u></u>

Included in the following balance sheet captions:

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

	<u>2010</u>	<u>2009</u>
Cash and cash equivalents	\$ 2,962,531	\$ 2,276,685
Designated by Board of Trustees	1,793,850	1,929,345
Restricted by donors	10,000	1,800
Held by trustee for debt service - current	351,517	-
Held by trustee for debt service	<u>1,012,169</u>	<u>1,345,018</u>
	<u>\$ 6,130,067</u>	<u>\$ 5,552,848</u>

**Note 4: Patient Accounts Receivable**

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

	<u>2010</u>	<u>2009</u>
Medicare	\$ 1,080,114	\$ 741,452
Medicaid	104,338	146,806
Blue Cross	108,397	163,839
Commercial	260,398	409,177
Private pay	480,907	442,450
Gross accounts receivable	<u>2,034,154</u>	<u>1,903,724</u>
Less allowance for contractual adjustments	(449,681)	(481,048)
Less allowance for doubtful accounts	<u>(239,052)</u>	<u>(85,701)</u>
Patient accounts receivable, net	<u>\$ 1,345,421</u>	<u>\$ 1,336,975</u>

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

	<u>2010</u>	<u>2009</u>
Medicare	53%	39%
Medicaid	5%	8%
Blue Cross	5%	9%
Commercial	13%	20%
Private pay	<u>24%</u>	<u>24%</u>
Total	<u>100%</u>	<u>100%</u>

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

**Note 5: Capital Assets**

Capital assets activity for the years ended December 31 was:

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

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

	<b>2009</b>				<b>Ending Balance</b>
	<b>Beginning Balance</b>	<b>Additions</b>	<b>Deletions</b>	<b>Transfers</b>	
Land	\$ 27,954	\$ -	\$ (2,480)	\$ -	\$ 25,474
Land improvements	789,843	-	-	-	789,843
Buildings	11,104,807	12,616	(39,881)	17,000	11,094,542
Fixed equipment	1,062,479	-	-	-	1,062,479
Moveable equipment	2,564,785	925,113	(65,102)	-	3,424,796
Construction in process	3,622	50,704	-	(17,000)	37,326
	<u>15,553,490</u>	<u>988,433</u>	<u>(107,463)</u>	<u>-</u>	<u>16,434,460</u>
Less accumulated depreciation					
Land improvements	(116,176)	(57,636)	-	-	(173,812)
Buildings	(1,079,439)	(612,311)	6,979	-	(1,684,771)
Fixed equipment	(396,495)	(84,994)	-	-	(481,489)
Moveable equipment	(1,799,641)	(228,486)	65,102	-	(1,963,025)
	<u>(3,391,751)</u>	<u>(983,427)</u>	<u>72,081</u>	<u>-</u>	<u>(4,303,097)</u>
Capital assets, net	<u>\$ 12,161,739</u>	<u>\$ 5,006</u>	<u>\$ (35,382)</u>	<u>\$ -</u>	<u>\$12,131,363</u>

**Note 6: Medical Malpractice Claims**

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

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

**Note 7: Physician Receivable/Payable**

During 2009, the Hospital entered into a contract with a physician to relocate to Fredonia, Kansas to establish a practice. The Hospital has advanced \$42,349 to the physician. The physician is required, for a minimum of five years, to establish and maintain an internal medicine and primary care practice on a full-time basis in Fredonia, Kansas. In the event the physician fails to perform her obligations under the contract, she is to reimburse the Hospital all sums advanced minus any amounts forgiven pursuant to the terms of the contract. This agreement also includes other advances for student loans, sign-on bonuses, relocation expenses and marketing expenses that are included in the physician receivables on the balance sheet. The physician is now in the forgiveness period of the contract. The carrying amount of the liability for the Hospital's obligations under the guarantee contract is \$134,622 at December 31, 2010.

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

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

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**Note 8: Long-term Obligations**

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

	<b>2010</b>					
	<b>Beginning</b>			<b>Ending</b>	<b>Current</b>	<b>Long-term</b>
	<b>Balance</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance</b>	<b>Portion</b>	<b>Portion</b>
3.75% Series 2010 Revenue Bonds, due in annual installments beginning October 28, 2011 to October 28, 2020, with interest due annually on October 28.	\$ -	\$ 179,000	\$ -	\$ 179,000	\$ 15,083	\$ 163,917
6.125% Series 2007 Revenue Bonds, due in annual installments beginning August 15, 2009 to August 15, 2037, with interest due semi-annually on February 15 and August 15.	10,560,000	-	140,000	10,420,000	150,000	10,270,000
Capital leases	575,027	128,483	140,098	563,412	154,536	408,876
	<u>\$11,135,027</u>	<u>\$ 307,483</u>	<u>\$ 280,098</u>	<u>\$11,162,412</u>	<u>\$ 319,619</u>	<u>\$10,842,793</u>

**Fredonia Regional Hospital**  
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**Notes to Financial Statements**  
**December 31, 2010 and 2009**

	2009					
	Beginning			Ending	Current	Long-term
	Balance	Additions	Deletions	Balance	Portion	Portion
6.125% Series 2007 Revenue Bonds, due in annual installments beginning August 15, 2009 to August 15, 2037, with interest due semi-annually on February 15 and August 15.	\$10,745,000	\$ -	\$ 185,000	\$10,560,000	\$ 140,000	\$10,420,000
4.5% Series 1999A General Obligations Bonds, due in annual installments to October 1, 2009, with interest due semi-annually on April 1 and October 1.	40,000	-	40,000	-	-	-
Capital leases	280,578	392,691	98,242	575,027	128,977	446,050
	<u>\$11,065,578</u>	<u>\$ 392,691</u>	<u>\$ 323,242</u>	<u>\$11,135,027</u>	<u>\$ 268,977</u>	<u>\$10,866,050</u>

