FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
DECEMBER 31, 2011 AND 2010

CONTENTS

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the financial performance of Labette County Medical Center d/b/a Labette Health provides a narrative overview of Labette Health's financial activities for the years ended December 31, 2011 and 2010. Please read it in conjunction with the accompanying basic financial statements.

Financial highlights

Labette Health's net assets decreased by $1,527,295 or 4.1 percent in 2011 and decreased by $1,313,396 or 3.4 percent in 2010.

Labette Health reported an operating loss of $880,892 in 2011, an operating loss of $425,235 in 2010, and operating income of $1,003,684 in 2009.

Using these financial statements

Labette Health'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 financial statements and related notes provide information about the activities of Labette Health, including resources held by or for the benefit of Labette Health, and resources restricted for specific purposes by contributors, grantors, and indenture agreements.

One of the most important questions asked about Labette Health's finances is, "Is Labette Health 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 Labette Health'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. For purposes of these two statements, revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report Labette Health's net assets and changes in them. Labette Health's net assets - the difference between assets and liabilities - may be thought of as one way to measure its financial health, or financial position. Over time, increases or decreases in Labette Health's net assets are one indicator of whether its financial health is improving or deteriorating. Consideration must also be given to other nonfinancial indicators, such as changes in Labette Health's patient base and measures of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of Labette Health.

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing 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 balance during the reporting period?"

Assets, liabilities, and net assets

Labette Health's balance sheets as of the end of each of the last three years are summarized as follows:

	2011	2010	2009
Assets			
Current assets	$ 16,989,510	$ 14,871,875	$ 16,380,518
Assets limited as to use	10,634,847	10,891,831	12,120,200
Capital assets, net	43,352,688	46,704,388	48,047,801
Other assets	2,301,280	2,342,809	1,961,749
Total assets	$ 73,278,325	$ 74,810,903	$ 78,510,268
Liabilities			
Current liabilities	$ 6,937,594	$ 6,361,206	$ 7,710,294
Long-term liabilities	30,467,159	31,048,830	32,085,711
Total liabilities	$ 37,404,753	$ 37,410,036	$ 39,796,005
Net assets	$ 35,873,572	$ 37,400,867	$ 38,714,263

Cash and cash equivalents in the current asset category decreased by $112,917 in 2011 and decreased by $1,080,807 in 2010. The changes in both years are due to cash flows from operations being less than the cash used by capital and related financing activities.

Net patient accounts receivable increased by $1,795,687 in 2011 and increased by $645,487 in 2010. The number of days of net revenue represented by net accounts receivable was 68 days, 57 days, and 52 days as of December 31, 2011, 2010, and 2009, respectively. The median value of similar hospitals for this ratio is 46 days.

Net capital assets decreased by $3,351,700 in 2011 and decreased by $1,343,413 in 2010. Capital asset acquisitions during 2011 and 2010 were funded from operating cash flow, capital lease obligations, and proceeds of the bonds issued during 2007. Cash outlays for capital asset acquisitions totaled $1,478,128 during 2011, of which $547,000 (37.0 percent) was financed with capital lease obligations and the rest was paid for from operating cash flow. Capital asset acquisitions in 2010 of $2,387,519 for renovations and additions to Labette Health's facilities were funded with proceeds from the 2007 bonds. Total capital asset acquisitions in 2010 were $5,004,740. Of the remaining $2,617,221 of capital asset acquisitions, $194,105 (7.4 percent) was financed with capital lease obligations and the rest was paid for from operating cash flow.

Labette Health's net assets decreased by $1,527,295 or 4.1 percent in 2011 and decreased by $1,313,396 or 3.4 percent in 2010. The percentage of total assets financed with net assets, or equity, was 49.0 percent, 50.0 percent, and 49.3 percent as of December 31, 2011, 2010, and 2009, respectively.

Operating results and changes in net assets

Labette Health's operating results and changes in net assets for each of the last three years are summarized as follows:

	2011	2010	2009
Operating revenues	$ 54,120,929	$ 53,318,989	$ 53,169,310
Operating expenses	55,001,821	53,744,224	52,165,626
Operating income (loss)	(880,892)	(425,235)	1,003,684
Ambulance subsidy	621,345	589,341	621,308
Interest expense	(1,815,519)	(1,661,361)	(1,000,786)
Other nonoperating revenues	317,996	153,574	184,186
Capital grants and contributions	229,775	30,285	269,440
Change in net assets	$ (1,527,295)	$ (1,313,396)	$ 1,077,832

The first, and most significant, component of the overall change in Labette Health's net assets is its operating income or loss - generally, the difference between net patient service revenue and the expenses incurred to perform those services. Labette Health's operating income decreased by $455,657 and $1,428,919 in 2011 and 2010, respectively.

