

**Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center**

Accountants' Report and Financial Statements

September 30, 2010 and 2009



**Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center
September 30, 2010 and 2009**

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Directors
Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center
Marion, Kansas

We have audited the accompanying balance sheets of Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center and its discretely presented component unit as of September 30, 2010 and 2009, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center and its discretely presented component unit as of September 30, 2010 and 2009, 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.

The accompanying management's discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were 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 audits 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.

BKD, LLP

March 23, 2011

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Management's Discussion and Analysis Years Ended September 30, 2010 and 2009

Introduction

This management's discussion and analysis of the financial performance of St. Luke Hospital and Living Center (the Hospital) provides an overview of the Hospital's financial activities for the years ended September 30, 2010 and 2009. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and cash equivalents and short-term certificates of deposit decreased in 2010 by \$398,896 or 16% and increased by \$650,431 or 35% in 2009.
- Accounts receivable increased by \$161,229 or 21% in 2010 and decreased by \$194,552 or 20% in 2009.
- The Hospital's net assets increased by \$170,791 or 4% and \$564,826 or 15% in 2010 and 2009, respectively.
- The Hospital reported operating losses in both 2010 (\$567,667) and 2009 (\$202,494). The operating loss in 2010 increased by \$364,718 or 180% over the operating loss reported in 2009. The operating loss in 2009 decreased by \$112,217 or 36% from the operating loss reported in 2008.

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 assets; and a statement of cash flows. These statements 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.

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

One of the most important questions asked about any Hospital's finances is "Is the Hospital as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues, expenses and changes in net assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that 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 assets and changes in them. The Hospital's total net assets – the difference between assets and liabilities – are one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of

whether its financial health is improving or deteriorating. Other non-financial factors, such as changes in the Hospital's patient base, 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 resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for and what was the change in cash during the reporting period.

The Hospital's Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the balance sheet. The Hospital's net assets increased by \$170,791 or 4% in 2010 over 2009, and increased by \$564,826 or 15% in 2009 over 2008, as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2010	2009	2008
Assets			
Cash and short term certificate of deposits	\$ 2,114,348	\$ 2,513,244	\$ 1,862,813
Restricted cash - held under bond indenture	5,838,777	-	-
Patient accounts receivable, net	947,228	785,999	980,551
Estimated amounts due from Medicare and Medicaid	325,000	185,000	-
Other current assets	200,134	205,824	204,572
Other noncurrent assets	177,024	-	-
Long-term certificates of deposit	-	-	215,393
Capital assets, net	1,880,057	1,713,154	1,977,784
	<u>\$ 11,482,568</u>	<u>\$ 5,403,221</u>	<u>\$ 5,241,113</u>
Liabilities			
Long-term debt, including current portion	\$ 6,148,290	\$ 430,392	\$ 763,663
Accounts payable and accrued expenses	277,455	189,550	312,570
Deferred grant revenue	180,090	-	-
Deferred property tax revenue	420,049	497,386	443,813
	<u>7,025,884</u>	<u>1,117,328</u>	<u>1,520,046</u>
Net Assets			
Invested in capital assets, net of related debt	1,208,075	1,282,762	1,214,121
Restricted expendable	610,747	-	-
Unrestricted	2,637,862	3,003,131	2,506,946
	<u>4,456,684</u>	<u>4,285,893</u>	<u>3,721,067</u>
Total net assets	<u>\$ 11,482,568</u>	<u>\$ 5,403,221</u>	<u>\$ 5,241,113</u>
Total liabilities and net assets	<u>\$ 11,482,568</u>	<u>\$ 5,403,221</u>	<u>\$ 5,241,113</u>

Significant changes in the Hospital's assets in 2010 include a decrease in cash and increase in accounts receivable. Cash balances declined due to decreases in patient volumes while net accounts receivable increased due to slower collections. Another significant change is the increase in restricted funds related to the building project that were obtained through the 2010 bond issuance. The project and bonds will be discussed in greater detail below.