**2010 Revenue Bonds Payable**

The 2010 revenue bonds payable, issued by the City, consist of United States Department of Agriculture Revenue Bonds (Bonds) in the original amount of \$179,000 dated October 18, 2010, for the purpose of purchasing two ambulances. The Bonds are payable in annual installments through October 28, 2020. The Hospital is required to make monthly deposits of approximately one-twelfth of the next principal and interest payment due to the debt service fund held by the trustee beginning December 1, 2010. The owner of the Bonds may require and compel the Hospital to comply with the above provision of the Bond Resolution. The Hospital failed to segregate these funds during the year, which is a violation of the debt covenants, however, the Hospital was in compliance with this covenant subsequent to year-end. All of the Bonds still outstanding may be redeemed at the Hospital's option at 100% of the redemption price. The Bonds are secured by the net revenues of the Hospital.

**Fredonia Regional Hospital**  
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**2007 Revenue Bonds Payable**

In July 2007, the Series 2007 Revenue Bonds were issued by the City to fund the construction and equipping of the Hospital's expansion and partial replacement. The Bonds are secured by the net revenues of the Hospital.

**Capital Leases**

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

	<b>2010</b>	<b>2009</b>
Moveable equipment	\$ 895,998	\$ 845,665
Less accumulated depreciation	(374,859)	(289,926)
	\$ 521,139	\$ 555,739

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

	<b>Long-term Debt</b>		<b>Capital Lease</b>	
	<b>Principal</b>	<b>Interest</b>	<b>Principal</b>	<b>Interest</b>
2011	\$ 165,083	\$ 644,938	\$ 154,536	\$ 26,582
2012	175,631	635,184	164,085	18,144
2013	181,235	624,798	102,515	10,532
2014	196,843	614,083	71,475	4,520
2015	207,475	602,426	70,801	126
2016-2020	1,227,733	2,813,762	-	-
2021-2025	1,520,000	2,410,800	-	-
2026-2030	2,050,000	1,884,969	-	-
2031-2035	2,765,000	1,174,163	-	-
2036-2037	2,110,000	218,050	-	-
	\$ 10,599,000	\$ 11,623,173	\$ 563,412	\$ 59,904
Total payments				

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2010 and 2009**

**Note 9: Management Agreement**

The Hospital has a management agreement with Great Plains Health Alliance, Inc. to provide management and accounting services to the Hospital. Fees incurred under this agreement for the years ended December 31, 2010 and 2009, were \$99,128 and \$101,428, respectively.

**Note 10: Pension Plan**

Fredonia Regional Hospital Employees' Pension Plan (the Plan) is a defined contribution pension plan that was effective as of January 1, 1992. Eligible employees are those who work 1,000 hours or more each year, have attained the age of 21 and have completed two years of service. The Hospital's share of the contribution is 4% of the covered payroll and the employees share is 3% of the covered payroll. The employees may contribute any additional amount to the Plan on a voluntary basis. The contributions are invested as each employee directs. Each participant chooses which accounts to use and may change the election once each calendar year. Contributions actually made by plan members and the Hospital aggregated \$153,100 and \$120,525 during 2010 and \$116,929 and \$136,752 during 2009, respectively.

**Note 11: Related Party**

The Fredonia Regional Health Care Foundation, Inc. (Foundation) is a nonprofit organized to perpetuate the advancement of health, health care and medical education, research and welfare services for residents of Fredonia, Kansas and its outlying regions. The Foundation has not been included as a component unit of the Hospital. The Foundation contributed \$300,000 to the Hospital in 2009 that is included in capital grants and gifts on the statements of revenues, expenses and changes in net assets. In connection with the issuance of the Series 2007 Revenue Bonds (see *Note 8*), the Foundation has provided a financial guarantee.

**Note 12: Risks and Uncertainties**

***Current Economic Conditions***

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

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

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

**Note 13: 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.

## **Supplementary Information**

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Insurance Coverage**  
**December 31, 2010**

**AFS/IBEX Financial Services**

Policy No. HPL0015260, expiring October 1, 2011

**A. Professional Liability**

1. Hospital Limits

a. Each Claim	\$ 200,000
b. Annual Aggregate	600,000

2. Health Care Stabilization Fund

a. Each Claim	300,000
b. Annual Aggregate	900,000

3. Additional Insureds - employees, students, volunteers

a. Each Claim	1,000,000
b. Annual Aggregate	3,000,000

**B. Commercial General Liability**

a. Bodily Injury or Property Damage Liability	1,000,000
b. Annual Aggregate	3,000,000

**C. Employee Benefits Liability**

a. Each Claim	250,000
b. Annual Aggregate	250,000

**Kansas Hospital Workers' Compensation Fund**

Certificate No. 55, expiring December 31, 2010

Bodily injury by accident	500,000
Policy limit	500,000

**Cincinnati Insurance**

Policy No. CPP 0864945, expiring October 1, 2011

Blanket building and contents value	19,109,687
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Policy No. CA 143380, expiring October 2, 2011

Commercial automobile liability	500,000
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**Kansas Health Service Corporation**

Expiring October 1, 2011

Directors and officers' liability	1,000,000
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Policies expiring December 31, 2010, were renewed for another policy term.