Gross and net patient service revenue for the past three years are analyzed as follows:

	2011	2010	2009
Inpatient services	$ 46,482,654	$ 41,884,776	$ 40,936,518
Outpatient services	76,116,946	67,946,807	65,467,134
Physician services	11,888,527	9,591,243	8,625,066
Gross patient service revenue	134,488,127	119,422,826	115,028,718
Medicaid disproportionate share payments	259,859	455,118	909,899
Contractual adjustments	(73,482,090)	(60,202,404)	(56,845,542)
Provision for bad debts	(6,249,848)	(4,697,687)	(4,872,679)
Charity care	(1,996,563)	(2,716,315)	(2,073,360)
Net patient service revenue	$ 53,019,485	$ 52,261,538	$ 52,147,036

Labette Health raised its overall charge rates by approximately 9.6 percent in 2011 and by approximately 5.2 percent in 2010. Total inpatient revenues increased 11.0 percent during 2011. This increase was a result of the charge rate increases, a 3.8 percent increase in acute and ICU patient days in 2011, and a 65.1 percent increase in rehabilitation unit patient days in 2011. Total inpatient revenues increased 2.3 percent during 2010. The charge rate increases and a 7.6 percent increase in acute and ICU patient days in 2010 was partially offset by a 49.3 percent decrease in rehabilitation unit patient days and lower utilization of ancillary services than in 2009. Outpatient revenues increased by 12.0 percent during 2011 because of charge rate increases, which were more substantial for emergency and therapy services, and a .5 percent decrease in outpatient registrations. Outpatient revenues increased by 3.8 percent during 2010 because of charge rate increases and a 2.7 percent decrease in outpatient registrations. The change in physician service revenue is primarily due to changes in the number of physicians working for Labette Health.

Labette Health has agreements with various third-party payors that provide for payments to it at amounts different from its established charge rates. These differences are referred to as contractual adjustments. These adjustments are affected by the mix of revenues as well as by increases in Labette Health's charge rates relative to changes in rates paid by third-party payors.

The provision for bad debts and charity care write-offs combined represent 6.1 percent, 6.2 percent, 6.0 percent, and 5.5 percent of gross patient service revenue during 2011, 2010, 2009, and 2008, respectively. This rising trend is reflective of the current health care environment in which an increasing number of patients are uninsured, or insured by plans requiring higher out-of-pocket expense covered by the insured.

Employee salaries and wages decreased by $509,331 or 2.2 percent in 2011 and increased by $1,040,630 or 4.8 percent in 2010. The number of full-time equivalent employees decreased by 33.4 (7.4 percent) during 2011 and decreased by 4.6 (1.0 percent) during 2010.

The cost of employee benefits equaled 19.3 percent, 20.0 percent, and 22.3 percent of salaries and wages during 2011, 2010, and 2009, respectively. Variations in employee benefit costs generally correlate with claims experience under Labette Health's self-insured employee health insurance plan.

Supplies and other expenses increased by 8.5 percent in 2011 and increased by 1.7 percent during 2010. These changes are consistent with the patient volume fluctuations experienced by Labette Health combined with the general rate of health care inflation, as well as a shift in 2011 of certain services obtained from contracted individuals rather than employees.

Nonoperating revenues include sales tax revenues received from the County. This subsidy offsets losses incurred by Labette Health in operating the local ambulance service. Labette Health began receiving this subsidy in 2002.

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Trustees
Labette County Medical Center
d/b/a Labette Health

We have audited the accompanying financial statements of the business-type activity and discretely presented component units of Labette County Medical Center d/b/a Labette Health as of and for the years ended December 31, 2011 and 2010, which collectively comprise Labette Health's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Labette Health's management. Our responsibility is to express opinions 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 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 Labette Health's internal control over financial reporting. Accordingly, we express no such opinion. 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 respective financial position of the business-type activity and discretely presented component units of Labette County Medical Center d/b/a Labette Health as of December 31, 2011 and 2010, and their respective results of operations, changes in net assets, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 4 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of

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inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Wendling Noe Nelson & Johnson LLC

Topeka, Kansas
May 15, 2012

FINANCIAL STATEMENTS

LABETTE COUNTY MEDICAL CENTER

D/B/A LABETTE HEALTH

BALANCE SHEETS

December 31,

ASSETS

	2011			2010		
	Labette Health	Foundation	Clinic	Labette Health	Foundation	Clinic
CURRENT ASSETS						
Cash and cash equivalents	$ 3,785,701	$ 256,489	$ 96,207	$ 3,898,618	$ 328,728	$ 96,883
Investments		810,524			802,326	
Assets limited as to use	1,122,067			801,236		
Patient accounts receivable, net of allowance for uncollectible accounts of $1,415,087 in 2011 and $2,229,368 in 2010	9,920,845			8,125,158		
Other receivables	182,910	33,095		76,715	33,095	783
Estimated third-party payor settlements	182,247			257,992		
Inventories	1,277,304			1,229,935		
Prepaid expenses	518,436			482,221		
Total current assets	16,989,510	1,100,108	96,207	14,871,875	1,164,149	97,666
ASSETS LIMITED AS TO USE						
Internally designated for capital assets	8,327,458			8,261,565		
Under indenture agreement - held by trustee	3,429,456			3,431,502		
By contributors for employee assistance and capital acquisitions		8,863			9,073	
Principal of permanent endowments		58,064			58,064	
	11,756,914	66,927	-	11,693,067	67,137	-
Less amounts required to meet current obligations	1,122,067			801,236		
	10,634,847	66,927	-	10,891,831	67,137	-
CAPITAL ASSETS, net	43,352,688	-	161,912	46,704,388	-	178,082
OTHER ASSETS						
Investment in affiliate	619,599			576,295		
Advances receivable	1,139,024			1,189,214		
Other	542,657	118,513		577,300	118,513	
	2,301,280	118,513	-	2,342,809	118,513	-
	$73,278,325	$ 1,285,548	$258,119	$74,810,903	$ 1,349,799	$275,748

The accompanying notes are an integral part of these statements.