Significant changes in the Hospital's assets in 2009 were the increase in cash and receivable from Medicare and Medicaid.

Operating Results and Changes in the Hospital's Net Assets

In 2010, the Hospital's net assets increased by \$170,791 or 4%, as shown in Table 2. This increase is made up of several different components. The Hospital's change in net assets increased by \$564,826 or 15% in 2009.

Table 2: Operating Results and Changes in Net Assets

	2010	2009	2008
Operating Revenues			
Net patient service revenue	\$ 6,649,047	\$ 6,817,715	\$ 6,526,084
Other operating revenues	122,352	106,536	132,320
Total operating revenues	6,771,399	6,924,251	6,658,404
Operating Expenses			
Salaries and wages and employee benefits	3,685,200	3,723,956	3,720,343
Purchased services and professional fees	1,749,531	1,575,993	1,472,858
Depreciation	399,488	412,737	346,447
Other operating expenses	1,504,847	1,414,514	1,433,922
Total operating expenses	7,339,066	7,127,200	6,973,570
Operating Loss	(567,667)	(202,949)	(315,166)
Nonoperating Revenues (Expenses)			
Property taxes	703,061	711,086	720,736
Interest income	24,199	35,385	50,520
Noncapital grants and gifts	23,386	47,319	28,651
Interest expense	(12,188)	(26,015)	(28,882)
Total nonoperating revenues	738,458	767,775	771,025
Increase in Net Assets	\$ 170,791	\$ 564,826	\$ 455,859

Operating Loss

The first component of the overall change in the Hospital's net assets is its operating income or loss – generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In each of the past three years, the Hospital has reported an operating loss. The Hospital levies property taxes to provide sufficient resources to enable the facility to serve lower income and other residents.

The operating loss for 2010 increased by \$364,718 or 180% as compared to 2009. The primary components of the increased operating loss are:

- A decrease in net patient service revenue of \$168,668 or 2%.
- An increase in purchased services and professional fees of \$173,538 or 11%.
- An increase in other operating expenses of \$90,333 or 6%.

Purchased services and professional fees increased primarily due to increases in amounts paid for temporary physician coverage for the clinic and emergency room coverage.

The operating loss for 2009 decreased by \$112,217 or 36% as compared to 2008. The primary components of the decreased operating loss are:

- An increase in net patient service revenue of \$291,631 or 4%.

Nonoperating Revenues

Nonoperating revenues consist principally of property taxes and noncapital grants and gifts. Property tax revenue remained relatively stable in all three years. The Hospital receives noncapital grants and gifts from various state and federal agencies and individuals. Noncapital grants and gifts received in 2010 totaled \$23,386 as compared to \$47,319 in 2009 and \$28,651 in 2008.

The Hospital's Cash Flows

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

Capital Asset and Debt Administration

Capital Assets

At the end of 2010, the Hospital had \$1,880,057 invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. The Hospital purchased new equipment costing \$566,391 and \$148,107 in 2010 and 2009, respectively. The majority of the capital purchases made in 2010 were related to architectural services for the building project that was started in August 2010. The \$6.2 million dollar renovation is scheduled to be completed late fall 2011.

Debt

At September 30, 2010, the Hospital had \$6,148,290 in bond and capital lease obligations outstanding, as detailed in *Note 7* to the financial statements. The Hospital issued bonds in May 2010 to fund the building project that was started in August 2010 and is scheduled to be completed late fall 2011.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Hospital Business Administration by telephoning 620.382.2177.

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Balance Sheets

September 30, 2010 and 2009

Assets

	2010	2009
Current Assets		
Cash and cash equivalents	\$ 1,662,491	\$ 1,846,472
Short-term certificates of deposit	451,857	666,772
Restricted cash - held under bond indenture	180,090	-
Patient accounts receivable, net of allowance; 2010 - \$295,000; 2009 - \$337,000	947,228	785,999
Estimated amounts due from third-party payers	325,000	185,000
Supplies	112,815	112,559
Prepaid expenses and other	87,319	93,265
Total current assets	3,766,800	3,690,067
Noncurrent Cash and Investments		
Held under bond indenture for capital acquisitions	5,228,030	-
Held under bond indenture for debt service	430,657	-
	5,658,687	-
Capital Assets, Net	1,880,057	1,713,154
Deferred Bond Costs	177,024	-
Total assets	\$ 11,482,568	\$ 5,403,221

Liabilities and Net Assets

	<u>2010</u>	<u>2009</u>
Current Liabilities		
Current maturities of long-term debt	\$ 148,290	\$ 277,794
Accounts payable	277,455	189,550
Accrued expenses	<u>600,139</u>	<u>497,386</u>
Total current liabilities	1,025,884	964,730
Long-term Debt	<u>6,000,000</u>	<u>152,598</u>
Total liabilities	<u>7,025,884</u>	<u>1,117,328</u>
Net Assets		
Invested in capital assets, net of related debt	1,208,075	1,282,762
Restricted - expendable for		
Debt service	610,747	-
Unrestricted	<u>2,637,862</u>	<u>3,003,131</u>
Total net assets	<u>4,456,684</u>	<u>4,285,893</u>
Total liabilities and net assets	<u><u>\$ 11,482,568</u></u>	<u><u>\$ 5,403,221</u></u>

**Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center
St. Luke Hospital Foundation
Statements of Financial Position
September 30, 2010 and 2009**

	2010	2009
Assets		
Cash	\$ 443,198	\$ 70,330
Short-term certificates of deposit	55,954	57,394
Long-term certificates of deposit	58,523	55,402
Total assets	\$ 557,675	\$ 183,126
 Unrestricted Net Assets	 \$ 557,675	 \$ 183,126

**Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center**

Statements of Revenues, Expenses and Changes in Net Assets

Years Ended September 30, 2010 and 2009

	2010	2009
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2010 – \$229,000, 2009 – \$206,000	\$ 6,649,047	\$ 6,817,715
Other	122,352	106,536
Total operating revenues	6,771,399	6,924,251
Operating Expenses		
Salaries and wages	3,079,243	3,140,362
Employee benefits	605,957	583,594
Purchased services and professional fees	1,749,531	1,575,993
Supplies and other	1,504,847	1,414,514
Depreciation	399,488	412,737
Total operating expenses	7,339,066	7,127,200
Operating Loss	(567,667)	(202,949)
Nonoperating Revenues (Expenses)		
Property taxes	703,061	711,086
Interest income	24,199	35,385
Interest expense	(12,188)	(26,015)
Noncapital grants and gifts	23,386	47,319
Total nonoperating revenues	738,458	767,775
Increase in Net Assets	170,791	564,826
Net Assets, Beginning of Year	4,285,893	3,721,067
Net Assets, End of Year	\$ 4,456,684	\$ 4,285,893

**Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center
St. Luke Hospital Foundation
Statements of Activities
Years Ended September 30, 2010 and 2009**

	2010	2009
Unrestricted Revenues, Gains and Other Support		
Contributions	\$ 536,735	\$ 16,150
Interest income	2,497	3,828
Total revenues, gains and other support	539,232	19,978
Unrestricted Expenses		
Support to St. Luke Hospital and Living Center	164,683	83,972
Total expenses	164,683	83,972
Change in Unrestricted Net Assets	374,549	(63,994)
Unrestricted Net Assets, Beginning of Year	183,126	247,120
Unrestricted Net Assets, End of Year	\$ 557,675	\$ 183,126

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Statements of Cash Flows Years Ended September 30, 2010 and 2009