LIABILITIES AND NET ASSETS

	2011			2010		
	Labette Health	Foundation	Clinic	Labette Health	Foundation	Clinic
CURRENT LIABILITIES						
Current maturities of long-term obligations	$ 1,036,103	$ -	$ -	$ 1,081,836	$ -	$ -
Accounts payable	2,292,770			1,782,280		
Capital asset acquisitions payable	358,446			50,000		
Accrued salaries, wages, and benefits	1,005,552		7,184	1,210,012		6,304
Accrued compensated absences	929,186			1,105,558		
Accrued interest payable	587,067			616,833		
Accrued health insurance claims	325,762			339,624		
Estimated third-party payor settlements	386,070			172,070		
Deferred grant revenue	16,638			2,993		
Total current liabilities	6,937,594	-	7,184	6,361,206	-	6,304
LONG-TERM OBLIGATIONS, less current maturities	30,452,575			30,994,204		
POST-RETIREMENT BENEFITS	14,584			54,626		
Total liabilities	37,404,753	-	7,184	37,410,036	-	6,304
NET ASSETS						
Invested in capital assets net of related debt	15,033,418		161,912	17,746,519		178,082
Restricted						
For debt service	1,315,093			840,631		
Expendable for capital acquisitions	50,000	50,456			220,623	
Nonexpendable permanent endowments		58,064			58,064	
Unrestricted	19,475,061	1,177,028	89,023	18,813,717	1,071,112	91,362
Total net assets	35,873,572	1,285,548	250,935	37,400,867	1,349,799	269,444
TOTAL LIABILITIES AND NET ASSETS	$73,278,325	$ 1,285,548	$258,119	$74,810,903	$ 1,349,799	$275,748

LABETTE COUNTY MEDICAL CENTER

D/B/A LABETTE HEALTH

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Year ended December 31,

	2011			2010		
	Labette Health	Foundation	Clinic	Labette Health	Foundation	Clinic
Operating revenues						
Net patient service revenue	$53,019,485	$ -	$ -	$52,261,538	$ -	$ -
Other	1,101,444	241,974	81,192	1,057,451	339,633	81,113
Total operating revenues	54,120,929	241,974	81,192	53,318,989	339,633	81,113
Operating expenses						
Salaries and wages	22,161,012		4,550	22,670,343		4,555
Employee benefits	4,274,188			4,523,568		
Supplies and other	23,445,683	320,976	24,981	21,610,746	143,156	61,751
Depreciation and amortization	5,120,938		16,170	4,939,567		16,170
Total operating expenses	55,001,821	320,976	45,701	53,744,224	143,156	82,476
Operating income (loss)	(880,892)	(79,002)	35,491	(425,235)	196,477	(1,363)
Nonoperating revenues (expenses)						
Ambulance subsidy	621,345			589,341		
Investment income	115,646	14,751		110,547	80,364	
Interest expense	(1,815,519)			(1,661,361)		
Noncapital grants and contributions	132,842			67,959		
Other	69,508			(24,932)		
Total nonoperating revenues (expenses)	(876,178)	14,751	-	(918,446)	80,364	-
Excess of revenues over (under) expenses before capital grants and contributions	(1,757,070)	(64,251)	35,491	(1,343,681)	276,841	(1,363)
Capital grants and contributions	229,775			30,285		
Distributions to members			(54,000)			
Change in net assets	(1,527,295)	(64,251)	(18,509)	(1,313,396)	276,841	(1,363)
Net assets beginning of year	37,400,867	1,349,799	269,444	38,714,263	1,072,958	270,807
Net assets end of year	$35,873,572	$ 1,285,548	$250,935	$37,400,867	$ 1,349,799	$269,444

The accompanying notes are an integral part of these statements.

LABETTE COUNTY MEDICAL CENTER

D/B/A LABETTE HEALTH

STATEMENTS OF CASH FLOWS

Year ended December 31,

	2011			2010		
	Labette Health	Foundation	Clinic	Labette Health	Foundation	Clinic
Cash flows from operating activities						
Receipts from and on behalf of patients	$51,513,543	$ -	$ -	$51,554,344	$ -	$ -
Payments to or on behalf of employees	(26,869,936)		(3,670)	(26,831,884)		(3,878)
Payments for supplies and services	(22,968,587)	(320,976)	(24,981)	(22,521,974)	(143,156)	(61,751)
Other receipts and payments	1,073,696	241,974	81,975	1,079,393	342,434	85,443
Net cash provided (used) by operating activities	2,748,716	(79,002)	53,324	3,279,879	199,278	19,814
Cash flows from noncapital financing activities						
Ambulance subsidy	616,722			595,061		
Noncapital grants and contributions	114,939			77,696		
Distributions to members			(54,000)			
Net cash provided (used) by noncapital financing activities	731,661	-	(54,000)	672,757	-	-
Cash flows from capital and related financing activities						
Acquisition of capital assets	(1,478,128)			(5,004,740)		
Capital lease obligations incurred	547,000			194,105		
Repayments of long-term obligations	(1,103,704)			(1,010,410)		
Interest paid	(1,841,300)			(1,903,983)		
Capital grants and contributions	187,499			45,025		
Proceeds from sale of capital assets	2,500			7,165		
Net cash used by capital and related financing activities	(3,686,133)	-	-	(7,672,838)	-	-
Cash flows from investing activities						
Changes in						
Assets held by trustee	2,046			2,385,463		
Internally designated funds	(82,343)			140,907		
Assets restricted by contributors		210			(2,640)	
Investments		(16,777)			(13,646)	
Distribution from affiliate	41,040					
Investment income received	132,096	23,330		113,025	19,873	
Net cash provided by investing activities	92,839	6,763	-	2,639,395	3,587	-
Net increase (decrease) in cash and cash equivalents	(112,917)	(72,239)	(676)	(1,080,807)	202,865	19,814
Cash and cash equivalents at beginning of year	3,898,618	328,728	96,883	4,979,425	125,863	77,069
Cash and cash equivalents at end of year	$ 3,785,701	$256,489	$ 96,207	$ 3,898,618	$328,728	$ 96,883

The accompanying notes are an integral part of these statements.