	2010	2009
Operating Activities		
Receipts from and on behalf of patients	\$ 6,347,818	\$ 6,767,267
Payments to suppliers and contractors	(3,230,857)	(3,070,127)
Payments to and on behalf of employees	(3,582,447)	(3,670,383)
Other receipts (payments), net	122,352	106,536
Net cash provided by (used in) operating activities	(343,134)	133,293
Noncapital Financing Activities		
Property taxes supporting operations	703,061	711,086
Noncapital grants and gifts	23,386	47,319
Net cash provided by noncapital financing activities	726,447	758,405
Capital and Related Financing Activities		
Principal paid on long-term debt	(282,102)	(333,271)
Proceeds from issuance of long-term debt	6,000,000	-
Payment of bond issuance costs	(177,024)	-
Interest paid on long-term debt	(12,188)	(26,015)
Purchase of capital assets	(496,317)	(132,759)
Net cash provided by (used in) capital and related financing activities	5,032,369	(492,045)
Investing Activities		
Interest income	24,199	35,385
Purchase of certificates of deposit	(900,893)	(968,239)
Maturities of certificates of deposit	1,115,808	849,252
Net change in construction escrow and debt-related accounts	(5,838,777)	-
Net cash used in investing activities	(5,599,663)	(83,602)
Increase (Decrease) in Cash and Cash Equivalents	(183,981)	316,051
Cash and Cash Equivalents, Beginning of Year	1,846,472	1,530,421
Cash and Cash Equivalents, End of Year	\$ 1,662,491	\$ 1,846,472

**Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center**

**Statements of Cash Flows (Continued)
Years Ended September 30, 2010 and 2009**

	2010	2009
Reconciliation of Net Operating Loss to Cash Used in Operating Activities		
Operating loss	\$ (567,667)	\$ (202,949)
Depreciation	399,488	412,737
Changes in operating assets and liabilities		
Patient accounts receivable, net	(161,229)	194,552
Estimated amounts due from and to Medicare	(140,000)	(245,000)
Accounts payable and accrued expenses	120,584	(24,795)
Other assets and liabilities	5,690	(1,252)
Net cash provided by (used in) operating activities	\$ (343,134)	\$ 133,293
Supplemental Cash Flows Information		
Capital assets additions included in accounts payable	\$ 70,074	\$ 15,348

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2010 and 2009

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

Nature of Operations and Reporting Entity

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center (Hospital) owns and operates an acute care hospital located in Marion, Kansas. The Hospital is operated by a Board of Directors elected by the qualified voters of the District. The Hospital primarily earns revenues by providing inpatient, outpatient, emergency and residential long-term care services in the Marion County area. It also operates a home health agency in the same geographic area.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place. Operating revenues and expenses include exchange transactions. Property taxes, interest income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

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

Use of Estimates

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

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At September 30, 2010 and 2009, cash equivalents consisted primarily of certificates of deposit.

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements September 30, 2010 and 2009

Property Taxes

The Hospital received approximately 9% of its financial support from property taxes in both 2010 and 2009. One hundred percent of these funds were used to support operations in both years.

Property taxes are levied in November of one year and are received beginning in January of the following year. Property tax revenue is recognized in full in the year following the year the taxes were levied, which is the year in which use is first permitted.

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; 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.

Investments and Investment Income

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition and in nonnegotiable certificates of deposit are carried at amortized cost. All other investments are carried at fair value. Fair value is determined using quoted market prices. Investment income includes interest income.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

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

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 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 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 years
Buildings	10 – 50 years
Fixed equipment	3 – 20 years
Major moveable equipment	3 – 20 years

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

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements September 30, 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 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.

Income Taxes

As an essential government entity, 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.

Foundation

St. Luke Hospital Foundation (the Foundation) is a legally separate, tax-exempt component unit of the Hospital. The Foundation's primary function is to raise and hold funds to support the Hospital and its programs. The board of the Foundation is self-perpetuating.

Although the Hospital does not control the timing or amount of receipts from the Foundation, the Foundation's by-laws restrict its resources and related income to be used for the benefit of the Hospital. Because these resources held by the Foundation can only be used by, or for the benefit of, the Hospital, the Foundation is considered a component unit of the Hospital and is discretely presented in the Hospital's financial statements.

During the fiscal years ended September 30, 2010 and 2009, the Foundation provided \$164,683 and \$83,972 of support to the Hospital, respectively. Complete financial statements of the Foundation may be obtained from its administrative office at the following address: 1014 East Melvin, Marion, Kansas 66861.

Subsequent Events

Subsequent events have been evaluated through March 23, 2011, which is the date the financial statements were available to be issued.

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements September 30, 2010 and 2009

Note 2: Net Patient Service Revenue

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

Medicare. The Hospital is recognized as a Critical Access Hospital (CAH) and is paid at one hundred one percent (101%) of allowable costs for certain inpatient and outpatient services. 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. Home health services are paid on a per-episode basis using clinical, diagnostic and other factors.

Medicaid. The Hospital is paid for inpatient and outpatient services rendered to Medicaid program beneficiaries who are not part of a Medicaid managed care network on a cost reimbursement methodology. Medicaid managed care patients are reimbursed under a prospective reimbursement methodology. Medicaid rural health clinic services are reimbursed under a cost-based methodology. The Hospital and rural health clinic are reimbursed at tentative rates with final settlements determined after submission of annual cost reports by the Hospital and reviews thereof by the Kansas Health Policy Authority.

Medicaid reimbursement for long-term care facility residents is based on a cost-based prospective reimbursement methodology. The Hospital is reimbursed at a prospective rate with annual cost reports submitted to the Medicaid program. Rates are computed each calendar quarter using an average of the 2005, 2006 and 2007 cost reports and changes in the Medicaid resident case mix index. The Medicaid cost reports are subject to audit by the State and adjustments to rates can be made retroactively.

Approximately 54% and 56% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended September 30, 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.

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2010 and 2009

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; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the state of Kansas; bonds of any city, county, school district or special road district of the state of Kansas; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

At September 30, 2010 and 2009, respectively, \$1,507,449 and \$1,518,612 of the Hospital's bank balance of \$3,777,878 and \$2,577,786 was exposed to custodial credit risk as follows:

	2010	2009
Uninsured and uncollateralized	\$ -	\$ -
Uninsured and collateral held by pledging financial institution's trust department or agent in other than the Hospital's name	1,507,449	1,518,612
	\$ 1,507,449	\$ 1,518,612

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 and in bank repurchase agreements. It may also invest to a limited extent in corporate bonds and equity securities.

The Hospital had no investments at September 30, 2009. At September 30, 2010, the Hospital had the following investments and maturities:

Type	Fair Value	September 30, 2010 Maturities in Years			
		Less Than 1	1-5	6-10	More Than 10
Cash and cash equivalents	\$ 1,524,460	\$ 1,524,460	\$ -	\$ -	\$ -
State of Kansas municipal obligations	4,314,317	4,314,317	-	-	-
	\$ 5,838,777	\$ 5,838,777	\$ -	\$ -	\$ -

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements September 30, 2010 and 2009

Summary of Carrying Values

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

	2010	2009
Carrying value		
Deposits	\$ 2,114,048	\$ 2,513,049
Petty cash	300	195
Investments	5,838,777	-
	\$ 7,953,125	\$ 2,513,244

Included in the following balance sheet captions:

	2010	2009
Cash and cash equivalents	\$ 1,662,491	\$ 1,846,472
Short-term certificates of deposit	451,857	666,772
Restricted cash - held under bond indenture	180,090	-
Held under bond indenture for capital acquisitions	5,228,030	-
Held under bond indenture for debt service	430,657	-
	\$ 7,953,125	\$ 2,513,244

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 September 30, 2010 and 2009, consisted of:

	2010	2009
Medicare	\$ 247,771	\$ 215,901
Medicaid	67,802	75,137
Blue Cross	132,095	88,450
Other third-party payers	174,394	209,916
Patients	620,166	533,595
	1,242,228	1,122,999
Less allowance for uncollectible accounts	295,000	337,000
	\$ 947,228	\$ 785,999

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements September 30, 2010 and 2009

Note 5: Capital Assets

Capital assets activity for the years ended September 30, 2010 and 2009, was:

	2010			
	Beginning Balance	Additions	Disposals	Ending Balance
Land	\$ 28,253	\$ -	\$ -	\$ 28,253
Land improvements	50,908	-	-	50,908
Buildings	2,250,221	-	-	2,250,221
Construction in progress	57,355	523,691	-	581,046
Fixed equipment	963,139	-	-	963,139
Major moveable equipment	2,631,239	42,700	(18,367)	2,655,572
	5,981,115	566,391	(18,367)	6,529,139
Less accumulated depreciation				
Land improvements	50,908	-	-	50,908
Buildings	1,454,685	74,845	-	1,529,530
Fixed equipment	903,477	20,270	-	923,747
Major moveable equipment	1,858,891	304,373	(18,367)	2,144,897
	4,267,961	399,488	(18,367)	4,649,082
Capital Assets, Net	\$ 1,713,154	\$ 166,903	\$ -	\$ 1,880,057

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2010 and 2009

	2009			
	Beginning Balance	Additions	Disposals	Ending Balance
Land	\$ 28,253	\$ -	\$ -	\$ 28,253
Land improvements	50,908	-	-	50,908
Buildings	2,228,030	22,191	-	2,250,221
Construction in progress	-	57,355	-	57,355
Fixed equipment	963,139	-	-	963,139
Major moveable equipment	2,574,765	68,561	(12,087)	2,631,239
	5,845,095	148,107	(12,087)	5,981,115
Less accumulated depreciation				
Land improvements	50,908	-	-	50,908
Buildings	1,379,222	75,463	-	1,454,685
Fixed equipment	880,998	22,479	-	903,477
Major moveable equipment	1,556,183	314,795	(12,087)	1,858,891
	3,867,311	412,737	(12,087)	4,267,961
Capital Assets, Net	\$ 1,977,784	\$ (264,630)	\$ -	\$ 1,713,154

Note 6: Medical Malpractice Coverage and Claims

The Hospital purchases medical malpractice insurance under a claims-made policy with a fixed premium which provides \$200,000 of coverage for each medical incident and \$600,000 of aggregate coverage for each policy year. The policy only covers claims made and reported to the insurer during the policy term, regardless of when the incident giving rise to the claim occurred. The Kansas Health Care Stabilization Fund provides an additional \$800,000 of coverage for each medical incident and \$2,400,000 of aggregate coverage for each policy year.

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

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2010 and 2009

coverage ratio of at least 1.15 during construction and at least 1.40 thereafter. For the year ended September 30, 2010, the Hospital's historical debt-service coverage ratio was 3.30.

The debt service requirements as of September 30, 2010, are as follows:

Year Ending September 30,	Total to be Paid	Principal	Interest
2011	\$ 501,678	\$ -	\$ 501,678
2012	512,275	50,000	462,275
2013	559,463	100,000	459,463
2014	555,088	100,000	455,088
2015	550,088	100,000	450,088
2016-2020	2,711,094	560,000	2,151,094
2021-2025	2,616,688	695,000	1,921,688
2026-2030	2,520,569	890,000	1,630,569
2031-2035	2,482,981	1,190,000	1,292,981
2036-2040	2,289,750	1,590,000	699,750
2041	757,625	725,000	32,625
	<u>\$ 16,057,299</u>	<u>\$ 6,000,000</u>	<u>\$ 10,057,299</u>