LABETTE COUNTY MEDICAL CENTER

D/B/A LABETTE HEALTH

STATEMENTS OF CASH FLOWS - CONTINUED

Year ended December 31,

	2011			2010		
	Labette Health	Foundation	Clinic	Labette Health	Foundation	Clinic
Reconciliation of operating income (loss) to net cash provided (used) by operating activities						
Operating income (loss)	$ (880,892)	$ (79,002)	$ 35,491	$ (425,235)	$196,477	$ (1,363)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities						
Depreciation and amortization	5,120,938		16,170	4,939,567		16,170
Provision for bad debts	6,249,848			4,697,687		
Changes in						
Patient accounts receivable	(8,045,535)			(5,343,174)		
Other receivables	(27,748)		783	46,912	2,801	4,330
Advances receivable	50,190			(404,849)		
Estimated third-party payor settlements	289,745			(61,707)		
Inventories	(47,369)			(87,667)		
Prepaid expenses	(36,215)			(202,001)		
Accounts payable and accrued expenses	75,754		880	120,346		677
Net cash provided (used) by operating activities	$ 2,748,716	$ (79,002)	$ 53,324	$ 3,279,879	$199,278	$ 19,814

The accompanying notes are an integral part of these statements.

LABETTE COUNTY MEDICAL CENTER

D/B/A LABETTE HEALTH

NOTES TO FINANCIAL STATEMENTS

December 31, 2011 and 2010

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting entity

Labette County Medical Center d/b/a Labette Health is owned by Labette County, Kansas (the County), and governed by a nine-member Board of Trustees appointed by the Board of County Commissioners of the County. Labette Health is a 109-bed, not-for-profit general hospital located in Parsons, Kansas. Labette Health can sue and be sued and can buy, sell, or lease real property. Bond issuances must be approved by the County. Labette Health is a component unit of the County.

The component units discussed in Note A2 are included in Labette Health's reporting entity because of the nature and significance of their relationships with Labette Health.

2. Component units

The financial statements include the financial data of the discretely presented component units described below. The component units are reported separately to emphasize that they are legally separate from Labette Health.

Labette Health Foundation, Inc. (the Foundation), is a not-for-profit corporation formed to receive, invest, and disburse funds received for the benefit, support, and maintenance of Labette Health. The Foundation is administered by a Board of Trustees, of which three members are appointed by Labette Health's Board of Trustees.

Labette County Medical Clinic, LLC (the Clinic), is a Kansas limited liability company that was formed on August 28, 1995, with a duration of 20 years. The Clinic is organized to own, manage, and operate a medical office building and to engage in any other lawful act or activity for which limited liability companies may be formed under the Kansas Limited Liability Company Act.

3. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 these estimates.

4. Basis of accounting

Labette Health uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Accounting," Labette Health has implemented all GASB pronouncements and only relevant pronouncements of the Financial Accounting Standards Board (FASB) issued before November 30, 1989.

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

5. Cash and cash equivalents

Labette Health considers all cash and invested cash to be cash equivalents, excluding any assets limited as to use and items classified as investments by the Foundation.

6. Allowance for uncollectible accounts

Labette Health provides for accounts receivable that could become uncollectible in the future by establishing an allowance to reduce the carrying value of such receivables to their estimated net realizable value. Labette Health estimates this allowance based on the aging of its accounts receivable and its historical collection experience for each type of payor.

7. Inventories

Inventories are stated at the lower of cost or market with cost determined on the average cost method.

8. Investments and investment income

Investments in debt and equity securities are reported at fair value. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating revenue when earned.

9. Assets limited as to use

Assets limited as to use include assets set aside by the Board of Trustees for replacement of capital assets or for purchase of additional capital assets, over which the Board retains control and may, at its discretion, subsequently use for other purposes; assets held by a trustee under bond indenture agreements; assets restricted by contributors for a particular purpose; and assets required by contributors to be retained in perpetuity. Amounts that are required for obligations classified as current liabilities are reported in current assets.

10. Capital assets

Capital assets (including assets recorded as capital leases) are stated at cost. Depreciation and amortization of capital assets are provided on the straight-line method over the estimated useful lives of the assets which are substantially in conformity with the guidelines established by the American Hospital Association.

The costs of maintenance and repairs are charged to operating expenses as incurred. The costs of significant additions, renewals, and betterments to depreciable properties are capitalized and depreciated over the remaining or extended useful lives of the item or the properties. Gains and losses on disposition of capital assets are included in nonoperating revenues and expenses.

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

11. Costs of borrowing

Interest costs (including amortization of original issue premiums and discounts, deferred financing costs, and deferred refunding losses) incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Costs incurred in connection with the issuance of long-term debt (including original issue premiums and discounts, and deferred refunding losses) are amortized using the interest method over the term of the related debt.

12. Grants and contributions

From time to time, Labette Health receives grants and contributions from individuals and private organizations. Revenues from grants and contributions, including contributions of capital assets, are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

13. Restricted resources

When Labette Health has both restricted and unrestricted resources available to finance a particular program, its policy is to use restricted resources before unrestricted resources.

14. Accrued health insurance claims

Labette Health is self-insured for health insurance claims of its employees. Management estimates the net liability for reported and unreported claims incurred as of the end of each reporting period. These estimates are based on known claims and historical claims experience.

Management believes that estimates for accrued health insurance claims are reasonable. However, it is possible that actual incurred claims expense may vary significantly from the estimate included in the accompanying financial statements.

15. Net assets

Net assets of Labette Health are classified in four components. "Net assets invested in capital assets net of related debt" consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. "Restricted expendable net assets" are noncapital net assets that must be used

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

for a particular purpose, as specified by creditors, grantors, or contributors external to Labette Health, including amounts deposited with trustees as required by indenture agreements. "Restricted nonexpendable net assets" equal the principal portion of permanent endowments. "Unrestricted net assets" are remaining net assets that do not meet the definitions of the other three components of net assets.

16. Operating revenues and expenses

Labette Health's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, which is Labette Health's principal activity. Nonexchange revenues, including noncapital grants and contributions and the ambulance subsidy, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

17. Net patient service revenue

Net patient service revenue is reported at established charges with deductions for discounts, charity care, contractual adjustments, and provision for bad debts, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

18. Charity care

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

19. Income taxes

Labette Health is exempt from federal income taxes pursuant to Sections 115 and 501(a) of the Internal Revenue Code.

The Foundation is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on its related income pursuant to Section 501(a) of the Code.

The Clinic is treated as a partnership for income tax purposes. Each owner not exempt from income taxes is responsible for paying taxes attributable to their share of the Clinic's net earnings.

NOTE B - NET PATIENT SERVICE REVENUE

Labette Health has agreements with third-party payors that provide for payments to it at amounts different from its established charge rates. The amounts reported on the balance sheets as estimated third-party payor settlements consist of the estimated differences between the contractual amounts for providing covered services and the interim payments received for those services. A summary of the payment arrangements with major third-party payors follows:

Medicare - Inpatient acute, rehabilitation, and skilled nursing care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or per day. Outpatient services are paid at prospectively determined rates per occasion of service. The prospectively determined rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Labette Health is paid for cost reimbursable and other items at tentative rates with final settlement determined after submission of annual cost reports by Labette Health and audits or reviews thereof by the Medicare administrative contractor. Labette Health's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. Labette Health's Medicare cost reports have been audited or reviewed by the Medicare administrative contractor through December 31, 2009.

Medicaid - Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. All other services rendered to Medicaid beneficiaries are paid at prospective rates determined on either a per diem or a fee-for-service basis.

The Kansas Medicaid program provides additional payments to qualifying providers under a reimbursement formula that incorporates uncompensated care costs, Kansas Medicaid utilization, public support of the provider, and other factors. Labette Health qualified for these disproportionate share payments during both 2011 and 2010.

Blue Cross and Blue Shield - All services rendered to patients who are insured by Blue Cross and Blue Shield are paid on the basis of prospectively determined rates per discharge or discounts from established charges.

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

NOTE B - NET PATIENT SERVICE REVENUE - Continued

A summary of gross and net patient service revenue follows:

	2011	2010
Gross patient service revenue	$ 134,488,127	$ 119,422,826
Medicaid disproportionate share payments	259,859	455,118
Contractual adjustments	(73,482,090)	(60,202,404)
Provision for bad debts	(6,249,848)	(4,697,687)
Charity care	(1,996,563)	(2,716,315)
Net patient service revenue	$ 53,019,485	$ 52,261,538

Revenue from the Medicare and Medicaid programs accounted for approximately 38 percent and 8 percent, respectively, of Labette Health's net patient service revenue during 2011, and 40 percent and 7 percent, respectively, of Labette Health's net patient service revenue during 2010. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

NOTE C - DEPOSITS WITH FINANCIAL INSTITUTIONS

Kansas statutes authorize Labette Health with certain restrictions, to deposit or invest in open accounts, time deposits, certificates of deposit, repurchase agreements, U.S. Treasury bills and notes, and the State Treasurer's investment pool. Kansas statutes also require that collateral be pledged for bank deposits with a fair value equal to 100 percent of the uninsured amounts and must be assigned for the benefit of Labette Health.

At December 31, 2011, the carrying amount of Labette Health's bank deposits, including certificates of deposit, was $12,104,323 and the bank balances were $12,623,847. Of the bank balances, $1,605,078 was covered by federal depository insurance and $11,018,769 was covered by collateral held by third-party banks, but not registered in Labette Health's name.