Capital Lease Obligations

The Hospital is obligated under leases for equipment that are accounted for as capital leases. Assets under capital leases at September 30, 2010 and 2009, totaled \$311,199 and \$558,649, respectively, net of accumulated depreciation of \$835,014 and \$1,364,111, respectively. The following is a schedule by year of future minimum lease payments under capital leases including interest at rates of 3.64% to 4.69% together with the present value of the future minimum lease payments as of September 30, 2010:

Year Ending September 30,	
2011	\$ 150,454
Less amount representing interest	<u>2,164</u>
Present value of future minimum lease payments	<u>\$ 148,290</u>

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2010 and 2009

Note 8: Pension Plan

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension 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 the Hospital. The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's governing body. Employees may contribute up to 60% of eligible compensation subject to a maximum established by the Internal Revenue Service. Contributions actually made by plan members and the Hospital aggregated \$113,515 and \$25,132, respectively, during 2010, and \$132,947 and \$26,544, respectively, during 2009.

Note 9: Current Economic Conditions

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

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of our 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 allowances for accounts receivable that could negatively impact the Hospital's ability to maintain sufficient liquidity.

Note 10: Subsequent Events

Medicaid Provider Assessment

On February 2, 2011, the Centers for Medicare and Medicaid Services (CMS) approved a Medicaid State Plan amendment which provides for additional funds to be paid to operators of long-term care facilities. The Kansas Department on Aging has estimated the additional net receipts for the Hospital to be approximately \$66,000. These receipts are expected to begin in March 2011.

Supplementary Information

**Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center**

**Comparison of Revenues and Expenses (Cash Basis) – Actual and Tax Budget
Calendar Year Ended December 31, 2009**

	<u>Actual</u>	<u>Tax Budget</u>	<u>Actual Over (Under) Budget</u>
Net patient service revenue	\$ 6,577,747	\$ 6,511,551	\$ 66,196
Other revenue	<u>107,322</u>	<u>131,201</u>	<u>(23,879)</u>
Total operating revenue	<u>6,685,069</u>	<u>6,642,752</u>	<u>42,317</u>
Operating expenses	7,178,545	8,734,229	(1,555,684)
Interest paid	<u>22,390</u>	<u>-</u>	<u>22,390</u>
Operating expenses	<u>7,200,935</u>	<u>8,734,229</u>	<u>(1,533,294)</u>
Operating loss	<u>(515,866)</u>	<u>(2,091,477)</u>	<u>1,575,611</u>
Property tax revenue	711,271	722,921	(11,650)
Other nonoperating revenues	<u>79,893</u>	<u>48,769</u>	<u>31,124</u>
Total nonoperating revenues	<u>791,164</u>	<u>771,690</u>	<u>19,474</u>
Excess (deficiency) of revenue over expenses	<u><u>\$ 275,298</u></u>	<u><u>\$ (1,319,787)</u></u>	<u><u>\$ 1,595,085</u></u>

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Insurance Coverage September 30, 2010 and 2009

General Casualty	Coverage Limits	Premiums
Expiring October 1, 2010:		
Buildings and contents	\$ 17,608,045	\$ 17,249
Electronic data processing equipment	391,838	669
Business income with extra expense	6,297,000	1,561
Expiring October 1, 2010:		
Employee theft	500,000	1,296
Forgery and alteration	500,000	
Computer fraud coverage	100,000	
Expiring October 1, 2010:		
Comercial automobile	1,000,000	2,156
U.S. Specialty Insurance Company		
Expiring October 1, 2010:		
Directors and officers with employment practices	2,000,000	5,623
KHA Worker's Compensation Fund, Inc.		
Expiring January 1, 2010:		
Workers' compensation:		36,993
Per accident	500,000	
Per employee disease	500,000	
Policy limit	500,000	
Kansas Medical Mutual Insurance Company		
Expiring October 15, 2010:		
Professional liability	200,000/600,000	13,303
Kansas Healthcare Stabilization Fund	800,000/2,400,000	6,255
General liability	1,000,000/3,000,000	2,000
Additional insureds	5,000,000/5,000,000	20,952
Fire legal liability	50,000	