NOTE D - ASSETS LIMITED AS TO USE

The composition of assets limited as to use is as follows:

	2011	2010
Internally designated for capital assets		
Cash	$ 190,140	$ 187,764
Certificates of deposit	8,128,882	8,048,915
Accrued interest receivable	8,436	24,886
	$ 8,327,458	$ 8,261,565
Under indenture agreement - held by trustee		
Cash and money market funds	$ 3,429,456	$ 3,431,502
By contributors for employee assistance and capital acquisitions		
Cash	$ 8,863	$ 9,073
Principal of permanent endowments		
Cash	$ 1,434	$ 1,434
Pooled investments (see Note E)	56,630	56,630
	$ 58,064	$ 58,064

NOTE E - INVESTMENTS

The Foundation's investments are stated at fair value. The composition of its investments is as follows:

	2011	2010
Money market mutual funds	$ 58,140	$ 59,650
Common stock	53,684	49,431
Equity mutual funds	466,242	479,899
Fixed income mutual funds	288,881	269,769
Accrued interest receivable	207	207
	867,154	858,956
Less principal of permanent endowment	56,630	56,630
	$ 810,524	$ 802,326

NOTE F - CAPITAL ASSETS

Capital asset additions, retirements, and balances are as follows:

	2011			
	Beginning balance	Transfers and additions	Retirements	Ending balance
Land	$ 999,199	$ 7,900	$ -	$ 1,007,099
Buildings	54,240,033	534,145	369,435	54,404,743
Fixed equipment	8,734,042	502,594	562,592	8,674,044
Major movable equipment	19,042,755	1,207,582	923,833	19,326,504
Totals at historical cost	83,016,029	2,252,221	1,855,860	83,412,390
Less accumulated depreciation and amortization				
Buildings	17,266,431	2,952,833	365,851	19,853,413
Fixed equipment	5,238,340	539,460	133,890	5,643,910
Major movable equipment	14,243,548	1,628,645	910,451	14,961,742
	36,748,319	5,120,938	1,410,192	40,459,065
	46,267,710	(2,868,717)	445,668	42,953,325
Construction in progress	436,678	(37,315)		399,363
Capital assets, net	$ 46,704,388	$ (2,906,032)	$ 445,668	$ 43,352,688

	2010			
	Beginning balance	Transfers and additions	Retirements	Ending balance
Land	$ 919,074	$ 80,125	$ -	$ 999,199
Buildings	47,904,542	6,500,077	164,586	54,240,033
Fixed equipment	8,110,340	633,067	9,365	8,734,042
Major movable equipment	18,712,880	934,266	604,391	19,042,755
Totals at historical cost	75,646,836	8,147,535	778,342	83,016,029
Less accumulated depreciation and amortization				
Buildings	14,719,303	2,685,060	137,932	17,266,431
Fixed equipment	4,769,077	477,323	8,060	5,238,340
Major movable equipment	13,055,363	1,777,184	588,999	14,243,548
	32,543,743	4,939,567	734,991	36,748,319
	43,103,093	3,207,968	43,351	46,267,710
Construction in progress	4,944,708	(4,508,030)		436,678
Capital assets, net	$ 48,047,801	$ (1,300,062)	$ 43,351	$ 46,704,388

NOTE F - CAPITAL ASSETS - Continued

Construction in progress at December 31, 2011, consists primarily of costs incurred to date for various renovations to Labette Health's facilities.

NOTE G - INVESTMENT IN AFFILIATE

Labette Health's ownership interest in the Clinic was 76 percent at December 31, 2011 and 2010. The other investors in the Clinic are members of Labette Health's medical staff. Labette Health accounts for its investment in the Clinic using the equity method.

NOTE H - ADVANCES RECEIVABLE

Labette Health has determined that recruitment of physicians to serve the residents of Labette County is in the best interests of Labette Health, its patients, and the community, and will enable Labette Health to enhance its ability to meet the health care needs of the community's residents. To accomplish this, Labette Health has entered into agreements with certain physicians to provide them with financial assistance as an inducement for them to establish medical practices in Labette Health's service area. In return, the physicians agree to provide professional services for the residents of Parsons and Labette County over periods varying from three to six years. The financial assistance is rendered in the form of interest-bearing loans from Labette Health to the physicians. Upon establishment of their practices, principal and the accumulated interest on loans are forgiven ratably over the required service periods. If the physicians do not establish a medical practice, or if they leave the community prior to completion of the service obligation, they will be required to repay any unpaid or unforgiven principal and accumulated interest on the loans.

Labette Health's future exposure to credit loss on these agreements is dependent upon the performance of the physicians under these agreements. Outstanding commitments for future advances were approximately $295,000 at December 31, 2011.

NOTE I - HEALTH INSURANCE CLAIMS

Labette Health sponsors a self-insured employee health insurance plan. Labette Health has reinsured a portion of its risk for health insurance claims of its employees. The reinsurance arrangement generally covers claims totaling over $60,000 for each covered individual on an annual basis. The reinsurance arrangement also covers aggregate annual claims of the plan in excess of an amount determined in relation to the number of individuals participating in the plan during the year. Covered employees also provide part of the funds to pay claims through monthly contributions at predetermined rates. Labette Health has retained an agent to process and settle claims. The following is a summary of the activity under this arrangement:

	2011	2010
Estimated net health insurance claims payable at beginning of year	$ 339,624	$ 344,839
Provision for employer's share of incurred claims and related expenses for the year, net of any reinsurance proceeds	1,839,301	2,119,787
Participant contributions	888,322	817,495
Payments made for claims and related expenses	(2,741,485)	(2,942,497)
Estimated net health insurance claims payable at end of year	$ 325,762	$ 339,624

NOTE J - LONG-TERM OBLIGATIONS

Long-term obligations are summarized as follows:

	2011	2010
5.00% - 5.75% Labette County, Kansas Hospital Refunding and Improvement Revenue Bonds, Series A, 2007; issued on July 19, 2007, in the original amount of $24,765,000; due serially through September 1, 2037, with principal payments beginning on September 1, 2020, including unamortized premium of $562,389 in 2011 and $592,926 in 2010	$ 25,327,389	$ 25,357,926
7.00% Labette County, Kansas Taxable Hospital Refunding and Improvement Revenue Bonds, Series B, 2007; issued on July 19, 2007, in the original amount of $6,435,000; due serially through September 1, 2019	5,000,000	5,460,000

NOTE J - LONG-TERM OBLIGATIONS - Continued

	2011	2010
Capital lease obligations; imputed interest rates from 1.95% to 8.47%; collateralized by leased equipment with an amortized cost of $1,254,265 at December 31, 2011	$ 1,166,536	$ 1,263,240
	31,493,925	32,081,166
Unamortized deferred refunding loss	(5,247)	(5,126)
	31,488,678	32,076,040
Less current maturities	1,036,103	1,081,836
Long-term obligations, less current maturities	$ 30,452,575	$ 30,994,204

The following is a summary of changes in long-term obligations:

	Capital lease obligations	Hospital revenue bonds	Total long-term obligations
Outstanding at January 1, 2010	$ 1,654,545	$ 31,273,717	$ 32,928,262
Obligations incurred	194,105		194,105
Principal payments	(585,410)	(425,000)	(1,010,410)
Amortization of bond premium		(30,791)	(30,791)
Outstanding at December 31, 2010	1,263,240	30,817,926	32,081,166
Obligations incurred	547,000		547,000
Principal payments	(643,704)	(460,000)	(1,103,704)
Amortization of bond premium		(30,537)	(30,537)
Outstanding at December 31, 2011	$ 1,166,536	$ 30,327,389	$ 31,493,925

On July 19, 2007, the County issued $24,765,000 in Hospital Refunding and Improvement Revenue Bonds, Series A, 2007, and $6,435,000 in Taxable Hospital Refunding and Improvement Revenue Bonds, Series B, 2007 (the 2007 bonds), for the benefit of Labette Health pursuant to a Bond Trust Indenture dated June 1, 2007. The proceeds of the 2007 bonds were used, together with other available funds of Labette Health, for the purpose of providing funds to (1) pay for renovations and additions to Labette Health's facilities, (2) refund the Hospital Refunding Revenue Bonds, Series A, 1996, and Series A, 2001, previously issued for the benefit of Labette Health, (3) refinance an outstanding bank loan, (4) fund a debt service reserve fund for the 2007 bonds, and (5) pay for certain costs related to issuance of the 2007 bonds.

NOTE J - LONG-TERM OBLIGATIONS - Continued

The indenture agreement for the 2007 bonds requires Labette Health to transfer to a trustee, on a monthly basis, specified amounts which, when combined with interest earned on the respective funds held by the trustee, will provide sufficient funds to pay the bond principal and interest on the appropriate due dates. Such amounts were maintained and are included with assets limited as to use in the financial statements. The obligations of Labette Health under the indenture agreement are secured by a pledge of its unrestricted revenues, subject to the right of Labette Health to dispose of or encumber property as defined and permitted in the indenture agreement. The indenture agreement also includes certain restrictive covenants relating to the disposition of property, incurrence of additional indebtedness, the level of days cash on hand, and the level of fees and rates charged. The covenant in the indenture agreement regarding the level of days cash on hand requires that those levels equal or exceed 45 days. The covenant in the indenture agreement regarding the level of fees and rates charged requires that fees and rates for services be set at levels sufficient for Labette Health to produce income available for debt service in each fiscal year equal to 125 percent of the debt service requirements during that fiscal year for outstanding debt.

The bond refunding and bank loan refinancing increased total future debt service requirements of Labette Health by $4,112,932 because the repayment period of the new debt is significantly longer than were the remaining repayment periods for the extinguished debt. This resulted in an economic gain (difference between the present value of the future debt service payments on the old and new debt) of $36,124. As a result of the bond refunding, a deferred refunding loss of $5,045 was recognized for the difference between the book value of the refunded debt and the amount required to extinguish that debt.

Scheduled annual debt service requirements on long-term debt are as follows:

	Principal	Interest	Total
2012	$ 485,000	$ 1,761,200	$ 2,246,200
2013	520,000	1,727,250	2,247,250
2014	560,000	1,690,850	2,250,850
2015	595,000	1,651,650	2,246,650
2016	640,000	1,610,000	2,250,000
2017 - 2021	3,905,000	7,329,500	11,234,500
2022 - 2026	5,140,000	6,071,713	11,211,713
2027 - 2031	6,805,000	4,412,550	11,217,550
2032 - 2036	8,995,000	2,218,637	11,213,637
2037	2,120,000	121,900	2,241,900
	$ 29,765,000	$ 28,595,250	$ 58,360,250

NOTE J - LONG-TERM OBLIGATIONS - Continued

The following is a yearly schedule of future minimum lease payments under capital leases as of December 31, 2011:

	Principal	Interest	Total
2012	$ 551,103	$ 34,408	$ 585,511
2013	213,643	18,447	232,090
2014	179,410	10,939	190,349
2015	112,735	5,334	118,069
2016	109,645	1,820	111,465
Total minimum lease payments	$ 1,166,536	$ 70,948	$ 1,237,484

Total interest costs are summarized as follows:

	2011	2010
Total interest incurred	$ 1,811,534	$ 1,912,272
Amortization of bond premium	(30,537)	(30,791)
Amortization of deferred financing costs	34,643	35,043
Amortization of deferred loss on bond refunding	(121)	(126)
	1,815,519	1,916,398
Less		
Interest earned on borrowed funds held by trustee offset against capitalized interest costs		(414)
Net capitalized interest costs		(254,623)
Interest expense	$ 1,815,519	$ 1,661,361

NOTE K - DEFINED CONTRIBUTION PENSION PLANS

Labette Health sponsors a defined contribution pension plan that provides pension benefits for substantially all of its full-time employees. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. The plan is administered by a third-party insurance company and can be amended by the Board of Trustees. The provisions of the plan are as follows.

Employees become eligible for employer contributions after completing one year of service. Labette Health contributes a percentage of gross compensation based on the eligible employee's years of service as follows: 2 percent if more than one year but less than 5 years of service; 4 percent if five or more years of service but less than fifteen; and 6 percent if fifteen or more years of service. Labette Health may also make a discretionary matching contribution of participant contributions to the plan. The contribution

NOTE K - DEFINED CONTRIBUTION PENSION PLANS - Continued

cannot exceed a percentage of gross compensation based on the eligible employee's years of service as follows: 1 percent if more than five years of service but less than ten years of service and 2 percent if more than ten years of service.

The employees are not required to make contributions to the plan but may elect to contribute from 1 percent to 20 percent of the participant's compensation subject to maximum limits as defined by the Internal Revenue Service. Labette Health's contributions for each employee are fully vested after 10 years of continuous service.

For the years ended December 31, 2011 and 2010, Labette Health and covered employees made contributions to the plan as follows:

	2011	2010
Employer contributions	$ 520,376	$ 457,215
Employee contributions	395,857	449,637
	$ 916,233	$ 906,852

Labette Health has entered into deferred compensation agreements with certain employees. These agreements are eligible deferred compensation plans under Section 401(a) or 457(b) of the Internal Revenue Code. The plans can be amended by mutual consent of Labette Health and the plans' participants. All assets of the plans are held by a third-party investment company for the sole benefit of the employee and the employee's designated beneficiary. The plans generally provide for employer contributions based on the employees' years of service. The employees are not required to make contributions to the plans but may elect to contribute a percentage of compensation subject to maximum limits as defined by the Internal Revenue Service. Labette Health's contributions become fully vested after periods defined in each plan. For the years ended December 31, 2011 and 2010, Labette Health and covered employees made contributions to these plans as follows:

	2011	2010
Employer contributions	$ 131,232	$ 164,995
Employee contributions	57,340	56,889
	$ 188,572	$ 221,884

NOTE L - CONCENTRATION OF CREDIT RISK

Labette Health grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of patient accounts receivable from patients and third-party payors at December 31, 2011 and 2010, is as follows:

	2011	2010
Medicare	34.4%	25.8%
Medicaid	11.5	8.3
Blue Cross	12.0	11.2
Other insurers	20.5	24.0
Patients	21.6	30.7
	100.0%	100.0%

NOTE M - RISK MANAGEMENT

For the years ended December 31, 2011 and 2010, Labette Health was insured for hospital professional liability under a comprehensive hospital liability policy provided by an independent insurance carrier with limits of $200,000 per occurrence up to an annual aggregate of $600,000 for all claims made during the policy year. Labette Health is further covered by the Kansas Health Care Stabilization Fund for claims in excess of its comprehensive hospital liability policy up to $300,000 pursuant to any one judgment or settlement against Labette Health for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy year in the amount of $900,000. The policy provided by the independent insurance carrier provides for umbrella liability in excess of the underlying limits set forth above in the amount of $1,000,000 per occurrence with an aggregate amount in any policy period of $3,000,000. All coverage is on a claims-made basis. The above policies were renewed on January 1, 2012, for the policy period from January 1, 2012 to January 1, 2013.

In addition to the risk disclosed elsewhere in these financial statements and notes thereto, Labette Health is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors or omissions; injuries to employees; and natural disasters. Labette Health purchases commercial insurance for these risks. Settled claims have not exceeded this commercial coverage in any of the past three years.

NOTE N - COMMITMENTS AND CONTINGENCIES

Labette Health purchases professional and general liability insurance to cover medical malpractice and other liability claims (see Note M). There are known claims and incidents that have been asserted. These claims have been referred to Labette Health's insurance carriers and are in various stages of processing. No accrual for loss contingencies related to these items has been made in the financial statements as the amount of ultimate settlement, if any, cannot be reasonably estimated.

NOTE O - RELATED PARTY TRANSACTIONS

Labette Health received $275,117 and $76,666 of contributions from the Foundation during 2011 and 2010, respectively. Labette Health incurred $101,217 and $98,071 in salary expense on behalf of the Foundation during 2011 and 2010, respectively.

Labette Health paid rent to the Clinic totaling $61,704 during both 2011 and 2010.

Labette Health has three capital lease obligations with a local bank. Outstanding principal balances on these obligations totaled $597,292 at December 31, 2011. The President and a member of the board of directors of this bank both serve on Labette Health's Board of Trustees.

NOTE P - COUNTY TAX PROCEEDS

On June 26, 2001, voters of the County approved a .25 percent healthcare retailers' sales tax to be used as a source of funding for the provision of emergency medical services. The County has agreed to pay Labette Health an amount equal to the lesser of 100 percent of the sales tax or 95 percent of Labette Health's direct loss attributable to the provision of ambulance services.